

THE MAKE OR BUY DECISION

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Introduction

Are you outsourcing enough? This was one of the main questions asked by management consultants during the outsourcing boom. Outsourcing was viewed as one of the best ways of getting things done for a fraction of the original cost.

Outsourcing is closely related to make or buy decision. The corporations made decisions on what to make internally and what to buy from outside in order to maximize the profit margins.

As a result of this, the organizational functions were divided into segments and some of those functions were outsourced to expert companies, who can do the same job for much less cost.

Make or buy decision is always a valid concept in business. No organization should attempt to make something by their own, when they stand the opportunity to buy the same for much less price.

This is why most of the electronic items manufactured and software systems developed in the Asia, on behalf of the organizations in the USA and Europe.

Four Numbers You Should Know

When you are supposed to make a make-or-buy decision, there are four numbers you need to be aware of. Your decision will be based on the values of these four numbers. Let's have a look at the numbers now. They are quite self-explanatory.

- The volume
- The fixed cost of making
- Per-unit direct cost when making
- Per-unit cost when buying

Now, there are two formulas that use the above numbers. They are 'Cost to Buy' and 'Cost to Make'. The higher value loses and the decision maker can go ahead with the less costly solution.

$\text{Cost to Buy (CTB)} = \text{Volume} \times \text{Per-unit cost when buying}$
 $\text{Cost to Make (CTM)} = \text{Fixed costs} + (\text{Per-unit direct cost} \times \text{volume})$

Reasons for Making

There are number of reasons a company would consider when it comes to making in-house. Following are a few:

- Cost concerns
- Desire to expand the manufacturing focus
- Need of direct control over the product
- Intellectual property concerns
- Quality control concerns
- Supplier unreliability
- Lack of competent suppliers
- Volume too small to get a supplier attracted
- Reduction of logistic costs *shippingetc.*
- To maintain a backup source
- Political and environment reasons

- Organizational pride

Reasons for Buying

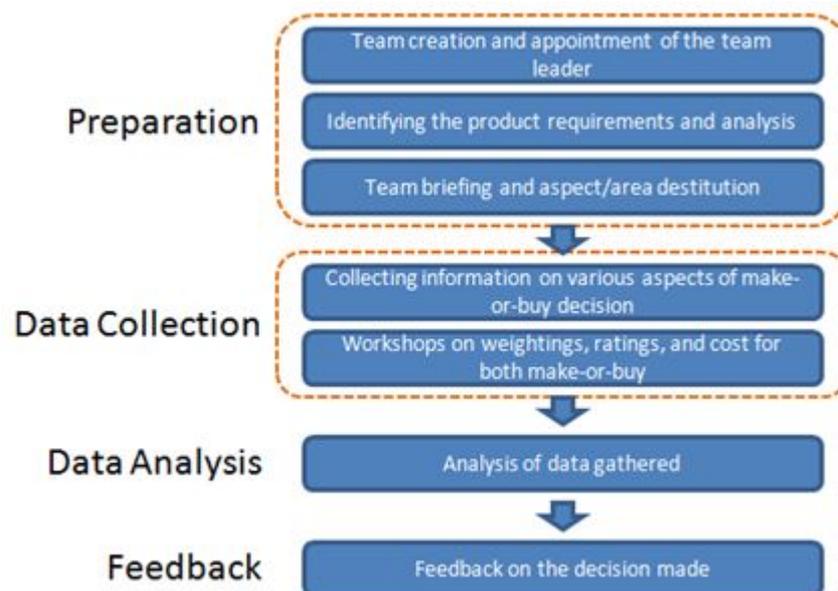
Following are some of the reasons companies may consider when it comes to buying from a supplier:

- Lack of technical experience
- Supplier's expertise on the technical areas and the domain
- Cost considerations
- Need of small volume
- Insufficient capacity to produce in-house
- Brand preferences
- Strategic partnerships

The Process

The make or buy decision can be in many scales. If the decision is small in nature and has less impact on the business, then even one person can make the decision. The person can consider the pros and cons between making and buying and finally arrive at a decision.

When it comes to larger and high impact decisions, usually organizations follow a standard method to arrive at a decision. This method can be divided into four main stages as below.



1. Preparation

- Team creation and appointment of the team leader
- Identifying the product requirements and analysis
- Team briefing and aspect/area destitution

2. Data Collection

- Collecting information on various aspects of make-or-buy decision
- Workshops on weightings, ratings, and cost for both make-or-buy

3. Data Analysis

- Analysis of data gathered

4. Feedback

- Feedback on the decision made

By following the above structured process, the organization can make an informed decision on make-or-buy. Although this is a standard process for making the make-or-buy decision, the organizations can have their own varieties.

Conclusion

Make-or-buy decision is one of the key techniques for management practice. Due to the global outsourcing, make-or-buy decision making has become popular and frequent.

Since the manufacturing and services industries have been diversified across the globe, there are a number of suppliers offering products and services for a fraction of the original price. This has enhanced the global product and service markets by giving the consumer the eventual advantage.

If you make a make-or-buy decision that can create a high impact, always use a process for doing that. When such a process is followed, the activities are transparent and the decisions are made for the best interest of the company.

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