

Outsourcing, make or buy decisions

[Business](#), [Work](#)



MAKE OR BUY? — THE CHOICES When firms face a “ make-or-buy” decision, it means that they have to choose whether to insource a particular production process or service or to outsource it to a third party. The word “ insourcing” stems from the union of the words “ inside resource using” and indicates the “ use of internal labor, personnel and resources to supply the operational needs of the enterprise” . A firm can decide either to insource — i. e. to produce in-house- a production process or a service from the beginning or to take in-house a previously external or outsourced production process or service. For example, in 2009 Volkswagen AG decided to focus more on and to increase by yearly 10% its own production of automobile components. In order to realize this, Volkswagen AG decided to insource human capital in the engineering, production, prototyping and toolmaking fields. A further example is represented by “ the insourcing of the funds administration business of Credit Suisse in Germany” by the german subsidiary of the french bank “ Société Générale”. The latter “ will provide a broad range of administrative and technological solutions to Credit Suisse (Deutschland) AG, including front office services (ASP), funds administration and reporting services” . Instead, the word “ outsourcing” stems from the union of the words “ outside resource using” and indicates the “ delegation of one or more processes to an external service provider” . Firms usually outsource the production of services or goods when the production processes are neither too technical nor standardized. However, they should never outsource activities related to their core competences as by doing so they would lose their (sustainable) competitive advantage in the market. A special case is the “ intern outsourcing”, where the third party to which a

process is transferred is the holding company. Some examples of outsourcing companies are Chrysler, Ford and Boeing: the first one has outsourced half of its minicompact and subcompact cars' manufacturing to Japan; the second one produces less than half of its total vehicles in-house; the latter produces only 10% of its Boeing-767's value in-house as the remaining 90% is produced by a third party. There are three types of outsourcing, which depend on where the outsourced activities are allocated: offshoring, which describes the allocation in another continent -which is called the " inshoring continent"- (for example, Deutsche Bank allocates activities in India); nearshoring, that refers to an allocation in another country of the same continent (for example, Whirlpool (USA) allocates activities in Kanada); onshoring, that implies an allocation in another region of the same country (for example, Société Générale allocates activities in Marseille) . All of these three types of outsourcing strategies are implemented by firms in order to decrease labour costs, to increase the quality of the services offered and to have access to crucial know-how . A clarifying example to this classification is related to the company Panasonic, which has its manufacturing activities for Europe in Slovakia, but its R&D, its marketing and its technology centre in Germany . Therefore, it profits from the low labour costs of Slovakia and of the valuable engineering know-how of Germany . It is important to stress that no type of outsourcing is better than the other. Each of them responds to different needs a firm might have. However, in our research we noticed that the advantages offered by offshoring and nearshoring are the most discussed ones. On the one hand, offshoring offers a " greater access to human capital scattered around the

globe" and allows to choose among countries with a low tax rate and low worker rights protection. On the other hand, nearshoring permits thanks to the relative proximity of countries an easier communication and a lower risk of political instability among the involved countries and a reciprocal better knowledge of the market. Also when comparing insourcing and outsourcing one can not simply tell which one is better, because they respond to different strategic, economical, political, socio-cultural and technological needs a company might have. On the one hand, outsourcing allows firms to focus on their own core competences, to decrease investments on PPE, fixed costs and break-even point and to fasten their response to the environment. On the other hand, insourcing has the advantage of training and increasing the skills of firms' own employees in order to specialise them. Furthermore, when firms insource they do not face the risk of losing R&D competitiveness as in the case of outsourcing, where a third party might profit from or disclose inside information. Finally, insourcing eliminates the common agency problems related to outsourcing and allows firms to have a direct control on the whole process.