



Important Factors on Make or Buy Strategy for Margin Improvement on Consumer Goods Company

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ABSTRACT: Consumer goods industry have tight a competition in the market. Therefore, companies that operate in this kind of industry should continuously improve sustainable competitive advantage. The strategy to increase competitive advantage is not through innovation but also requires cost leadership so that the company obtains an adequate profit margin. One of the efforts to gain cost leadership is that companies need to choose between make inhouse production or buy goods directly from appointed third party supplier. This study based on qualitative research methodology aims to discuss the important factors for building a business case on the make or buy options. Data for analysis purpose are obtained from interviews with individuals representing one of the leading multinational companies operating in Indonesia that produces personal care, hygiene and home care. Interviews results are written in transcript, coded and mapped to illustrate the keywords mentioned by respondents then being categorized as important factors or not. The result of the study showed that cost, capability, capacity, quality, service level and technology are important factors on consideration make or buy. Cost factor also consider projection volume, transportation and investment.

KEYWORDS: Competitive Advantage, Cost Leadership, Make-or-Buy, Margin Improvement, Supply Chain

1. INTRODUCTION

Fast Moving Consumer Goods (FMCG) industry have mass production to offer low price goods while keeping sustainable competitive advantage by offering value to consumers. Stock availability, delivery and price are important aspects for the industry or consumers will change choice to competitors.

Consumer goods industry enters an industry characterized by tight competition in the market both in normal economic conditions and the worldwide Covid-19 pandemic. Based on Porter's (1998) framework of five competitive forces (1998) it has high threat of new entrants as local and global company easily to enter the market by offering products with various feature. Buyers or consumers have high bargaining power as their changing behavior create fluctuate demand and company need to be very agile and adaptive to fulfill demand. In the other side, supplier has medium bargaining power of suppliers as for key materials company has some suppliers as contingency plan for flexible supply, but for some materials company only have single supplier to reduce complexity. Threat of substitute products is categorized high because when company unable to maintain service level in right time, quantity and quality of products, consumers are easily to substitute with products from another brand.

Company which is already well-known in strong heritage brand but engages in an industry with intense competition, need to have business strategy which being updated to be relevant in the market. Company not only continues to carry out an innovation, but also pursues a cost leadership strategy. Through a cost-leadership strategy, the company can generate lower cost of goods sold. Thus, the company will be able to sell products at more competitive prices and also to increase profit margins. Production costs are crucial to bring in cost leadership. Companies can consider whether it is better to produce goods in-house or buying from third parties known as outsourcing to reduce production costs. However, to choose one of these options the company must consider several factors. This paper is discussed on important factor to build business case on make or buy decision to have sustainable competitive advantage.

2. REVIEW LITERATURE

To remain competitive, one of the company strategies is consideration on make product by produce goods inhouse or buying from third party or subcontractor supplier as finish goods under company license with expected feature, appearance and quality, by analyzing saving and profitability for business. Make or buy is a strategic decision and has implications for the overall corporate strategy of the organization by describing a model which involves analyzing a number of strategic factors. This decision can often



be a major determinant of profitability, making a significant contribution to the financial health of the company (McIvor, Humphreys, & McAleer, 1997). Making the right choice on make or buy can be the key factor in sustaining a company competitive advantage and is one of the most important tasks of a successful management. (Bajec & Jakomin, 2010).

There are three main reasons why a company would seek to use suppliers for its business are capability that the company cannot make the item, manufacturing competitiveness where supplier has lower cost, faster availability, etc, and technology usage in supplier has higher performance (Fine and Whitney, 1996). Some other reasons for outsourcing are lack of management expertise, need to jump the learning curve, want to move fast, area requires re-engineering, lack of management resources, too much cost to do it internally, not core, business going through major change and need to make more variable cost, need to focus resources for training, investment, time, etc. These reasons can be structured into five groups: financial, technology, managerial, resource management, and personal (Waters & Rinsler, 2015).

Outsourcing can be used to either maintain the competitive position of the organization or act as a source of competitive advantage. Clearly, outsourcing to reduce costs can deliver benefits for the organization and impact directly upon the bottom line. In many cases, it is likely that the organization is accessing the capabilities of a supplier that are also accessible to its competitors. Organizations can employ outsourcing as a vehicle to achieve competitive advantage (McIvor, 2005)

III. RESEARCH METHODOLOGY

This study is using qualitative approach. Data obtained through interviews with 10 key informants who are competent and experienced in their respective fields, consisting of four senior leaders in operations, three senior leaders in procurement, and the rest are senior leaders in marketing, demand planning, and finance. Different role of key informant expected to enhance research insight from various perspectives to answer research question. The key informants from the different clusters are asked about current company performance and margin improvement in their perspective. It’s continued with company strategy and kind of important attributes or parameters on make or buy strategy. Interviews were conducted for four weeks based on the time allocated by each key informant.

The analysis of the results of the interviews followed the qualitative research data analysis scheme suggested by Creswell & Creswell (2018). It started from raw data of interviews which write into transcript, continue with organizing preparing data for analysis, reading through all data, then coding the data to finding keywords, continue with interrelating to literature and finish with interpreting the meaning of themes or descriptions.

IV. FINDINGS

From the interview sessions with 10 key informans, interview transcripts from respondents are analyzed to find keywords from statement as research major constructs which mentioned frequently by respondents. These major constructs are categorized as sub-sub-category, sub-category, category and super category based on similarities by doing interpretation. There are 42 keywords as point of discussion with total 383 mentioned during interview session.

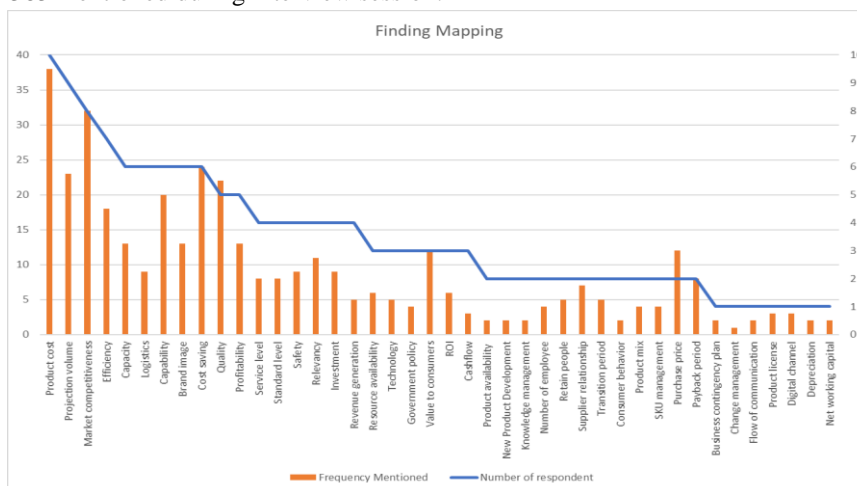


Figure 1. Frequency Finding Chart



There are 10 major findings and 3 emerging constructs from the interview sessions which are discussed further by comparing with literature. The 10 major findings are keywords that have highest frequency mentioned by the respondents, while 3 emerging constructs from the experts. Then it all considered to be important factor in make or buy strategy or not.

Product Cost is the most frequently mentioned keywords during the interview sessions which mentioned by 10 out of 10 respondents is product cost. Product costs include such things as raw materials, direct labor expense, and manufacturing overhead. These are reported on the income statement as costs of goods sold (COGS), but they include both fixed and variable costs (Ross et al., 2013). As consumers goods company with cost leadership strategy, keeping low price is one of the values offered to consumers. Cost analysis will be required to consider lowest product cost or COGS which becoming main factor on consideration make or buy strategy.

Projection volume is the second most mentioned keywords which mentioned by 9 out of 10 respondents. When business decides to launch a new product, supply chain ensure firm can handle volumes. Types of equipment, people, or facilities are influenced by predicted volume levels for a product (Bozarth & Handfield, 2019). Projection volume in indicates growth of products which can be seen from historical sales, forecast, potential market and promotion strategy to continuously grow. Production volume as one of important factor will impact on product cost, as higher volume will increase efficiency and lowered product cost.

Market Competitiveness is the third most mentioned keywords which mentioned by 8 out of 10 respondents are is market competitiveness. Remaining competitive means supply management must contribute to profitability by focusing not only on cost savings but also on contributions to top-line growth and innovation (Monczka et al., 2020). Company needs to be relevant and adaptive with market, as buying power of consumers are high. Gaining market competitiveness is objective of make or buy strategy, not one of important factor.

The fourth most mentioned keyword is efficiency. This keyword mentioned by 7 out of 10 respondents. End-to-end process need to have efficient process for moving business forward. Efficient supply chains are built for efficiency and low cost by minimizing inventory and maximizing efficiencies in process flow. Collier & Evans (2020) stated efficiency is most effective for goods with highly predictable demand, stable product lines with long life cycles that do not change frequently, and modest contribution margins. Current process available should be reviewed and analyzed to understand unnecessary, non-value added and inefficient process for having optimized process. Efficiency is objective of the make or buy strategy consideration, not the important factor.

The fifth most mentioned keyword is cost saving. This keyword mentioned by 6 out of 10 respondents. Cost management is now an essential component of purchasing and supply chain management. With the inability to raise prices to customers, cost management becomes critical to long-term success (Monczka et al., 2020; Collier & Evans 2020). Therefore, cost saving or cost reduction is one of the strategies for lowering product cost which create company more competitive in the market to generate more revenue. Cost saving is important to gain competitive advantage, it is objective of make or buy strategy, not the important factor.

Capability is the sixth most frequently mentioned keywords which mentioned by 6 out of 10 respondents. Operations and supply chain management people are always concerned with how well new products or services match up with existing products or capabilities (Bozarth & Handfield, 2019). Capability to produce consist of facility such as machines and people who operate machine. Investment maybe required to build capability of machine and people. People capability to produce goods can be sharpen through experiences and training for development. Capability is one of important factor in make or buy strategy consideration.

Capacity is the seventh keywords which mentioned by 6 out of 10 respondents. Capacity measures the maximum amount a facility can process. A facility with little excess capacity will likely be more efficient per unit of product it produces than one with a lot of unused capacity (Chopra, Meindl, & Karla, 2017). Capacity strategies need to balancing capacity and demand which shown that production capacity is an important factor.

The eight keyword is brand image which mentioned by 6 out of 10 respondents. Brands are valuable intangible assets that provide several benefits for customers and business which need to be managed carefully (Kotler & Keller, 2016). Brand image still can be maintained wherever products are made as consumers won't notice any difference as long as still having high quality. It means brand image isn't the important factor on make or buy strategy.

The ninth keyword is logistics, mentioned by 6 out of 10 respondents. Closeness of key supplier location to manufacturing place create lower logistics cost which cause competitive purchase material price and reliability of supply. Logistics costs are an



important component that determines the determinants affecting the total operating costs (Savić, Petrović & Vasiljević, 2020). It indicates logistics is one of important factor in cost analysis.

The tenth keyword is quality mentioned by 5 out of 10 respondents. Quality is meeting or exceeding customers' expectations. Providing goods that satisfy customers and meet their needs is essential for business sustainability. In operations, the most useful definition of quality is how well the output of a manufacturing process conforms to the design specifications (Collier & Evans, 2020). Maintaining good products quality means maintaining a good brand reputation. It indicated that product quality become an important factor in make or buy strategy.

There are 3 keyword as emerging construct which mentioned by the 2 experts from supply chain and procurement during interviews sessions. Even the number of respondents mentioned not as high as major findings, these emerging constructs are also discussed further. The first is investment. Firms typically make a variety of long-term investments, but the most common is in fixed assets, which include property (land), plant, and equipment (Gitman & Zutter, 2019). When the company will carry out investment activities, it needs to analyze its feasibility in terms of payback period, net present value and rate of return to find out whether the investment will generate profits (Ross et al., 2013). Investment indicates an important part in cost factor in make or buy strategy.

Second emerging construct is technology. Changes in technology can allow organizations to develop significant advantages and in some cases change the nature of competition within an industry. Examples of technologies include information technology, robotics, machine tools, etc (McIvor, 2005). Advancement technology in system and machine will build capability. It indicates technology is one of important factor in make or buy strategy.

The third emerging construct is service level. Service level is also one of measurement on product availability. Once an inventory policy has been implemented, it is important that its performance be tracked and monitored (Chopra, Meindl, & Karla, 2017). Service level is one of the important factors on make or buy strategy to keep customer satisfaction.

Based on the results of the analysis above, it can be summarized the important factors for determining the make or buy option in Table 1. Then the relevant factors are selected and classified into two categories: cost and benefit attributes (Figure 2)

Table 1. Findings Mapping as Important Factor for Make or Buy

No	Findings	Remarks
1	Product cost	Yes, cost factor
2	Projection volume	Yes, cost factor
3	Market competitiveness	No, strategy objective
4	Process efficiency	No, strategy objective
5	Cost saving	No, strategy objective
6	Capability	Yes, benefit factor
7	Production capacity	Yes, benefit factor
8	Brand image	No, impact of decision
9	Logistics	Yes, cost factor
10	Product quality	Yes, benefit factor
11	Investment	Yes, cost factor
12	Technology	Yes, benefit factor
13	Service Level	Yes, benefit factor

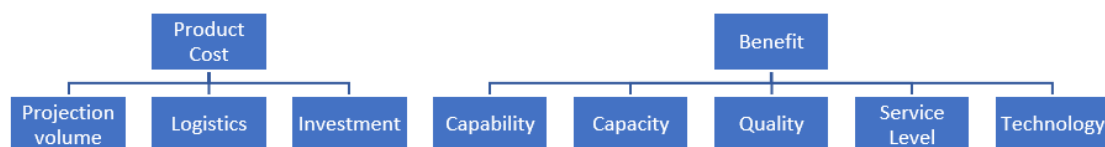


Figure 2. Cost and Benefit Attributes

Product cost has detail calculation which also consider projection volume, logistics cost and investment as some of the important factors. Projection volume is about future growth of product, transportation related to cost to move material and goods from one place to another place, while investment is related to capital required for activities to generate more profit.



Make or buy consideration shouldn't only consider on cost only but also business benefit from the decided strategy. Attributes that categorized as important factors in benefit are capability, capacity, quality, service level and technology. From the interview sessions, weighted on each of benefit attribute shown in table 2 below.

Table 2. Weighted Benefit Attribute

Benefit Attribute	Number of Respondents Mention	Weighted
Capability	6	0.25
Capacity	6	0.25
Quality	5	0.21
Service Level	4	0.17
Technology	3	0.13
Total	24	1

V. CONCLUSION

The results of this study indicated that the important factors that company need to consider to choose the option between make or buy can be categorized as cost and benefit attributes. In terms of cost attributes, the important factors are volume projections, transportation costs, and investment. These factors will have an impact on the cost of goods sold. Meanwhile, in terms of benefit attributes are: capability and capacity of people and machine for production, quality of products which need to be maintained for a good brand, service level as reliability supply to avoid out of stock and technology advancement to produce goods are the important factors.

From the important factors, decision on make or buy should continue through make or buy framework such as using McIvor's Make or Buy frameworks which consider core activities or competency, value chain analysis to do benchmarking, total cost analysis and relationship with available suppliers (McIvor, 2003). The decision can be strengthened through using Simple Multi Attribute Rating Technique (SMART) trading cost and benefit analysis (Goodwin, 2004).

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