

Make, buy or ally? Determinants and performance

Introduction

A key feature of contemporary economy is the vertical disintegration of corporations. The value added chain, which is a metaphor for all the steps that have to be taken in the production of a good or a service, is not necessarily integrated in one organisation. For each task an organisation has to perform - be it research and development of new products, customer services or cleaning the workplace - it can decide to take care of this task internally, to outsource it or to enter into an alliance with a partner external to the organisation.

The first possibility will be named the make-option: an organisation decides to fulfil the task internally. A restaurant which bakes its own bread rolls and pastry is a simple example. The second option is the buy-option. In this case the restaurant owner chooses one wholesaler in bread and pastry on the market to supply him. The last possibility is the ally-option. Suppose a bakery in the neighbourhood agrees to deliver bread rolls to this restaurant. The bakery does this on a daily basis, but is also sensitive to the special wishes of the restaurant owner: for the Christmas menu it can deliver confectionary pastry. The restaurant owner has now entered into an alliance with the bakery.

In this study, we investigate the factors which determine the choice between make, buy and ally. Additionally, we study which effect this decision has on the performance of the relationship between exchange partners.

Theoretical framework

Williamson's transaction cost economics investigates which factors determine the boundaries of an organisation (Williamson, 1981, pp. 548-577). Transaction costs are defined as the costs of planning, adapting and monitoring task completion and are viewed as the determinants of the choice between making and outsourcing¹. Transaction costs are described in three critical dimensions: uncertainty, the frequency with which transactions recur and the degree to which durable, transaction-specific investments are required or asset specificity. For example: when the completion of a task requires specific investments in the knowledge of employees and the presence of production means, non-marketability problems arise and the task must be completed internally.

The transaction cost approach has been found too limited in scope by the resource based view of the firm, which states that the make-buy-ally-decision must be viewed as a strategic decision (Espino-Rodríguez & Padrón-Robaina, 2006, pp. 49-70). Whether or not an organisation outsources an activity

¹ The transaction cost approach states that transaction costs are inevitable because parties in a transaction are only boundedly rational and opportunistic.

depends on the resources available in the organisation and the strategic value of those resources. Within this perspective, the core competences approach is an important framework to explain why companies turn to outsourcing. Core competences are defined as the competences providing the organization's growth and direction. Thus, improved performance in an organization can be achieved through focusing on those resources that provide the core competences. It follows that a core-related activity will be kept in house, while an activity unrelated to the core competences of the firm should be outsourced (Barthélemy & Quélin, 2006, pp. 1775-1797).

A sociological critique on both transaction cost economics and the resource based view of the firm has been that the prosperity of an inter- or intra-organisational relationship is not guaranteed by rational decision making. Characteristics of the interactions between exchange partners, going well beyond contractual obligations, matter too. Nee and Ingram (1998, pp. 87-111) and Lorenz (1991, pp. 183-192) argue that factors such as the presence of shared implicit norms and trust between exchange partners influence the success of the exchange relation, especially in alliances. Embeddedness is a crucial characteristic of the relationship between exchange partners: besides trust, the amount of joint action or the degree of cooperation and coordination and the quality and scope of information exchange also play a role in determining the success of the exchange relation (Gulati & Sytch, 2007, pp. 32-69).

Research goals

The goals of this study are:

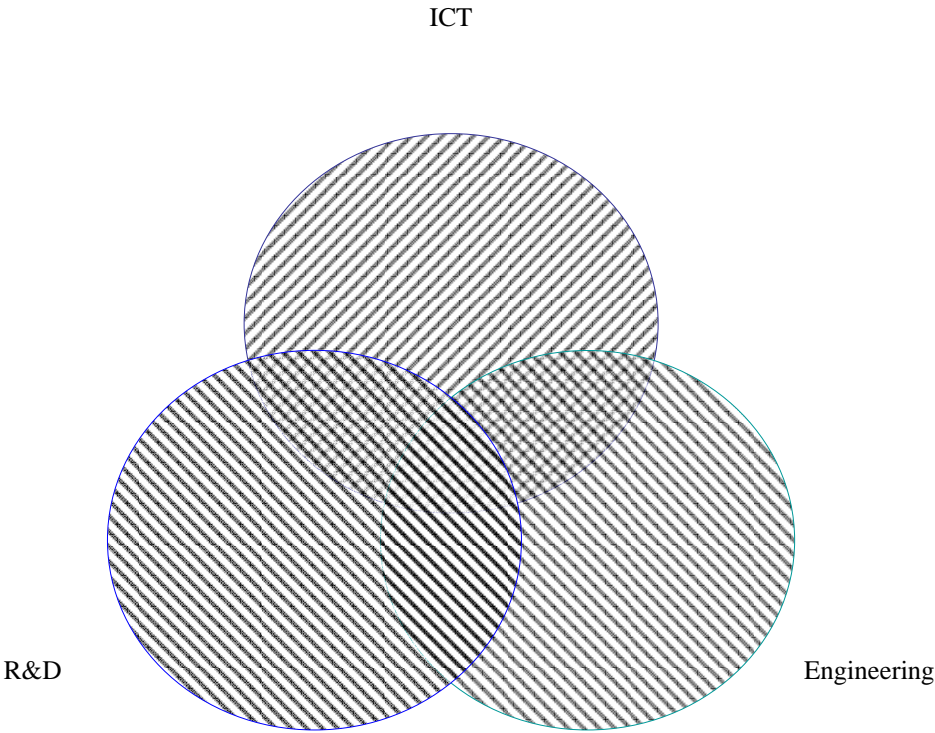
- Integrating transaction cost economics, the resource based view of the firm and their sociological critique describing relationship characteristics in one model. By doing so, we place ourselves in a recent empirical tradition searching for the complementarity between different theories explaining the sourcing behaviour of organisations.²
- Investigating which factors influence the decision to perform an element of the value added chain internally, to acquire it externally on the market or to enter into an alliance.
- Investigating which factors determine the performance of the exchange relation.
- Determining how factors directly influencing the make-buy-ally-choice, are also indirectly influencing the performance of the chosen relationship.

² Authors aiming to integrate different theories are among others Tiwana and Keil (2007, pp. 623-634) and Berkovitz, Jap and Nickerson (2006, pp. 724-740)

Data

Data will be gathered at the task level. In different organisations, the most knowledgeable respondent will be selected to comment on the ICT-, engineering- or R&D-related tasks, which are fulfilled either internally, through an alliance or through a market relationship.

The demarcation of the population and the sample frame occurred on the basis of the analysis of a preparatory survey and a literature review, which revealed business functions in which sourcing occurs regularly. This identification of relevant business functions is necessary to guarantee a sufficient amount of variation in the make-, buy- and ally-options. For this reason, we chose to select organisations in which ICT occurs in combination with R&D or engineering. In the figure below, this selection is symbolized by the crosshatched intersections.



Empirical model

An illustration of the empirical model which will be tested can be found on page 5. On the basis of the theoretical framework introduced above, hypotheses have been formulated.

In our model, frequency is conceptualized as the frequency with which a certain task has to be performed. It is hypothesized that repetition of a transaction increases transaction costs, making the make-option more efficient. It is also hypothesized that repetition of the transaction and thus of interaction between exchange partners invokes shared norms (Nee & Ingram, 1998, pp. 87-111). Shared norms are conceptualized as the sharing of norms between exchange partners, concerning flexibility, participation and solidarity (Berkovitz, Jap & Nickerson, 2006, p. 729).

H1: A frequently performed task will be fulfilled in the make-option.

H2: Frequently performed tasks invoke shared norms.

Asset specificity is conceptualized as the degree to which exchange partners have to make specific investments in order to perform the task. It is hypothesized that asset specificity increases transaction costs, therefore making the make-option more attractive. Further, it is hypothesized that asset specificity invokes shared norms. Task-specific requirements make participation of both exchange partners necessary.

H3: High asset specificity makes the make-option more likely to occur.

H4: High asset specificity invokes shared norms.

Uncertainty is conceptualized as unpredictability of the requirements and the context of the task fulfilment. It is hypothesized that uncertainty increases transaction costs and therefore making the make-option more rewarding. Further, it is hypothesized that uncertainty necessitates flexibility, participation and solidarity between the exchange partners, and therefore invokes shared norms.

H5: Uncertainty makes the make-option more likely to occur.

H6: Uncertainty increases shared norms.

Core related specificity is conceptualized as the extent to which the resources that underlie an activity contribute to a firm's competitive advantage (Barthélemy & Quélin, 2006, pp. 1775-1797). It is hypothesized that core related specificity makes the make-option and the ally-option more plausible than the buy-option. Because the task has to be done, gives direction to the organisation and has to assure its growth, the three dimensions of shared norms, are crucial. Therefore we hypothesize that core related specificity invoke shared norms.

H7: High core related specificity makes the make- and the ally-option more plausible than the buy-option.

H8: High core related specificity invokes shared norms.

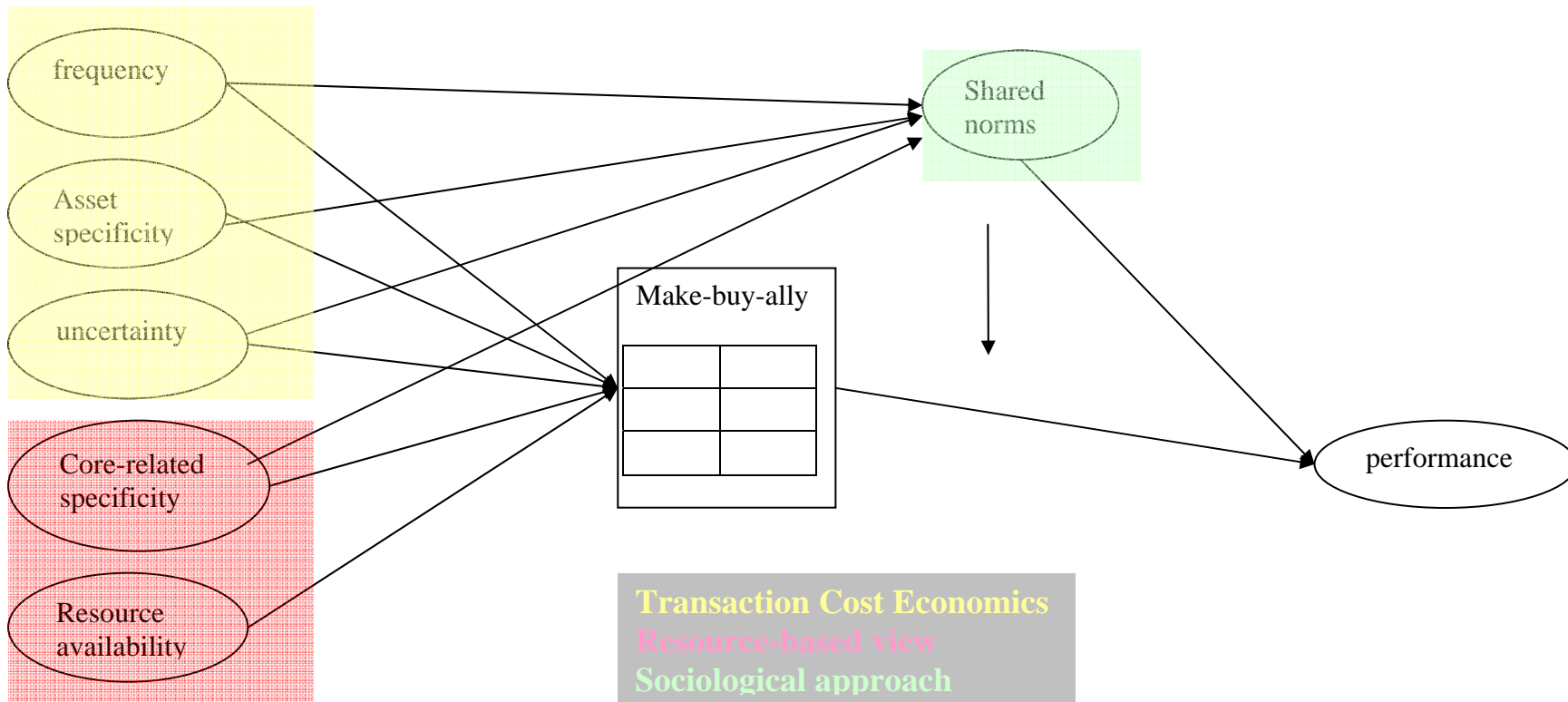
Resource availability is conceptualized as the degree to which the resources that underlie an activity are present in the organisation. It is hypothesized that resource availability makes the make-option and the ally-option more likely to occur than the buy-option.

H9: Resource availability makes the make- and the ally-option more plausible than the buy-option.

Performance is conceptualized as the assessment of the other party's performance and the overall evaluation of the exchange relationship. We hypothesize that performance increases with shared norms, but will do so more in the case of an alliance and an internal relationship, than in the case of a mere buy-relationship. In the case of a mere market relation, compliance with formal transaction agreements indeed suffices to have a satisfying transaction. Given the circumstances in which we hypothesize an internal relationship or an alliance to occur, shared norms will enhance the chance on a satisfying outcome. Thus, we hypothesize that the main effect of the make-buy-ally-decision will be insignificant when controlling for the interaction effects with shared norms.

H10: Performance increases with shared norms, but will do so more in the case of an alliance and an internal relationship, than in the case of a mere buy-relationship.

Sector and firm size are two control variables included in our model. We control for differences between sectors, which might occur because of institutional effects. Additionally, firm size is expected to influence the make-buy-ally-decision: we believe the make-option will occur more frequently in large organisations.



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