

# Make-or-Buy: The Strategic Decision Between In-House Manufacturing and External Procurement

Make-or-Buy refers to the strategic decision of whether a company manufactures a service, a component or an entire production stage itself (Make) or procures it from external suppliers (Buy). The decision has a lasting impact on cost structure, vertical integration, ability to supply and the negotiating position in procurement. For technical buyers, it is one of the most consequential questions of procurement strategy, as it directly affects long-term capital commitment, quality responsibility and supplier risks.

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## Key facts at a glance

- 01 Make-or-Buy is the systematic weighing-up of in-house manufacturing versus external procurement of components, parts or services.
- 02 Cost comparisons alone are rarely sufficient; strategic criteria such as core competence, vertical integration and supply risk are also decisive.
- 03 In practice, depending on the starting position, a well-founded decision can often unlock five to ten per cent of the relevant total costs.
- 04 The decision is not a one-off event but should be reviewed regularly – for example when orders or technologies change.
- 05 Hybrid solutions such as partnerships, licences or partial in-house manufacturing are often the most economical alternative.

## Definition: Make-or-Buy

Make-or-Buy encompasses all considerations, analyses and decisions that determine whether services are provided in-house or procured externally. It is a classic question of production and procurement

strategy with a direct impact on the depth of value creation.

### **Conceptual classification**

The term originates from production economics and has been used in procurement for decades as an instrument of sourcing strategy. At its heart is the question of how to shape the value chain in the long term: which processes does the company keep under its own control, and which does it hand over to specialised suppliers? The answer shapes capacity planning, plant investments and staffing structures alike. It should therefore always be taken in interplay between development, production, procurement and controlling – ideally as a cross-functional decision with a clear process organisation and documented responsibilities.

## **| Methods and approach in the Make-or-Buy analysis**

A multi-stage approach has established itself in practice: first strategic criteria are examined, followed by an economic evaluation and finally a risk and implementation analysis. Only when all three levels yield a viable picture should the decision be documented and implemented.

### **Strategic criteria**

The starting point is the question of core competence: if the component or process differentiates the company's own product in the market, there is a strong case for in-house manufacturing – even if it is nominally more expensive. Standard components without a differentiating effect, by contrast, are typical candidates for external procurement. Further criteria are technological leadership, protection of intellectual property, economies of scale and dependence on individual suppliers. Clean supply chain mapping helps identify overarching dependencies and potential pooling levers across multiple product groups.

### **Cost comparisons and types of assessment**

The classic cost comparison sets the total costs of in-house manufacturing against purchase prices including freight, quality assurance and administrative costs. Three types of assessment have established themselves in practice: short-term assessment based on variable costs (relevant where spare capacity exists), long-term assessment with complete process and investment costs, and total cost of ownership assessment over the entire life cycle. A common mistake is to treat fixed costs as allegedly variable, or to disregard capacity commitment, set-up times and scrap rates.

### **Risk and scenario analysis**

The quantitative analysis is supplemented by scenarios: what happens with demand fluctuations, supplier failures or spikes in raw material prices? Instruments from operational risk management, such as supplier de-risking, provide methodological approaches here. For parts with a critical supply situation – for example with suppliers in a monopoly position – a higher purchase price can be the safer alternative than risky in-house manufacturing with untried processes.

## **| Key KPIs and assessment figures**

Whether the decision taken is economically viable only becomes apparent in ongoing management. These key figures help compare Make and Buy options continuously and validate the decision.

### **Cost and efficiency indicators**

Key figures are the unit costs compared with the calculation, the cost per production hour, capital commitment and the contribution margin of the affected production cell. For external procurement, material landed costs, supplier on-time delivery and PO cycle time as a measure of process speed count. The price formation and its transparency at the supplier – for example via a price list – also feed into the ongoing assessment.

### **Quality and delivery indicators**

Quality audits, scrap rates, complaint rates and on-time delivery determine whether external procurement meets the requirements placed on in-house manufacturing. For in-house manufacturing, first-pass yield, OEE and throughput time are the most important control variables. The share of shipping costs and ongoing freight cost management expenses, such as an applicable freight surcharge, belong in the total cost assessment of the Buy case.

## **| Risks and controls**

Both in-house manufacturing and external procurement carry specific risks that should be identified during the analysis phase and addressed with suitable control mechanisms.

### **Risks of external procurement**

Typical risks are supplier failures, quality deviations, IP losses, hidden dependencies and price changes over the contract term. Instruments such as regular quality audits, structured supplier management and the use of a supplier portal for data transparency mitigate these risks. For critical parts, dual sourcing or a contractually fixed contract duration with clear adjustment mechanisms is recommended.

### **Risks of in-house manufacturing**

In-house manufacturing ties up capital in plant and personnel, requires process expertise and can lead to excess capacity if demand declines. Manufacturing risks such as scrap, maintenance effort and the availability of specialists are also real. Regular planned-versus-actual comparisons of the calculation against actual costs and clear approval processes for additional investments protect against creeping loss of value.

## Current developments

Make-or-Buy is not a static topic. Supply chain effects, the digitalisation of procurement and European sustainability regulation have significantly shifted the assessment landscape in recent years.

### Resilience instead of pure cost optimisation

Supply failures and geopolitical tensions have shifted the focus from pure unit costs to security of supply. Many companies are examining re-shoring or near-shoring and deliberately accepting higher costs in order to reduce availability risks. Repatriation processes into in-house manufacturing or diversification across several suppliers are common patterns in this regard.

### Digitalisation of the decision-making basis

Modern procurement systems, data-based market analyses and a procurement ETL process that automatically prepares cost data make Make-or-Buy analyses significantly faster and more robust. Demand planning via Material Requirements Planning (MRP) also provides more reliable quantity and schedule frameworks on the basis of which the decision matures.

### Sustainability and regulatory pressure

Carbon accounting, supply chain laws and sustainability reporting are expanding the assessment criteria. Processes with high energy demand or critical supply chains are increasingly also evaluated from a sustainability perspective – which makes in-house manufacturing more attractive in some cases where clean energy sources and short transport routes are available. Whether this triggers legally relevant obligations should be examined on a case-by-case basis.

## Typical metrics

| Metric                                   | Typical value                                                                                                    |
|------------------------------------------|------------------------------------------------------------------------------------------------------------------|
| Unit cost deviation from the calculation | < 5%<br><i>Indicator of whether the original Make-or-Buy calculation still holds</i>                             |
| Supplier on-time delivery                | > 95%<br><i>Common practical target value for reliable external procurement</i>                                  |
| Scrap rate in in-house manufacturing     | < 3%<br><i>Benchmark for established series production; industry-dependent</i>                                   |
| PO Cycle Time                            | typically 2–5 working days<br><i>Measure of the speed of the operational procurement process in the Buy case</i> |

## Practical example

A medium-sized mechanical engineering company with around 400 employees had hitherto manufactured all sheet steel components in-house. An extensive Make-or-Buy analysis revealed that standard sheet metal could be procured externally at significantly lower cost, while special components with tight tolerances clearly belonged to the company's core competence. The standard sheet metal segment was completely relocated to a regional supplier.

- Structured market analysis and request for quotations to several sheet metal suppliers with uniform technical specifications
- Total cost comparison over five years including set-up, logistics and quality assurance costs
- Approval of dual sourcing for critical components during the transition phase
- Contract adaptation with a long-term contract duration, price list transparency and defined quality audits

## Conclusion

Make-or-Buy is one of the most strategic decisions in technical procurement and far more than a cost comparison. A clean analysis combines strategic core competence criteria, complete total cost assessments and an honest weighing-up of risks. The decision must be reviewed on a recurring basis, as technology, demand and the supplier market situation change continuously. Companies that approach Make-or-Buy systematically and link it to methods such as supply chain mapping, quality audits and a clear process organisation sustainably improve their competitiveness. Those who reduce the assessment to the purchase price alone, however, risk costly misinvestments and avoidable dependencies.

## Frequently asked questions

### ? What does Make-or-Buy mean?

Make-or-Buy refers to the strategic decision of whether a company manufactures a service or component itself (Make) or procures it externally (Buy). The question concerns vertical integration, cost structure and supplier risks. It is one of the central tasks of technical procurement and production strategy.

### ? Which criteria feed into a Make-or-Buy decision?

Key factors are core competence, technological relevance, total cost of ownership (not just the purchase price), capacities, supplier availability, quality requirements, dependency risks and strategic flexibility. In practice, the assessment is divided into strategic, economic and risk criteria. Only once all three levels have been plausibly assessed should a decision be made.

### ? When is in-house manufacturing worthwhile despite higher costs?

In-house manufacturing can make sense when components contribute to the differentiation of the

company's own product, when intellectual property must be protected, or when no reliable suppliers are available. Free internal capacity and strict quality tolerances can also justify in-house manufacturing. What matters is that the additional costs can be offset against measurable strategic benefits.

### ? **How do you conduct a Make-or-Buy analysis?**

A three-step approach has proven its worth in practice: first strategic filters, then a comparison of total costs over the assessment period, and finally a risk and implementation analysis. Transport costs, scrap, administrative costs and investments are included. The result is documented and converted into an implementation plan with clear responsibilities.

### ? **Is Make-or-Buy a one-off decision?**

No. Since technology, demand, cost structures and the supplier market situation change continuously, the decision should be reviewed at regular intervals. Fixed review dates or a trigger based on significant changes in volumes, costs or suppliers make sense. Many companies align this review with their annual procurement strategy.

### ? **What role does procurement play in Make-or-Buy?**

Procurement provides key market information: available suppliers, price ranges, delivery times and the risks of the external market. In the decision-making process, it acts as a partner to development, production and controlling. After the decision, it is responsible for supplier selection, contract negotiations and ongoing supplier management.

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