

Nuanced case for outsourcing by automakers

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Automakers who favor the flexibility and price savings of outsourcing production must weigh carefully the product life cycle implications of sacrificing in-house manufacturing, according to the Management Insights feature in the current issue of Management Science, the flagship journal of the Institute for Operations Research and the Management Sciences (INFORMS).

Management Insights, a regular feature of the journal, is a digest of important research in business, management, operations research, and management science. It appears in every issue of the monthly journal.

"How Does Outsourcing Affect Performance Dynamics? Evidence from the Automobile Industry" is by Sharon Novak of MIT and Scott Stern of Northwestern University.

The study examines the impact of outsourcing on performance in automobile product development.

While outsourcing allows firms to take advantage of a wide range of global suppliers and specify high-powered performance contracts, vertical integration allows firms the flexibility to adapt to customer feedback and develop capabilities over time.

This leads to an important managerial trade-off when considering the outsourcing decision: while outsourcing will tend to deliver higher levels of initial performance during the life cycle of a product, in-house development will allow a firm to experience a higher rate of

performance improvement over the entire product life cycle.

One implication of this trade-off is that the value to in-house development is not captured by a simple assessment of upfront cost or metrics exclusively based on initial quality. Instead, managers can justify in-house development when sustainable competitive advantage is based on developing capabilities and enhancing the customer experience over time.

This perspective doesn't argue against outsourcing. Instead, by adopting more of a product life cycle perspective, managers can more effectively anticipate — and be able to mitigate — the challenges that are likely to arise as a consequence of their choice of outsourcing versus internal development.

The current issue of Management Insights is available at mansci.journal.informs.org/cgi/reprint/54/12/iv .

Source: Institute for Operations Research and the Management Sciences

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