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Should Buyers use Procurement Service Providers when Suppliers have Private Information about Supply Disruptions?

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Abstract

We consider a supply chain with one buyer and multiple suppliers, who are subject to disruptions and whose likelihoods of disruption are their private information. In such setting, should the buyer procure directly from the suppliers or engage services of a better-informed procurement service provider (PSP)? Conventional wisdom says that hiring a PSP is always the right choice, because the PSP's knowledge of the supply base improves supplier selection and management. On the other hand, earlier studies prove that using a PSP purely for its superior knowledge about supply costs is always worse for a buyer than contracting with the suppliers directly. Our answer to this research question is more nuanced. Contrary to the findings of the earlier studies, the buyer may benefit from using a PSP. We identify, quantify, and explain all of the benefits and the costs of using a PSP, and describe conditions under which benefits exceed the costs. The positive value of using a PSP is derived with some combinations of suppliers from reduction of information costs due to supplier collusion and improved supply availability. The negative value of using a PSP with some combinations of suppliers comes from the loss of direct control over the supplier's production actions, which leads to reduced supply availability, and increased informational costs; and from the PSP facilitating implicit supplier collusion. Comparative statics analysis indicates that the PSP is valuable only if the buyer diversifies in one procurement model, but not the other one; and that hiring a PSP is not a solution to the problem of unreliable supply base.