

# Strategic Sourcing: Competitive Advantage in Supply Chain

Ajay A. Damle

Engineering Consultant Professional, DBA Student SP Jain, University of Mumbai, India

**Abstract:** *The competitive market situation has created a shift in companies' strategy thinking. Strategies focus increasingly on core activities and business development. One effect of this is that companies choose to outsource activities they don't consider to be core business (Van Weele, 2010; Thru-logachantar and Zailani, 2011). The purpose of this study is to investigate strategic sourcing (SS) plans that organization can apply to increase their competitive advantage. The research will have conducted through a qualitative study with a deductive approach. A multi-case study will be made on small & medium enterprises (SME) in India with unstructured & semi-structured interviews, questionnaire, survey at each company. The investigation resulted in a current view of SMEs sourcing and suitable recommendations for SMEs to direct their purchasing activities to strategic sourcing. The process of implementing a strategic sourcing for SMEs can be seen as relatively difficult but there are purchasing activities that can be improved by a strategic thinking. To keep in mind is that supplier's performance matter, but it is the resources of suppliers that are the main competitive advantage and it is in this area where supplier development and sourcing strategies should focus. Due to the strict time frame and limited resources for the research, this research was carried out in the context of SME industry, the research concepts such as SS, Supply chain integration (SCI) and Sourcing performance are relevant to other settings as well (industry and companies). Nevertheless, since the data were collected from a sample of SME industry, it would be interesting to see if similar findings were to be found in other production (commodity) based industries.*

**Keywords:** Strategic Sourcing, competitive advantage, SME, Sourcing Performance

## 1. Introduction

### Background of Study:

Competitive conditions on markets have gone through changes in the last decades, which have led to a need for companies to adapt to new requirements imposed on them either by consumers or competition (Porter, 1985; Galbreath, 2002). Competition is affected by market changes and the requirements for companies to stay competitive in these markets. Conditions effecting the environment are changed buyer preferences, increased globalization, shorter product life cycles and technology changes (Pressey et al. 2007). The competitive market situation has created a shift in company's strategy thinking. Strategies focus increasingly on core activities and business development. One effect of this is that companies choose to outsource activities they don't consider to be core business. This has made management more aware of purchasing functions growing influence in the business and strategic role in the overall corporate strategy.

Strategic approach is defined in this research as an effort by the company to create long-term goals, objectives and strategies concerning management of supply base and purchasing functions. It is making decisions on a management level that affect activities on an operational level and making the purchasing department a central part of the information and material flow. (Xu, 2010) define supply chain as a set of activities ranging company's functions from the ordering and receipt of raw material, manufacturing of products, through to the distribution and delivery to the customer. An objective of a Supply Chain Management (SCM) for the buying company is to achieve sustainable competitive advantages among others by reducing cost and lead time and enhance quality, delivery performance and effectiveness.

Shin et al. (2000) explain that the term Supply Management (SM) is used to describe the management efforts or philosophy necessary for creating an operating environment where the buyer and supplier interact in a coordinated fashion. According to Rendon, (2005) Strategic Sourcing is an aspect that characterizes the shift to supply management. Sourcing strategies should be in line with business strategy, processes and integrate Information Technology (IT) services (Rendon, 2005; Van Weele, 2010).

## 2. Problem Statement

The structure of the current business context is changing quickly, generating a great deal of uncertainty. This environment forces SME, to be innovative and to constantly review their processes and practices in order to survive on the market. Definition of a SME or large enterprises can be measured by its employment, sales, or profit (Tam et al. 2007). The increased competitions on markets has led to a focus on innovation business models and products. One threat is how easily the innovation of products can be copied which decreases the competitive advantage (Oke and Kach, 2012). This leads to a need to find innovations that are harder to copy. SME have advantages such as flexibility and higher efficiency. However, SME have some factors against them such as less resources, lack of funds and limited physical human resources and may have less power in both collaboration and competition with large organizations (Tam et al. 2007). These factors affect SMEs competitive position and ability to stay competitive though product development and growth (Hammer, 2004).

### 3. Research Objective

- To understand current sourcing in SME.
- To understand strategic sourcing options available for SME.
- Develop and test a conceptual framework based on the first two objectives, in order to progress the current understanding of sourcing plan in SME & how to develop strategic sourcing as competitive advantage.

### 4. Significance of Study

Using a sample from the SME industry in India, this study makes the following contributions to the management of organization:

- Strategic Sourcing constructs a competitive advantage by having access to raw materials, suppliers with an effective system for measuring quality of products supplied, develop advantage over competitors in relationship with suppliers manufacturing company.
- A company can create a winning situation with strategic sourcing for both the buying company and the suppliers.

The findings from this study are significant for managers and operational decision makers, since the initiative of strategic sourcing has been proven to be affective and result in cost reduction, increases in productivity, quality improvement, and return on investment (Rendon, 2005).

### 5. Literature Review

Strategic sourcing (SS) is a well-established and proven methodology for managing large-scale, medium to long term procurement activities. (State Government Victoria, 2012) It consists of two key capabilities:

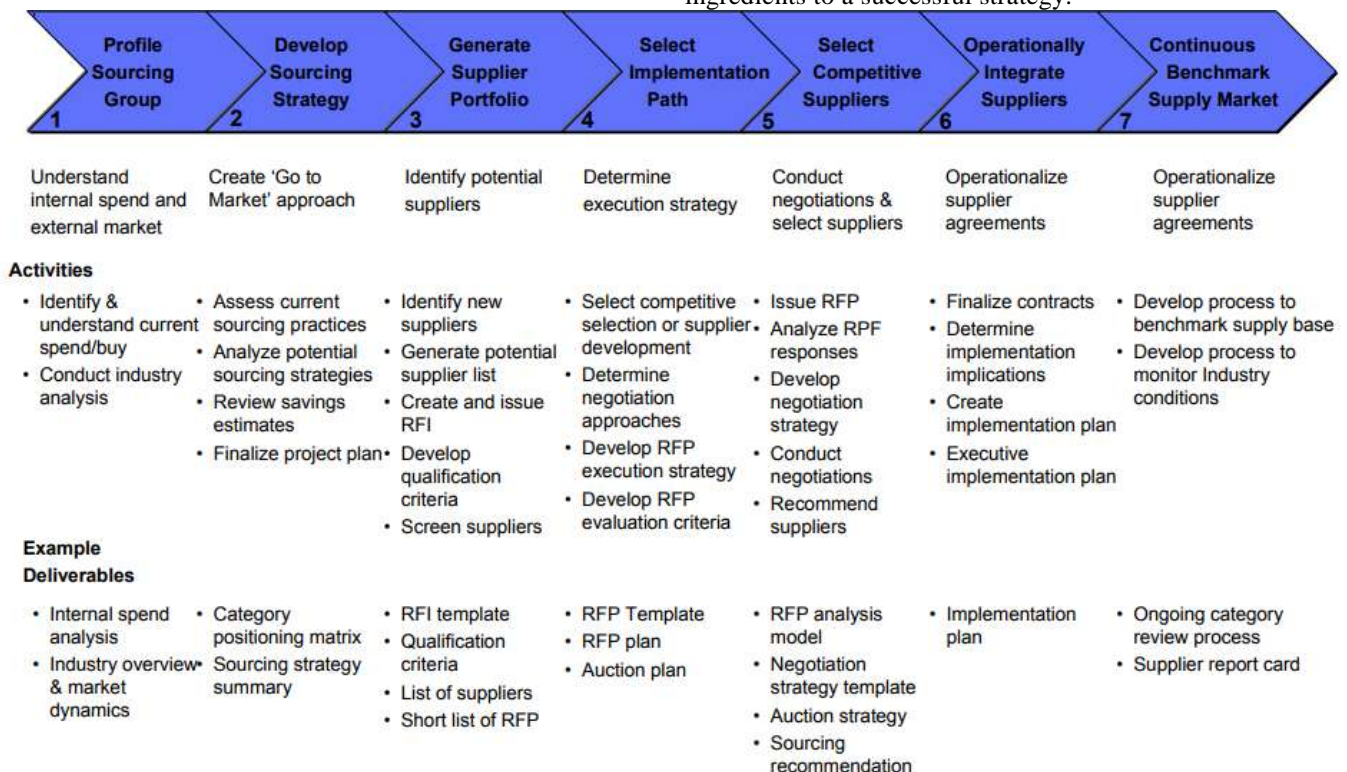
**Strategic contracting** focuses on developing a detailed knowledge base of the market and the category being sourced and using this knowledge to develop optimal sourcing solutions.

**Category Management (CM)** focuses on managing contracts to ensure that the negotiated contract benefits are realized, and driving continuous improvement in contract benefits year on year.

SS is a process driven by an identified goal or need and consists of:

- 1) Evaluating current and potential sourcing opportunities.
- 2) Assessing their value and relevance to long-term goals and overall business and supply chain objectives.
- 3) Formulating and applying action plans and processes for critical commodities or supply networks.

Figure focuses on 7-step SS process (Stegner, 2011), one of many multi Stepped processes used in commodity industry. However, there is no doubt that understanding buyer supplier relationship and supplier evaluation are key ingredients to a successful strategy.



SS has a crucial contribution to the bottom line of a manufacturing company (Johnson, 2005). Portfolio analysis is a way to structure and segment the supply base (Handfield et al. 2009). Often there are four groups in which products are divided; critical, routine, leverage and

bottleneck products. Depending on the type of product the sourcing strategy is identified. Critical products are often high-tech, high volume products and are often supplied at customer specification. There is also only one source of supply available and usually the type of product represents

a high share in the cost price of the company's end product (Handfield et al. 2009, p. 196). The suppliers should preferably be strategic and can be seen as means to help develop competitive advantage and work beyond a simple purchasing agreement. If focus is on selecting strategic supplier, there is an enhanced chance of integration (Koufteros et al. 2012). Low cost products are referred as routine products. The aim is to reduce the number of items in the category through for example small volume spend and simplification of the procurement process using electronic tools. There is also work involved with trying to find the suppliers that can automate the purchasing process as much as possible. Leverage commodity or preferred suppliers generate the possibility for cost savings as the items or services in the category represent a significant part of the spend and are important for business. Bottleneck commodity and transactional suppliers have unique requirements or niche suppliers which is significant to the business.

SS enables an organization to identify and select suppliers through supplier integration i.e. strategic long term partnerships, portfolio analysis, by providing benchmarks, laying emphasis on evaluation of supplier performance and providing feedback to suppliers, information sharing with the suppliers (Kocabasoglu and Suresh, 2006). Outsourcing, global sourcing and e-procurement have become key aspects of strategic sourcing. Strategic sourcing requires certain planning and operational changes in the manner the procurement and supply management functions are managed. So to carry out these changes Internal Integration is required at organizational level. The status of purchasing within the organization and the nature of internal coordination required undergoes significant changes. When conducting a plan for strategic sourcing there are some aspects to consider related to customer integration, such as quality, availability, deliver dependability, time to market, cost, technology and fulfillment. Technology is a vital part for more effective communication with suppliers, customer.

The choice of preceding strategic Sourcing is not only to reduce price but to enhance quality, reliability and technology of components and products. How to source globally is based on strategic decisions that are effected by a company's capabilities to compete (Kotabe and Murray, 2004). There are both advantages and disadvantages for the company when using Strategic sourcing. Advantages are mostly connected to cost and price benefits such as lower unit cost and different productivity levels. The importance is to also consider the possible advantages beside costs such as access to product and process technology, developing alternative suppliers to stimulate competition, getting access to new markets and enhance quality while lowering costs.

## 6. Theoretical Framework

The systematic literature review identified a number of theoretical approaches used to examine the SS. Based on the conceptual framework a set of research hypotheses on

the direct, and mediating relationships amongst SS, SCI & sourcing performance are proposed.

### Conceptual Framework:

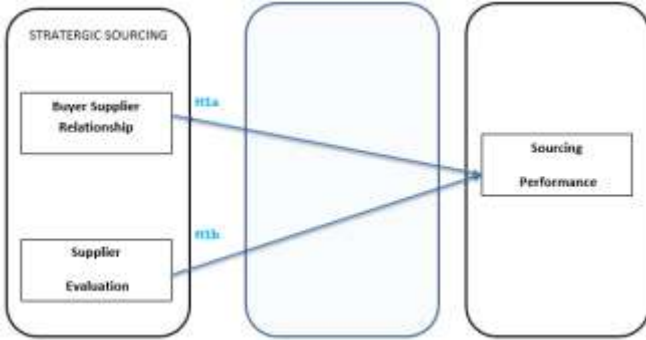
Both SS and SCI have a direct impact on Sourcing performance. This study also demonstrated the importance of examining the above association in the SME. Three objectives were proposed to explore the mediating impact of SS on the association between SCI and sourcing performance:

- 1) To ascertain the direct impact of SS dimensions (buyer supplier relationship, supplier evaluation) on SCI (internal, customer and supplier), in order to suggest improvements in sourcing performance of the supply chains.
- 2) To empirically examine why and how SCI mediates the impact of SS on Sourcing performance in SME. Therefore, shedding some light on the level of integration needed for better performance in such context.
- 3) Develop and test a conceptual framework based on the first two objectives, in order to progress the current understanding of SS, SCI and sourcing performance of the supply chains.

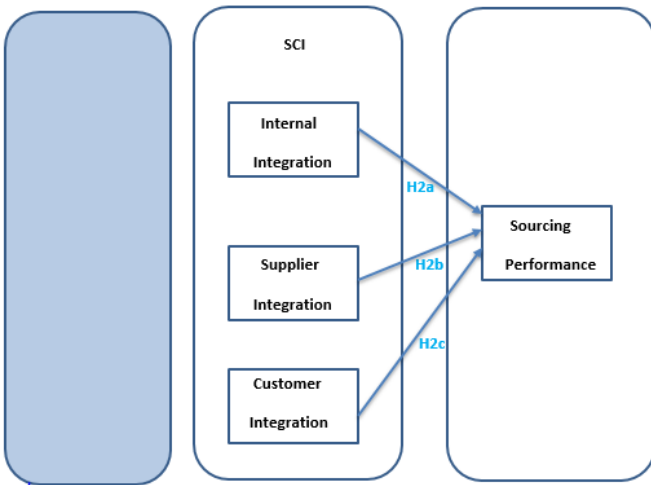
Cavana et al. (2001) suggested that research hypotheses are logical speculated associations between two (or more) research variables, which are stated in a line or a statement. By testing such hypotheses and confirming or rejecting such statements, it is anticipated that an answer to the research problem which is under study can be obtained. Table presents the 17 hypotheses in relation to the four research questions under investigation.

Research Hypotheses
<b>RQ 1: What is the relationship between strategic sourcing and sourcing performance in the supply chains?</b>
H1. a Buyer supplier relationship is negatively related to sourcing performance.
H1. b Supplier Evaluation is negatively related to sourcing performance.
<b>RQ 2: What is the relationship between the dimensions of supply chain integration and Sourcing performance in the supply chains?</b>
H2. a An Internal integration is positively related to sourcing performance.
H2. b Supplier integration is positively related to sourcing performance.
H2. c Customer integration is positively related to sourcing performance.
<b>RQ 3: What is the relationship between the dimensions of strategic sourcing and supply chain integration in the supply chains?</b>
Hypothesis 3a: Buyer supplier relationship is negatively related to internal integration.
Hypothesis 3b: Buyer supplier relationship is negatively related to supplier integration.
Hypothesis 3c: Buyer supplier relationship is negatively related to customer integration
Hypothesis 4a: Supplier Evaluation is negatively related to internal integration.
Hypothesis 4b: Supplier Evaluation is negatively related to supplier integration.
Hypothesis 4c: Supplier Evaluation is negatively related to customer integration.
<b>RQ 4: Does supply chain integration mediate the relationship between strategic sourcing and sourcing performance of the supply chains?</b>
Hypothesis 6a: Internal integration mediates the negative impact of buyer supplier relationship on sourcing performance.
Hypothesis 6b: Internal integration mediates the negative impact of supplier evaluation on sourcing performance.
Hypothesis 7a: Supplier integration mediates the negative impact of buyer supplier relationship on sourcing performance.
Hypothesis 7b: Supplier integration mediates the negative impact of supplier evaluation on sourcing performance.
Hypothesis 8a: Customer integration mediates the negative impact of buyer supplier relationship on sourcing performance.
Hypothesis 8b: Customer integration mediates the negative impact of supplier evaluation on sourcing performance.

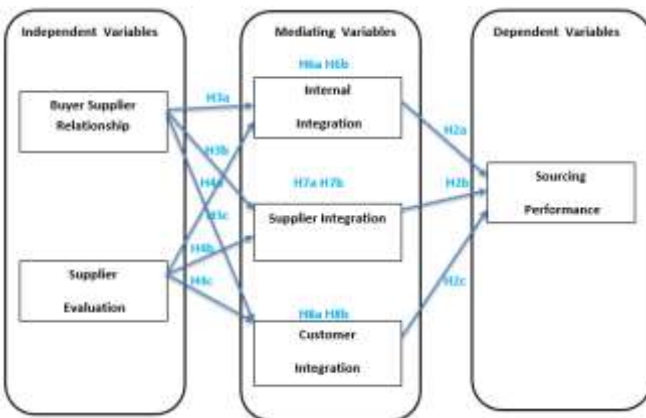
The figure 3.1, illustrates the theoretical framework for the direct relationships between SS and Sourcing performance.



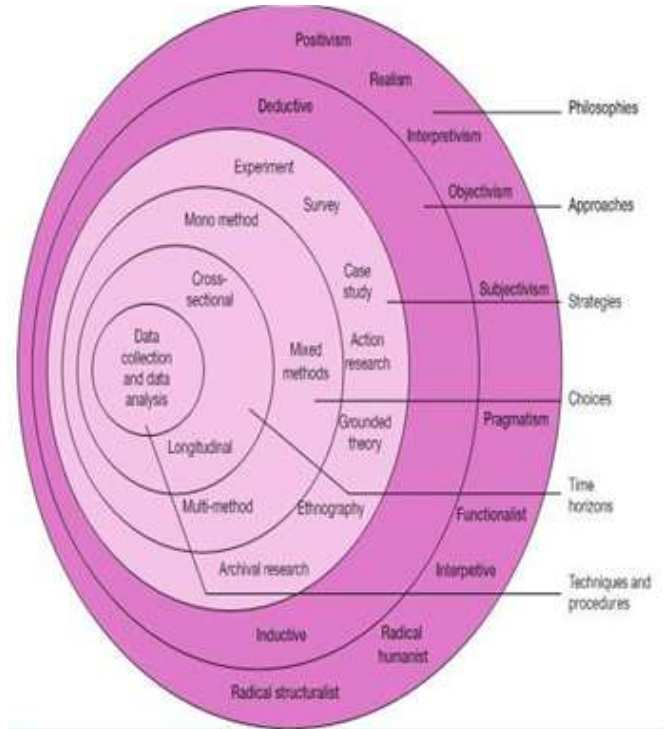
The figure 3.2, illustrates the theoretical framework for the 3 direct relationships between SCI and Sourcing performance



The figure 3.3, illustrates the theoretical framework for the direct relationships between SS and SCI, and also the 6 mediating hypotheses of SCI on the relationship between SS and Sourcing performance.



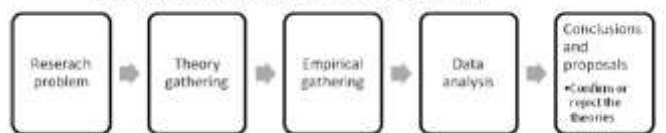
**7. Methodology**



As shown in figure above, there are a number of research philosophies. However, the predominant philosophies used in management include positivism, interpretivist and realism. There are basically two approaches to research design. The deductive approach allows the research to create the research hypotheses, and design an approach to verify such hypotheses (Gill and Johnson, 2010). The inductive approach allows the research to first collect data and consequently develop theory based on the analysis.

By conducting a literature review and establishing the conceptual framework, this research takes a quantitative (deductive) approach in collecting and analyzing the information from the target respondents.

A graphic illustration of the deductive approach



(Bryman and Bell, 2005)

**Collection of Data:** There are two types of data:

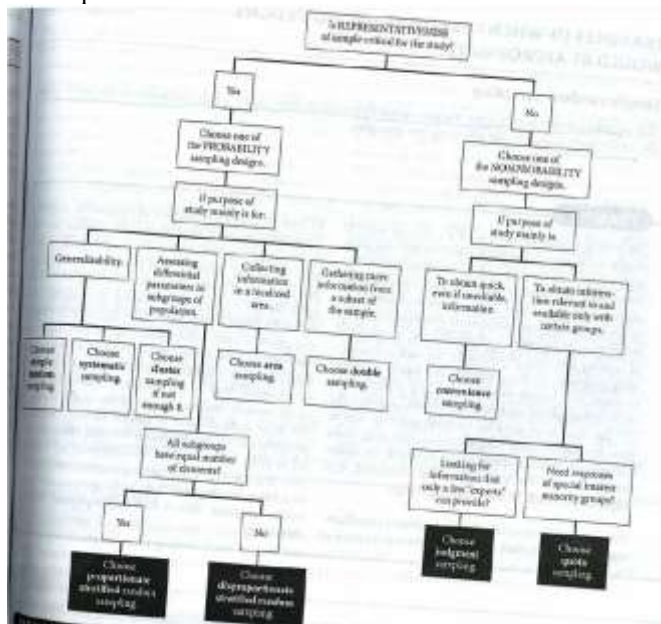
- 1) Primary data: Data that is gathered by a researcher for the first time for a particular ongoing research project.
- 2) Secondary data: Data that has been formerly gathered by other researchers for other reasons.

For this research we will use both, primary data through interviews, questionnaire, focused group to get a relevant and reliable data and secondary data from different sources, such as books, journals and articles as a supportive data which helps in building the frame of reference for the study.

Data should be collected from the right people, events, or objects that can provide the correct answers to solve the problem. The whole research will be in vain if population is not correctly targeted. The process of selecting a sufficient number of right individuals, objects, event from the

population for research is called **Sampling**. (Uma sekaran & Bougie, 2013).

The reasons for using a sample, rather than collecting data from the entire population, are self-evident. In research investigations involving several hundreds and even thousands of elements, it would be practically impossible to collect data from, or test, or examine every element. Even if it were possible, it would be prohibitive in terms of time, cost, and other human resources. Study of a sample rather than the entire population is also sometimes likely to produce more reliable results. (Uma sekaran & Bougie, 2013). Following figure represent different sampling technique used in research.



**Sampling method** selection depends on many factors, including the following:

- 1) Extent of prior knowledge in the area of research undertaken.
- 2) The main objective of the study is generalizability, efficiency, knowing more about subgroups within a population, obtaining some quick information, etc.
- 3) Cost considerations is exactitude and generalizability worth the extra investment of time, cost, and other resources in resorting to a more, rather than less sophisticated sampling design? Even if it is, is sub optimization because of cost or time constraints called for?

By conducting a literature review and establishing the conceptual framework, for this research purposive sampling will be employed for study because researcher will select individuals, sites & process for study who can provide the desired information, either because they are the only ones who have it, or conform to some criteria set by the researcher.

## 8. Limitations

This research was carried out in the context of SME industry, the research concepts such as SS, SCI and sourcing performance are relevant to other settings as well

(industry and companies). Nevertheless, since the data were collected from a SME industry, it would be interesting to see if similar findings were to be found in other production based industries. Thus, a comparative research might be useful to precisely set generalizability limitations on the research outcomes.

## 9. Conclusion

The conclusions are based on theoretical assumptions where SMEs can gain competitive advantages by implementing a strategic sourcing in the organization. The process of implementing strategic sourcing is long and a constant project that preferably has to penetrate the whole organization, especially management level. The process of implementing a strategic sourcing for SMEs can be seen as relatively difficult, due to the limiting factors mentioned before. The theories are more appropriate for larger enterprises but there are some aspects of the strategic sourcing which SMEs can apply to enhance their competitiveness. To keep in mind is that supplier's performance matter, but it is the resources of suppliers that are the main competitive advantage and it is in this area where supplier development and sourcing strategies should focus.

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