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The Effect of Sourcing Strategies on the Relationship Between Competitive Strategy and Firm Performance

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The paper presents a study which seeks to add to the body of knowledge that relates Porter's generic strategies, and sourcing strategies to organizational performance in the context of Malaysia manufacturing industry. Using mail survey, the study first identified the natural taxonomy of two strategic types of manufacturing firms, based on their use of Porter's generic strategies in pure form, and sourcing strategies of make and buy options. The study examined specific strategic types were associated with specific sourcing strategies. The findings indicate the cost leadership strategy that is mediated by make strategy generate better performance than other types of association. Similar to the relationship between differentiation strategy and organizational performance which mediated by buy strategy, have superior performance than other type of association. The study concludes that the research provided body of knowledge relevant for the Malaysia manufacturing industry, which may be used by top management in the industry in the strategy formulation process as well as by the researches in exploring the influence of different contingencies on manufacturing industry's strategic orientation.

Field of Research: Competitive Strategy, Sourcing Strategy, Performance

1. Introduction

Manufacturers today face challenges on a variety of fronts. From competition that is increasingly global to technological advancement that rewrites the rules of the game, more is demanded of manufacturing firms than ever before. In response to these demands, manufacturing firms have pursued continuous improvement, leaned up production, reengineered business processes, and integrated supply chains. Over the past decade there is a growing realization of the important contribution that competitive strategy (Thompson et al., 2004; David, 2005), and sourcing strategy (Cousins et al., 2006) on organizational performance.

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The overall objective of the study was to examine the use of Porter's generic strategies, sourcing strategies, and their effect on organizational performance in the context of Malaysia manufacturing industry. The study first identifies the natural taxonomy of strategic types firms, based on their use of generic strategies in pure form. Next it examines whether specific strategic types were associated with specific sourcing strategies and organizational performance. Further the study discusses the findings and hypothesizes about their possible explanations. Finally, conclusions are drawn and their implications for managers are discussed.

2. Literature Review

2.1 Competitive Strategy

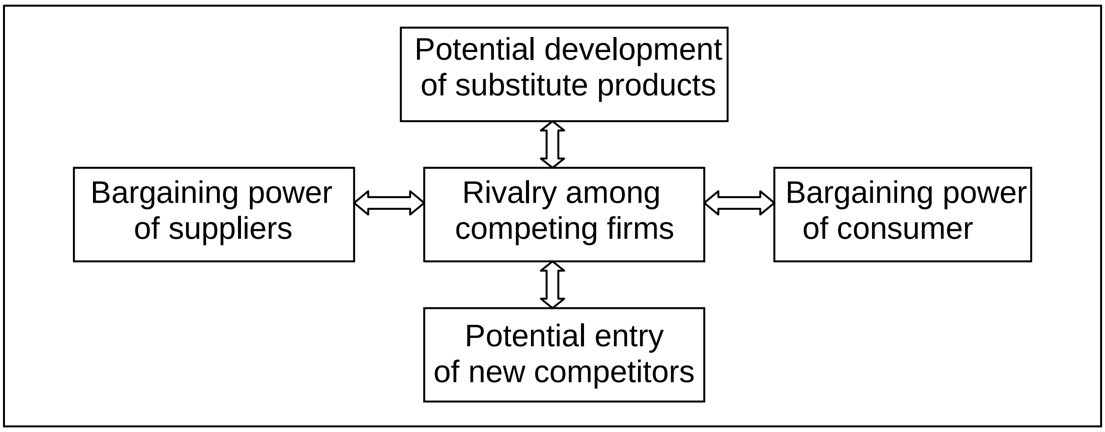
Porter's (1985) define strategy as positioning a business to maximize the value of the capabilities that distinguish it from its competitors. According to Porter, distinctive value can be achieved by pursuing the following generic strategies: cost leadership, differentiation and focus. He maintained that his strategies were mutually exclusive or at least non-complementary and referred to firms that attempt to pursue more than one generic strategy as "stuck in the middle".

Despite the differences all strategy frameworks have one thing in common which is that they all aim at maximizing the performance of an organization improving its competitiveness in relation to its competitors in the same competitive environment (Feurer & Chaharbaghi, 1997). Porter drew upon the frameworks of industrial economics which is embedded to industrial economics theory (IO Theory), which is better explained through the following simple paradigm (Shortell & Kalunzy, 1994):

Market Structure → Firm Conduct → Performance

By introducing the concept of industrial analysis Porter (1985) further provided insight into structures within different competitive environments. This concept assumes five competitive forces illustrated in Figure 1.1.

Figure 1.1: Porter's Five Forces



Organizations must constantly adapt to fast changing circumstances and, hence, move towards dynamic strategy development (Feurer & Chaharbaghi, 1997). Those frameworks and concepts have provided a better understanding of strategy. It was therefore felt that the framework of Porter's generic strategies could still employed in Malaysia manufacturing industry for generating knowledge, which may be used in the formulation and implementation of strategies.

2.1.1 Porter's generic strategies

The strategic typology developed by Porter (1980) emphasizes two types of competitive advantage: cost leadership and differentiation. Both of them represent what Porter calls "generic strategies". A third generic strategy is a subset of the other two. This strategy is focus. Porter's generic strategies imply different organizational arrangements, control procedures, and incentive systems.

2.1.1.1 Cost leadership

A primary reason for pursuing forward, backward, and horizontal integration strategies to gain cost leadership benefits. Among cost elements to consider are facilities, operations, overheads, cost saving from experience, and being relatively frugal in such areas as R&D, service, sales force, training and development and advertising (Porter, 1980; Hlavacka et al., 2001). Striving to be the low-cost producer in an industry can be especially effective when the market is composed of many price-sensitive buyers, when there are few ways to achieve product differentiation, when buyers do not care much about differences from brand to brand, or when there are a large number of buyers with significant bargaining power (Porter, 1980; Malburg, 2000; Venu, 2001; Davidson, 2001; Allen et al., 2006).. The basic idea is to underprice competitors and thereby gain market share and sales, driving some competitors out of the market entirely (Porter, 1980).

2.1.1.2 Differentiation

Firms that adopt a differentiation strategy seek to establish fundamental differences in a variety of dimensions so that buyers perceive a marked contrast between the products of one firm and its rivals. A firm focuses on providing a unique product or service (Porter, 1980; Cross, 1999; Hyatt, 2001; Bauer & Colgan, 2001; Hlavacka et al., 2001). Successful differentiation can mean greater product flexibility, greater compatibility, and more features (Porter, 1980; Davidson, 2001; McCracken, 2002; Allen et al., 2006). Differentiation yields high margins with which to deal with supplier power and clearly mitigates buyer power since buyers lack comparable alternatives and are thereby allows a firm to charge a higher price for its products (Porter, 1980; Venu, 2001; Hlavacka et al., 2001).

2.1.2 Sourcing strategies

Capron and Mitchell (2004) define make as when a firm recombine its existing resources or developing new resources on its own; and buy as when a firm trade its activities that held in a strategic capability which stems from external sources. The sourcing decision can often be a major determinant of profitability, making a significant contribution to the financial health of the firm (Yoon & Naadimuthu, 1994; McIvor et al., 1997). The sourcing strategy espoused by a firm may focus on cost leadership, differentiation, or other intents which form the basis of the competitive edge (Porter, 1980). One of the distinguishing attributes of effective sourcing strategy is that, it plays an integrative role in the firm’s strategic planning process (Reck & Long, 1988, Ammer, 1989; Carr et al., 2000; Carr & Pearson, 2002); and the key to succeed in achieving such integration lies in the skills and capabilities of the people who work in the purchasing function (Reck & Long, 1988; Carr & Pearson, 2002).

2.1.2.1 Make Strategy

Firms may opt for make strategy when targeted capabilities do not exist outside the firm or even if they do exist, they cannot be traded through markets or across firms (Capron & Mitchell, 2004), or when suppliers do not want to trade unique and valuable resources (Dierickx & Cool, 1989). To remain competitive, firms need to develop the ability to recombine its internal capabilities into new configurations of capabilities (Henderson & Clark, 1990; Galunic & Rodan, 1998).

Consistent with knowledge-based theorists and institutional theorists, the targeted and existing capabilities of make strategy targeted capabilities are narrow (Capron & Mitchell, 2004), which means it is suitable for the development of capabilities that do not depart significantly from the firm's routines and social values. However, owing to rapid changes in the market, this strategy makes firms less flexible (Hayes & Abernathy, 1980). Due to the gap in the literature with regards to the relationship between cost leadership strategy and make strategy, these attributes indirectly indicates the nature of the make strategy is consistent with the cost leadership strategy of the Porter's generic strategies which highly associated with internal development, low cost, learning curve benefits, and economies of scale (Porter, 1980; Malburg, 2000; Venu, 2001; Davidson, 2001; Allen et al., 2006).

2.1.2.2 Buy Strategy

Buy strategy or outsourcing can be defined as an act of moving some of a firm's internal activities and decision responsibilities to outside providers (Lankford & Parsa, 1999; Chase et al., 2004). Firms nowadays tend to contract out more manufacturing and service activities than they did a decade ago (Fuller, 2002). This trend has been driven by changes in the business environment and the pursuit of lean operations (Hui & Tsang, 2004). Through the buy strategy, firms could secure advantages such as economies of scale (mass production) and scope (specialization), cost reduction, quality, service and delivery improvement, organizational focus, greater product flexibility, and better chances to exploit change facilitation provided by external suppliers (McIvor et al., 1997; Fan, 2000; Zeng, 2000; Kakabadse & Kakabadse, 2000; Jennings, 2002; Hui & Tsang, 2004; Gilbert et al., 2006).

The literature clearly indicates the characteristics of buy strategy and differentiation strategy but very little empirical evidence relating to the association between these two variables. However, their respective characteristics are very much similar as the differentiation strategy favors unique product (Porter, 1980; Cross, 1999; Hyatt, 2001; Bauer & Colgan, 2001; Hlavacka et al., 2001), greater product flexibility, greater compatibility, and more features (Porter, 1980; Davidson, 2001; McCracken, 2002; Allen et al., 2006). Furthermore both strategies yield high margins through the mitigation of buyer power since buyers lack comparable alternatives and thereby allow firms to charge a higher price for its products (Porter, 1980; Venu, 2001; Hlavacka et al., 2001).

2.1.3 Porter's Types, Sourcing Strategies and Organizational Performance

Porter (1980) emphasized that generic strategies represent different alternatives to a firm seeking to establish a competitive advantage. Firms that are "stuck in the middle" compete at a disadvantage because the cost leaders and differentiators are all able to concentrate their capabilities more effectively and secure better performance (Porter, 1980; Fuerer & Chaharbaghi, 1997; Cross, 1999; Hlavacka et al., 2001).

Sourcing decision can often be a major determinant of profitability, making a significant contribution to the financial health of the firm (Yoon & Naadimuthu, 1994; McIvor et al., 1997). One of the distinguishing attributes of effective sourcing strategy is that, it plays an integrative role in the firm's strategic planning process (Reck & Long, 1988, Ammer, 1989; Carr et al., 2000; Carr & Pearson, 2002).

This study drew upon the framework of business level strategy (Porter's generic strategies – competitive strategy), functional level strategy (sourcing strategies), and organizational performance. The framework is best illustrated through the following simple paradigm.

Competitive Strategy → Sourcing Strategy → Organizational Performance
(Porter's generic Strategy) (Make or Buy)

The logic here is that the combined effects of competitive strategy (independent variable) and sourcing strategy (mediator variable) influence organizational performance (dependent variable).

2.1.4 Hypotheses

The primary research question for this study is to determine the extent to which specific sourcing strategy mediate the specific competitive strategy in its relationship with organizational performance. Given the gap in the literature on this perspective, this study intended to addresses the proposed hypotheses as follow:

H1: Firms pursuing cost leadership strategy that is mediated by make strategy produce better organizational performance than other type of association.

H2: Firms pursuing differentiation strategy that is mediated by buy strategy produce better organizational performance than other type of association.

3. Methodology and Research Design

The data for this study have been collected between May 2008 and July 2008. The sample for this study was chosen from the Federation of Malaysian Manufacturers (FMM) 2007 directory. This study aimed to investigate the influence of sourcing strategy as a mediator variable in the relationship between competitive strategy and organizational performance.

An instrument of measure the generic strategies were required. This study adapted an instrument developed and tested by Roth and Morrison (1990) which based on Porter (1980, 1985). Seventeen questions regarding various strategic practices were used to operationalized Porter's generic strategies. For sourcing strategies, this study used Kotabe and Omura (1989) developed and tested instrument. Twelve questions which regards to various sourcing practices were used to operationalized the sourcing strategies. For the organizational performance, this study combined instrument of measure developed and tested by Venkatraman and Ramanujam, (1986); Dess and Robinson, (1994); Lee and Miller, (1996); and Kaplan and Norton (1996). Seven questions regarding financial and non financial measures were used to operationalized organizational performance.

3.1 The Sample

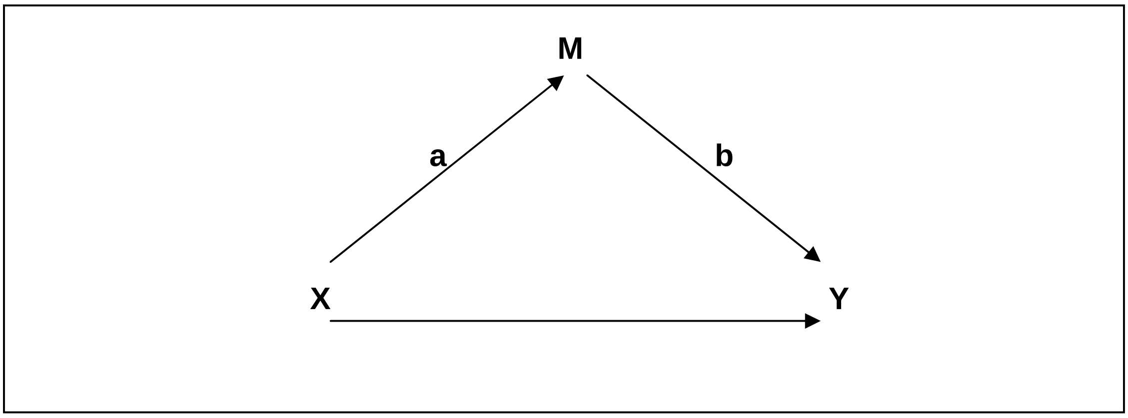
To reach a broad range of organizations and ensure a high response rate the survey was administered to convenience samples of Federation of Malaysian Manufacturer (FMM) respondents. It was determined a respondents must hold top management position in the organization under study to have adequate organizational knowledge to accurately complete the questionnaire. Usable responses included 153 opted for cost leadership strategy and make strategy, and 161 opted for differentiation strategy and buy strategy.

4. Discussion of Findings

The Cronbach Alphas were computed for the scale reliabilities. For 153 firms that opted for cost leadership strategy for competitive strategy option, and make strategy for sourcing strategy option; the Cronbach Alphas for the cost leadership factor of six items has an alpha of 0.715; the make factor consisted of twelve items has an alpha of 0.800; and the organizational performance of seven scale items has an Alpha of 0.745. For 161 firms that compete via differentiation strategy of the competitive strategy option, and buy strategy for sourcing strategy option; the Cronbach Alphas for the differentiation strategy of eleven items had an Alpha of 0.900; the buy strategy of twelve items had an Alpha of 0.900; and the organizational performance of seven scale items had an alpha of 0.789.

Hypothesis 1 was proposed as to test the role of make strategy as mediator in the relationship between cost leadership strategy, and organizational Performance. This means the make strategy is a mediator as it carriers the influence of a given independent variable to a given dependent variable. Figure 1.2 illustrates the mediated model.

Figure 1.2: Make Strategy as a Mediator in the Relationship between Cost Leadership Strategy and Organizational Performance



Hypothesis1: Firms pursuing Cost Leadership Strategy that is mediated by Make Strategy produce better organizational performance than other type of association.

The mediating role of make strategy of sourcing strategy in particular is tested based on a multiple regression which suggested by Baron and Kenny (1986). Baron and Kenny have suggested that a four-step approach should be conducted. Table 1.1 contains the analyses necessary to examine the mediation hypothesis.

Step 1, the established of Cost Leadership Strategy (predictor) is related to performance (outcome). The unstandardized regression coefficient ($B = 0.243$) associated with the effect of Cost Leadership Strategy on Performance is significant ($p < 0.01$). Thus, the relationship between the Cost Leadership Strategy and Performance is significant, and the requirement for mediation in step 1 as suggested by Baron and Kenny (1986) is met.

Step 2, the unstandardized regression coefficient ($B = 0.414$) associated with the effect of Cost Leadership Strategy on Make Strategy is significant ($p < 0.01$). The condition for step 2 is met. The Cost Leadership Strategy is associated with the Make Strategy.

Step 3, Performance (outcome) is tested with both Make Strategy (mediator) and Cost Leadership Strategy (predictor). The coefficient associated with the relation between the Make Strategy and the Performance also significant ($B = 0.155$, $p < 0.05$). This regression equation also provides an estimate of relation between Cost Leadership Strategy and Performance, controlling for Make Strategy ($B = 0.212$, $p < 0.01$).

Table 1.1: Testing Mediator Effects using Multiple Regression

	F(1,151)	B	SE B	Beta	t
Step 1					
Outcome: Performance	17.335**				
Predictor: Cost Leadership		0.243	0.058	0.321	4.164**
Step 2					
Outcome: Make Strategy	33.259**				
Predictor: Cost Leadership		0.414	0.072	0.425	5.767**
Step 3					
Outcome: Performance	14.706**				
Predictor: Cost Leadership		0.155	0.062	0.205	2.486*
Mediator: Make Strategy		0.212	0.064	0.273	3.307*

**p < 0.01, *p < 0.05

Step 4, the Sobel, Aroian, and Goodman tests are conducted to test whether the mediator carries the influence of the Cost Leadership Strategy to Performance. Table 1.2 shows the results are significant, $p < 0.05$. This means, the Make Strategy mediates the relationship between the Cost Leadership Strategy and the Performance.

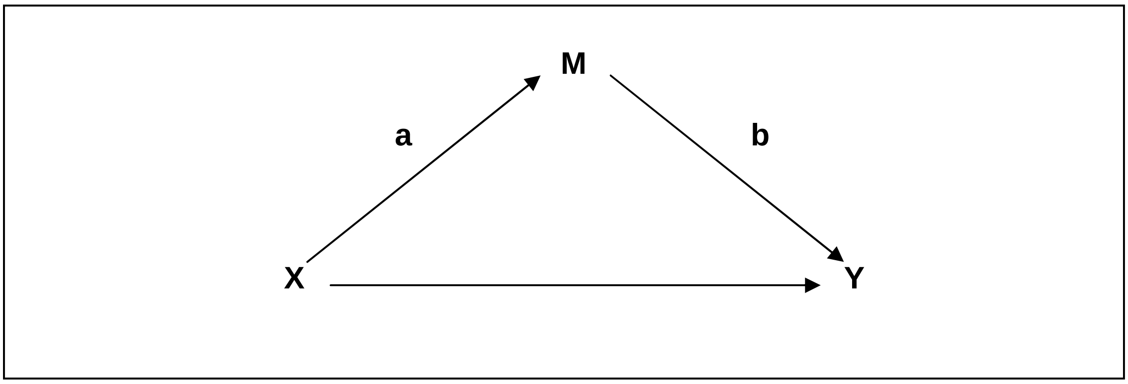
Table 1.2: The Sobel Test of Make Strategy as a Mediator in the Relationship between Cost Leadership Strategy and Performance

	Input		Test statistic:	*p*-value:
A	0.155	Sobel test:	2.00	0.05
B	0.212	Aroian test:	1.94	0.05
Sa	0.062	Goodman test:	2.06	0.04
Sb	0.064			

Hypothesis 1 is supported; make strategy mediate the relationship between cost leadership strategy and organizational performance.

The proposed Hypothesis 2 is to test the role of buy strategy as mediator in the relationship between differentiation strategy, and organizational Performance. This means the buy strategy is mediator as it carriers the influence of a given independent variable to a given dependent variable. Due to the gap in the literature concerning this perspective, this hypothesis is expected to fill the gap. Figure 1.2 illustrates the mediated model.

Figure 1.2: Buy Strategy as a Mediator in the Relationship between Differentiation Strategy and Organizational Performance



Hypothesis 2: Firms pursuing Differentiation Strategy that is mediated by Buy Strategy produce better organizational performance than other type of association

The mediating role of sourcing strategy or buy strategy in particular is tested based on a multiple regression which suggested by Baron and Kenny (1986). Baron and Kenny have suggested that a four-step approach should be conducted. Table 1.3 contains the analyses necessary to examine the mediation hypothesis.

Step 1, the established of Differentiation Strategy (predictor) is related to performance (outcome). The unstandardized regression coefficient (B = 0.268) associated with the effect of Differentiation Strategy on Performance is significant ($p < 0.01$). Thus, the relationship between the Differentiation Strategy and Performance is significant, and the requirement for mediation in step 1 as suggested by Baron and Kenny (1986) is met.

Step 2, the unstandardized regression coefficient (B = 0.325) associated with the effect of Differentiation Strategy on Buy Strategy is significant ($p < 0.01$). The condition for step 2 is met. The Differentiation Strategy is associated with the Buy Strategy.

Step 3, Performance (outcome) is tested with both Buy Strategy (mediator) and Differentiation Strategy (predictor). The coefficient associated with the relation between the Buy Strategy and the Performance also significant (B = 0.190, $p < 0.01$). This regression equation also provides an estimate of relation between Differentiation Strategy and Performance, controlling for Buy Strategy (B = 0.241, $p < 0.05$).

Table 1.3: Testing Mediator Effects using Multiple Regression

	F(1,159)	**B**	**SE B**	**Beta**	**t**
Step 1					
Outcome:					
Performance	47.828**				
Predictor:					
Differentiation		0.325	0.047	0.481	6.916**
Step 2					
Outcome:					
Buy Strategy	28.421**				
Predictor:					
Differentiation		0.268	0.050	0.389	5.331**
Step 3					
Outcome:					
Performance	19.098**				
Predictor:					
Differentiation					
Mediator:		0.190	0.056	0.276	3.385**
Buy Strategy					
		0.241	0.083	0.237	2.906*

**p < 0.01, *p < 0.05

Step 4, the Sobel, Aroian, and Goodman tests are conducted to test whether the mediator carries the influence of the Differentiation Strategy to Performance. Table 1.4 shows the results are significant, $p < 0.05$. This means, the Buy Strategy mediates the relationship between the Differentiation Strategy and the Performance. Hypothesis 14 is met.

Table 1.4: The Sobel Test of Buy Strategy as a Mediator in the Relationship between Differentiation Strategy and Performance

Input			Test statistic:	*p*-value:
A	0.190	Sobel test:	2.21	0.03
B	0.241	Aroian test:	2.15	0.03
Sa	0.056	Goodman test:	2.26	0.02
Sb	0.083			

Hypothesis 2 is supported; buy strategy mediate the relationship between differentiation strategy and organizational performance.

5. Conclusion

Specific competitive strategy with specific sourcing strategy would generate better organizational performance. In particular, make strategy mediates the relationship between cost leadership and organizational performance, and buy strategy mediated the relationship between differentiation strategy, and organizational performance. This study provides pertinent information for decision making process of the management. The results of this present study would assist top management team to make effective decision, plan, adopt and implement appropriate strategic approaches in order to achieve high positive outcomes such as competitive strategy, sourcing strategy, and organizational performance among the manufacturing sector managers.

This finding suggests the importance of sourcing strategy as a mediator in the relationship between competitive strategy and organizational performance. Therefore, management in the Malaysian manufacturing sector needs to know the importance of integrating specific competitive strategy, and sourcing strategy in order to strengthen their competitiveness, and organizational performance. In conclusion, this study generates an important implication for managerial practice which is that building and strengthening organizational competitive approach, and winning strategy in facing hyper competitive environments.

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