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Purchasing's Strategic Relevance

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Purchasing's Strategic Relevance

Abstract:

Recently Ramsay (2001) applied the resource based view of the firm (RBV) to argue that purchasing is a largely irrelevant activity from a strategic management point of view. In this paper it will be argued to the contrary on several grounds. First, it will be shown there is a much wider theoretical base underlying the field of strategic management, from which arguments can be drawn to substantiate that purchasing can indeed have strategic impact. Second, recent developments in the RBV will be discussed to illustrate that also within the RBV purchasing is a strategic activity. Furthermore there is much empirical evidence to demonstrate that purchasing and supply management activities contribute to sustainable competitive advantage. The paper then puts forward a systematic set of criteria, which may be of value to purchasing management researchers to assess whether studied phenomena have strategic impact. Finally some hints are given for future research directions.

Key words:

Strategic management, sourcing strategy, resource-based view, purchasing research

1. Introduction

There appears to be an ongoing search for a separate identity for the field of purchasing management. Ramsay (2001) intends to contribute to this search by investigating whether purchasing can live up to the standards set by strategic management. Strategic management is the area of management studies concerned with decisions that help a firm obtain sustainable competitive advantage (SCA). SCA is said to occur when a firm implements a strategy that is "not simultaneously being implemented by any current or potential competitors *and* when these other firms are unable to duplicate the benefits of this strategy" (Barney, 1991: 102, emphasis in original). The central question in this paper is whether purchasing management can help a firm build SCA. Ramsay uses the Resource-Based View of the firm (RBV) to investigate this question. He concludes (2001: 257) that "purchasing typically has no significant strategic role to play, and that the function's activities are operational in nature".

In this paper Ramsay's view will be challenged on three main grounds. First, in section two, it will be shown there is a much wider theoretical base underlying the field of strategic management, from which arguments will be drawn to substantiate that purchasing can indeed have strategic impact. Then, in section three, recent developments in the RBV will be discussed to illustrate that also within the RBV purchasing is seen as a strategic activity. In section four empirical examples will be provided to help demonstrate that purchasing and supply management can contribute to competitive advantage according to the definitions set by the RBV. In section five this paper puts forward a systematic set of criteria for assessing whether phenomena in purchasing management have strategic impact. Section six concludes that purchasing is a strategically relevant activity and provides some points of future research interest.

2. The RBV within the field of strategy

In this section the position of the RBV within strategy will be analysed. In particular it will be argued there are several alternative streams of strategic management literature that have something to say about the strategic potential of purchasing. The RBV has today arguably become the most dominant perspective for thinking about firm strategy. However, to fully appreciate resource-based thinking it should be placed within its historical context. The RBV was truly developed in the late 1980s as an antidote to the then dominant positioning school, coming out of industrial organisation and headed in particular by Porter (1980, 1985), which suggested a firm's competitive position can be analysed by looking at industry structure. On the basis of the characteristics of an industry, including the bargaining power of suppliers, the best firm strategy can be determined. The role of internal decision making was largely, if not fully, neglected by Porter (1980).

This was not in line with the earlier strategic management tradition, which stressed both internal and external factors (Ansoff, 1965; Skinner, 1969) and therefore several scholars felt a different perspective would be appropriate and went on to develop the RBV. Some key papers include Barney (1991), Amit and Schoemaker (1993), and (Peteraf, 1993). The roots on which these authors build lie back further in time (Coase, 1937; Penrose, 1959; Wernerfelt, 1984). While Coase's (1937) article is generally known for stipulating the role of transaction costs, it also explicitly recognises that there can be and normally is heterogeneity of resources among different firms. This is an important departure from neo-classical economics and, as shall be demonstrated in a moment, a key building stone of the RBV. Penrose's (1959) contribution is particularly in recognising the importance of accumulation of resources within a firm and linking them to firm performance. Wernerfelt (1984), other than naming the RBV, proposed an analysis of firms by resources (inputs) rather than product-market categories (outputs). Wernerfelt (1984) suggested this approach might be most appropriate under the conditions of high dynamism that are so typical of many industries today.

After that the RBV was further developed in an effort to stress the importance of managerial choice and internal factors in general. Hence the RBV, to put it in the words of its leading proponent Jay Barney (1991), 'examines the link between a firm's internal characteristics and performance' by looking at heterogeneous resources within the firm. This makes the choice for applying the RBV to assess whether purchasing management has any strategic relevance (Ramsay, 2001) something of an odd one. Purchasing management is, by the nature of its activities, condemned to obtaining inputs from outside partners in the firm's environment. *How can we judge activities that are mostly external in nature by applying a perspective that is primarily internal in nature*? It appears that applying the RBV in its original form is almost a case of circular reasoning. Since we assume SCA derives from within the firm, we find that an activity performed between a firm and its external partners does not lead to SCA. This is a useless exercise unless one is willing to depart from the assumption that only internal resources can contribute to SCA. As the next section will discuss, by looking more closely at resource-based thinking and applying its more recent extensions, it is more feasible to judge the strategic relevance of purchasing management.

First, however, it is necessary to elaborate further on the limited scope of using only resource-based thinking to determine whether purchasing management is strategically relevant. Although the RBV is currently the most widely applied perspective for studying firm strategy, which is why it represents the field well, it is not the only perspective in the field of strategic management. In fact, a wide range of concepts and perspectives have been used in this field, among them population ecology, institutional theory, transaction cost economics, industrial organisation, knowledge-based thinking, resource dependence, dynamic capabilities, agency theory and the relational view.

This raises an important question concerning the applicability of the RBV when judging the strategic relevance of purchasing management (Ramsay, 2001). *How can we pick one out of many strategic management perspectives and then conclude that the field of strategic management as a whole has nothing positive to say about the rent-generating potential of purchasing*? In fact, to support such a statement one would have to exhaustively apply all these various perspectives on which the field of strategic management rests, to then find that none of them amounts to the possibility that purchasing management can be a strategic activity. To make the counter-statement that purchasing management matters strategically, it suffices to find but one perspective in strategic management that has something positive to say about purchasing management. Two examples will now briefly be discussed.

Porter's (1980) positioning argument that specifies four generic strategies a firm can follow, is based particularly on the assessment of the well-known five forces model. As suggested above Porter looks at external factors to determine a firm's strategy. The five forces Porter (1980) mentions are threat of new entrants, bargaining power of buyers, threat of substitute products or services, bargaining power of suppliers and rivalry among existing competitors. Interestingly, a minimum of three of those five forces involves the suppliers of a firm and therefore purchasing management.

The bargaining power of suppliers is the most obvious force related to purchasing management. Firms may find ways to assemble more bargaining power vis-à-vis suppliers, for example by bundling purchases from multiple divisions. The threat of new entrants consists partly of new start-ups or diversification by other firms but another way to enter a market mentioned by Porter (1980) is downstream investment by suppliers. That is, suppliers that are not well managed by their customers can become competitors of a firm. Again, managing supplier relations thus is a strategically important activity for the firm. The same applies for the third force, threat of substitute products or services. It may actually be suppliers of the firm with their wealth of specific knowledge that innovate by producing a substitute for the firm's products. The management of relations with suppliers thus contributes directly to three of the five forces that determine industry profitability. Therefore it is impossible to conclude that purchasing has no strategic role to play on the basis of the work of Porter (1980). Of course in practice the degree to which purchasing is strategically relevant differs widely among industries, for example because of varying degrees of commoditisation of supplies (Porter, 1985).

The relational view is a much more recent perspective developed in particular by Dyer and Singh (1998) as part of the growing literature on the importance of trust in and relation building with other firms in order to obtain joint benefits. Its core statement is that relations with outside parties, such as suppliers, may help a firm develop ‘relational rent’, superior performance due to idiosyncratic relations. Dyer and Singh (1998: 661) formulate it as follows:

> “Firms who combine resources in unique ways may realize an advantage over competing firms who are unable to do so. Thus, idiosyncratic interfirm linkage may be a source of relational rents and competitive advantage.”

They then go on to describe four important mechanisms through which such advantages may be realised: joint investments, knowledge exchange, combining valuable and scarce resources, and more effective governance. One empirical example of obtaining such relational rents is the ‘Keiretsu’ supplier network of Chrysler, as discussed by Dyer (1996). Dyer argues that Chrysler has been able to replicate some of the positive traits of Japanese supplier networks and that this provides the firm with a competitive advantage. Clearly the relational rent framework assigns a very strategic value to the management of outside partners and therefore contains an important role for purchasing management.

3. Resource-based thinking revisited

The argument that has just been made suggests that an analysis of other approaches to firm strategy indeed amounts to strategic relevance for purchasing. Now it will be argued that the same is true for the RBV.

3.1 Open markets versus quasi-integration

Ramsay (2001: 258) is correct in noticing that the RBV has established that:

> "…firms cannot expect to purchase sustained competitive advantages on open markets. Rather such advantages must be found in the rare, imperfectly imitable, and non-substitutable *resources already controlled by a firm*" (Barney, 1991: 117, emphasis added).

This is a logical observation since the key trait of an open market is that every participant can purchase the same goods at the same price. It is difficult to obtain *competitive* advantage when all competitors can immediately replicate a firm's actions. Neo-classical economics even extends this premise further by suggesting that SCA is impossible altogether, whether it be through markets or through hierarchies. By introducing the assumption of heterogeneous resources, the RBV can claim that SCA is possible. If firms use a differing set of resources different competitive outcomes can occur. However, in two important counts Ramsay's (2001) interpretation of the RBV is faulty here. First, it is important to look at the definition of an open market and its occurrence in empirical reality. Second, it will be demonstrated that the RBV has never effectively ruled out obtaining SCA through outside partners, not even in its original programme, although it appeared there rather marginally.

One of the key criticisms of Williamson's (1975) original markets and hierarchies programme, as well as of other streams of economics, is that it holds an inaccurate view of these markets and hierarchies. Granovetter (1985) argues that Williamson demonstrated an undersocialised view of markets while holding an oversocialised view of organisations. The first point is of most interest here. Granovetter suggests that in reality most markets will not reflect the atomistic structures Williamson (1975) ascribes to them. In fact, markets will rely on important social mechanisms for purposes of cohesion but also to facilitate information exchange. This is true even for the most atomistic kind of market we know of, the stock market. In stock markets signalling devices (Spence, 1974) that operate according to mutually agreed schemes are crucial for the functioning of the market. As the renowned economist Simon (1991) has argued, the current economic landscape consists mostly of organisations and transactions between them. Only to a very limited extent do we see the kinds of markets neo-classical economics presupposes. Hennart (1993) has added to this the idea that most transactions are a mix of modes and carry in them both elements of 'marketness', through price controls on outputs, and 'hierarchyness', through authority controls on inputs. Open markets, then, are rather exceptional.

Once we apply this knowledge to the field of purchasing management, what do we see? Purchasing management deals with business-to-business markets, which often simultaneously are oligopsonies, with few buyers, and oligopolies, with few sellers. Therefore social structure tends to be even more important in business-to-business or industrial markets, as parties know each other very well and there is a large 'shadow of the future' (Axelrod, 1984). Opportunistic behaviour is at a minimum discouraged in such environments. Business-to-business markets do not conform well to the idea of an open market. Thus the fact that SCA can not be obtained through purchasing in open markets, tells us nothing about the strategic relevance of purchasing.

This discussion of the nature of markets has coincided with the development of an alternative to markets and hierarchies, namely interorganisational relations (IORs, see Barringer and Harrison, 2000; Mol, 2001; Ring and van de Ven, 1992). In Williamson's (1991) terms this is called quasi-integration or relational contracting. There is a widespread belief that such IORs are increasingly being used in practice and it is definitely true that research interest in them has grown disproportionately in recent years (Barringer and Harrison, 2000). One form of an IOR is the buyer-supplier relation (Barringer and Harrison, 2000; Ring and van de Ven, 1992). Therefore firms do not only purchase through open markets but also, and increasingly, through interorganisational relations with dedicated suppliers. In fact, as should be clear by now, almost all purchasing by firms will take on at least some of the elements of an interorganisational relation. The literature on interorganisational relations has provided a wealth of examples that buyer-supplier relations can lead to SCA, some of which will be discussed in section four. Ramsay's (2001) contention that purchasing can not lead to SCA because purchasing through open markets can not lead to SCA thus seems to be misinformed.

A second and related point is whether the RBV is in disagreement with the literature on IORs. At first sight the Barney (1991) quote cited above seems to suggest so. However, in his text Barney does not suggest there is nothing beyond these open markets. To the contrary in fact, on the condition of social complexity, which is one route to SCA, he states elsewhere that (1991: 110, emphasis added):

"A wide variety of firm resources may be socially complex. Examples include the interpersonal relations among managers in a firm, … a firm's culture, … *a firm's reputation among suppliers*".

This sheds quite a different light on the work of Barney than what is suggested by Ramsay (2001). Barney appears to think that IORs, established outside of the realm of either the open market or the firm, may indeed be a source of SCA through a superior reputation among suppliers. Note that the example of reputation is only one manifestation of how SCA through purchasing may come about.

Further evidence is found in the emphasised part of the earlier quote. Barney does not say that a firm needs to own resources in order to exploit them. He indicates a firm must control them. In order to control resources it is not necessary to own them. A long-term relation with a supplier may also deliver effective control of resources, particularly when guarantees and mutual commitment are built in. It must be concluded then that the RBV in its original form is not in disagreement with the IOR literature and has even embraced the possibility of obtaining SCA through outside relations, although it tends to see these relations as an internal resource.

3.2 Transitory core competence view

There are two widely different interpretations of the core competence argument, one of which goes unmentioned by Ramsay (2001), when he discusses the performance impact of the make-or-buy decision. On the one hand there are those (e.g. Quinn, 1999) who argue that any activity that is not based on a core competence ought to be outsourced, as Ramsay (2001) correctly notes. Quinn (1999) argues that firms are unlikely to excel in a wide range of activities and therefore should outsource all activities in which they are not 'best-in-world' to a best-in-world outside supplier.

On the other hand there is the view that looks not only at the activities that are based on a core competence, but also on activities that are (closely) related to these activities as potentially strategic activities that ought to be performed in-house. This has been referred to as the transitory core competence view (Kotabe, 1998). D'Aveni and Ravenscraft (1994) argue and provide evidence that a firm can benefit from economies of scope by performing activities in-house even if not all of these activities are based on a core competence. Kotabe (1998) has pointed at the importance of the interfaces between the marketing, R & D and production functions when making a make-or-buy decision. Kotabe suggests that firms add value precisely at these intersections.

This makes both the outsourcing decision more complicated and arguably far more strategic than acknowledged by Ramsay (2001), and provides a perspective whereby activities that are related to core competences, though not based on them, may be sourced internally or externally. The latter point shows that activities that are supplied by external partners may be of a strategic nature despite not being core to a firm[1].

3.3 Recent extensions to the RBV

Since the RBV was originally positioned as an internal approach to studying SCA, as described above, one natural criticism was that it was not enough concerned with the context in which the firm operates (Oliver, 1997). In this spirit several extensions were made to resource-based thinking in recent years. For example Oliver (1997: 707) states that:

> "Alliances allow firms to tap into time compression diseconomies and history-dependent competencies that are difficult to trade in strategic factor markets."

Oliver suggests that alliances are an important form of social capital and resources in themselves. This has implications for the strategic value of these alliances, among them buyer-supplier partnerships. Similarly Barney (1999) has explicitly acknowledged that important capabilities are often obtained from outside parties through what he labels 'intermediate governance'. He further specifies this by stating the conditions under which this is particularly useful (1999: 143):

> "Under conditions of high uncertainty, firms prefer to gain access to another firm's capabilities through strategic alliances….rather than through acquisitions."

In later work Barney once again stresses the importance of relations to outside parties like suppliers when he discusses current resource-based thinking (2000: 263):

> "….[S]ocial structure, both within an organization and outside an organization, has a significant impact on an organization's form and on its ability to accomplish its goals".

In recent work of Quinn (1999), who is concerned far less with theory than Barney, a similar trend is visible. Quinn (1999) says that links to outside knowledge sources that are able to assemble diverse expertise greatly affect the timing and amplitude of innovations. He further adds that sophisticated outsourcing supported by new electronic communications, modelling, and monitoring techniques enables companies to reduce innovation cycle times and costs by 60 percent to 90 percent and decrease investments and risks by equal amounts. Quinn also suggests that top management ought to get involved in such outsourcing decisions given their importance. This effectively implies that purchasing decisions enter the board room, yet another sign of the strategic importance of these decisions. It can be concluded that recent additions to the RBV, both conceptually and practically, have stressed the importance of managing relations with outside parties, like suppliers, for obtaining SCA. Again, this is an indication of the strategic importance of purchasing management activities.

4. Empirical support

Providing theoretical support for the link between purchasing and SCA is an important first step. This step, however, is rather meaningless if subsequent empirical tests fail to support it. There are several empirical problems attached to the statement that purchasing is strategically irrelevant. One issue neglected by Ramsay (2001) is the difference between a purchasing department and the purchasing function. It is increasingly recognised that purchasing management as a function encompasses a much wider range of activities than the mere ordering of pencils (Monczka, Trent, and Handfield, 1998). A purchasing department, an organisational unit that is, may indeed mostly be involved with such relatively simple activities to the extent that this unit could under certain circumstances even be outsourced. The key question, then, is whether assessing the strategic potential of purchasing management requires an assessment of the strategic nature of the activities undertaken by a purchasing department or an assessment of the activities that are normally included in the definition of the purchasing function.

The answer to this question is perhaps best provided by a brief look at research in the field of purchasing management. For this, one can turn to current output in the field. Other than Ramsay (2001), 22 articles appeared in the European Journal of Purchasing and Supply Management in 2001 of which 6 were concerned with relations with suppliers. Another 5 investigated the impact of sourcing or make-or-buy decisions on an organisation and its goals. Some 9 articles looked at tools and systems of purchasing like IT and lean supply. And 2 articles were of a more general, conceptual nature. This means that at least half of the articles were related to topics that can have a strategic impact on firms. Of course there are all kinds of limitations to such a casual look at a field that stretches beyond Europe, beyond a single journal and beyond a single year. Other research topics and approaches might for instance dominate in other areas of the world. Bearing in mind those limitations, it still seems fair to say that purchasing management nowadays involves far more than studying people ordering goods.

But is there empirical evidence that these issues are related to SCA of the firm? There is in fact plenty of evidence. A meta study on financial performance by Capon, Farley and Hoenig (1990) clearly demonstrated that the make-or-buy decision, where firms choose whether to outsource or to vertically integrate, had significant impact on the financial performance of firms in almost all studies included. More recent evidence includes Murray, Kotabe and Wildt (1995). For buyer-supplier relations there have been similar contentions, for example by Gulati (1995), Lane and Bachmann (1996), and Ford (1998). Thus it seems that the field of purchasing management has responded well to the changes in managerial practice by increasingly including strategically relevant activities like supplier management and sourcing strategy in its research agenda.

5. Assessing the strategic importance of purchasing activities

Given that purchasing has substantial strategic relevance, how can the impact be analysed in purchasing management research? Several criteria emerge based on the previous discussion.

5.1 Measurement of performance

Having a competitive advantage implies that a firm outperforms its competitors. Empirically proving this point requires the registration of an appropriate performance measure. This raises the issue what makes a performance measure appropriate apart from the fact that it must be quantified. In strategic management research most measures of performance are firm level constructs. However, in the context of purchasing research one might also think about intermediate measures like reliability of deliveries. The drawback of such measures is that they are often highly firm specific.

This brings up an important requirement: a performance measure used to assess one firm must be comparable to that used to assess its competitor. This means very firm specific measures are not useful in this respect. As we wish to compare the performance of one firm to that of its competitors it is also necessary to measure the performance of its competitors. Furthermore, since a measure has to be replicated across time it should also not be time specific. As the reliability of deliveries may increase over time among all companies, it is difficult to compare this year's delivery performance with last year's delivery performance unless some mechanism exists to make performance comparable over these years. In general then, performance measures must be quantifiable, comparable across firms and comparable across time to be useful for measuring SCA.

5.2 Establishing a causal relation

A next important step is to establish a causal relation between the dependent (a certain purchasing strategy) and independent (performance) variables. First, and this is obvious, it should established that a relation between two variables does indeed exist. To do so requires a clear understanding of what variables will be related to each other, which is usually best achieved in the form of a hypothesis. Once the relation has been established its causality comes into question. Causality can be found on the basis of theory (deduction) and / or ex post empirical assessment (induction). For a deductive assessment a logical and coherent theory connecting purchasing strategy and performance is needed. For an inductive assessment either a qualitative research method could be used, or a quantitative longitudinal study that shows that performance changes follow the introduction of a new purchasing strategy and not the other way around.

5.3 Determining the possibility of SCA

As noted earlier the issue of sustainability of competitive advantage has best been captured by Barney (1991). He argues that to gain SCA firms must have implemented a value creating strategy that is not simultaneously implemented by competitors. In Barney's (1991) view such sustainability can arise given the existence of all of the following conditions:

- Resources are valuable
- Resources are rare
- Resources are imperfectly imitable because they are history dependent or causally ambiguous or socially complex or a combination thereof
- Resources are not substitutable

In purchasing management many examples arise of these conditions. For example, valuable resources may include a highly reputable or knowledgeable purchasing manager that suppliers are more eager to work with or more willing to deal with. Rare resources can include an exclusive relation with a best-in-world supplier of a strategic input to the firm's key product. Imperfectly imitable resources can involve a wide range of resources. One example would be a decision several years ago to keep production of a good in-house whereas competitors outsourced production, when that good now turns out to be the basis of a key innovation that revolutionises an industry. In this case a firm possessed foresight that its competitors did not have, meaning both path dependence and causal ambiguity are present. Finally, non-substitutability of resources implies that the strategic value of a resource is not similar to that of another resource controlled by competitors. That is, if a firm has a superior purchasing staff, competitors must not be able to equal that advantage by outsourcing their purchasing function altogether.

What would be needed when researching the strategic value of (parts of) the purchasing function is an assessment of the extent to which these conditions apply in the specific area being researched. For instance, somebody doing research on supplier relations in the Brazilian manufacturing industry, should be concerned with the extent to which buyer-supplier relations in this context are socially complex, can deliver superior value etc. If these conditions exist to some extent, then SCA can be obtained. One other thing to keep in mind is the problem of 'luck' in strategy research (Barney, 1986; Stinchcombe, 2000). Any firm is due to encounter runs of good and bad luck and it is very difficult to distinguish between good luck and a good strategy in a given case (Stinchcombe, 2000). A longitudinal perspective may be required to do that. That is, it must be shown that firms with a particular, idiosyncratic strategy outperform their competitors not just at one point in time but consistently.

6. Conclusions

The field of strategic management has enough positive things to say about the strategic potential of purchasing to conclude that purchasing is strategically relevant. In fact, purchasing can even be said to have become more relevant in recent years as firms have outsourced more activities and look towards their external suppliers to create added value. This indicates strategic advantage not only resides within the firm but also between the firm and its partners (Dyer and Singh, 1998). To their merit, scholars in the resource-based view of the firm have increasingly recognised this in recent years.

Purchasing management research seems to have done well by picking up the overall point that purchasing matters to competitive advantage. In doing so it would benefit by incorporating a list of criteria that must be met for a purchasing activity to be strategically relevant. In this paper, such a list is proposed.

Another point of interest for future research is the nature of theory formation in purchasing management. It can be observed that purchasing management textbooks (e.g. Monczka, Trent, and Handfield, 1998), which are representative of the field, put up a wide variety of frameworks that are very easy to apply for managers. Arguably, the same can be said for most of the scholarly articles in the field. However, these frameworks are best seen as managerial heuristics rather than theories describing the way in which purchasing management helps a firm obtain sustainable competitive advantage. To date there appears to be too great a need among purchasing management researchers to come up with their own frameworks of what the world looks like. This leads to both fragmentation of the field and a lack of theoretical rigour. It appears that this is one pressing issue researchers in the field of purchasing management need to tackle if they wish to go into the research direction captured by the question 'how do firms obtain SCA'.

Wider borrowing of theories stemming from strategic management and organisation theory could be one solution for purchasing management research. When researching the strategic impact of purchasing it appears sensible to draw from specialists in strategic management as they have studied the strategic impact of a wide range of firm decisions. Formulating testable hypotheses based upon such theories would be an important step forward in this respect. Implementing such changes will benefit researchers in the field of purchasing management and will in fact increase the relevance of their research for managerial audiences.

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Footnotes

[1] There is one more problem to the view Quinn (1999) holds on make-or-buy decisions, although this is only weakly related to the current discussion. It is generally believed firms can have only one or a few core competencies. Outsourcing all other activities to a best-in-world party would leave a firm with very few activities indeed, which might best be called hollow. It is questionable any firms should and would really want to go that far.