



# Linking the Chain: Aligning Sourcing Strategy and Supplier Relationships

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**Supplier relationship management is a major contributor to effective supply chains. While we know much about sourcing strategy and relationship management as independent fields, little research exists on how these two factors interrelate. This briefing illustrates the importance of aligning a firm's sourcing strategy with the appropriate type of supplier relationship. The challenge for purchasing professionals is to align the appropriate relationship processes to deliver the desired outputs.**

## **Background**

Effective management of supplier relationships is central to competitive success. Over the past two decades, the sourcing strategies available to supply managers have become increasingly sophisticated, while competitive forces have reshaped the nature of supplier relationships. For example, strategic sourcing frameworks, such as Kraljic (1983), have focused purchasing attention, while supplier relationships have shifted away from the arms-length, adversarial relationships, and towards close, collaborative relationships with a smaller number of 'mega' suppliers.

Despite a vast knowledge about how supplier relationships and sourcing strategies evolve, comparatively little research exists on how these two factors interrelate. A gap in our knowledge thus exists as neither sourcing strategy, nor supplier relationships, can be pursued in isolation from each other. Indeed, we argue in this briefing that achieving desired business outcomes rests in *linking* a firm's

strategic sourcing strategies with the appropriate supplier relationship for that strategy. Whilst this may appear to be intuitively obvious, many firms often follow a particular supply sourcing strategy with little to no regard of the relationship and strategic implications of doing so.

### *Strategic Sourcing Strategies*

A number of different sourcing strategies are available to organisations when dealing with their suppliers in order to exploit purchasing power and reduce supply chain risk. Kraljic (1983) highlighted four such strategies based on the strategic importance of an item and the complexity of its supply market. These sourcing strategies are: leverage; critical; bottleneck and routine. Here we discuss two of these strategies termed critical and leverage.

*Critical sourcing* strategies may be applied to items which have a difficult supply market and represent high value to the buyer. The aim is to ensure long-term availability with global suppliers, and as such, long term commitments of up to ten years may be made. *Leverage sourcing* strategies, on the other hand, are pursued where the items are high value, based on the level of spend, but the supply market is relatively low risk (i.e. abundant suppliers of commodity products). The abundance of suppliers and focus on cost reduction means that contracts are entered into over a shorter time horizon, typically 12 to 24 months.

### *Supplier Relationships*

Firstly, we argue that supplier relationships need to be thought of as a *process* to be

managed, and designed in a way that will achieve certain business benefits. Thus, a simple relationship process (e.g. price negotiation) is required to deliver a simple outcome (e.g. price reduction), while a complex process (e.g. cross-functional team working) is required for a complex outcome (e.g. joint product development).

Second, organisations maintain a portfolio of relationships with suppliers, ranging from arms-length to collaborative. *Collaborative relationships*, which require high-involvement of both parties are characterised by mutual dependency, long-term contracts and high interactions between both parties. Consequently, they entail considerable economics cost, with organisations able to maintain relatively few true strategic partnerships.

By comparison, *arms-length relationships* require little investment, and are characterised by frequent price benchmarking and less expenditure on inter-personal communication and assistance. They are often intended to deliver definable short-term benefits, such as price reductions, delivery improvement and quality gains.

## Research Questions

We argue that different relationship management approaches are appropriate, and have the potential to deliver different types of performance improvements for the firm, *depending* on the sourcing strategy adopted. We do not advocate the use of one mode of

operating with suppliers over another. Over-investing in a relationship to secure simple gains, and under-investing in a relationship intended to achieve complex outcomes, is likely to be detrimental to performance.

Our research questions focus on: (1) aligning sourcing strategy and relationship type; and (2) the performance effects of this alignment.

### *Critical Sourcing, Collaborative Relationships & Firm Performance*

Firms following a critical sourcing strategy, based around high value items and high complexity supply markets, will need to make investments of time, effort and resources in developing a collaborative relationship with the supplier in order to fulfil its goals. In other words, when sourcing a critical item, performance improvements along a range of outcomes, either business-related (time-to-market, market share growth and cycle times) or relationship-related (joint product development, integration of business processes and risk and reward sharing) can only be achieved if the firm follows a collaborative approach to managing its supplier. Successful sourcing of critical items requires relationship-specific investments in structures, processes, and people, which in turn, builds trust and cooperation between buyer and supplier, and is necessary for achieving the more complex outcomes desired.

### *Leverage Sourcing, Arms-Length Relationships & Firm Performance*

Firms following a leverage sourcing strategy do not require such investments in relationship

building in order to achieve the same outcomes. The high value of spend created by pooling items creates leverage for the buyer to extract favourable price concessions from the supplier. Leveraging is a very common strategy used by most major firms, and consultancy companies, to achieve rapid benefits, particularly along operational dimensions, such as cost and delivery. Negotiations revolve predominantly around issues of price, quality and delivery terms, with little emphasis on collaborative working. Pursuing a collaborative relationship in this situation would be counterproductive; arms-length modes of operating provide the most efficient means of delivering required performance improvements.

## Method

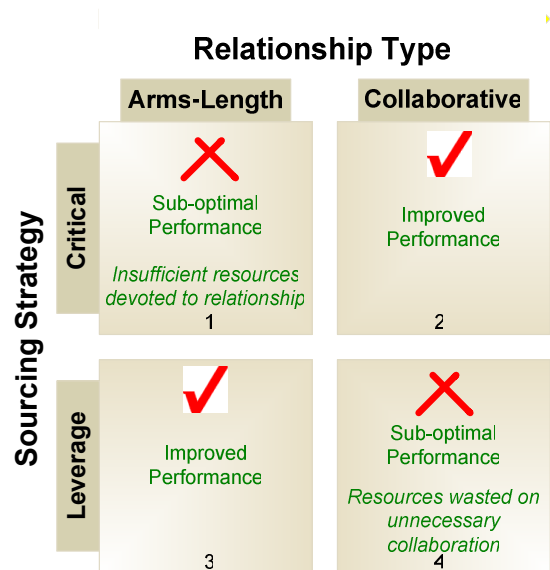
We sampled 520 UK manufacturing firms from the KOMPASS database, receiving 142 responses (27.3% response rate). Purchasing executives within the buyer firm were asked to answer the survey in the context of a single supplier relationship considered strategic to their firm. We used a statistical modelling technique called Structural Equation Modeling (SEM) to help answer our research questions.

## Results

The results provide support our various hypotheses. Sourcing critical items required collaborative relationships with suppliers, and were associated with higher financial and operational performance. Similarly, sourcing leverage items required only arms-length relationships to improve performance.

## Discussion

These results are summarised in the 2x2 matrix below.



**Quadrant 1** – Our findings show that attempting to source a critical item, without also developing a close supplier partnership, leads to suboptimal performance. The lack of necessary resources and commitment to the relationship restricts opportunities for joint performance improvement (e.g. product development, process restructuring), as well as negating any impact on financial performance. Firms in this situation must build the relationship; in the short term via increasing volume to the supplier, and in the longer term by building closer ties (IT and human) with the supplier.

**Quadrant 2** - Our results support our hypothesis that when sourcing a critical item, a collaborative relationship is necessary in order to improve firm performance. We found that the most successful relationships firstly identified critical items, and second, developed a collaborative supplier relationship to source

those items. Thus, the more important the item being sourced, the greater degree of partnering that needs to take place. The buyer must invest the resources, skills, competencies and technologies to ensure that such relationships are maintained and managed well. We found that close linkages then allow improvements along multiple dimensions of operational performance and financial performance.

**Quadrant 3** – Contrary to the popular perception that firms adopting collaborative supplier relationships are more successful than those that do not, this research found that arms-length relationships (when applied within a leverage sourcing strategy) also provide improved operational and financial outcomes. Many large manufacturing and retail firms, such as General Motors, Marks and Spencer and Tesco, are advocates of this approach. Arms-length transactions are the *most appropriate* approach when following a leverage strategy focused on cost savings and efficiency.

Recall that leverage sourcing strategies arise from the need to secure market advantage through economies of scale. This may arise from a change in the supply configuration i.e. moving from multiple sourcing to delegated or parallel sourcing relationship. Such an approach will provide quick wins in the short-term but can also be highly risky. Leverage sourcing can lead to situations where the firm has few substitutes and few alternative products or services with which to negotiate terms. Power thus becomes concentrated in the hands of the supplier. This is true of a variety of companies that have embraced supplier

reduction and supply chain re-configuration strategies. For example, Rover in the automotive industry implemented a wide spread supplier reduction and supply tier approach, combining this with a leverage sourcing strategy. In the short-term this offered the firm some success, but, in the medium-to-long-term, the supplier obtained a superior bargaining position and contributed to Rover's business difficulties.

**Quadrant 4** - Attempting to develop a collaborative relationship when a leverage strategy is pursued will result in suboptimal outcomes. Although the supplier relationship may be strong, it is not necessary given the sourcing objectives. Indeed, it may succeed only in wasting the scarce resources of the organisation. Our results also showed that leverage sourcing strategies were negatively related to collaborative relationships, indicating that most firms recognised the problems suboptimal configuration.

## Recommendations & Outputs

1. **Relationships are a process.** We show that a supplier relationship is a process that can be structured to achieve certain benefits for the firm. For example, relationships that underpin a critical sourcing strategy require a collaborative form of working between buyer and supplier to achieve more complex outcomes.
2. **Firms operate relationship portfolios.** Collaborative relationships are not always appropriate. A portfolio approach to relationships is the most beneficial, with

different relationships providing different benefits depending on the structures used to manage them.

3. *Aligning sourcing strategy and relationship type is the key.* Supply managers need to choose the *appropriate* relationship that best fits the characteristics of the supply market and the level of resource that firms are prepared to commit to the relationship. It is suggested that if you wish to achieve the benefits from a critical sourcing strategy, attention needs to be focused on increasing the mutual dependencies and two-party commitment to the relationship in order to access these increased benefits.
4. *Relationships are dynamic.* Supplier relationships will evolve over time and levels of supplier involvement will change. Each approach has its own limitations: collaborative relationships are costly and resource intensive; while arms-length agreements potentially expose buyers to dominant suppliers. When choosing the most appropriate sourcing strategy and supplier relationship model, strategic managers must undertake a cost versus benefit analysis based on the levels of inter-firm dependency required to achieve agreed organisational goals. The strength of a supply chain lies in the ability of supply managers to align and connect each link appropriately.

*\* This Executive Briefing is based on the article by Paul Cousins and Benn Lawson (2006). "Sourcing strategy, supplier relationships and firm performance: An empirical investigation of UK organisations". In Press at the British Journal of Management. Please contact the authors for further information.*



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The Supply Chain Management Research Group (SCMRG) was launched in January 2006. It aims to be an internationally recognised centre of excellence for scholarly and relevant research in Supply Chain Management. Further information about SCMRG including its research projects, industry briefings and scholarly publications can be found at: [www.mbs.ac.uk/research/supply-chain/](http://www.mbs.ac.uk/research/supply-chain/)