

# Procurement Strategy in the SMEs Business to Business Relationship



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**Abstract:** SME industry had been acknowledged by the government as an important component for the creation of jobs and the backbone of economic development. Having a reliable and better operation process will benefit the SMEs in facing the uncertainty in the business environment. In conjunction with this, SMEs must have a proper implementation of a procurement strategy to make them sustainable in their operation. In this research, the researcher adopts the qualitative method and in-depth interview as a data collection approach. Data from the in-depth interview were analyzed to form findings and discussion. In this study, the saturation model was applied to determine the final number respondent of which five (5) SMEs has been selected based on the saturation principle. The results reveal that each SMEs in this study invest in considerable effort to develop their procurement strategy that suited to their organization objective and operation needs. This research also identifies a few similar challenges faced by SMEs in implementing the procurement strategy. This study offers as a preliminary finding on the procurement strategy research in SMEs which is not fully explored for the benefit of future study.

**Keywords:** Supply Chain Management, Procurement Strategy, SMEs.

## I. INTRODUCTION

In Malaysia, SME contribution to country's GDP is increasing from 29% in 2004 to 41% in 2016 and it is expected to reach 62% in 2020. SMEs roles are not only limited in contributing to the national economy development but also providing a platform for other business entity such as supplier to build-up a business relationship for SMEs sustainable business growth. This relationship is called business-to-business (B2B) relationship. B2B is referring to a business conducted between companies, such as one involving a manufacturer and supplier. This relationship is vital and forms a foundation for the SMEs business framework. This study aims to explore the influence of this relationship to the development of the Procurement strategy for SMEs.

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## II. SMEs BUSINESS PRACTISE

### A. Business-to-Business Relationship (B2B)

Business to business, also called B2B, is a business transaction that occurs between firms, rather than between a company and end-user. In B2B, SMEs must define their purpose for engaging in a relationship, select parties for relationship and develop a strategy for the relationship that the goal is to ensure the sustainability of the SMEs business.

In B2B, the relationship is the center of all activities directed towards establishing, developing, and maintaining successful exchange with the vendor or supplier. The development and maintenance of positive relationships between buying and selling organization are pivotal to success. Collaboration and partnership over the development, supply, and support of products and services are considered core elements of B2B. A well-developed ability to create and sustain a successful working relationship with a supplier or vendor gives the SMEs a significant competitive advantage.

### B. Issues and Challenges in SME Business-to-Business Relationship

Despite the number of benefits that B2B practices can offer to SMEs, it is surprising that many SMEs are not utilizing it. SMEs companies often find themselves at a disadvantage when it comes to supplier relationships unless the suppliers or vendors are also the same sizes. It is because of the SMEs does not have the scale to create leverage in the business transaction when dealing with a larger organization. The general perception of SMEs can't effectively compete because they don't have the purchasing volume to drive cost reduction, garner significant attention from suppliers, and unlock access to a large and diverse supplier base is not always true. One way to avoid this issue is to choose suppliers and partners that operate on a similar scale of SMEs [10]. But in reality, this is often not possible, especially as global consolidation continues to cultivate markets with fewer and larger participants.

## III. PROCUREMENT STRATEGY IN SMEs

A key activity for procurement strategy as noted by [1], is the ability to adopt a strategic purchasing practice by establishing a formal written long term planning that is systematically reviewed and revised in accordance to changing of company strategy and the business environment [9] as well as the relationships established with the key suppliers.



Consequently, some of the researchers are suggested that the implementation of procurement strategy may not suitable for SMEs, which often lack the flexibility to allocate an equitable resource to such initiatives [15] & [19]. However, this opinion was contended by [11], which believe that the procurement strategy is relevant to all firms irrespective of size due to fact that these SMEs need to respond to the increasing challenges of competitive markets by integrating the procurement function into strategic planning. Empirical evidence in the study by [6], [13], [7] and [11] suggested that some SMEs were successfully adopted and replicating the strategies implemented at a larger firm through cooperation with their suppliers. However, the adoption and role played by procurement strategy in SMEs have remained a relatively unexamined phenomenon in the research of SMEs area [2].

Different SMEs have different management techniques to carry out the efficient functioning of their procurement process. It is often handled by the owner-manager [9] & [14] who the important figure to the organization that inspiring and shaping the direction of SMEs purchase process, [8].

Generally, SMEs is lacking the ability of economy of scale as compared to larger enterprises which are a disadvantage during a negotiation process with suppliers. Although current supplier relationships are inadequate, SMEs often endure due to their lack of resources to monitor and enforce contracts [9]. In many instances, the supplier will take advantage of the SMEs weakness purchase process to gain leverage in the negotiation process and simply increase the price to make an excessive profit [3]. However, [1] conclude that the implementation of the procurement strategy had a significant positive impact on supplier evaluation systems for SMEs. [9] argues that there is a significant difference between the type of SMEs in managing their purchasing practice. Within the SMEs organization, procurement process usually a responsibility of owner-manager and is often centralized. [9] noted that procurement objective in SMEs focusing on strengthening the company's competitive advantages as opposed to only cost reduction. [9] also noted that the procurement strategy for SMEs leads to an increase in business performance, which could further strengthen the importance of SMEs of working strategically with the vendor or supplier. According to [2], SMEs are very often characterized as having limited resources which leads to lack of attention for strategic procurement. SMEs owners-manager do not develop their skills in purchasing and procedures of that kind as a result of just performing operational acquisition of components. A consequence of having limited resources is that the vulnerability of the company increases as resulted lack of focus on procurement strategy [2]. One of the most challenging tasks in the implementation of the procurement strategy is the selection and development of competent suppliers [4] & [15]. The supplier selection process is a methodology specifically designed to identify the gaps and capabilities of supplier that essentially require the SMEs intervention in maintaining the business relationship and developing an action to improve the supplier capability as required in the SMEs organization objective. The importance of supplier selection process is unarguably important as part of the procurement strategy due to direct impact to another business process such as inventory management, production planning, cash flow control, and

product quality which eventually influencing firm's business performance. Effective evaluation and selection of suppliers are considered to be one of the critical areas in the SMEs business environment.

#### IV. RESEARCH APPROACH

In this study, the data was collected based on a qualitative method using in-depth interviews with the selected SMEs in the manufacturing industry. A questionnaire was developed based on the previous study that serves as a guide to the researcher during the interview session. In compliance to the research ethics and to gain a better quality of responses, the researcher has selected the respondent from the owner-manager of the company that technically have sound knowledge on the subject research and appropriate with the nature of the SME business operation. Based on the saturation principle, five (5) SMEs owner-manager was interviewed and reached the saturated information on the investigation interest. The data collected from the interview were analyzed to identify converging or diverging areas of interest.

#### V. RESULT AND DISCUSSION

This finding from the in-depth interview with five (5) SMEs is discussed in the following sub-heading:

##### A. Procurement Process in SME Business

The data gathered from the interview session had identified similarity among the respondents on the implementation of the procurement process. This contends the finding by [8] & [13] which implies the increase of knowledge among the SME owner-manager on the adoption of best practices for their business process. The procurement process in SMEs is started with defining the needs or identifying of their production. This step, in particular, is important to ensure the right requirement for SMEs need is meet considering all the constraint due to characteristics of SMEs business.

Once SMEs had identified their needs for their business operation, SMEs in this study will choose suitable sourcing strategy that meeting their organization objective. There is a various strategy adopted by the SMEs in this study such as blanket purchase, contract purchase, and vendor managed inventory, of which the implementation heavily relies based on trust or minimum legal commitment. However, the execution process is similar to what has been implemented in a large company. The suppliers identified in this study comes from different size of the operation. However, majority of SMEs indicate that they are more prefer to work with a supplier that has a similar capacity which conforming the suggestion by [9], that SMEs will lose leverage when the partnership with the largest company.

The negotiation process is one of the important stages that will leverage SMEs in term of pricing, specification, delivery, and payment terms. In this study, each SMEs have their negotiating terms according to their priority which is focusing on the specification and quality of the supply materials.



Despite claiming their concern on the purchase cost, most of the SMEs are unable to verify their claim on the application of appropriate methodology such as Total cost ownership (TCO) in the negotiation process to verify the price offered by the supplier. Majority of the purchase negotiation is based on the trust developed through long term relationship with the supplier. This support [9] findings that SMEs is more focus on strengthening the company competitive advantage rather than their business sustainability which implies the higher failure rate of SMEs establishment.

In this study, the majority of SMEs using cash term in the purchase transaction. This is expected since SMEs in this study is dealing with the supplier with a similar size which can't give a longer payment term as can be offered by the large company. This finding implies a SMEs struggle in maintaining the cash flow for the business operation.

Forecasting is also important in the procurement strategy as it can ensure no stock shortage that can affect the flow of production. This is proven the statement from William [16] that stated the purpose to forecast market demands to ensure the well-being of daily operation and to avoid stakeouts. Forecasting planning differs according to the way the company manages its inventory. Majority of the forecasting activity is led by the owner-manager which according to [8] is responsible in the direction of SMEs purchase process.

Dealing with different supplier seems a critical challenge for the SMEs in this study. This conforming [5] & [17] that suggest SMEs is reality is facing uphill skill to maintain a relationship with a competent supplier. The importance of having a competent supplier not only impacting the cost but also the sustainability of SMEs business in the long run. This issue has motivated the majority of the SMEs to explore the potential supplier from the global sourcing such as supplier from china that is more competitive in term of cost and quality.

**B. Challenges of Procurement Implementation in SME Business.**

All five (5) companies face different challenges in implementing procurement strategy. Among the challenges is the high fluctuation in the demand due to seasonality. This created a stiff competition among the SMEs in the same business that fighting for the same source of purchase which eventually will benefit the supplier. As a result, the supplier may increase the price from the desperate situation faced by the SMEs [3].

Another challenge for SMEs is to understand and acted according to supplier behavior. Using common sense in evaluating potential and unreliable supplier is a risk in the business relationship. Majority of the SMEs in this study have implemented a vendor selection process based on their requirement which is much simple from what being practice in the large company. This support argument by [9] [1]; [14]; [19] that SMEs do invest in a considerable time to identify and select the supplier. SME needs to have a good vendor line up. Company often overlooked the importance of maintaining a good buyer and supplier relationship that could result in the future potential transaction [4] & [16]. Supplier plays an important role in ensuring smooth production flow and each SMEs using their own experience in handling

unreliable suppliers.

The implementation of procurement strategy in SMEs should be supported by the availability of right human resource capital that capable to execute the strategy. In this study, SME owner-manager is leading the implementation which heavily influences based on their education level. These conforming [2] findings that SMEs are very often characterized as having limited resources which leads to lack of attention for strategic procurement.

**C. The Impact of Implementing Procurement Strategy Towards SMEs business.**

Agreed by all the SMEs in this study that a good procurement strategy contributes to their business sustainability. Majority SMEs in this study stated a positive implication to the inventory management process in maintaining good control over the production. Without good inventory management, there will be a shortage of stock that can jeopardize the production line and orders cannot be completed within the expected time. It also helps to monitor the lifespan of finished goods and the quality delivered to the customer.

A good forecasting and planning methods should be supported by a reliable procurement strategy which is the heart of the planning. A sustainable material supply needs by the production can distinguish the performance of SMEs with the other by ensuring a continuous and healthy inventory level that require by customer. It also helps the forecasting process by providing more quality input to improve the accuracy of the forecasting process by avoiding the shortage or excess of the material required in the production and inventory management process.

A supplier selection which becomes a central concern of SMEs management can be improved through a proper procurement strategy. The selection of supplier either locally or externally should in line with the procurement strategy.

**D. Summary of Findings**

The finding of the research is summarised in Table -1.

**Table. 1 Summary of Findings**

Research area	Findings
Procurement Process	Defining needs of production requirement
	Sourcing internal & external Supplier
	Negotiation Process
	Determine mode of payment
	Forecasting and planning
Challenges	High fluctuation in the demand
	Supplier Behaviour
	Lack of Human resource capital
Impact to SMEs business	Business sustainability
	Improve Inventory management process
	Increase quality of products
	Valuable forecasting input
	Sustainable Supplier



## VI. CONCLUSION

This study highlighted the implementation of procurement strategy at SMEs industry. Despite mixed argument between the researcher on the suitability of the strategic approach for the procurement management in SMEs, it is evident in this study to conclude the elements of strategic procurement play a considerable role in the SMEs.

To ensure SMEs organization manage the strategy well, technology system needs to be applied despite a capital constraint. Hence, the policymaker must explore the potential of other cheap solution such as I-cloud technology to be used in the SMEs environment which recently widely used in various disciplines in the business process. With the use of technology, SMEs management will be more structured in term of exploring various sourcing technic using the technology application.

Procurement function in SMEs organization can be performed either in traditional or in strategic ways. Due to consistent pressure from the internal and external environments, many SMEs progressively shifting their approach in procurement management from the tradition ways towards the strategic approach. This move contends the argument by [1]; [13]; [19] that question the suitability of the strategic approach to purchasing management in SMEs.

Findings from the previous study have suggested the element of procurement strategy in the development of suppliers that influencing SMEs success. In SMEs environment, the owner-manager is solely responsible for building a relationship with the suppliers and heavily influence the ongoing relationship for their long term strategic partnership. In spite of the tendency to establish specific relations with strategic suppliers, SMEs' in this study admits the important to have multiple sources multi-sourcing strategies from the alternative suppliers to ensure the sustainability of supply. This finding confirming the previous study [2], [9], and [7]. As stated by [11] that variations of supplier selection processes in SMEs are mainly determined by the owner-manager criteria that can vary greatly from one business entity to another.

The findings in this study indicated that SME has the interest to invest in considerable time to develop a Procurement strategy for their business. Even though the strategy applies in SMEs environment is much direct and simple, but it indicates the changes in SMEs practice that can benefit SMEs itself in the long run. This study offers a preliminary finding on the procurement research implementation in the SMEs which is not fully explored for the benefit of future study.

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