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**Malaysian Based  
Manufacturing Firms'  
Strategic Sourcing: A Test  
of Transaction Cost  
Economics Theory and  
Resource Based View**

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# **Abstract**

The relentless searching of strategic sourcing, due to the fact that globalization is inevitable and today's

manufacturers are  
competing in highly  
competitive environment,  
has pooled many business  
practices into two  
competing school of

thoughts related to  
sourcing strategies, i.e.  
Transaction Cost  
Economics (TCE) Theory  
and Resource Based View  
(RBV). This paper explored



sourcing strategies and  
sourcing supplying  
countries of firms in  
Malaysia in responding to  
the intensified competition  
and put these strategies as

an integral parts of firms' distinctive competencies. Specifically, the results indicated sourcing strategies have significant effects to both financial and

non-financial performance.  
However, both models  
indicated the 'self-produce'  
and 'outsourcing' strategies  
affect non-financial  
performance more than

financial performance. The results also indicated the most popular supplying countries for both sourcing strategies (self-produce and outsourcing) are

Malaysia, China and Singapore and the majority of them received supply from one country. These findings provide new insights of sourcing

practices among Malaysia based manufacturing firms and how those companies perceive and react to the competition environment surrounding them.

**Keywords:** Sourcing  
Strategies, Self-produce,  
Outsourcing, Performance

# **Introduction**

Manufacturing based firms face challenges on a variety of fronts. Today's competition is highly



competitive if compared to 20 years ago. In other words, technological advancement is happening every second and around the globe. There is no

guarantee that today's leading firm will retain its position tomorrow. All these rewrite the rules of the game as more is demanded than ever

before. In response to these demands, more and more manufacturing based firms pursue continuous improvement, leaned up production, reengineered

business processes and  
integrated supply chains.

Over the past decade, there  
has been a growing  
realisation on the

importance of purchasing and supply management (Cousins, Lawson, & Squire, 2006) on organizational performance. Both academics and

practitioners agree on the importance of sourcing strategy and its role in enhancing competitiveness of firms. Global deregulation in many

industries also leads to the standardization of business practices and the increase of co-operation between customers, suppliers and other stakeholders (Ranky,

2007). The World Trade Organization (WTO), ASEAN Free Trade Area (AFTA), Free Trade Agreement (FTA), and North America Free Trade



Area (NAFTA) are among most widely cited forces that shape today's business practices (Hilman, 2010).

This study specifically investigated sourcing practices of manufacturing based firms in Malaysia. Firms that were referred to as using a self-produce

strategy are firms that produced 51% or more of their products' components. Meanwhile, outsourcing strategy refer to firms that bought 51% or

more of their products'  
components.

# **Literature Review**

## ***Sourcing Strategy***

Market globalization or  
borderless world

phenomenon is driving firms to put greater emphasis on sourcing practices (Branemo, 2006). One of the earliest typologies examining

purchasing function configurations was developed in 1998 by Reck and Long. The typology consists of four stages of purchasing development

from passive, independent,  
supportive to integrative.

Since then sourcing has  
become an important factor  
for firms to gain advantage



over competitors  
(Kemppainen &  
Vepsäläinen, 2003) and a  
key factor in enhancing  
firms' competitiveness and  
organizational

performances (Fantazy, Kumar & Kumar, 2009). More and more firms became very critical in determining sourcing strategies between self-

produce versus outsourcing that are both strongly related to the Transaction Cost Economics (TCE) and Resource Based View (RBV) (Wei & Chen, 2008).

Historical events like the 1970s' Arab-oil embargo in the USA have made firms recognize strategic role of sourcing and turned sourcing unimportant or

clerical function to a highly skilled strategic function and component of strategic planning (Branemo, 2006). The recognition is even greater now as many

leading firms have  
considered control cost and  
supply management as  
important factors in  
maintaining

competitiveness (Fantazy et al., 2009).

### **Self-Produce**

Capron and Mitchell (2004) argue that self-produce and

outsourcing strategies  
present differences in their  
capacity to cope with  
contractual hazards,  
strategic gaps and internal  
legitimacy difficulties.



Based on the transaction cost arguments, managers are more likely to choose self-produce over outsourcing when the targeted capabilities face

increasing asset specificity  
and contractual hazards  
(Watson, 2004).

Generally, firms opt for self-  
produce 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). Therefore, to remain competitive requires firms

to develop the ability to recombine internal capabilities into new configurations (Galunic & Rodan, 1998).

Such approach is based on the RBV where firms seek unique or otherwise costly-to-copy inputs. For example, Barney (1986) argues that organizational

culture can be leveraged for superior performance because it is rare and difficult to imitate. This notion applies directly to the challenge of

appropriation of new  
technology benefits. High  
technology oriented firms  
invest more in building  
technical capabilities  
besides allocating scarce



resources in a very specific way and always consistent with their core strategies (Barney, 1986). The RBV logic predicts that activities will be outsourced when

suppliers possess superior knowledge only (Kogut & Zander, 1996).

## *Outsourcing*

Outsourcing can be defined as an act of moving some of a firm's internal activities and decision

responsibilities to outside providers (Chase, Jacobs & Aquilano, 2004). Nowadays more and more firms contract out significant percentage of their

manufacturing and service activities than they did two decades ago (Hilman, 2010). This trend is due to changes in the business environment and the

pursuit of lean operations  
(Hui & Tsang, 2004).

Despite the advantages,  
there are disadvantages in  
adopting outsourcing such

as making firms too dependent on outside suppliers, failure to realise the purported hidden cost saving to outsourcing, losing control over critical

functions and lowering the morale of permanent employees (Tsai, Liao & Han, 2008). Poor observation on advantages and disadvantages of



outsourcing may put  
respective firms'  
competitiveness at stake  
(Hilman, 2010).

The root of outsourcing is based on Williamson (1975), which was inspired by Coase (1937) and Arrow (1962). Firms adopting this strategy are driven by

transaction cost economics (TCE) and intention to minimize costs or costs due to organizational hierarchy. The central question of TCE is still whether a

transaction is more  
efficiently performed  
within firm or by  
outsourcing it, by  
autonomous contractors

(Geykens, Steenkamp &  
Kumar, 2006).

## ***Sourcing Strategies and Performance Link***

There is no doubt on the importance of sourcing issue in manufacturing

strategy (McIvor & Humphreys, 2000). The sourcing decision has been recognized by practitioners as one of major determinants contributing

to the financial health of firms (Zeng, 2000; Cousins et al., 2006). Interestingly, the interest in conducting researches on sourcing decisions can be traced to



the era of the 1930s (Park, Reddy & Sarkar, 2000).

Issue of self-produce or outsourcing remains as one of the most strategic issues

to most firms. Most scholars agree that core activities should stay in-house, whilst non-core activities can be outsourced (Mullin, 1996).

Interestingly, several empirical researches indicated that outsourcing is not used for support services or non-core activities only but activities

'closer to core' (Harland, Lamming & Walker, 2005).

However, it is risky to focus solely on costs because such performance

assessment might lead managers to ignore other strategic objectives (Karsak & Tolga, 2001; Morgan & Daniels, 2001). Over the last ten years, many

authors have suggested that performance measurement should comprise both financial and non-financial measurement tests (Venkatraman and

Ramanujam, 1986; Lee and Miller, 1996; Kaplan & Norton, 1996).

This study adopted performance

measurements that were used widely in business whereas consisting of both financial and strategic performance (Kaplan & Norton, 1996). The



dimensions representing the organizational performance (dependent variable) are: (1) return on sales (ROS), (2) return on investment (ROI), (3)

market share, (4) sales growth rate, (5) innovation and learning perspective, (6) customer perspective, and (7) internal business perspective.

# **Research Methodology**

Data for this study was collected using a mail survey approach. A set of questionnaires were sent

out to 1300 firms (total population) and 314 or 24% of them responded. Specifically one set of questionnaire was sent out to individual holding senior

position (e.g. CEO, Managing Director, and General Manager) of firms listed in the Federation of Malaysian Manufacturers (FMM).

The questionnaires were adopted from previous researches. For sourcing strategies, the instruments have twelve questions, which were adopted from

Kotabe and Omura (1989).  
For the organizational  
performance, the  
instruments combined both  
financial and non-financial  
measurement instruments.

Specifically, it consists of seven questionnaires which were adopted from Venkatraman and Ramanujam, (1986); Lee and Miller, (1996); and



Kaplan and Norton (1996).  
Specifically this study  
addressed the following  
questions:

- Which sourcing strategies are used the most by manufacturing based firms in Malaysia?

- Where are the supplying countries?
- Which one of the sourcing strategies

affects financial and non-financial most?

- How significant does the 'self-produce' and

'outsourcing' strategies  
affect performance?

Besides that, this study also  
addressed the following  
hypotheses.

- **Hypothesis 1:** Self-produce strategy effects organizational performance

- **Hypothesis 2:**  
Outsourcing strategy  
effects organizational  
performance

This study defines a firm sourcing strategy using the percentage of components of its major product that was self produced or outsourced. If majority of



the components or 51% were for self-produce then the company is categorized as using self-produce strategy and vice versa.

# **Findings**

*Sourcing Strategy  
Preferences among  
Respondents*

For the continuous variable (percentage) of sourcing strategy, the outsourcing strategy was found the most popular option of the two with 51.27% of the

respondents opted for this strategy. This means the remaining respondents or 48.73% used the self-produce strategy.

The result clearly indicated that most of manufacturing based firms in Malaysia adopted both strategies. This means no clear preferences and differences

between the two strategies.  
This finding does not go  
along fully with present  
trend on today's sourcing  
strategy that is clearly

inclined towards  
outsourcing strategy.

## ***Distribution of Supplying Countries (Self-produce & Outsourcing)***

Out of four groups of supplying countries, the



self-produce strategy oriented firms' were relying on one and more than one supplying country. Specifically, 49.67% rely on supplier from one country,

26.79% from two countries,  
10.46% from three  
countries and 13.08% from  
four countries. Meanwhile,  
for the outsourcing strategy  
oriented firms; 19.25%

received supply from one country, 19.88% from two countries, 44.72% from three countries and 16.15% from four countries.

## *Distribution of Supplying Countries (Self-produce strategy)*

The top ten or most popular supplying country

for firms opted self-produce strategy was Malaysia (18.79%) and followed by China (4.14%), Singapore (3.26%), Indonesia (3.03%),

Thailand (2.31%), Japan (1.67%), USA (1.18%), UK (1.04%), Germany (0.96%), and Vietnam (0.96%). The option for 'others' consists of many countries with

small percentage. (see  
Table 1).

# **Table 1: Top 10 Supplying Countries for Self-produce Strategy**

**Please see Table 1 in full PDF version**



The results clearly indicate that most manufacturing based firms in Malaysia that opted for self-produce strategy get supply from local suppliers. Next

popular sourcing countries are ASEAN countries as three of them listed among top five supplying countries besides China. These finding shows that most

firms in this category  
benefited from the AFTA  
and ASEAN – China FTA  
agreements.

## *Distribution of Supplying Countries (Outsourcing Strategy)*

For the outsourcing strategy, the top ten most

popular country for firms  
opted for outsourcing  
strategy was Malaysia  
(13.77%) and followed by  
China (7.32%), Singapore  
(4.38%), Japan (3.50%),

USA (3.26%), Germany (2.63%), South Korea (2.31%), Thailand (2.23%), Indonesia (1.91%), and UK (1.27%). Meanwhile the option for 'others' consists

of many countries with small percentage. (see Table 2).

## **Table 2: Top 10 Supplying Countries for Outsourcing Strategy**

**Please see Table 2 in full PDF version**



The findings also indicate that Malaysia is the most popular sourcing country for firms that opted for the outsourcing strategy. The second and third most

popular supplying countries were China and Singapore. However, for rank fourth and fifth were not ASEAN countries but Japan and USA respectively.

These show firms that  
opted for this strategy  
more advanced and  
aggressive than its  
counterparts that opted for  
self-produce strategy in

seeking best source of  
supply.

***Self-produce Strategy and  
Effects on Financial and  
Non-Financial  
Performance***

Path analysis was conducted to describe the effect of the self-produce strategy (independent variable) on financial and non-financial performance

(dependent variable). The results indicate regression coefficients are significantly different from zero and beyond 0.01 levels. This indicates a positive

relationship exists between the 'self-produce strategy' and the 'financial and non financial performance'.



The standardized estimates show the relative contributions of each predictor variable to each outcome variable. This means when the 'self-

produce strategy' goes up  
by one standard deviation  
then the financial  
performance goes up by  
0.33 of standard deviation  
and when the 'self-produce

strategy' goes up by one standard deviation then the non-financial performance goes up by 0.36 of standard deviation. This means the 'self-produce strategy' has

higher impact on 'non-financial performance' than the 'financial performance'.

***Outsourcing Strategy and  
Effects on Financial and  
Non-Financial  
Performance***

Similar findings were identified for the relationship between 'outsourcing strategy' and 'financial and non financial performances' as

regression coefficients significantly different from zero and beyond 0.01 levels. The results indicate that a positive relationship exists between the

'outsourcing strategy' and the 'financial and non financial performance'. The standardized estimates show the relative contributions of each



predictor variable to each outcome variable. When the 'outsourcing strategy' goes up by one standard deviation then the financial performance goes up by

0.21 of standard deviation  
and when the 'outsourcing  
strategy' goes up by one  
standard deviation then the  
non-financial performance  
goes up by 0.39 of standard

deviation. Specifically the 'outsourcing strategy' has higher impact on the 'non-financial performance' than the 'financial performance'.

***Measuring Degree of  
Influence of Self-Produced  
Strategy on  
Organizational  
Performance***

**Hypothesis 1:** Self-produce strategy effects organizational performance

A linear regression analysis was conducted to evaluate

the prediction of the 'self-produce strategy' from the 'organizational performance'. The result indicates the two variables have positive relationship;

$R^2 = 0.154$ ,  $\text{Adj. } R^2 = 0.149$ ,  
and  $F(1,151) = 27.585$ ,  $p < 0.05$ . The  $R^2$  means that  
15% of the variance in the  
organizational performance  
increase was explained by

the self-produce strategy.  
Approximately, 15% of the  
variance of the  
organizational performance  
is accounted for by its  
linear relationship with the



self-produce strategy.

Support Hypothesis 1: Self-produce strategy effects organizational performance. The regression regression

equation for predicting the  
organizational performance  
is:

$$\text{Regression Equation}(y) = a + bx + e$$

$$\text{Performance} = 3.790 + 0.349 (\text{Self-produce strategy}) + e$$

***Measuring Degree of  
Influence of Outsourcing  
Strategy on  
Organizational  
Performance***

**Hypothesis 2: Outsourcing  
strategy effects  
organizational performance**

A linear regression analysis  
that was conducted to

evaluate the prediction of the outsourcing strategy from the organizational performance indicates that the two variables have positive relationship;  $R^2 =$

0.145, Adj.  $R^2 = 0.139$ , and  $F(1,159) = 26.926$ ,  $p < 0.01$ .  
The  $R^2$  means that 15% of the variance in the 'organizational performance' increase was

explained by the  
outsourcing strategy.  
Approximately, 15% of the  
variance of the  
organizational performance  
is accounted for by its



linear relationship with the outsourcing strategy.

Support Hypothesis 2: Self-produce strategy effects organizational performance. The

regression equation for  
predicting the  
organizational performance  
is:

$$\text{Regression Equation}(y) = a + bx + e$$

$$\text{Performance} = 3.496 + 0.409 (\text{Outsourcing strategy}) + e$$

Both hypotheses 1 and 2 produced similar results. This means sourcing strategies are important and play significant role in determining financial and

non-financial performances  
of firms.

## **Discussion and Conclusions**

The study confirms the importance of sourcing strategy to Malaysia's

manufacturing firms. The findings recognized sourcing as another strategic issue in modern business management. It indicated that 51.27% of

firms in Malaysia opted for 'outsourcing strategy' while 48.73% opted for 'self-produce' strategy. Specifically the most popular supplying



countries for firms opted for the 'self-produce strategy' was Malaysia (18.79%), China (4.14%) and Singapore (3.26%). Similar preferences

occurred for the  
'outsourcing strategy',  
which Malaysia (13.77%)  
was ranked first and  
followed by China (7.32%)  
and Singapore (4.38%).

The findings analysis indicated Hypothesis 1 and 2 indicate positive relationship between the independent variable and independent variables.

Hypothesis 1 indicates to describe positive relationship exists between the 'self-produce strategy' and the 'financial performance' as well as

between the 'self-produce strategy' and the 'non-financial performance'.

Similar findings for

Hypothesis 2 as the result indicate positive

relationship between the  
'outsourcing strategy' and  
the 'financial performance'  
as well as between the  
'outsourcing strategy' and  
the 'non-financial

performance'. Specifically both models indicate that the 'self-produce' and 'outsourcing' strategies affect 'non-financial performance' more than

the financial performance. These findings go along with the literature that self-produce and outsourcing strategies are determinants of profit making or financial



health of firms (Yoon & Naadimuthu, 1994; McIvor & Humphreys, 2000; Zeng, 2000; Cousins et al., 2006).

In conclusion, managers could make better decisions in the context of determining sourcing destinations, options (self-produce and outsourcing).

However, several opportunities for future research exist. For example, given the dearth of studies relating to sourcing firms in Malaysia, further

investigation including  
other sectors and countries  
would assist with our  
understanding of  
generalising these results.  
In addition, other aspects of

the sourcing model should examine to understand the mediating or moderating relationship between sourcing strategy and performance.

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