Effect of Global Sourcing on Profitability of Medium Motor Vehicle Firms in Kenya: A Survey of Nairobi County

Evans Magara*, Margaret Oloko, Andrew Nyangau*****

** M.Sc. Candidate, Department of Entrepreneurship and Procurement, School of Human Resource and Development, Jomo Kenyatta University of Agriculture and Technology, Kenya. E-mail: evansmagara@yahoo.com*

***Lecturer, School of Human Resource Development, Jomo Kenyatta University of Agriculture and Technology, Kenya.*

**** Lecturer, Department of Management, Marist International University College, Kenya.*

Abstract

Global sourcing has been widely used in the motor vehicle businesses in the resent past due to its ability to increase competitiveness of firms in the markets. It has opened up opportunities in the industry making a significant contribution to the economic growth of developing countries. Since the 1980s, global sourcing has experienced rapid expansion in Kenya which has seen many firms target the global market for their goods and services which are not available locally in the Kenyan market so as to increae their profit margins by sourcing from low costcountries. The study, therefore, discusses the effect of global sourcing on financial performance of small and medium motor vehicle firms in Kenya: A survey of Nairobi County. It aimed to establish the effect of currency exchange rates on the profitability of small and medium motor vehicle firms and to analyse the effect of government policy on the financial performance of these firms in Kenya. Exploratory research design was used in conducting the study to ensure a complete description and analysis of the situation in Nairobi County. The target population of the study consisted of 298 motor vehicle firms which operate and have offices in Nairobi County. A total of 89 respondents was selected from the target population where each firm produced one respondent who was a procurement manager in the firm. Questionnaires were used in obtaining accurate information from the respondents and these data were analysed using quantitative techniques. T-test and Chi square test were also used where applicaple and the findings were presented using tables and percentages. From the analysis the results showed that currency fluctuations and government policies affect the businesses greately affecting the financial performance of motor vehicle firms.Therefore, if implemented correctly it can be seen that most firms in the sector improve their financial performance.This implementation will go hand in handwith the required infrastructure, support from the top management and the goodwill of employees in doing their work.This will increase their competitive edge to match their counterparts across the region.

Keywords: Global Sourcing, Financial Performance, Logistics, Profitability, Sourcing, Service Delivery

Introduction

Today's business environment is challenging to many successful businesses in the world. Many manufacturing companies therefore must intergrate effectively their internal functions within the company and link these functions to external operations of suppliers andrestof the company's supply chain linkages. As competition increases in the global markets, organisations must get involved in how their suppliers and customers do business by focusing on processes that have an impact on enhancing their supply chain performance. This will make them have a competitive edge over their competitors (Parmar, 2012).

For the growth and development of small and medium size motor vehicle firms, there should be well established linkages between the large motor vehicle firms and the small and medium size firms. In many cases small and medium firms buy their required components from local large motor vehicle firms, though to some extent these firms do carry out global sourcing for components which are either available locally or globally in the markets. Small and medium size motor vehicle firms play a very important role in most developed and developing countries because of their number, variety and their role in employment creation. The potential of small and medium firms in employment creation, and raising incomes of many Kenyan families makes them important in poverty eradication strategy since a large population of the labour force is absorbed in the informal sector (Oyugi *et al.*, 2011).

Most successful world class organisations use just in time (JIT) production in their supply chain in meeting both the internal and external customer's needs and expectations. Research shows that the implementation of this system thought differs from company to company, it has performed in many organisations regardless of the company circumstances, the areas of success include in preventive maintenance, pull production system, JIT supply management, and set up time management.The different components of JIT, if implemented correctly, are critical in the success of businesses (Hassan, 2012).

Inventory is the stock held by a business, for sale in the normal operations of the business. Proper handling of these inventory is critical in the success of the business. Effective and efficient management of inventory leads to a great reduction in costs and improved firm performance. Inventory stabilisation is a predictor of a well-managed inventory management system. Many organisations with different qualifications significantly differ with regard to handling their inventory and its management. Different locations have different inventory handling management systems (Chalotra, 2013).

This sector has a number of concerns. Small and medium size firms in developing countries have been exposed to intense competition due to the accelerated globalisation process which has brought the need for these firms to develop competitiveness for their survival as well as growth. These firms are limited in terms of finances, marketing, human resource, gender inequality, and limited access to information and linkages to large motor vehicle firms, therefore, the ability of these firms to compete in the global markets depends on the ability of these firms to access these resources in order to improve their performance and overall competitive edge against others in the market (Thitapha, 2000).

Inability of organisations to be innovative and adding service value to the core product to overcome the constraints of time and place of delicery has made these organisations unable to satisfy the customer's needs with an edge over the other competitors in the market. This has been a matter of concern to these firms' supply chain profitability. Streamlining the supply chain for these firms and creating strong linkages in the supply chains that connect the focal firms and the customers and other organisations involved in the chain will creat a more input to the firm's profitability and hence increase the firm's competitiveness amongst its peers in the market (Mohan, 2013).

Most manufactures in the market agree that in a case of severe competition, lead time management is a clear effective competition tool as customers become less patient and less willing to wait for the delivery of their order. The reduction of these lead time will not only increase organisation's efficiency and effectiveness but also their responsiveness, commitment, and pioneering by bringing new products into the markets quicker than the competitors. Managemet practices such as JIT have proved to reduce these lead time significantly (Singh, 2013).

Purchasing accounts for the largest part of the total costs in any organisation. Due to this fact sourcing has become an important part of organisations (Monczka & Trent, 2003). Sourcing is a strategic philosophy of selecting vendors in a way that makes them part of the buying firm for a particular component or product that they supply. Manufacturing firms takes this strategic decision to create a close relationship with supplier firms to improve their competitive edge against competing firms in their respective markets. This makes firms in developing countries to source to low cost suppliers in global markets for materials, components and parts that they need. (Zeng, 2003).

With globalisation of the economies in the modern world, the survival of small and medium firms and enterprises has become a challenge. These small and medium firms face a stiff competition from bigger firms globally.To face these competition from global markets, small and medium firms must effectively manage their supply chains so as to have a competitive and consistent value addition. With a well-cordinaed and effective management, supply chain increases the supply chain profitability, although these may be hindered by lack of resources and proper directions. Firms should invest in their supply chains in order to realize profits (Kumar, 2012).

According to Monczka (2003), strategic sourcing is critical in achieving large and sustainable cost reductions in firms. Long term supply stability of products needed in the organisations and minimisation of supply risks incurred are also achieved by leveraging spending across departments, as well as reconfiguring the supply specifications and developing strategic partnership. According to Okuogume (2011), for organisations to compete in today's business environment, sourcing is essential. With changing markets and technologies in the world, the firm's measurement of success has shifted to re-think on how to acquire materials easily and cheaply for their processes and to enable them deliver promises to their final customers.

Statement of the Problem

The demand for vehicles on the domestic market is rising steadily with no long term strategy to facilitate the transition from assembly of motor vehicles to manufacture as most suppliers in the motor vehicle industry depend on global markets for their supply. This has limited the growth of the motor vehicle sector which is praised for its role in employment creation and raising incomes in the government's poverty eradication strategy. Currently this sector depends heavily on currency exchange rates for its survival in the global markets where the large motor vehicle firms have an advantage over the small and medium size firms because of their capital size. The purchaser in the global market pays more than expected when the exchange rates shifts (Kenneth, 2006).

Unstable currency exchange rates make the market uncertain of the currency that should be used to buy the products which sometimes make the firmsuse the supplier's currencies, since suppliers fear the frequent exchange rate changes in the world markets.

This raises the degree of uncertainty in the markets making it difficult to do business (Marcus, 2011). Many studies in motor vehicle firms have shown that the profits of a firm are as a result of the dynamic global market, like the shifts in prices which are parallel to exchange rates and sourcing policies which make the prices of products to rise.

This study, therefore, will establish effect of global sourcing on financial performance or the profitability of small and medium size motor vehicle firms who take the initiative of buying from the global markets instead of from large motor vehicle firms locally.

Objectives of the Study

i. To establish the effect of fluctuation of currency exchange rates on the profitability of motor vehicle firms in Kenya.

ii. To analyze the effect of government policies related to sourcing on the profitability of motor vehicle firms in Kenya.

Justification of the Study

A competitive business environment for firms is needed to enhance their profitability, cost reduction and improvement on efficiency which is a central part of firms which compete against others in the world markets (Hogan & Armstrong, 2001). By analysing the effect of global sourcing on small and medium size motor vehicle firms in Kenya, the study brings forth the knowledge on how to utilise the strategic global sourcing function to gain competitive advantage and improve the firm's profitability.

Theoretical Literature Review

Fluctuation of Currency Exchange Rates

Rao (2008), in his paper, Exchange rate risk in the automobile industry, mentions that small currency exchange rate fluctuations have negative effect on the stock returns of firms. Using quantitative research method, the research investigated the effect of currency exchange rate movements on stock returns of European based motor vehicle companies with market interests in USA. He concluded that the short movement in exchange rates have no significant effect on the stock returns of the companies investigated in the research.

According to Juan (2008), money used in global purchases is moved between the domestic countries and the foreign partners in global sourcing and the stability of the domestic currency used enables the international trade to be easier as instability makes global sourcing more complex introducing more risks in the markets. If trade amounts to millions of dollars per transaction then a slight deviation of about 0.5% on the exchange rate creates a huge effect on the effectiveness of global sourcing strategy and the profitability of the whole supply chain of the firms.

Governments Policy Related to Sourcing

Special regulations by governments involved in global sourcing influence the global sourcing strategy either directly or indirectly or make it complicated altogether with the main regulations being the quotas and the tariffs. Non-tariff regulations are restrictions such as complicated documentation requirements or international trade bills that pose difficult challenges the buyers from other countries have to face. The government use of tariffs and quotas earn revenue and sometimes make foreign goods more costly to protect the national products of the country to save its industries and firms from collapsing. Several restrictions indicated by international trade bills include protectionism. (Sowinski, 1999).

A well-managed global sourcing strategy benefits customers and firms as it is able to deliver lower costs, high quality; flexibility, improved delivery dependability, and quick response time to customers' requests. These leadto better competitive position and better sales and in return better profits for these firms. The motor vehicle firms in Kenya depend on importation of both parts and fully assembled motor vehicles although some firms deal with second-hand vehicles. Motor vehicle importers contribute to the country's economic growth through payment of taxes, and employment creation in the country. Although it has many advantages in the societal developments in the country,these industry faces a lot of challenges that affect their performance and these include competition among players, cultural differences among players, and the regulatory framework in line with the government policies in place (Makembo, 2012).

Research Methodology

The research design is a statement of the conceptual structure in which the research is conducted. This makes the research more visible and easier thereby yielding more information for a good and detailed research (Kothari, 2004). Descriptive survey design was considered as it ensured a complete description of the situation in Kenya, Nairobi County minimizing biasness in data collection and the reduction of errors in data interpretation. The target population in this research is 298 motor vehicle firms in Nairobi County.

From the target population, a sample size of 89 motor vehile firms was selected which represents 30% of the target population. Questionnaires were used to collect information from the respondents using the drop and pick method where necessary. Validity was checked on the questionnaires by involving the experts in the field, and taking ideas from the university supervisors. Reliability of the questionnaires was done using the test retest method and the thereafter an analysis was carried out on the data collected using statistical package for social sciences (SPSS) which was used to code and enter data. T-test and Chi-square tests were used in data analysis and the results were presented using tables, charts and percentages in order to draw a conclusion and draw recommendations on the effect of global sourcing on financial performance of small and medium motor vehicle firms in Kenya.

Findings

Fluctuation of Currency Exchange Rates on Profitability

In Table 1,Chi square statistics was carried out to establish the effect of fluctuation of currency exchange rates on profitability of small and medium sized motor vehicle firms with three degrees of freedom and sample size of 89 respondents. The respondents were asked if their company was affected by fluctuation of exchange rates. The sample included those respondents who strongly agreed, those who agreed, those who disagreed, those who strongly disagreed, and those who did not know. The relationship between these values were significantly different X_5 (5,N=89)=171.57, p<0.05. The results showed that the currency exchange rates significantly determine the number of products purchased for these firms from the global markets X_5 (5,N=89)=111.57, p <0.05. Exchange rates were also researched before adoption of global sourcing for these firms X_5 (5, N=89) =189.86, p <0.05. Global sourcing strategy was influenced by fluctuation of currencies used in the global markets. This showed that there was a strong significant deference between the global markets and the exchange rate changes X_5 (5, N=89) =60.71, p <0.05. Many firms had large inventory to cater for inflation periods so that they go to global markets when the exchange rates are favourable X_5 (5, N=89) =145.92, p <0.05. Some of the firms replaced preferred supplier because of the changes in rates though most of them did not, due to the costs of shifting supplier bases in the markets. From the results we can show that the fluctuations in the currency exchange rates greatly affect global markets especially the motor vehicle markets which were under this study (Marcus, 2011). Higher fluctuations in exchange rates come with many small charges that are included in the total cost of products and therefore higher price of goods and services (Chaodong, 2008).

Government Policies Related to Sourcing on Profitability

In Table 2, Chi square statistic analysis was carried out to analyze the effect of government policies related to global sourcing on profitability of small and medium motor vehicle firms in Kenya with three degrees of freedom and a sample size of 89. The respondents were asked their views on various statements and their responses

Table 1: Fluctuation of Currency Exchange Rates

	Your company is affected by fluctuation of currency exchange rates	Currency exchange rates determine the number of products purchased	Exchange rates are researched before adoption of global sourcing	Global sourcing strategy is influenced by fluctuation of currency	Firms have large inventory to cater for inflation periods	Have you ever replaced a preferred supplier because of the change
Chi-Square(a)	171.571	111.571	189.858	60.719	145.925	54.708
Df	5	5	5	5	5	5

a 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 8.9.

Table 2: Government Policies

	Are different standards between different countries affecting global sourcing in your company	Do any regulations such as customs duties affect the processes of global sourcing	Do the government policies and regulations on global sourcing affect pricing of products	Do you conduct an audit of policies of different suppliers overseas	Your organisation use international global sourcing standards	Your organisation has global sourcing policies which are in line with government policies
Chi-Square(a)	178.172	181.309	108.509	193.360	201.993	217.021
Df	5	5	5	5	5	5

a 0 cells (.0%) have expected frequencies less than 5. The minimum expected cell frequency is 8.9.

were analyzed as shown in Table 2 on the scale of those who strongly agreed (1), those who agreed, those who disagreed, those who strongly disagreed, and those who did not know. The results were strongly significant as they showed different standards between different countries affecting global sourcing X^2_5 (5,N=89)=178.17, p <0.05. Government regulations such as customs duties affect the processes of global sourcing X^2_5 (5, N=89) =181.30, p <0.05. The results also showed that government policies and regulations on global sourcing affect pricing of products in motor vehicle businesses, X^2_5 (5, N=89) =108.50, p <0.05. These companies do carry out an audit on policies of different supplies before asking them to supply X^2_5 (5, N=89) =193.36, p <0.05. It was also shown that these companies use international policies where applicable, for example, when their country's regulations are not sufficient for the transactions as the international policies are sometimes used as standards in some transactions, X^2_5 (5, N=89) =201.99, p <0.05. These policies are in line with those of the governments involved and the companies as well, X^2_5 (5, N=89) =217.02, p <0.05. This analysis showed that there was a significant relationship between the fluctuations of currencies and profitability of these firms and, therefore, need to be cautious in practicing global sourcing which is directly affected by these fluctuations.These will in turn have an effect on profitability of these firms. Through payment of taxes such as import duty, VAT, as well as employment creation in the country and realisation of revenue, policies that support this global sourcing will boost the economy (Makembo, 2012). Government policies and proper strategies, therefore, are keys to improving the financial performance of this industry. Proper sourcing strategies can enable organisations save a lot and still be able to compete and sustain the business in the market (Kenya motor industry report, 2007).

Conclusion

Most firms in the motor vehicle industry are affected by the shifts in the currency exchange rates in their markets. From this research when the Kenya shilling becomes stronger against the dollar, the value of the motor vehicles appreciates. This shows that there is a relationship between the exchange rate shifts and the profits made by the firms in the supply chain. In this research a number of products sold or purchased by a firm from the global market will largely depend on the currency rate shifts in the markets. Small and medium firms in the motor vehicle industry acknowledge that large inventory on the other hand will help during these large shifts in exchange rates and therefore they should have optimal inventory capacity to cater for these periods. Optimisation of the inventory helps create an optimal inventory to optimise the firms costs that could have reduced the firms profits.

Different standards in different countries determine the way suppliers and buyers behave in the market. In the motor vehicle industry, this is not an exception, therefore the firms' policies should be in line with the government's policies and the international policies of the industry for the firms to realise the full benefit of global sourcing in the industry.

There was a limitation to the number of firms seveyed due to the limited funds for the research. Some respondents did not respond for fear of victimisation and this had an effect on the findings of the research that was carried out .

This research was limited to Nairobi County, therefore there were various issues that were assumed, like the same findings could be applied across the region. A further research that covers the whole region of East Africa to acertain the effect of global sourcing on profitability and the influence of asian motor vehicle firms on the profitability of East African firms will encourage investors to join the East African community and hence improve the livihood of its population.

References

Chaodong, H., Martin, D., & Robert J. W. (2008). Impact of global sourcing and exports on US manufacturing inventories. *International Journal of Physical Distribution and Logistics Management,* 37(6), 475-497.

Chalotra, V. (2013). An exploratory framework of the role of handling inventory and its management. *Journal of Supply Chain Management,* 2(3), 57-64.

Hassan, F., Yasser, S. F., Maryam, A. K., & Mohsen, S. N. (2012). A method for Identifying critical success factors of JIT implementation in defferent circumstances (Case study: Appliance Industry). *Journal of Supply Chain Management,*1(1), 1-9.

Hogan, J. E., & Armstrong, G. (2001). Towards a resource based theory of business relationship; the role of asset value. *Journal of Business Marketing.* 8(4), 3-28.

Juan, C., (2008). *Global sourcing under Imperfect Capital Markets.* Paris School of Economics.

Kenneth, L., & Brian, F. (2006). *Purchasing and Supply Chain Management, (7th edition).* London, Pearson Educational Limited.

Kumar, R., Singh, K. R., & Shankar, R. (2012). Supply chain management issues in an Indian SME: A Sap-Lap analysis, 1(2), 34-44

Makembo, G. (2012). Factors affecting the performance of secondhand motor vehicle importers in Nairobi, Nairobi. *Unpublished master's thesis of Kenyatta University. Kenya.*

Marcus, K., Helmut, R., & Eduard, T. (2009). The micro-economic effect of large exchange rate appreciations, OECD Development centre. Paper no. 296 Retrieved from http://www.oecd-ilibrary .org/papers.

Mohan, A., & Deshmukh, A. K. (2013). Conceptualization and development of a supply chain-customer relationship management (sC2R-M). *Journal of Supply Chain Management,* 2(3), 9-25

Monczka, M., & Trent, J. R. (2003). Understanding integrated global sourcing. *International Journal of Physical Distribution and Logistics Management, 33*(7) 607-629. *Retrieved July 11, 2013,* from*http:// www. Emeraldinsight.com/journals.htm.*

Mugenda, O. M., & Mugenda, A. (2003). *Research Method: Qualitative and Quantitative Approach,* Nairobi, ACTS press.

Oyugi, L., Okatch, B. A., & Mukulu, E. (2011). Constraints to subcontracting arrangements between SME's and large firms in the motor vehicle industry in Kenya. *International Journal of Business and Social Sciences,* 2(15), 208-223.

Parmar, H. A., & Chaudhari, J. (2012). Supply chain management practice of weaving industry. *Journal of Supply Chain Management,* 1(1), 35-43.

Rao, F. (2008). Exchange rate risk in automobile industry. An empirical study on Swedish, French and Germany multinational companies. Handelshogskolan: UMEA University.

Singh, R. J., Sohani N., & Marmat, H. (2013). Effective lean/JIT practices and supply chain intergration on lead time performance, 2(2), 34-41.

Sowinski, L. L. (1999). Legal issues for shippers, what you don't know can hurt you. *World trade,* 56-57.

Thilapha, W. (2002). SME subcontracting as abridge head to competitiveness: An assessment of supply side capabilities and demand side requirements. *Asia Pacific Development Journals*, 9(1), 65-86.

Zeng, A. Z. (2003). Global sourcing process design for efficient management. *International Journal of Supply Chain and Management*, 18(3) 369-379.