

The Challenge of Building Sustainable Supply Chain Relationships among Small Firms in Developing Economies: The Case of Kenya

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1.0 ABSTRACT

The core goal of any enterprise is to grow both in assets and profitability. Such growth is critical to the wellbeing of individual firms and the economy in general. Sound supply chains that offer strong reliable relationships have been found to play a critical role in the growth and sustainability of firms. Studies show that enterprises that exploit the benefits of supply chain management improve performance by up to 80 percent depending on the extent of adherence to key supply chain requirements.

However, Small firms have largely remained far removed as far as structured growth and development of supply chain relationships is concerned. Although significant levels of success have been reported among larger firms with regard to supply chain relationships such success has not been widely replicated among smaller firms.

It is largely appreciated that competition is no longer based on just the bare company-versus-company business models but also on the extended virtual enterprise of supply chain-versus-supply chain. This underpins the importance of optimizing an enterprise's performance within the wider context of strong inter-firm and firm-market relationships.

Many studies have been conducted to try and understand the supply chain scenario. However, most of these studies have concentrated on European and American firms. However, the social, economic, cultural and other fundamentals that influence the success of supply chains for small firms in developed economies are largely different from those in developing countries and that on this account these studies, although important as reference points for further study, may not be representative of the scenario in developing economies.

There is, therefore, need to examine the supply chain relationship gaps that characterize small firms in developing economies. This would help develop recommendations that can be used to strengthen these relationships and so improve business performance among small firms in these economies.

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Field of Study: Supply Chain Management

2.0 INTRODUCTION

The crucial role the small and medium enterprise sector plays in the growth of developing economies and its ability to generate employment cannot be underestimated (CBS, ACEG & K-REP, 1999; Birch 1987). These enterprises provide many benefits to the economy, some of which are of a social nature and are, therefore, difficult to quantify. Various definitions have been ascribed to small firms in different countries based on factors such as capital outlay, profitability and employee size.

Given the important role that small enterprises play in the growth of developing economies, it is essential that the development and growth of small firms is sustained. Particularly, quick graduation of these firms to larger enterprises on a continuous basis is desirable. Such graduation is only possible if all factors contributory to enterprise growth are put in place. These factors include sound supply chain relationships, necessary training, marketing support, and sound support regulatory framework (Stokes, 1995).

2.1 Problem Statement

Studies show that enterprises that exploit the benefits of supply chain management improve performance by up to 80 percent depending on the extent of adherence to key supply chain requirements (Wagner *et al.*, 2003). However, Small firms have largely remained far removed as far as structured growth and development of supply chain relationships is concerned (Morrissey & Pittaway, 2004). For instance, studies by Morrissey and Pittaway (2004) on SMEs show that small firms tend to be reluctant to collaborate with other firms in order to improve the channel of material supply and dispersal of finished products.

Studies also show inherent weaknesses in supply chain relationships among small firms. However, some justifications as to why small firms tend to exhibit weakness in their supply chain relationships have been advanced by various writers. Tarn (2002) argues that small firms deliberately exhibit a wide disjoint between corporate goals and the strategies for achieving those goals on one hand and the supply chain goals and strategies on the other. It is clear that although significant levels of success have been reported among larger firms with regard to supply chain relationships such success has not been widely replicated among smaller firms (Quayle 1999; Quayle 2001; Morrissey & Pittaway, 2004). There is, therefore, need to examine the supply chain relationship gap that characterizes small firms as far as customer and supplier relationships are concerned in Kenya.

3.0 LITERATURE OVERVIEW

3.1 Growth and Sustainability of Kenya's SMEs

SMEs have for a long time experienced high mortality rates owing to a variety of reasons. Many of them die even before they can gain enough stamina to compete with favorably. A 1993 GEMINI (3) survey estimated that there were approximately 910,000 SMEs (those employing less than 50 employees) in Kenya employing about 2 million individuals or 16% of the labor force. The survey further found that only 38% of these SMEs had grown since being started and that 47% of them were single person operations. It also found that one third of the 325,000 SMEs started in 1993 had failed or closed, as well as 90,000 failures or closures of enterprises started in the previous years (ILO, 2004). This scenario is not far removed from that of most other developing economies, especially in Africa.

3.2 Sound Supply Chain Relationships

Various writers have tried to describe what, in their opinion, makes up an ideal supply chain relationship. According to Sahay (2003) a sound supply chain system is one which adequately covers at least the following supply chain activities: general procurement, inventory management, product design and new product development, manufacturing (planning), order processing, transportation/distribution, sales, demand management, and customer service. Quayle (2001) argues that a good supply chain system must be able to anticipate and appreciate future changes in the internal and external operating environments of an enterprise in order to position the firm well to meet those challenges. The argument here is that the relationship between an enterprise and its suppliers and customers is a function of time and so must be understood within this context. Quayle (2001), also, asserts that a good supply chain relationship must have both social as well as economic value. The relationship should, therefore, be quantifiable in terms of business brought in as a result of sound supplier and customer relationships respectively.

3.3 Factors that Influence Sound Supplier Relationships

Bretherton and Chaston (2005) reviewed a number of factors that are seen as essential in the creation, management and maintenance of a collaborative arrangement among partners in a supply chain and concluded that commitment between members of the supply chain is seen as one of the essential ingredients of trust, a factor that in itself is critical to the maintenance of a sound relationship.. A number of authors have noted that the relationship between the producer and its customers and suppliers is part of a firm's operations management transformation process (Mason-Jones *et al.*, 2000; Naylor, 1996).

Other writers have, however, argued that supply chain relationships are subject to many enterprise and customer factors including information exchange and the firm's nature and scope of planning (Chen, 2003). Towers and Burns (2007), however, argue that SMEs do not face any trade-off between their own requirements and their customers' requirements per se. Rather the choice they face is the degree to which they are willing or able to contribute to supply chain optimization through the process of aligning themselves to customer and supplier needs and circumstances.

Writers also link the success of supply chain relationships to many other factors including product quality. Fisher (1997) proposes in his model a link between product characteristics and supply chain strategy. He argues that supply chain strategies must be linked to product features for those strategies to succeed. In this typology, Fisher groups product characteristics into 'functional products' and 'innovative products'. He describes functional products as having a stable demand pattern, a longer life cycle, lower product variety, lower contribution margin, and longer lead times for make-to-order products. On the other hand, innovative products are those having shorter product life cycles, higher product variety, higher contribution margins, and shorter lead times for make to order products. Fisher argues that demand patterns are more predictable for the functional group as compared to the innovative category. This well supports arguments presented variously in other writings in this literature review.

It is noteworthy that transaction costs can impede successful supply chain relationships if they are not controlled. The supply chain process is deemed incomplete until the product is taken up by the customer. However, cost of the product, which is a build-up of product and process costs, is a key determinant of if and when the product will be taken up to complete the process. Transaction costs are largely informed by the model of governance adopted for the particular supply chain process. Whereas some processes are more expensive others are cheaper but still effective. This depends on the number and nature of process stages that characterize the process.

4.0 METHODOLOGY

The study was largely of a qualitative exploratory nature. It targeted the city of Nairobi and its environs. The target population of this study was Small firms that are loan clients of FAULU-Kenya. These enterprises were identified from the FAULU Kenya's client list. By the time of conducting the study, FAULU Kenya had 124,000 active loan clients country-wide.

A sample of 200 small enterprises in general retail was purposively selected for this study. However, the actual respondents that the study realized were 155. The study was conducted in Kariobangi, Gikomba, Githurai and Kawangware market centers within Nairobi.

Being a largely qualitative study a thematic approach was adopted. The following three themes were identified and studied:

1. Role of supplier relationships in enterprise growth
2. Role of customer relationships in enterprise growth
3. Challenges facing the building and strengthening of supply chain relationships

5.0 FINDINGS

5.1 General Effectiveness of Existing Supplier and Customer Relationships

From the information gathered during the study, it is clear that existing relationships between enterprises and suppliers on one hand and enterprises and suppliers on the other had not been built upon sustainable fundamentals that would have ensured sustainability of the relationships and, therefore, optimized their benefit to both parties. It was also clear that in spite of some effort having been put by enterprise owners and managers to creatively develop tools and mechanisms to enhance these relationships, very little tangible results were forthcoming in the way optimum relationships.

Effectiveness of existing supply chain relationships was defined on the basis of two fundamental factors:

1. The extent to which enterprises on one hand and suppliers and customers on the other felt they appreciated existing business relationships
2. The extent to which existing business relationships contributed to the rapid growth of business turnover and net worth

The information gathered shows that although there was a general appreciation that sound relationships based on mutual benefit by enterprises and their customers and customers were beneficial, most players in the partnerships felt that meaningful sustainable relationships did not exist. In the few cases where such relationships existed, there was a general feeling that they were not borne out a deliberate structured effort or process, rather they had just developed spontaneously more so out of necessity for survival by enterprises. A number of enterprises, actually, didn't seem to have a clear plan of action to nurture or strengthen business relationships.

The study, further, shows that many enterprise owners lacked the knowledge, and therefore, the tools needed to move their business relationships to the next level. This is evidenced by the low levels of education recorded among the vast

majority of the respondents. It is noteworthy that where effort to develop sustainable relationships existed, the entrepreneur had some business or business related knowledge or had employed a professional manager.

This lack of a structured effort to nurture sustainable business relationships can also be traced to the weak management structures that many businesses had. For instance, most respondent business did not well defined positions of management. This meant that all employees did everything depending on what instruction they were given at that point in time. As such, there was no ownership of the process of nurturing business relationships and records that would be useful to achieve this were, also, either lacking or poorly maintained.

From the foregoing, it is clear that although business relationships play a critical role in enterprise growth and sustainability, many entrepreneurs don't spend time and effort to nurture them. The researcher arrived at the conclusion that either complete knowledge about enterprise operations, particularly the determinants of enterprise success, lacked among respondents or that the planning scope of most enterprises is too short to allow them to factor in the planning for long term relationships.

It was clear that in the few cases where sound relationships were actually posted, these enterprises experienced faster growth. In this category of enterprises there was generally a higher level of awareness and knowledge among the owners and/or their managers. Most of these enterprises were, also, generally found on the upper side of enterprise size with most of them having over 15 employees. Among this cluster were enterprises that had a clear definition of who their main suppliers and customers were. Some of them were actually serving niche markets.

With regard to customer relationships, the study found that most entrepreneurs relied on walk-in customers who had no tangible allegiance to the enterprise. This meant that these enterprises were generally engaged in serving a common pool of clients who could be shared by anybody in the enterprise pool. There lacked meaningful relationships between the customer pool and the enterprise pool. This, also, meant that the customer pool did not benefit from positive criticisms that stem from committed relationships and help to improve themselves.

5.2 A Summary of Key Hindrances to Effective Supply Chain Relationships

The study found some supply chain process-based hindrances that had far reaching negative implications on business growth. These role inhibitors are summarized below.

5.2.1 Early-chain Factors

Findings of this study indicate that a number of hindrances to these relationships emanate from the supplier side of the relationship. It was clear that the supplier relationships that existed among most business players were fairly weak and were not built on strong business fundamentals. Most of the respondents said that they found it difficult to nurture strong supplier relationships because of the following reasons.

- 1. Untrustworthy Suppliers:** Respondents cited failure to deliver the quality and quantity paid for as key evidence to this. When probed further, many indicated that in many cases they had to pick supplies themselves to avoid sending suppliers back with their wares (if they did not meet specifications) since this always created friction between them and the suppliers especially with regard to the cost attached to returning the goods. Where the suppliers supplied to the doorstep of the enterprise, it was always necessary that the owner inspected the goods himself since his employees would easily be corrupted to receive inadequate or poor quality supplies.
- 2. Inadequate Capital:** Enterprises interviewed defaulted paying for supplies often. In some cases they delayed payments by a few days while in others they did not pay altogether for various reasons. They cited a strain on their working capital as the reason for this.
- 3. Inconsistencies created by Suppliers:** Respondents complained that suppliers had the tendency to change goal posts with regard to price and quality, in most cases at no notice to the purchasing enterprise. The effect of this was that these enterprises had to pass the changes to their clients in the same haphazard way. Generally, consistency seemed to lack across the entire supply chains.
- 4. Poor Supplier Records as Kept by the Purchasing Entity:** According to the findings, many enterprises did not keep good records that would help them to keep track of their supplier trends with regard to prices, frequency of supply and quality of supply, among others. As such, documentation on key supplier fundamentals upon which such relationships would be built was missing.
- 5. Poor Planning:** In many cases purchasing was handled situationally without much planning or research of suppliers, their quality or even prices. Many enterprises therefore bought if and when supplies run out and since most of this purchase was usually hurried they tended to buy from whoever had the item at that point in time.

5.2.2 Chain-end Factors

Findings also show that sound supply chain relationships were adversely affected by supply factors from the customer side of the relationship. The following main factors were variously mentioned as the key forward integration hindrances to supply chain relationships as highlighted below.

- 1. Unfair Competition:** Many entrepreneurs felt that unfair competition, especially based on price, meant that their most trusted customers could easily move away from them to buy cheaper products of less quality. They blamed this on lax regulation by government agencies.
- 2. Poor Quality Products Sold at High Prices:** Respondents indicated that sometimes owing to factors beyond their control, e.g. supplier prices, they were forced to sell to customers at prices they felt were expensive. However, they also indicated that they often took advantage of market factors such as product shortage to make an unfair price gain
- 3. Lack of or Poor Customer Statistics and Records:** It was difficult for most of these entrepreneurs to closely keep track of their main customers since they hardly kept their records. However, many had developed relationships with a number of customers and offered them products at an additional value. Many used price and additional products to strengthen the relationship. Relationships between customers and the respondent enterprises were generally rated better than relationships between the respondents and suppliers though.
- 4. Interpersonal Challenges:** These were based on non-enterprise factors such as race, religious inclination and other perceptions- many respondents indicated that customers from tribes, religious inclination, or social backgrounds different from theirs, were keen on building business trust with those they perceived to share social, cultural and religious backgrounds with. There was a general feeling that many enterprises did not spend time to respond to customer needs for attention.

5.2.3 Policy Challenges in Relationship Nurturing

Respondents were asked to highlight issues of government policy that worked for and against their efforts to develop lasting relationships with their customers and suppliers. The following factors (in their order of frequency) were most cited as largely contributing to the perpetuation of negative relationships between entrepreneurs and customers on one hand and suppliers on the other.

- 1. Government Taxes and Levies:** Taxation and licensing were the most cited examples. Respondents argued that these levies made relationships expensive to nurture and maintain. Also, Respondents complained that various arms of government (both central and local) were charging high and varied taxes and levies.

2. **City Council Requirements and Hindrances:** These were reported in areas such as advertising, motor vehicle parking and business branding. There were complaints across the board that the city council had become so restrictive that its requirements had started affecting services by enterprises to their customers. They also argued that the city council required them to have many licenses even for closely related businesses and that it was tedious getting these licenses processed.
3. **Corruption:** It was explained by many respondents that city council officers were corrupt and so extorted money from enterprises even when they had complied with city council requirements. This cost was always passed on to the customer.
4. **Quality and Standardization Policies:** Requirements by Kenya Bureau of Standards were particularly cited by many small processing and manufacturing entrepreneurs. Others mentioned were the city council and National Environment Management Agency, with regard to environment and health issues, respectively.

5.3 Measures Taken by Entrepreneurs to Improve Supply Chain Relations

Many respondents cited varied factors that had been enacted to improve supply chain relationships. For instance:

1. Various enterprises went out of their way to build positive public relations e.g. by improving frequency and nature of communication- a few larger enterprises (mainly with over 15 employees) made deliberate efforts to keep communication with their suppliers and customers running.
2. Others tried to tag customers to their enterprises by offering them credit and promotional items. This was more pronounced among larger firms who had structured promotional efforts. A number indicated that they had actually set aside promotional budgets. Smaller firms mainly gave credit to a select clientele within largely non-structured mechanisms. The most frequently used promotional tool was quantity, with many indicating that they gave two or three items over and above the quantities bought to clients who either bought frequently or in large volumes. Non-quantity promotional tools were largely lacking among smaller enterprises.
3. Some enterprises tried to improve product quality and reduced product prices. This factor was mentioned across the board. However, further probing indicated that it was in very rare cases that improving price went together with price reduction. It was clear that in most cases whenever price was reduced quality also suffered.

4. Other enterprises developed loose clubs among their customers, e.g. serving the loyal ones more uniquely a number of small firms indicating that they used customer clubs to strengthen their relationships with customers. Many of them distinguished their enterprises as meeting points for friends. This was more the case with entrepreneurs who run food points and retail shops. Less than 20% of all retail outlets went out of their way to provide seats and newspapers where friends, who also formed their business club could relax and chat. Again less than 20% of all food points used television, especially sporting channels as the point around which they nurtured business clubs

With regard to supplier relationships most entrepreneurs seemed not to employ any serious measures to keep the relationship going. However a number noted the following as some of the ways they tried to nurture the relationships:

1. they paid for supplies promptly
2. they involved them in their own personal as well as their business initiatives and functions

6.0 Conclusion

From the study it was clear that most entrepreneurs were more interested in nurturing relationships with their customers but were largely unwilling to spend resources and time strengthening their relationships with suppliers. Many respondents harbored the expectation that it was the suppliers' role to strengthen the relationship with the purchasing entity.

It is also clear from the study that supply chain relationships play a key role in business growth and profitability. Small firms in developing countries must, therefore, be assisted to embrace the ideals of sound supply chain relationships as minimum platforms upon which to grow their profits and business capacities.

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