DOI: 10.2478/v10051-009-0003-4

How does Networking Impact the SMEs Growth

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Today's market conditions are forcing companies to adapt to changes in order to survive, grow and be competitive. Such changes include inter-company cooperation and networks, which allow for competition and innovation in a dynamic environment. Today, almost all industries are affected by the evolution of networking relationships within and between firms; however, previous studies have revealed that companies differ in their competitive strategies, strategic and technological orientation, and methods of networking. Most of these studies have linked networking with performance, with less empirical evidence on linking networking in SMEs with company growth. Previous research has also shown that entrepreneurial potential in Slovenia is not fully utilized. For this reason, the presented paper investigates a networking in SMEs and its contribution to the companies' growth.

Keywords: networking activities, entrepreneurship, entrepreneurship theory, SME, growth, growth aspirations

1 Introduction

There is a difference in legitimacy and value, as well as in the practical and theoretical importance of studying entrepreneurship. Yet there is no longer doubt that small and medium-sized enterprises (SMEs) contribute to economic growth, job creation, innovation, etc. Perhaps the largest obstacle to creating a conceptual framework for entrepreneurship as a discipline has been its definition. To date, most researchers have defined the field *solely* in terms of who the entrepreneur is and what he or she does (Venkataraman, 1997). The problem with this approach is that entrepreneurship involves the nexus of two phenomena: the presence of lucrative opportunities and the presence of enterprising individuals (Venkataraman, 1997). For the purposes of our research, we follow the definition of entrepreneurship by Shane and Venkataraman (2000), which states: *Entrepreneurship is an activity that involves discovery, evaluation, and exploitation of opportunities to introduce new goods and services, ways of organizing, markets, processes, and raw materials through organizing efforts that previously have not existed.*

While this is a useful conceptual definition of entrepreneurship, it is also very difficult to be operationalised in empirical research. Our research concentrates on the entrepreneurs' personal network and its impact on companies' growth. A key distinguishing feature of a successful SME is a balanced alignment of the owner-entrepreneur's intention, his or her business abilities, and environmental opportunities. Crucially, each of the variable sets of intention, ability, and opportunity are linked intrinsically, and business success is unlikely to be achieved should one be missing or unduly weak.

While investigating the impact of entrepreneurs' network on SMEs growth, we have followed the principles of entrepreneurship theory (based on authors Shane and Venkataraman, 2000). Strategic cooperation and networks should allow SMEs to compete and innovate in a dynamic business environment. The success of a company depends also on its collaboration with other organisations that influence the creation and delivery of its products or services (Valkokari & Helander, 2007). The building process of networks is uncertain and involves socio-psychological aspects (Valkokari & Helander, 2007). Networks of SMEs are especially based on personal relationships, where the small companies' networks overlap with entrepreneurs' networks (Biggiereo, 2001). A challenge for SMEs is to use networks in a proper way and to profit from organisations within these networks.

The success, as well as the growth, of firms is a key to economic development and to the creation of wealth and employment. Recent research in entrepreneurship (*Slovenian Entrepreneurship Observatory* and *Global Entrepreneurship Monitor*) has stated that entrepreneurial potential is not fully utilized. Therefore, an increased understanding of this phenomenon is vital for at least three target areas. From a *societal perspective,* there is good reason to seek more knowledge about the factors that promote and deter entrepreneurship in small firms. From a *theoretical perspective,* such knowledge is needed for strengthening the empirical micro-level basis of theories of entrepreneurship and theories of the firm. From

a *policy-making point of view*, it is helpful when making choices between support to large vs. small firms, active vs. passive support, general vs. selective support, to what extent new venture creation vs. development of existing firms should be promoted, and how such support should be tailored to yield a maximum return to society.

Today, hardly any industry remains unaffected by the evolution of network-like relationships within and between firms. For SMEs, knowledge and network management can be difficult tasks as their characteristics often hamper the leverage of the resources and competencies needed within the organization in order to yield new opportunities.

Compared to large firms, SMEs tend to have more limited financial and human resources, less access to information, and shorter time horizons. In addition, they are generally more risk-averse and reluctant to engage outside help, except for very specific short-term needs. However, when assessing the consequences for networking behaviour, one should avoid generalisation since SMEs form a very diverse population (OECD, 2004). The primary reason why the majority of SMEs do not take full advantage of networking opportunities is their lack of motivation to do so.

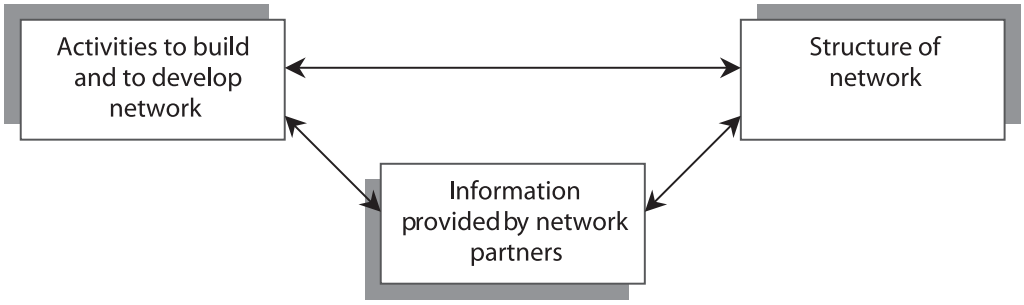
The purpose of the paper is to analyse characteristics of networking and networking approaches in Slovenian small and medium sized enterprises (SMEs). The term networks can be interpreted as connections and interactions between individuals, groups, and organizations. Networks may result through internalisation or externalisation. The internalisation could be seen as intensification of internal cooperation in the company, and the externalisation in the form of a limited number of outsourcing relationships. The relationships evolving between actors can be categorised according to contents, form, and intensity. The networks could be established in different forms and some of them are discussed in the paper. Therefore, the study's aim is to gain understanding of networking in SMEs and how networking contributes to the companies' growth. Furthermore, the paper connects networks with the past growth, as well as the future growth aspirations of companies.

2 Characteristics of networks in SMEs

Networking and the concept of a network have various definitions in the literature reviewed. Network could be stated as a specific set of linkages among a defined set of actors. However, networks are also often defined as relationships between different actors (Aldrich & Zimmer, 1986; Gulati, 1998; Ireland et al., 2001). Actors in a social network can be persons, groups, and collectives of organisations. Personal networking is defined as the management of relationships or alliances that the individual has with others in their society (Dubini & Aldrich, 1991; Aldrich & Zimmer, 1986). An organizational network is a voluntary arrangement between two or more firms that involves durable exchange, and sharing or co-development of new products and technologies (Groen, 2005). Others define networks as a set of interdependent actors, activities and resources (Hakansson, 1989; Groen, 2005). Hakansson and Snehota (1995) developed a network model in which the ties between actors, activities, and resources comprise a business network. In the business practice, networks may have different forms, including strategic alliances, joint ventures, licensing arrangements, subcontracting, joint R& D, and joint marketing activities (Groen, 2005).

Networking in a small firm context could be defined as activities in which the entrepreneurially oriented SME owners build and manage personal relationships with particular individuals in their environment (Carson et al., 1995). Many (small) firms cooperate beyond their individual scope with other organisations, large and small, to exploit new technologies in networks. This is considered to be entrepreneurial networking (Groen, 2005). The entrepreneur plays a crucial role in building both formal and informal relationships with people within their society who are, or may become, material in assisting them to progress the growth ambitions of their enterprise (Hill et al., 1999). Such networks are an intangible asset. Another specific characteristic of entrepreneurial networking is that entrepreneurs will, themselves, operate as actors in the network and will often be involved in the execution of project activities (During & Oakey, 1998) The more networking activities an entrepreneur engages in, the larger his personal network and the more central his position in it should be (Witt, 2004). However, some entrepreneurs have no aspirations to create growing companies, so they may purposefully restrict their network size (Chell & Baines, 2000) and their networking activities.

The network could be characterised by many attributes. Witt (2004) analysed three groups of network characteristics: namely, (1) activities to build networks, (2) structure of network, and (3) acquired information by network partners, as represented in *Figure 1*. A number of different items have been suggested in the reviewed literature to measure networking activities. One of the proposals is to state the amount of time an entrepreneur invests in a defined period on the creation, preservation, and enlargement of his personal network. Another suggestion is to measure the frequency of communication between the entrepreneur and network partners during a defined time (Witt, 2004; Ostgaard & Birley, 1996). Also the structure of network could be measured by different items, such the size of an entrepreneur's personal network and the heterogeneity of network contributors or their diversity (such as different groups of people—family, friends, and business partners). Another structural measure is the density of network (Witt, 2004), which means the number of direct relations between the entrepreneur's personal network partners (Witt, 2004; Hansen, 1995). The third attribute of the network characteristics is the output of the network, which consists of benefits attained through entrepreneurial networking activities (Witt, 2004). The benefits could be measured by frequency of new information provided by other contributors in the network or by their supportive actions.



Source: Witt, 2004

Figure 1: Attributes of entrepreneurial network

Networking in SMEs varies in different dimensions that could be classified into (1) level of networking, (2) strength of network ties, and (3) networking proactivity (O'Donnell, 2004) on the continuum. The level of networking refers to the range of the network and it should be positively connected to the companies' ownership (Birley et al., 1991; Burns & Dewhurst, 1996). Therefore, the level of networking in which an owner-entrepreneur engages, could be positioned on a continuum from "limited" to "extensive" (O'Donnell, 2004), where "limited" refers to a small network with some connections, and "extensive" refers to a network with many connections. The strength of network ties is defined as a combination of time, emotions, intimacy, level of maturity, degree of trust, and previous experiences between actors (Johannissonn, 1986). Strong ties are relations that an entrepreneur can "count on", and weak ties as relations in which people typically have little emotional investment (Dubini & Aldrich, 1991). Therefore, the strength of tie between an entrepreneur and a network participant can be positioned along a continuum from "weak" to "strong" (O'Donnell, 2004). The degree of networking proactivity is related to the entrepreneur—and partly to other actors—involved in a particular network. Some studies have shown that entrepreneurs are aware of the benefits that a particular network has for their companies (Shaw, 1999). The level of networking proactivity could be on a continuum from "reactive" to "proactive" (O'Donnell, 2004).

The main limitation of network research arises from the fact that empirical studies must use quantitative measures to estimate qualitative information. The problem applies to data collection as well as data evaluation (Daft & Lengel, 1986).

3 Measurement construct

3.1 Hypotheses

Entrepreneurship is a complex phenomenon, involving the individual, the firm, and the environment within which it occurs (Begley, 1995, as cited in Solymossy, 1998: 5). While this is recognized, the nature of the relationship between these three elements is not understood (Solymossy, 1998: 5). In our paper, we investigate the entrepreneurs networking activities and their impact on previous growth as well as growth aspirations of the company. We have tested the described relationship through the following two hypotheses:

Table 1: Tested hypothesis

Hypothesis 1	Networking is positively correlated with the past growth of the company.
Hypothesis 2	Networking is positively correlated with growth aspirations of the company.

First, a framework has been developed for a conceptualization of entrepreneurship that incorporates measures relating to the networking activities. This involves a refinement of previously proposed, but inadequately tested, theoretical constructs into an empirically testable framework. The second, and closely related, objective of this research is the development and testing of a valid and reliable survey instrument that lends itself to establishing this framework for future studies, enabling an international comparison of a multi-dimensional conceptualization of entrepreneurship phenomena.

2.2 Data

The statistical population of the research is Slovenian small and medium-sized companies (joint-stock companies, limited liability companies, non-limited liability companies) in all Standard Industry Classification (SIC) categories.

Quota sampling, as one method of non-probability sampling, has been used. Obvious advantages of quota sampling are the speed with which information can be collected, the lower cost of collecting that information, and

its overall convenience. In quota sampling, the population is first segmented into mutually exclusive sub-groups, just as in stratified sampling. Then, judgment is used to select the subjects or units from each segment based on a specified proportion (in our case, company size, regional representation, SIC representation, and appropriate share (70:30) of males and females in the sample). The problem is that these samples may be biased because not everyone gets the chance of selection. This random element is its greatest weakness and quota versus probability has been a matter of controversy for many years. In *Table 2,* we present sample (N = 201) characteristics according to company size:

Table 2: Companies' share according to size classes

NUMBER OF EMPLOYEES		
1 - 9	**10 - 49**	**50 - 249**
86,6%	10,9%	2,5%

Questionnaires were used to gather data concerning company owners. A central difficulty with research trying to accumulate primary data about companies' activities is how to ensure a satisfactory response rate. The preparation and realization of research have been subordinated to the need of assuring the highest possible response rate. Interviews were carried out through the Computer Assisted Telephone Interviewing (CATI) method. The response rate was 11,4%. Questions have been prepared according to the interviewing method and the desired response rate. No open questions have been used. We wanted to ensure simplicity in completing the questionnaire.

3.3 Variables

The following paragraph describes measurements for all investigated categories. We have drawn these categories from existing research literature. The discussion will further review the testing, which culminated in the selection of measures for examining the elements of entrepreneurs' networking activities performance.

Networking activities – independent variables

The networking activities nature varies between different industries. Its core function is to enable information flow in order to increase acquired know-how and capabilities. Entrepreneurship research shows that networking activities represent an adequate way of gathering information (Ostgaard & Birley, 1996; Peters & Brush, 1996). The information exchange contributes to greater efficiency as a result of lower transaction costs (Jarillo, 1990; Blois, 1990). Entrepreneurs' networking size and activities have been studied before by Ostgaard and Birley (1996), Drnovšek (2002), Ruzzier (2004), etc. In our research, respondents have appraised the membership in expert or business related organizations, as well as in cultural and other voluntary arrangements such as sport clubs. We asked them to apprise the number of people with whom they spoke about their business (outside the company) in last two years. On the Likart scale from 1 (once a month) to 5 (did not cooperate), respondents have appraised the frequency of contacting the following target groups: final customers, equipment and material suppliers, financial suppliers, public or private educational institutions, public or private research and/or development institutions, supporting institutions (Chambers, Ministries, Regional agencies), distributor agents (wholesalers, retailers, agents), competitors, and consultants.

Growth and growth aspirations - dependent variables

Growth of the company begins with the ambition, determination, and action of entrepreneurs or managers. In our research, we have interviewed entrepreneurs who are owners, and at the same time responsible for managing the company. Small firm growth is neither a self-evident phenomenon nor is it a matter of chance; rather, it is a result of clear, positively motivated business intentions and actions on the part of the owner-entrepreneur, driven by the belief that (s)he can produce the desired outcomes. GEM research showed that nascent Slovene entrepreneurs express higher growth aspirations than other European representatives (Rebernik et al., 2006: 14). Unfortunately, with the company's ageing, growth aspirations decline rapidly (Rebernik et al., 2004: 25). For hypothesis testing, according with the aim of our research, we have measured growth for the last three years by the increase in the number of employees, the sales income, and overall assets of the company. Respondents have appraised growth aspirations using the same measures for the forthcoming three years.

3.4 Methodology

Quantitative business research methods have been used. We have done an extensive literature and empirical research review to depict the current stage of knowledge regarding the determinants of entrepreneurs' networking activities.

For the quantitative approach, we performed the following steps:

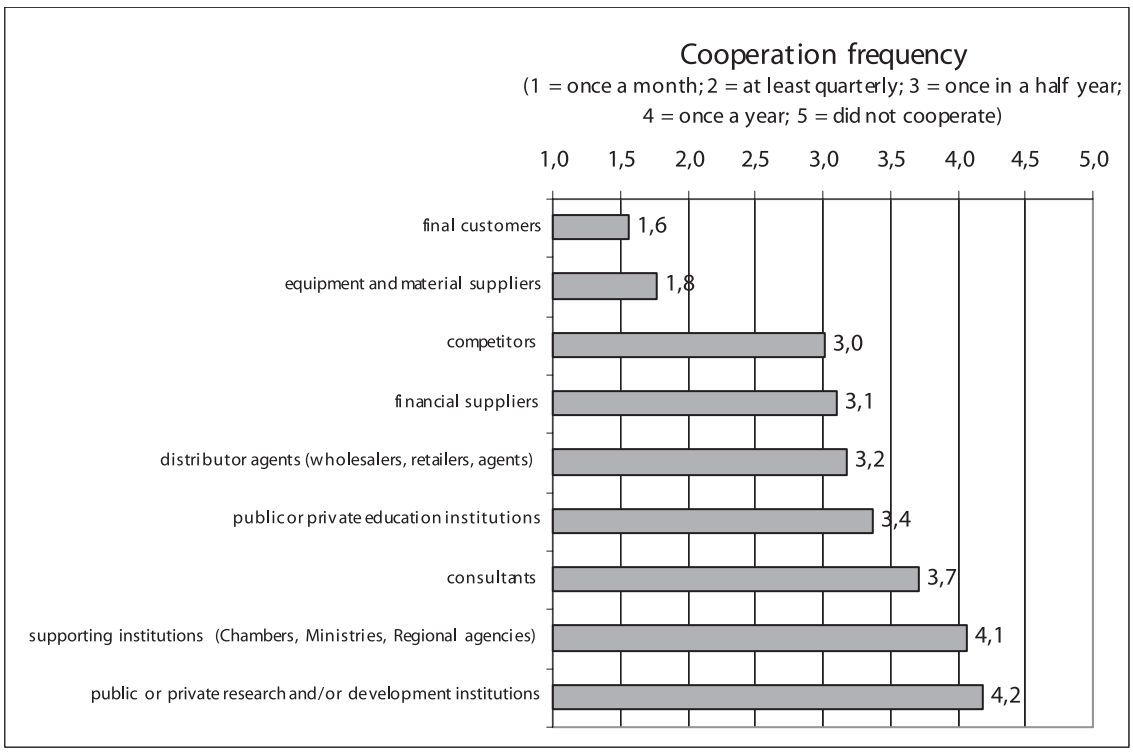
- Selection of an appropriate sample
  (The sample has been randomly selected from a reviewed list of entrepreneurial small and medium-sized companies in Slovenia.)
- Defining measurements of networking activities

- Model structuring
  (A model has been designed that includes elements relating to the companies' networking activities. Each element of the framework has been reviewed for its theoretical and empirical research foundation, and the questions used to provide measurement have been identified.)
- Preparation of questionnaire
- Interviewing
- Data processing
  (For the purpose of measuring the association or correlation between variables, we have used the Pearson correlation for data in the form of measurements on quantitative variables and chi-square statistic χ^2 for nominal data, together with phi coefficient ϕ and Cramer's V. For the purpose of comparing averages between different groups, an independent sample t-test for quantitative variables has been used. For data reduction, we have performed factor analysis in order to conclude our research with multiple regression analysis.)
- Research results (confirmation or rejection of the hypothesis) and comments, as well as suggestions for further research have been made

4 Findings

The following paragraph presents most important research finding in entrepreneurs' networking activities. Almost 80% of respondents are the members of 1 to 5 expert or business related organizations and only 28,9% are the members of 1 to 5 sport clubs or cultural and other voluntary arrangements. There is an extremely high percentage (70%) of entrepreneurs who are not members in any of the described initiatives. The size of entrepreneurs' network, appraised through the number of people with whom they spoke about their business (outside the company) in the last two years shows that almost 30% of respondents communicated with 5 to 10 individuals. It is interesting to note that 33,3% of respondents said that more then half of them are present business partners.

For SMEs, the cooperation with different partners is of utmost importance; they namely lack a certain amount of expertise, knowledge, experience, etc. In *Figure 2,* we therefore present the frequency with which they cooperate with others. The most frequently contacted groups in our research are final customers (76,6% cooperate with them on a monthly basis). Equipment and material suppliers have been quoted by 66,7% of respondents, and distributor agents in 29,4% of cases. It is interesting that cooperation with competitive companies ranked higher than supporting, educational, and R&D institutions. The frequency of cooperation with partners depends on the nature of business. Our findings certified the previous research results (for example, Rebernik et al., 2004a: 29-30; Rebernik et al., 2003: 25-27), which express a rather low level of cooperation between economic and educational or research institutions in Slovenia. In the past, there was the lack of a supportive infrastructure. Now, the con-



Source: Širec, 2007

Figure 2: Frequency of companies' cooperation with different target groups

ditions are more favourable, but the level of cooperation is still low.

For hypothesis testing, we have used the exploratory factor analysis. With the variables reduction, we have defined the following five factors:

FAC1: Companies that express frequent cooperation with educational, research, and supporting institutions.

FAC2: Companies that express frequent cooperation with final users, suppliers, and agents.

FAC3: Companies that are members in different associations and express cooperation with providers of financial suppliers.

FAC4: Companies that cooperate with competition and consultants.

FAC5: Companies with strong, non-formal connections.

Regarding past growth, we found the negative relationship between the growth of the number of employees and different types of networking activities. Those were statistically significant by two regression coefficients – for companies that express frequent cooperation with final users, suppliers, and agents (*FAC2* = -0,057, t = -1,791, p = 0,075) and for companies that cooperate with competition and consultants (*FAC4* = -0,063, t = -1,958, p = 0,052). Companies that frequently cooperate with educational, research, and supporting institutions express their income and asset growth. Similar results are found for companies that express frequent cooperation with final users, suppliers, and agents. They also express income and asset growth. That kind of cooperation enables them to achieve better performance in the value chain, which brings them to a superior competitive position. They do not have so much need for hiring additional employees as they can share some activities among partners in the value chain. According to the described findings, the first hypothesis can be partially confirmed.

Similar results were derived from the analysis of growth aspirations. Although many of the regression coefficients are statistically insignificant, it needs to be emphasized that companies with strong non-formal connections (*FAC5*) aspire to a growth in their number of employees, as well as their sales income. Those results can be hardly interpreted without deeper investigation, but according to other findings, the second hypothesis can also be partially confirmed.

5 Conclusions

In the introduction, we supported the choice of our topic with the findings of two recent research studies in entrepreneurship (*the Slovenian Entrepreneurship Observatory* and *the Global Entrepreneurship Monitor*), which stated that entrepreneurial potential in Slovenia is not fully utilized.

Thus, the reasonableness and applicability of our research are legitimate for all three declared target areas. From a *societal perspective,* there is good reason to seek more knowledge about the factors that promote and deter entrepreneurship in small firms. From a *theoretical perspective,* the proposed model enriches empirical evidence on the micro level of entrepreneurship theories, as well as theories of the firm. From a *policy-making perspective*, the present study represents a helpful tool when making choices between providing support to large vs. small firms, active vs. passive support, general vs. selective support, to what extent new venture creation should be promoted vs. the development of existing firms, and how such support should be tailored to yield a maximum return to society.

Small-firm growth is a complex matter and is multidimensional in scope and character (Scase and Goffe, 1989). It embraces a convergence of owners' (entrepreneurs') ambitions, intentions, and competencies; internal organizational factors; region-specific resources and infrastructures; and external relationships and network configurations (Storey, 1994; Glancey, 1998; Mitra & Matlay, 2000; Shaw & Conwey, 2000). This, in turn, undoubtedly impacts an individual small firms' orientation toward growth, and leaves a vast space open for future research. The refinement of the model is applied essentially to produce more comprehensive and reliable results. We are suggesting an extended model, which would incorporate the domains of competitive strategies and strategic and technology orientation, as well as the presented networking activities. It is important, however, for this further research to be systematic and continuous in order to contribute future knowledge about factors that support small firm growth.

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Vpliv mreženja na rast malih in srednjevelikih podjetij

Današnje tržne razmere silijo podjetja, da se za preživetje prilagajajo spremembam, rastejo in izboljšujejo svojo konkurenčnost. V dinamičnem okolju je dvig konkurenčnosti in inovativnosti mogoč le ob kontinuiranem medpodjetniškem sodelovanju in mreženju. Danes se vpliv razvoja mrežnih odnosov znotraj in med podjetji kaže tako rekoč v vseh gospodarskih panogah. Predhodne raziskave so pokazale, da se podjetja razlikujejo glede njihovih konkurenčnih strategij, strateške in tehnološke usmerjenosti, ter metod povezovanja - mreženja. Večina od teh študij proučuje mreženje v povezavi z uspešnostjo podjetij, manj empiričnih dokazov pa je moč najti na področju proučevanja učinkov mreženje na rast MSP. Predhodne raziskave so tudi pokazale, da podjetniški potencial v Sloveniji ni v celoti izkoriščena. Vse to so razlogi za predstavitev prispevka, ki proučuje mreženja v malih in srednje velikih podjetij in njihov vpliv na podjetniško rast.

Ključne besede: mreženje, podjetništvo, podjetniška teorija, MSP, rast podjetij, aspiracije po rasti