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Global Business Networks and Competitiveness of SMEs

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Abstract

In today's global economy new opportunities for growth and development are opening up for businesses, particularly those of a limited size. Projecting one's area of activity onto the global markets was once seen as one of the many strategic options open to businesses, but today it has become a necessity, a real 'condition for survival'. In this regard, global networks have become the system that most SMEs spontaneously choose to adopt in order to increase their competitiveness in a global environment. These networks make it possible to overcome the limitations of their small size, granting access, at a low cost, to the tangible and intangible resources all over the world that can be taken advantage of thanks to the network.

Keywords: Network; Competitiveness; Global Markets; SMEs

1. Global Competitive Context

The phenomenon of globalisation has brought a substantial evolution in the concepts of competition, the sector and its boundaries.

In closed, static markets, competition is seen as rivalry between businesses: two competitive businesses are rivals inasmuch as, because they compete to meet the same demand, they each feel threatened by the other's behaviour where control of a particular market is concerned. Businesses that operate in competition will find themselves competing within spaces of relative stability, with clear territorial and administrative boundaries, and a structure that can influence their business strategies[1]. In similar contexts, as we know, the sector acts as a privileged managerial instrument to study the functioning of the 'economic place where competition is played out' and to analyse the trend of its internal dynamics. Managerial behaviour adopted to gain competitive advantage in similar circumstances tends mainly to strive to achieve either a cost advantage, the product offered being equal (cost differentiation) or, alternatively, to place on the market a product that is strongly differentiated in relation to that of the competition (product

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differentiation). What is more, in closed, static markets, economies of scale, which can be pursued by exploiting elementary manufacturing factors, should be considered as a parameter capable of producing significant differentials of competitiveness between businesses.

Turning our attention from closed markets to very open, global markets, competitiveness between businesses tends to lose its meaning of antagonism and rivalry to acquire a meaning closer to cooperation and collaboration (Rancati 2010). For companies that compete with each other in global environments, collaboration becomes the favourite (and in some way obligatory) route to manage dynamism and global openness successfully, as these latter elements impose the redefinition of the competition boundaries between businesses: distances and territorial or administrative boundaries (market-space management) are no longer the reference parameters to outline the competition spaces, becoming increasingly weak, extended and growing constantly (Brondoni 2008)[2]. In an extended competitive space (*market-space management*) the increase in competitive intensity on one hand and of the systematic complexity/instability of the system on the other, make the realisation and defence of any competitive advantage subordinate to the activation of business policies that focus inevitably on the creation of a dense network of cooperative and collaborative relations with suppliers, customers, co-makers and external partners, even occasionally including competitors (co-opetition). In other words, because they can no longer rely exclusively on their own resources, knowledge and skills, businesses are forced to adopt very flexible managerial conduct, which involves different businesses and generates complex, ramified structures that are widespread and strongly interconnected (networks).

In extended competitive spaces, economies of scale become global and, as such, are no longer dependent on the degree of exploitation of elementary manufacturing factors, but they are functional *"to 'the intensity of sharing' of definite resources in a networking system, in other words to the sophistication of collaborative relationships between internal, external and co-makership structures."*(Brondoni 2008)[3]

Acting on global markets therefore triggers the development of a business culture that is identified with cross-cultural management, oriented to overcoming the physical competitive environment (market-space management) and local corporate involvement, and striving to achieve corporate governance no longer focused on the internal organisation (as it is on closed markets), but on intercepting and exploiting the opportunities offered by open markets. (Brondoni 2008)[4]

2. Globalisation, Networks and Company Size

In the current global economy, businesses (large, medium and small) have to engage in genuinely global competition, which makes it necessary to rethink the way they compete. In this regard, the size of businesses is hugely important; issues related a business's size and to the existence of a managerial culture oriented to growth and to sharing become crucial.

The economic logic of 'small is beautiful', on which the Italian development model was founded in the Eighties, in many circumstances tends to manifest its

fragility, not always being able to ensure that small businesses can remain competitive in the new global economy, a fact that is borne out by Italy's gradual loss of international competitiveness.

Being 'larger' is a precondition to boost a company's competitiveness, seen first and foremost as the capacity to invest in R&D, to trigger product and process innovation, through continuous investment in the generation of cognitive resources, to operate abroad through marketing branches and to export (Varaldo 2006)[5]. The propensity to invest in research, and consequently to generate innovation, has become a significant function of the size of the business, growing systematically from small to medium and large businesses as a result of the greater productivity and profitability associated with a larger size.

The scarce propensity for investing in R&D and in innovation that stems from structural technological backwardness is combined with further difficulties, which can be attributed to the limitations of a small size, as this exerts a significant brake on the maintenance/strengthening of the competitiveness of SMEs on a global scale. The most significant of these are:

- constant under-capitalisation induced primarily by limited access to the capital market, distorted in favour of large businesses;
- scarce managerial capabilities and a short-term vision, because of governance that is usually the exclusive prerogative of the entrepreneur-owner and his family;
- greater difficulty in finding human resources with suitable training, because they tend to be absorbed by large businesses.

It is a known fact that one of the most popular ways to 'become larger' and to speed up the recovery of competitiveness contemplates recourse to mergers and/or incorporations (M&A) and to business groups.

This association logic reflects a policy of strategic assembly which, in its basic form, consists of undertaking a series of acquisitions, each of which is a piece of the jigsaw from which a new type of business configuration is destined to emerge.

This process may appear easy to implement for large or medium-large businesses that intend to restructure or expand their business, but it is more difficult to put into practice for smaller businesses (which actually constitute the reference framework of the Italian manufacturing fabric), unless it is sustained and encouraged by targeted fiscal and financial policy measures (Varaldo 2006).

In fact dimensional growth achieved thanks to extraordinary operations, aggregations, concentrations and mergers between companies could spark a decrease in the level of flexibility and adaptation of businesses, in the face of sudden and increasingly unpredictable economic, financial and technological change that can influence the dynamics of the global markets and imposes equally sudden changes in companies' decision-making processes.

An alternative way of solving the size problem and raising/strengthening company competitiveness is by recourse to various types of bonds within and between companies, in the context of global business networks, which make it possible to strengthen the company's competitive structure rapidly and without losing sight of the specific characteristics of each participating entity, by activating an exchange of technology, goods and services, financial transactions, movements of people and tangible and intangible manufacturing factors (Varaldo 2004).

Generally speaking, being part of a network makes it possible for SMEs, many of which are undercapitalised, to become protagonists of globalisation, and to succeed in compete in an extended market space, because it offers them a possibility to 'act as if they were large' but without losing the individuality and peculiar characteristics that only a small manufacturing structure can offer.

Recourse to networks makes it possible to reach that 'critical mass' for dimensional growth between companies which allows participating companies (usually of a very small size) to strengthen their competitive capabilities on the global markets, to improve their economic performance and to achieve the 'systematic' economies of scale typical of medium and large companies, while maintaining the advantages typical of small ones. If we look closely, it is a *soft* approach to growth, because it does not entail a loss of identity, nor a general sharing of the strategies of the companies participating in the network.

In other words, "*in a network that functions well, each company, no matter how small, becomes part of a large system and can benefit from the economies of scale (in the use of knowledge and the expansion of the catchment area) of the large system that it belongs to*". (Rullani 2010)

From this perspective it is clear that the potential of the value associated to networks is higher than the value indicated in the financial statements of the companies that make up the network.

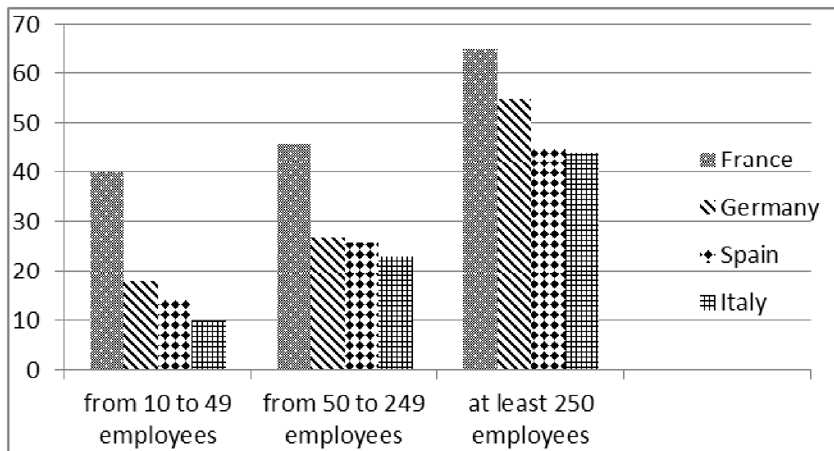
In short, the added value in terms of the competitiveness generated by being part of a network lies in the fact that *"networks can allow companies to specialise reciprocally, to be more creative and to share knowledge (technological, entrepreneurial and organisational), to co-innovate, maintaining low the costs and risks, which are distributed over several parties, to multiply the value of ideas, extending the use of original knowledge to different locations, sectors and applications, and to increase flexibility, the level of personalisation and time to market"*. (Rullani 2010)

The network should therefore allow participating companies both to 'internalise' the strategies of the better companies, thus increasing the value of the individual participating units, and to "externalise" (and therefore reduce) the incidence of certain fixed costs, which are often high (by sharing them over a wide range of companies).

Although the prospect of mutual competitive strengthening is considered fundamental in a global environment in order to trigger inter-organisational relations between small companies[6], only a limited number of small companies currently adopt the 'network formula', particularly in the form of recourse to cooperation agreements.

Where innovation is concerned, for example, the results of the latest Community Innovation Survey (CIS; Eurostat 2010) unequivocally demonstrate that companies shy away from cooperation agreements, whereas featuring the actors especially of larger size also affects small businesses (Figure 1).

Figure 1: *Innovative Manufacturing Companies by Size with Cooperation Agreements for Innovation, 2008 %*



Source: Eurostat (2010)

3. Competitive Drivers on Global Markets

As time passes, changing contextual conditions have driven companies to build up their competitive arsenals, introducing new factors that are able to face up to the increasingly complex competitive dynamics.

In the 1960s and '70s companies identified a cost advantage as the primary means of winning privileged positions in terms of competitiveness. Internal efficiency was considered the determinant in which to invest to achieve a sustainable competitive advantage on a market that was generally stable.

The fragmentation of domestic markets and demand that is increasingly variable, unpredictable and demanding has made cost competition a condition which, although still necessary, is no longer sufficient to 'stay on the market'. In response to environmental changes, companies have abandoned a competitive model that relied exclusively on the internal efficiency of the manufacturing process, and have adopted a market-oriented model, which sees product differentiation as the determinant in which to invest to maintain their competitive strength intact. The competitive battle is won or lost on the field of demand preferences, and the only way to win is to satisfy the consumer, who has become increasingly demanding, better than the competition, by marketing products that the public conceives as both different and better than those proposed by the competition.

The next step after cost competitiveness is product competitiveness, which in time overcomes normal differentiation, the fruit of the manufacturing skills possessed by each operator. It includes *"the distinctive image capabilities obtained by recourse to brand names to communicate and enhance its innovative potential on the market"*, as further potential elements of differentiation (Varaldo 2006).

In the new global scenario, and in the light of growing competitive pressure and expanding market boundaries, it becomes necessary to further review the levers on which competitiveness is based.

In global markets we are seeing a shift in the strategic levers adopted by organisations, from a focus on the qualitative and quantitative characteristics of the goods offered towards the qualification of the knowledge possessed and managed (Brondoni 2010).

Although knowledge has always been one of the foundations of company activities, in a global environment characterised by fiercer competition, high turbulence, dynamism and rapid saturation of the markets, as well as by accelerating technological obsolescence, where the only certainty is uncertainty, it represents one of the most important assets for companies, enabling them to generate efficient answers in terms of competitiveness.

Knowledge Management has become an indispensable tool to achieve competitive advantage that is sustainable in time, qualifying knowledge as a resource that is scarce and strategic in every way[7].

The role of strategic resource played by knowledge today is closely linked to the growing variety of information currently necessary to organisations to appropriately face up to the challenges of operating on global markets. t is only possible to establish the necessary correlation between one's own internal diversity and external variety and complexity if those who are part of the organisation have the variety that this entails; this variety may be increased by combining information differently, faster and more flexibly, granting each member of the organisation identical opportunities to access the information.

In this perspective, increasing competitiveness is not only a means of building up a larger store of knowledge inside each unit, but depends on the fact that the unit is part of a vaster system made up of a certain number of components, open to an exchange of resources, competences and capabilities even with local transitional networks, developing shared knowledge in global exchange, collaboration and partnership networks. On the other hand, a system is destined to dissolve if it loses its contacts with its framework environment, or if it no longer plays an active part in the extended networks that are present in it.

In this regard it becomes essential to invest in the continuous improvement of a company's relationship skills with the parties that make up the framework system.

In this perspective of 'global knowledge economy', a policy that aims to increase competitiveness must therefore be oriented towards investment (Rullani 2008):

- in *intelligence shared* with others, meeting some of the costs that are necessary to ensure that the systems which one decides to belong to is vital;
- in the creation of a reliable *circuit of relations* with the framework systems;
- in the company's *distinctive difference*, in other words in that type of knowledge, competence and capabilities that makes it different and increases its negotiating power on the markets, so that its cognitive performance becomes difficult to replace.

For that matter, investing in knowledge and sharing/multiplying it acts as an engine to drive the development of an independent and systematic capacity for product and process innovation which, as we all know, constitutes an indispensable determinant in which to invest in order to foster an increase in competitiveness on the global markets. It becomes indispensable to step up innovative processes,

particularly to create new competitive advantages, and this presupposes the continuous renewal of resources and skills, as well as a capacity for constant cognitive learning on the part of the company, in terms of both the refinement of existing knowledge, and the acquisition of new knowledge that can facilitate entry to new areas of activity.

4. Business Networks and the Competitiveness of SMEs in a Global Environment

Reading between the lines, the previous paragraphs reveal how important it is for their competitive survival that small companies in a global environment adopt a culture based on shared action.

In fact, in a global environment, competitiveness is an attribute that cannot be applied to individual companies, but must refer to the supply chain or network they belong to. Suppliers and customers (and even end customers) must also help, with their behaviour, to cut costs and to increase the utility produced as a whole. (Rullani 2009)

In this regard the leading role played by company networks becomes apparent. These are devices which allow individual companies to act independently but as a (specialist) part of a larger system (Rullani 2010), thus helping to increase the amount each company invests in knowledge and to make it give fruit in such a way as to speed up the innovative processes necessary to create competitive advantages in a global context[8].

The concept of the network can be considered a sort of interpretative metaphor that is useful as a means of analysing business systems or inter-organisational systems; it relies on certain essential elements that form the network structure. The latter emerges in particular as a suitable form of government to achieve managerial flexibility and, therefore, to improve performance; it is also a modern instrument to respond to the evolving environment, able to tackle the new demands that are emerging on the global markets. The architecture of the network can be seen as a net whose knots represent the activities performed by parties involved in the network, while the segments that connect the knots represent the flows, with their respective priorities and dimensions that link the individual operations.

The main structural components of a network are therefore the knots and the connections (or links) between them. The knots, which can also be considered network systems, can be made up of different entities: legally independent units (companies or other legally independent entities, for example a consortium, a professional association, etc.), or organisms inside the company (a business unit, a functional division, an office, a department, etc.). The knots must emerge as entities capable of conduct that is independent, but also self-referential, for their own survival, interacting with other systems to exchange resources, energy and values. The relationships that are built up between the various knots are defined as links or connections between knots. The purpose of the relationship is basically to be found in the nature of the exchange, while the network's operating characteristics are represented by the shared rules, which make the network formula successful: a common language, standards of behaviour, planning and control systems, design and innovation systems, and generally recognised and accepted incentive systems.

Networks, in hindsight, may pursue multiple specific objectives[9], even though all of them are related to the meta-goal represented by the strengthening of the competitiveness of companies operating on global markets, which would come up against unsurmountable difficulties if they were on their own. Together, companies in a network can carry out research, develop new technologies, open sales networks abroad, create shared brands, increase the range of products/services offered to customers, communicate with the end customer, etc.

Some networks remain in a traditional milieu (districts, supply chains, sub-supply chains), while others have new objectives and new protagonists (collaboration agreements between companies and research or training centres, meta-districts, technology hubs, alliances to support specific projects, public-private partnerships, etc.).

Whatever the formula for their application, it is widely accepted that networks are an important organisational model for the competitive development of SMEs in global markets, allowing individual knots (individuals or companies) to (AIP 2009):

a. *specialise mutually*, in order to increase the basin of use of each company's knowledge;
b. *share their knowledge*, in a mutually reliable environment;
c. *co-innovate*, using different skills and spreading the investment and the risk between several entities;
d. *expand the basin of use of a good idea* from one place to another, from one sector to another and from one application to another (Rullani 2010).

We can see that networks operate as stimulators of a capacity for constant learning, multiplying its positive effects because they have the ability to exploit the two inherent characteristics of knowledge, which are fundamental to generate value, i.e. difference and the multiplication of differences. Where difference is concerned, knowledge creates value if it is different, in other words, if it is able to produce something additional and different compared to what it would have produced without it. When operating in extended market spaces, where numerous other competitors also operate, a company must learn to be different and to make its difference felt. But difference alone is not sufficient to create value: to become productive from an economic perspective, this difference also has to be multiplied through a process of propagation.

This brings us to the other element that characterises the knowledge economy, i.e. the multiplication of differences, in the sense that if one has an original idea, one has to achieve a large number of applications, enlarging the number of companies that work around this idea. This is the best way to achieve the large numbers that make it possible to be part of the global economy, to raise competitiveness in a market "without boundaries", which grows disproportionately, generating the economies of scale on which to found a growth strategy that is sustainable in the long term. (Sanguigni, Bilotta 2011)

In the case of capitalism based on small companies, like the Italian system, networks therefore become the fabric that individual intelligence relies on in order to be transformed into a form of collective intelligence (Rullani 2010), which liberates the force necessary to remain competitive on global markets.

Being part of a network favours comparison and the exchange of knowledge between parties, increases knowledge, amplifies the capacity for innovation and

speeds up innovation processes, all fundamental aspects if a company is to successfully tackle global competitive dynamics.

Small companies therefore have to focus on generating the ability to ‘work in a network’ when they compete with large companies, with excellent chances of success if they are able to place good ideas at the service of a larger user base, which multiplies its value. (Rullani 2010)

5. Evolution of the Italian District

As we know, the strategic and operative approach to the network concept favoured by Italian SMEs up until now, has tended to take the form of membership of a local network.

The proximity between production districts and networks of firms is also apparent from the legislative point of view: it is not a case of ‘business networks’ as a new legal form, which sprung up in 2008, in the art. 6-bis of the Economic Maneuver – with the heading ‘productive Districts and business networks’.[10] In the light of this, athough aware of the fact that there are numerous other tools used by SMEs to create relations through the network (consortium, joint venture, contract of franchising, ecc.), we should dwell in particular on the phenomenon of the district. The new scenarios that are emerging with globalization, might in fact give rise to new questions about the ability of the traditional Italian district-based business model to guarantee participating SMEs the maintenance/reinforcement of their competitiveness; it is felt that for a single company to belong to an industrial district is no longer sufficient by itself to sustain that company’s stability/competitiveness, even at a local level. This opinion is shared by numerous expert analysts of Italian industrial districts (Varaldo 2006; Varaldo et al. 2006; Varaldo et al. 1998) who, while recognising the importance of the district as a peculiar reservoir of specialist manufacturing skills, knowledge and resources rooted in the local culture (Garofalo 2006), simultaneously underline their inadequacy to tackle the challenge of a global economy founded on knowledge.

The fragility of the district model, which becomes apparent when it is exposed to the whirlwind of globalisation, makes it necessary to rethink the model itself. From the traditional industrial district located inside limited territorial boundaries (network localism), we must hope that things evolve to vaster and more open forms of organisation, crossing sectors and territories, which can find an important engine of transformation in the organisational form of the global network. In other words, networks can provide significant support to the opening up of the *“district to the knowledge and skills present in other areas and other sectors, creating circuits of exchange and new cognitive sharing, unlike the classic circuits”*. (Rullani 2010)

In order to tackle global competitive dynamics, district networks must overcome local logics and embrace an extended vision, opening up to the global markets by participating actively in global networks. Basically, district networks must be oriented to disseminating their activities globally and to exploiting the opportunities for growth and profit that gradually emerge worldwide, establishing numerous relationships with and between companies in the context of global networks that trigger a continuous exchange of tangible and intangible resources.

This process of opening up the districts is the way to find competence and specialist skills outside the region, which are accessible on a global scale without having to produce them in-house at a high cost and at greater risk. The company's genius, the specialist skills of those who work and produce there and the region's own identity are combined in global networks, generating the large numbers of economies of scale, without necessarily needing large plants, large financial concentrations, or the mass production of processes and products. As a result, global networks may be the easiest way of transforming districts into systems that are open to non-local skills, and of making it possible to obtain/recover competitive advantages that are sustainable on both local and international markets.

As the districts open up to the global market, there is an increase in their systematic value as a result of the contribution that districts can make to global networks, in terms of specific knowledge, skills and specialisation.

Belonging to a global network obviously makes the manufacturing organisation of district businesses more complex; in fact every business is involved simultaneously in the cross-region and cross-sector networks it belongs to and in the local manufacturing district, being associated with distinctive knowledge, culture, people and infrastructure because they are only marginally mobile and marginally transferable. But this challenge is unavoidable for our districts if they wish to safeguard/renew their competitiveness, adapting it to the new global competitive environment.

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Notes

[1] We refer you to the SCP paradigm (Structure-Conduct-Performance).On the nature of the paradigm, the conceptual approach which is indicated by the abbreviation in English Structure-Behavior-Performance (SBP), the reader is referred in particular to: Philips (1970), Cowling (1976); Jacquemin and de Jong (1977) , Hay and Morris (1991), Devine et al. (1976); Reckie (1979).

[2] On this subject Silvio M. Brondoni wrote: "In global markets, businesses compete according to market-space competition logics, in other words with competition boundaries in which space is not a fact, a known and stable element of the decision-making process, but a competitive factor, whose profile is configured and modified by the actions/reactions of businesses and governments". Brondoni Silvio M. (2010) *Symphonya Emerging Issues in Management*, *(symphony.unimib.it),* n. 2.

[3] We refer you to Silvio M. Brondoni (2008) *Symphonya Emerging Issues in Management (symphony.unimib.it)*, n. 1, 2008, page 23.

[4] We refer you to Silvio M. Brondoni (2008) *Symphonya Emerging Issues in Management (symphony.unimib.it),* n. 1, 2008, page 24.

[5] Regarding exports in particular, we can see that if the exporter is a small company they are conducted mainly in small volumes, which means that their economic viability decreases "following the increase in the relationship, promotional, logistic and distribution costs necessary to operate in new markets and countries. In fact, because of the distance, risk and complexity, these are accessible almost exclusively to companies with a turnover of a certain size, and which can boast adequate organisational, equity and financial soundness." (Varaldo, 1/2006).

[6] In this regard, an investigation conducted by Fondazione Nord Est (2006) of a sample of SMEs, to discover the goals that persuade companies to join together, reveals that 60.4% of the businessmen interviewed believe that a small company must sign up to some form of aggregation in order to remain competitive.

[7] *Knowledge Management* is the area of managerial studies and practices that looks for instruments and methodologies to manage knowledge, in terms of the creation, memorisation, and dissemination of knowledge through a combination of measures regarding people, company organisation, culture and behaviour, and technologies that support communication and collaboration.

[8] Among the many definitions of business networks to be found in literature, we can mention: "The business network is that fabric of non-competitive relations that links institutionally different entities, without affecting their formal independence and without a unitary management and control (Soda, 1998); "a system of recognisable and multiple connections within which hubs with a high level of self-regulation operate, capable of interacting with each other to pursue common goals and shared results" (Butera, 1990).

[9] An analysis of the existing literature on this issue reveals that the objectives that can be pursued by recourse to a network (seen as an association between companies) can be broken down primarily into three categories: defensive, proactive, and consolidating, or a combination of these. Regarding the first of these (defensive), relations between companies make it possible to reduce risk, to increase flexibility, and to neutralise the structural conditioning of the sector; proactive objectives include: synergies, i.e. the multiplier effect that derives from the combination of resources, knowledge, skills and manufacturing efficiency resulting from cutting costs and improving the quality and the service, technological innovation and the pursuit of new competitive advantages that sums up the previous objectives, seen as the expansion of the competitive space even without an increase in size. The goal of consolidating market power is generally pursued by means of agreements with competitors that already occupy dominant positions.

[10] This is, in particular, of the Law of 6 August 2008 n. 133, converting Decree Law of 25 June 2008 no. 112. This law marks the beginning of a regulatory pathway that led to the introduction into the Italian legal system of the Contract (Article 3, paragraph 4 ter of Legislative Decree February 10, 2009, n., 5, converted, with amendments, Law 9 April 2009, n. 33 and subsequently amended on several occasions).