

INVESTING IN RELATIONS AS AN OPPORTUNITY FOR SMES GROWTH

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Summary: The main aim of the research is to develop the model of investing in relations carried out by small and medium enterprises (SMEs). On the basis of organisations' growth theories the author presents a model describing the approach and structure of investments in relationships among SMEs. Research conducted in 123 SMEs shows that the level of involvement in building relationships with stakeholders varies depending on a particular stage of growth. What is more, there is a difference in investing approach between companies with high and low performance level.

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1. Introduction

SMEs play a crucial role in European economy, which results in introducing special programmes aimed at supporting such organisations. Because SMEs operate in different branches, represent different sizes, business models and face markets of various dynamics, it is very difficult to create a general model to enhance SMEs productivity. Although many authors tried to capture and structurize similarities in this sector an unanimous model is impossible to create.

Reaching goals and adapting to changing conditions requires modification in the way SMEs act. There are many models presenting the way SMEs grow, and threats that may occur. However, none of these models shows clearly how SMEs should cope with obstacles. Such paths could help search for new capabilities that increase competitive advantage. According to many authors, the source of competitive advantage may lie in intangible assets that consist mostly of organisational, human and social capital. Social capital addressed to relations created between a company and its stakeholders. All the relations can help SME in reaching the desired level of goals achievement because they support decision making process provide with information about potential opportunities or threats. It may cause an increase in the market share by generating referrals from partners and build a positive image of the firm.

2. Theoretical background

2.1. SMEs growth theories

There are many models describing SMEs growth and they can be divided into four groups that take into consideration: (1) environment and strategy, (2) role of the entrepreneur/ manager, (3) resources and capabilities and (4) consequences of growth (Floren, 2011, p.117).

Taking into account the strategy of the growing firm the model of Cameron and Quinn (1983) can be discussed. It describes the most effective way of acting in four main stages of SMEs growth – entrepreneurial, collectivity, formalization and control, as well as elaboration of structure. At each stage, the organisation should introduce different acting models described

as Human Relations, Open Systems, Rational Goal and Internal Processes. The focus on each of the operating models will help reach desired goals and increase SME efficiency.

Adizes (2004, pp 21-181) PAEI model describes the way a manager/entrepreneur act at different stages of growth and presents roles to be performed. In this model, Adizes defined ten stages of organisational growth with different intensity of four roles: Productive, Administrative, Entrepreneurial and Integrative.

Resources and capabilities of a growing firm were discussed by Flamholtz and Aksehirli (2000). The authors presented six “building blocks” that should be focused on by managers at each of the seven defined growth stages. The “blocks” correspond to capabilities connected with: markets, products/services, resources, operational systems, management and culture.

The consequences of a firm’s growth are discussed in the Greiner (1998) model. The author presented five stages of organisational growth: creativity, direction, delegation, coordination and collaboration and five stages of crises resulting from each stage of growth: leadership, autonomy, control, red tape and not named last one (“?”).

Regardless of the approach taken, it can be stated that in each model a company can be characterised by a variety of attributes. These characteristics are influenced by an array of conditions and determine the size of the firm and their competitive potential (Hugo and Garnsey, 2005). This is why the analyses of capabilities is so important for SMEs.

2.2. Organisational capabilities

A capability is defined as a capacity to make use of a company’s assets in order to reach a higher level of performance (Maritan, 2001). Capabilities are skills and accumulated knowledge that are the foundation of organizational routines (Galbreath, 2005). These routines, having a strategic aspect, let organisations achieve new resource configuration when changes on the markets occur. They can integrate, restructure and release resources providing high level of adaptability (Eisenhardt and Martin, 2000). Capabilities stem from organizational practices and are crucial for achieving strategic goals, and they result from actions taken by people, organisation history and stakeholders’ activity (Kostova and Roth, 1999).

There are different sources of organizational capabilities which can be analysed according to Barney’s (1991) resource-based theory of a firm. Pike, Roos and Marr (2005) indicate that factors building organisations’ potential originate from human capital (knowledge, skills), organisational capital (culture, strategies, structures), relational capital (with suppliers, customers, business partners), and financial assets. It is worth mentioning that the way managers acquire capabilities can build competitive advantage as well (Maritan, 2001).

Because of their size and characteristics, SMEs can rely mostly on human capital and relational capital. As many authors claim this type of organisations do not have enough financial assets to compete with other (well-established) SMEs or large companies. They do not have well designed structures or procedures. That causes that entrepreneurs rely mostly on their employers’ knowledge, skills, motives and attitudes as well as on the owner’s own competencies. As external circumstances change, the way of doing business should be modified which requires improvement in competencies. This is quite difficult to do when the SME is not eager to cooperate with others or to gain information from customers as well as from suppliers. One of the activities that SMEs owners undertake when facing obstacles can be establishing strategic relationships based on reciprocity (Hugo and Garnsey 2005).

2.3. Importance of the relationships with stakeholders

To compete effectively firms have to increase the number of interactions with other market actors because the innovation activities are no longer processes than can be run solely by a SMEs (Lasagi, 2012). They should investigate which resources and their combinations are required for innovation (Halme and Korpela, 2013). Building relationships with stakeholders can be very fruitful for SMEs because it can create conditions to increase competitive advantage. Although the term stakeholder describes different groups of those who are able to influence a company, the relations with customers, suppliers and partners will be analysed.

Building relations with customers can help gain new buyers by referrals (Chollet, Garaudel and Mothe, 2014). In general, this type of organisations have limited resources that can be spent on promotion as well as on direct clients search. Additionally, SMEs because of their close relationships with buyers can gain information about trends and clients requirements.

Relationships with suppliers are treated as important, because of the impact of the quality of the supply chain on firm performance (Masquita and Lazzarini, 2008), and because vertical network can influence the product development process (Lasagi, 2012). Good relationships with suppliers can result in shorter delivery time, better quality of products and some additional information used in product or service improvement.

Cooperating with business partners can result in the creation of networks, that consist of a group of companies that face competition from other firms. In order to upgrade their capabilities they cooperate in designing new products, creating new brands or in lowering costs by combined logistics. Networking has also an impact on R&D potential of a SME. It requires an access to resources, knowledge, and risk sharing that a single company could not manage (Mahmood, Zhu and Zajac, 2011, Rese and Baier, 2011).

Although the cooperation with these three groups can enhance competitive advantage by enabling innovations or giving the opportunity to target new buyers it can also create firms' reputation that has an impact on the possibility to grow (Galbreath, 2005). Relationships can help build different capabilities required on the path of SMEs growth.

3. Theoretical model, hypothesis and methods

On the basis of organisational growth models (Greiner 1972, Churchil and Lewis, 1983, Quinn and Cameron, 1983, Flamholtz and Aksehirli, 2000, Adizes, 2004) a five stage growth model was described. General characteristics of the stages are the following: (1) *Survival* – low market share, no regular customers, financing by owner's capital, narrow offer; (2) *Take off* – products meet expectations, increasing incomes, widening internal processes, brand recognition in some groups; (3) *Prime* – increasing market share and incomes, developing and widening products, good brand recognition, new technological solutions, management systems; (4) *Maturity* – high incomes, higher costs, well designed management systems, well recognized brand, well designed cooperation with stakeholders; (5) *Decline* – decreasing incomes, market share and number of customers. Each of these stages can be also characterised by specific terms of cooperation and relationships with customers, suppliers and business partners. The quality of relations will impact the potential of using them as a capability that can leverage competitive advantage.

Building inappropriate terms of cooperation can threaten SMEs growth. This makes it necessary, for companies that operate in this sector, to invest in relationships. Relational-specific investments (RSI) are tangible and intangible investments spent on interfirm partnership focused on reaching particular, agreed goals. It consists of economic and social exchange (Luo, Liu and Xue, 2009). Particular areas of investments in relations are the following:

- Customer oriented investments: introducing loyalty programmes, gifts and promo materials, purchase of potential customers databases, introducing and conducting customer satisfaction surveys, auditing customer service process, analysing customer preferences, customers segmentation and preparing profiled offers.
- Suppliers oriented investments: organising meetings with suppliers, gifts, promo materials, organising special events, purchase of potential suppliers databases, enabling introducing quality control systems, market trends analyses.
- Business partners oriented investments: member of society fees, organising meetings and special events, supporting local societies, charity, costs of network functioning.

Investing in the above activities can result in tightening relationships with stakeholders improving SMEs' performance, protecting them against threats and providing possibilities to reach higher level of return on investments.

On the basis of the literature review and using the developed model three hypotheses can be formulated:

Hypothesis 1- the structure of investments oriented on customers, suppliers and business partners differ at every growth stage.

Hypothesis 2 – companies that invest more in relationships with stakeholders obtain higher levels of return on investments.

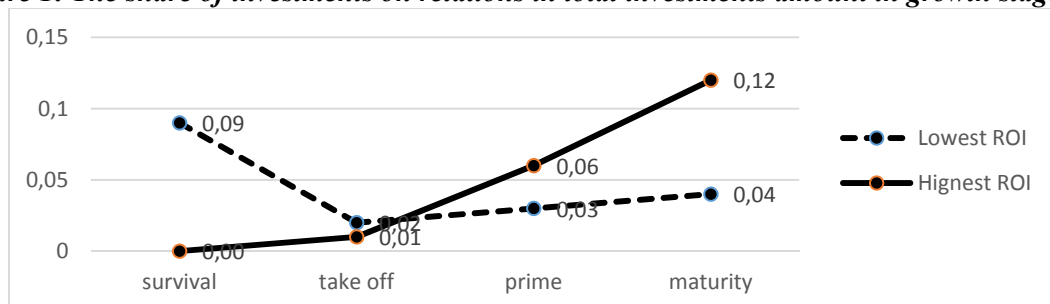
Hypothesis 3 – the share of investments in relationships in the total investments amount change at every stage.

In the research statistical analysis using structure and incidence (e.g. calculating the percentage of a given category of investment in the overall investments), selected descriptive statistics, as well as k-means clustering method and correlation coefficient were used. The research was conducted in June 2014 on a representative group of 382 SME. Unfortunately, a large group of companies did not provide information about investments outlay or gains and in some cases, the data were insufficient. Finally, 123 SMEs were taken into account making the return rate at the level of 32 percent. Such a small number of companies did not allow to conduct in-depth statistical analyses, and presented data can be treated as sample testing. The main problem appeared in under-representativeness of companies in decline stage (only 2 companies fell into this group).

4. Results and discussion

The share of investments in relational capital in the total amount of companies' investments differ in accordance with the stage of SME growth (see figure 1). In companies with the lowest level of ROI the share of investments in relational capital seems to be at the same level in most stages. Only at the survival stage SMEs spent more financial assets on promotion and attracting customers. Starting from the *take off* stage the owners prefer to invest in other areas such as tangible resources, human or organisational capital.

Figure 1: The share of investments on relations in total investments amount in growth stages

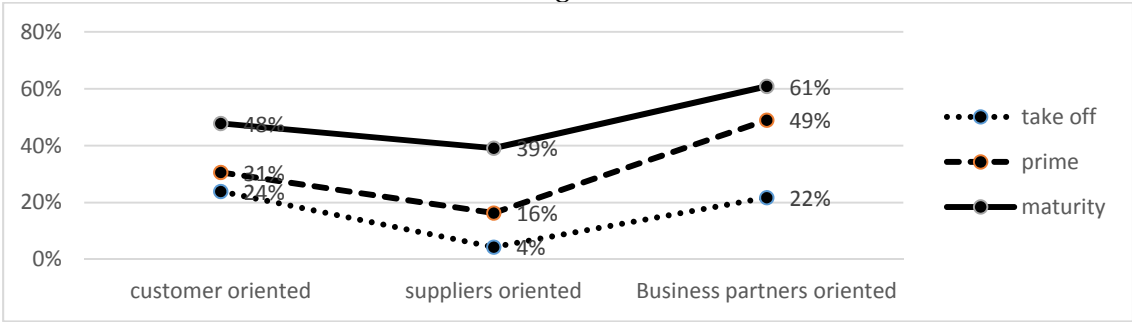


Source: empirical data

According to the companies with the highest ROI the situation is different. The share of investments on relationships is at the minimum level at the first stage and then increases on subsequent stages. That can be the result of the owners/managers attitudes focused on building networks, setting long-term agreements with suppliers and customers.

At every next stage, there is an increase in the number of companies that invest in relationships with customers, suppliers and business partners (see figure 2). At the stage of *take off* only 4 percent of companies declare to invest in relationships with suppliers, 22 with business partners and 24 with customers. At the *prime* stage, almost half of the companies invest in relationships with business partners, which may result from the orientation on searching opportunities to increase competitive potential by using external sources. It is worth mentioning that, because of dynamics in incomes and market share, at this stage SMEs are perceived as most wanted business partners for other market players. At the stage of *maturity* more than six out of ten companies invest in relationships with business partners. Almost half of SMEs invest in relationships with customers and four out of ten in relations with suppliers.

Figure 2: The percentage of companies investing in relationships with stakeholders on growth stages



Source: empirical data

The data gathered proves that mature SMEs tighten their cooperation with stakeholders. It may result from the consciousness of their own limitations and profits gained from cooperation as well as on better knowledge about market conditions.

Although the data gathered were insufficient to conduct in-depth statistical analyses, because of the sample size, some general findings can be presented. Investigated SMEs that invests more in relational capital obtained higher ROI which supports hypothesis 2. Moreover the share of these investments differ at every stage and in general increases with each subsequent - this supports hypothesis 3. The data presented on figure 2 show that the share of SMEs that invest in relationships with customers, suppliers and business partners increases at every stage of growth, which supports hypothesis 1.

Referring to the literature review it can be stated that experience gained by the managers and owners of SMEs while running their business, results in strengthening orientation on cooperation with stakeholders. They are unable to use solely their inner capabilities to provide further development of the organisation. Focusing on relationships with customers can provide them with information about requirements and market trends, cooperation with suppliers can support reputation building and lowering costs by setting long-term agreements, and networking can help with product innovation as well as with brand recognition.

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