

## **Building Business Networking: A Proposed Framework for Malaysian SMEs**

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*Social network is a significant value-added to business environments especially to the Small and Medium-sized Enterprises (SMEs). It is built when businesses interact with each other in the community, by exchanging rich and thoughtful experiences among themselves through various means. Little research has focused on how the business networking is valued in enhancing SMEs' business performance in Malaysia. The goal of this paper is to examine the importance of business networking as a critical success factor to SMEs in Malaysia. It describes how business network could be created based on six motives, adapted from Oliver, 1990, into why organisations are involved in business networks. Amongst the motives are necessity, asymmetry, reciprocity, efficiency, stability and legitimacy. The paper then present the proposed framework of business networking based on previous literature. The findings in this paper shall be useful for SMEs that are seeking for ways to develop and to attain success in their business.*

Keywords: SMEs, Entrepreneurship, Business Networking, Social Network, Malaysia

### **1. Introduction**

Superior productivity is not just relying on resources such as things and people, but also in social relations among people (Coleman 1988; Putnam 1993). A social relation or also known as social network is defined as a set of linkages among an identified group of people; the characteristics of which have some explanatory powers over the social behaviour of the people involved (Bowling, 1991).

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Social business networking (a.k.a. business networking), involves forming and maintaining the relationships with other businesses. Firms that pursue business networking will benefit from the relationships. Business networking will lead the firm to gain more clients, shareholders, business associates, suppliers, workforce, technical and market knowledge, trustworthiness, business guidance and problem solving.

Businesses that embedded resources in business networks gained competitive advantages through the flow of information. Vital information such as market situations, strategic locations, social 'ties', competitors position can provide useful information about business opportunities and alert firms about choices available that they could embark on. The networking also plays a critical role in business decision making (e.g., investment or joint venture) involving the capitals. This business relationship may be conceived by organizations as certifications of the firm's credentials, some of which reflect the firm's accessibility to resources through business networks. Finally, business networking also reinforces identity and recognition. Being assured and recognized of firm's worthiness not only provides support but also public acknowledgment. These reinforcements are essential for the maintenance of long term firm success. Therefore, it is important for firms to understand the role of business networking in influencing their business performance particularly to small and medium businesses. The purpose of this paper is to enlighten the role of business networking as a critical success factor to Small and Medium-sized Enterprises (SMEs) in Malaysia SMEs. The paper examines the importance of business networking based on Oliver's (1990) framework, focusing in the context of Malaysian SMEs.

## **2. Research Background**

### **2.1 Small Medium-sized Enterprises in Malaysia**

Small and Medium-sized Enterprises (SMEs) have been recognised as being one of the instrument of growth for many countries (Abdullah, 1999; Danis et al., 2006; Johan, 2007), including Malaysia (Aris, 2006). In Malaysia, SMEs are divided into two categories which is a) manufacturing, manufacturing-related services and agro-based industries, and b) services, primary agriculture and information and communication technology (Saleh and Ndubisi, 2006). These SMEs regardless of the categories and sectors, contribute to the Malaysian economy tremendously which includes; contribution of output (i.e. products and services); creation of jobs opportunities; developing a pool of skilled and semi-skilled workers; provide opportunities for technological development; offer an excellent ground for entrepreneurial and managerial talent (SMIDEC, 2006).

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In view of the rapid development of the SMEs, the Malaysian government has initiated several facilities and initiatives to improve SMEs' business performance. The government also formed and led an agency, known as Small and Medium Industries Development Corporation (SMIDEC) which is responsible for coordinating the development of SMEs. Apart from offering advisory services relating to the development of the industry, the agency also provides training and development programmes for SMEs as well as the public (National SME Development Council, 2006). Other government's support programmes include programmes on (Bank Negara Malaysia, 2007):

- Business loans and grants for example Development Financial Institutions (DFIs) and Enterprises Rehabilitation Fund (ERF),
- Consultancy services for example Business Advisory Centre and Standard Industrial Research Institute of Malaysia (SIRIM),
- Training and technical assistance for example National Productivity Centre (NPC) and Malaysian Entrepreneurial Development Centre (MEDEC),
- Advertising, selling and market research for example MEDEC and NPC, and
- Infrastructure facilities for example Free Trade Zones and Licensed Manufacturing Warehouse.

Despite the initiatives, the SMEs are still facing various levels of challenges in achieving their goals. Among the challenges faced by SMEs, particularly in Asian countries are: improving productivity and product / service quality; increasing entrepreneurial activity; encouraging innovation and technological upgrading among local firms; improving utilization of government incentives; developing human capital and encouraging smart partnerships (Habaradas, 2007). Saleh and Ndubisi (2006) suggested that Malaysian SMEs must develop business networking and strategic alliances as opportunities for SMEs to gain competitive advantages for successful business development.

Besides, the government agency, SMIDEC via SME Competitive Rating for Enhancement Tool (SCORE) suggested six factors that can enhance Malaysian SMEs businesses and lead them to successful performances. The factors are management, technical, financial, innovation, production and quality (see <http://www.smidec.gov.my>). Alternatively, Indarti and Langenberg (2004) proposed that social network is one of the leading factors to business success, including other factors such as characteristics of entrepreneur and SMEs, information access, legality, government support, capital access, entrepreneurial readiness, marketing and technology are the.

## **2.2 Business Network**

A business may develop relationships with variety of businesses and organisations as they may directly or indirectly affect the successful performance of the business (Hakansson and Ford, 2001). Firms have to rely on the capabilities of many people and many organisations, and the ability to merge these external capabilities with their own needs could allow these firms to achieve distinctive advantages (Loasby, 1998). These partners do not have to be formally linked by any formal structure and may include a variety of players. These players consist of individuals (e.g. business start-up),

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businesses (e.g. contractual agreements) or governments (e.g. grants, tax exemptions, loans, advisory services) (Abdullah, 1999; Lin and Zhang, 2005; Morgan et al., 2007; Lee and Lee, 2007). The activities the firms perform and the resources they employ in a network are interdependent (Anderson et al., 1994). 'Networks' is defined as a set of nodes and the relationships which connect them (Fombrun, 1982).

Business network is defined as a mode of organising economic activities through inter-firm coordination and cooperation in order to exchange or share information or resources. It is an integrated and coordinated structure of ongoing economic and non-economic relations embedded within, among and outside business firms (Yeung, 1998). It is also defined as a set of interconnected business relationships, in which each exchange relation is between businesses firms conceptualised as collective actors (Johanson and Vahlne, 2003). However, more recent studies referred business network as both formal and informal relationship; between an entity and another entity that is interacting with one another to gain business growth and success (see Indarti and Langenberg, 2004; Lin and Zhang, 2005; Danis et al., 2006).

Hence, business network concept suggests the coordination of activities between two firms in a business relationship which takes place within the wider business network context. Each firm can be expected to be engaged in a limited number of connected business relationships, each one coordinating the firm's activities with those of its counterpart (Hakansson and Snehota, 1995). In view of the above scenario, this paper aims to propose a conceptual framework to further understand the role of business networking in attaining business success. Ultimately, the framework will lead to the development of future research in this area of studies.

### 3. Literature Review

The theory that business networks constitute a source of ownership advantage for firms helping their growth in business is not a new phenomenon. It has been the focus of numerous recent studies, from both theoretical (Nohria and Eccles, 1992; Greif, 1993; Staber et al, 1996) and empirical aspects (Coviello and Munro, 1995, 1997; Yeung, 1998; Rauch and Trindade, 2002). The richness and variety of topics addressed under the business network concept have inevitably turned the topic into one of the most complex subjects in the area of business strategy (Ebers, 1997; Holmlund, 1997; Contractor and Lorange, 1988; Gulati et al, 2000). Oliver (1990) has integrated various literatures and proposed six general determinants or motives for businesses to form business networks. The six predictive motives are *necessity*, *asymmetry*, *reciprocity*, *efficiency*, *stability* and *legitimacy*. Each motive is unique and plays a vital role to build business networks. These motives are discussed as follows:

#### 3.1 Necessity

Organisations are ordered through law or regulation by authorities to establish a relationship (Oliver, 1990) by being member of a body or association, which governs the profession. Membership to a body would facilitate a more open stream of confidential

information sharing between exchange partners, and reduce conflict (Borch and Arthur, 1995). In Malaysia, the SMEs need to become members of a body or association related to the industry, which governs the profession for example legal firms must be a member of the Bar Council Malaysia and accounting firms must be a member of Malaysia Institute of Accountants (MIA). Through these bodies, relationships can be fostered and, firms can increase their revenue and reduce competition by binding competitors as allies (Porter and Fuller, 1986; Ebers, 1997).

### **3.2 Asymmetry**

Being in a network, sometimes, firms are not free to act according to their own, they need to consult and rely to others that are in the network such as getting approvals for licenses, business permit or loans etc. Asymmetry motive means building business networks on the basis that there is a probability of one party to exercise power or control over another on its resources (Oliver, 1990). For example, a firm may want to form a director interlock with a financial institution because then it may be able to control sources of capital and increase its power over the financial institution. This type of business relationship provides opportunity for a business to influence others (Hakansson and Ford, 2002) or vice versa.

### **3.3 Reciprocity**

Gulati et al. (2000) confirmed that a firm's competitive advantage rested on collaborative business networks. Businesses can pursue common or mutually beneficial goals or interests through co-operation, collaboration and coordination with other businesses (Oliver, 1990). For example, a joint venture of businesses that is of equal power, sharing knowledge of technology in their industry would result in an increase in productions. Building business network for this motive could increase the growth of existing resources and the ease of obtaining external resources (Lin and Zhang, 2005). It has been proven a study that that building business network does increase revenue and expand customer base significantly (see Saleh and Ndubisi, 2006) which consider as common goals for many firms.

### **3.4 Efficiency**

Oliver (1990) stated that this motive is internally oriented. Business networks are formed due to the need for a business to improve its internal input and output. Through business networking, firms can achieve efficiency by anticipating increases in return on assets or reductions in unit cost and waste a result of economies of scale (Contractor and Orange, 1988; Oliver, 1990). Further, forming business networks may also minimise business risk taking, reduce production cost, increase flexibility and increase firm's knowledge (Lin and Zhang, 2005). Ebers (1997) pointed out that,

“Firms engaging in inter-organisational networking may enjoy comparative advantage over self-sufficient firms, because they can draw on specialised yet complementary

partner contributions that extend the resource base and capabilities of the networked firms, and can entail production cost advantages...”

Clearly, firms that emphasized on building networks would be able to increase flexibility and efficiency (Lorenzoni and Baden-Fuller, 1995), allow access to critical network resources at minimal transaction cost (Casson and Cox, 1993) reduced business risk (Gulati et al., 2000) and ultimately leading to higher performance (Dyer and Nobeoka, 2000).

### **3.5 Stability**

Forming business network ensured that firms could better forestall, forecast, or absorb uncertainty affecting their activities (Oliver, 1990). The strategies to access new markets could be jointly achieved by participating in business networks (Saleh and Ndubisi, 2006). In achieving business stability, firms could team up for activities such as joint research, co-sponsor, co-branding, and co-production. Through networking, firms can gain competitive advantages through easy access to desired resources and capabilities. Thus, firms in different ways can enhance their stability via jointly sharing the risks or gaining the market power (Ebers, 1997).

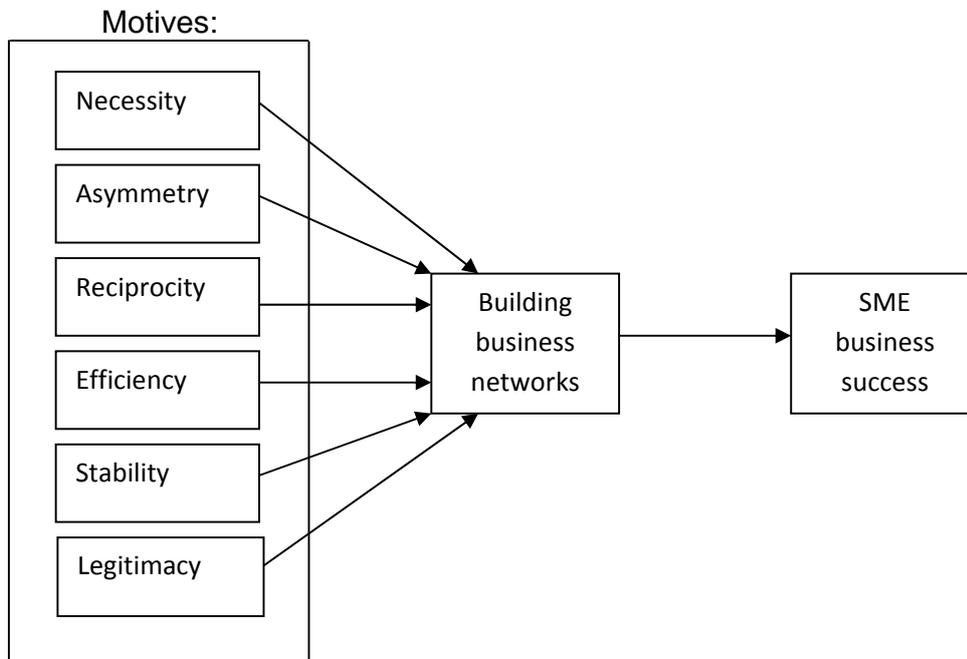
### **3.6 Legitimacy**

The final motive of building business networking is for legitimacy, which could be achieved through establishing or enhancing firms' business reputation, image and prestige (Oliver, 1990). For example if a business is able to obtain a partnership with another business that is a member of a prestigious organisation, this will boost the former business image and reputation. Relationships fostered with firms that are unique, well known and prestigious resulted in an advantage for the lesser partner to gain competitive advantage in a business (Anderson et al, 1994). Lack of such legitimacy is why SMEs are often ignored and bear relatively little relationship to the supply chains by which value is actually delivered.

## **4. Proposed Framework**

Based on the pertinent literature and theories presented earlier, a conceptual framework has been developed to propose how business networking could be built based on several motives and further leading to the relationship between the business networking and business performance (see Figure 1). The proposed framework was adapted and developed from Oliver's (1990) business networking model. Oliver's model includes necessity, asymmetry, reciprocity, efficiency, stability and legitimacy as the motives of building business networking which had been successfully tested in different organization setting. This study suggests the driving factors to building business networking are originated from the motives or relative advantages of it; they could be used either independently, all, or combining some the motives. Positive relationship in a business networks would then eventually lead to business success for SMEs.

Figure 1: Proposed Framework on Business Networking and SME Business Success



Source: Adapted from Oliver (1990)

Nevertheless, the conditions of this business networking framework suggest that:

- The motives of efficiency are influenced by internal factors of the business.
- The motives of reciprocity are affected by the properties of the businesses in the network and the degree of similarity with one another.
- The motives of necessity, asymmetry, stability and legitimacy are affected by external factors.

These assumptions propose that the dissimilarity in this theoretical paradigm is partially dependent on the differences in the businesses' need or situation. Hence this conceptual paper seeks to test the proposed framework of building business networks in the context of SMEs in Malaysia. It is worthwhile to explore whether the Malaysian SMEs' which comes from various sectors, business nature and establishment would focus on or influenced by the different motives of building networking that ultimately lead to the business success.

## 5. Conclusion

There is an increase in businesses that engage in business networks (Smith, 1997; Lin and Zhang, 2005). Therefore, it is important to understand the motives for forming business networks that will lead to business success for SMEs. An assessment of the circumstances of the motives of forming business networks disclosed several factors

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that influenced such as; necessity, asymmetry, reciprocity, efficiency, stability and legitimacy. They are related to laws and regulations, competition, compatibility with other businesses, relationship cost and benefits, and business risk. These motives are vital to be focused on as the starting point to promote business networking amongst SMEs in Malaysia.

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