

Business Relationships in an Interconnected World

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1. Introduction

The discussion on networks as structures of relationships has taken place mainly in organisational science, sociology, social psychology and social anthropology. Recent developments in economics and strategy have extended the field to embrace new business related research questions. The concepts of social, economic and psychological dependencies in a social network, mirror discussions of firm and business-group dependencies related to issues of buyer-supplier relationships, resource allocation within and between firms, inter-corporate directorship ties, co-operative business strategies in highly volatile and risky environment, or counter-trade deals with foreign governments (Scott, 1987, Johanson & Mattson, 1988, Ffletcher, 1996, Davis, 1997).

The bulk of the literature on international business networks has not recognised yet the rich conceptual apparatus of network analysis, and remains to a large extent constrained within the boundaries of economic research on foreign direct investment (FDI), mergers, acquisitions and joint ventures. An exception is the growing field of industrial marketing developed mainly at the Uppsala University (Turnbull & Valla, 1987, Holm & Johanson, 1997). Issues such as relational contracting and co-operative business ventures are circulated as new ideas in the area of international business.

The globalisation of markets changes the nature of the operations of firms. Their strategic advantages no longer derive from their internal capabilities and market position. Their competitive edge depends on their abilities to co-operate with other firms and governments across borders, to form business networks with suppliers and buyers and to share costs and benefits with partners in distant locations. Long-term co-operative strategies based on win-win scenarios and avoiding direct competition, enable firms to leverage their outputs for a broader commercial application across different locations and market segments (Lorange & Roos, 1993).

The aim of this paper is to build a bridge between network theory and the theory of the internationalisation of the firm in the context of co-operative relationships between economic agents. A new definition of the concept of network is introduced to extend the meaning and its application to international business research, and suggests three levels of business network analysis: the properties of the actors; the relationships between the actors (including exchange of resources and engagement in transaction events); and the network structure.

The paper builds upon the advancements in structural analysis (Wellman & Berkowitz, eds. 1988), network analysis (Nohria & Eccles, eds. 1992, Knoke & Guilarte, 1994), the Uppsala relational approach to networks and industrial markets (Johanson & Mattsson, 1988, 1992, Hakansson & Snehota, 1992, Hakansson & Johanson, 1992, Ford, 1997), cooperative business strategies (Contractor & Lorange, 1988, Buchko, 1994), the internalisation theory and the theory of foreign market entry (Buckley & Casson, 1976, Dunning, 1981, 1992, Rugman, 1982, Young, S. et al., 1989). We treat each market entry mode as a specific network configuration that facilitates international exchanges and transactions, and resembles a specific distribution of power

between inter-connected organisations. The focus of our conceptual framework is on the uneven distribution of resources, information, and control within international business networks, and how this affects the position of individual actors (organisations, firms, subsidiaries, institutions, or governments) within the relational set. The visualisation of the complex strategic relations between firms and governments is accompanied by examples of transactions that are typical for each type of network formation.

2. Foreign Market Entry and Co-operation Between Firms Across Borders

The research in the 1960s on entry-strategies had the focus on comparisons of export, licensing, and FDI, and the advantages and disadvantages of foreign investment strategies relative to foreign trade and licensing activities. Since then the emphasis shifted to non-equity inter-firm cooperative agreements; the relationship between market structure and mode of entry; internalization of activities across border; and factors attracting FDI such as: market factors (size, growth potential, margins); competitive factors; trade barriers; cost factors; and investment climate (political stability, legislation) (Buckley & Casson, 1976, 1985, Williamson, 1981, Dunning, 1992),

The contemporary acceleration of the technological factor only enhances the conditions for standardisation of products and markets, and international expansion of production, including the globalisation of trade, licensing, investment, lending, borrowing, financial intermediation practices, and the formation of national and international strategic alliances.

The rapid increase of international strategic alliances and global production networks in many sectors of the global economy (car manufacturing, airlines, tourism, telecommunications, computers, apparel, consumer durables, and others) are the visible side of the globalisation of production and distribution. The export activities and the global commodity chains, according to Gereffi (1994), are of two types: producer driven (an input-output structure of interlinked firms, with spatial dispersion and concentration of units along the value chain of raw material supply, production, export, and marketing); and buyer driven (a new evolutionary form of internationalisation, which has multiple backward and forward linkages, and resembles an alliance structure of inter-linked firms with complex logistics, pulled by the retail sector with buyer driven orders) (Gereffi, 1994). The selection and inclusion of firms in such commodity chains is governed by the co-ordinator's side being the producers vs. the buyers, and depends on the industry context and the wider environmental constraints and opportunities faced by individual firms. The globalization of these chains increases the complexity and the economies of scale and scope for the formations.

The financing of these global commodity chains is based on mobile capital and is controlled to a greater extent by multi-national corporations (MNCs) and trading firms in interaction with governments. The further expansion of the global commodity chains is through FDI, foreign market entry, and network expansion and extension of business relations. These globalisation strategies utilise an intra- and inter-firm international division of labour with distribution of inter-linked business functions across borders (Pennings, 1994). The flow of goods and resources is seen either as intra-firm trade, or as and internationalisation by exports and imports.

The discussion of licensing emerges when it becomes evident that not only commodities and tangible resources are exchanged, and subject to cross-border transactions, but also intangible resources such as know-how and technology. More permanent commitments of capital resources into foreign market operations and assets are seen as internationalisation through FDI (defined as

a long- term capital flow which is invested in a company abroad, by which the investor can exercise ‘some’ influence on the management and the operations of that firm (Ebberts & Todeva, 2002).

The complex relationship between FDI, foreign trade, and government led economic growth is very much in the focus of Dunning and Narula’s conceptual framework of the Investment Development Path (IDP) (1996). The authors describe five stages through which countries’ developmental processes evolve in relation to the global capital flows. Countries that are at the first stage of development usually do not offer location specific advantages with exception of their natural resources as a main driver for FDI inflow, and therefore both inward and outward investments are extremely limited with a domination of horizontal and vertical linkages between national firms. Dunning and Narula characterise the second stage of the IDP with countries attracting inward investment in primary commodities and natural resources, as well as offering opportunities for vertical integration in labour intensive low technology and light manufacturing. Stage three includes countries with a gradual decrease of inward FDI and increase of outward FDI, where the local technological capabilities encourage production of standardised goods, and the outward mobility of capital is explained with the search for international expansion and transfer of strategic capabilities of firms into foreign markets. At stage four of the IDP there is abundance of capital, and the cost of capital is lower than the cost of labour. Domestic firms will have an increasing propensity to engage in FDI rather than exports. Finally, at stage five there is almost complete internalisation of transaction costs within the MNC (Dunning & Narula, 1996), which resembles trade or cross-border co-operations within hierarchies.

One of the strengths of the model is that it can explain the outward and inward flow of capital in the early stages of globalisation, and the capital mobility related to global production. However, the framework can not address the questions of internationalisation through cross-border strategic alliances, and the expansion of global commodity chains. Building international strategic alliances and establishing international co-operative ventures with complex network structures has spread across matured and new emergent industrial sectors, and across developing and developed countries irrespective of their stage of development. Governments world-wide engage in similar attempts to encourage the international expansion of home-based businesses, through export policies, international trade negotiations, and through cross-border counter-trade agreements. Government procurement shows the strong interest of governments to initiate and control large-scale infra-structural projects and high-technology and collaborative agreements with international partners. Fletcher’s models of counter-trade activities in Asia (1996) give examples of government dominated internationalisation of developing, as well as de developed market economies. His approach is based on cases of cross border transactions between heterogeneous agents and a flow of heterogeneous resources (capital, knowledge, technology, commodities), employed in heterogeneous activities (technology and know-how transfer, development of production; establishment of new links for commodity transfers, resources exchanged through barter deals, offsets, counter-purchase and buy-back contracts between governments, public and private organisations). The complexity of managing such international collaborations goes beyond the capabilities of individual firms, managers, or government officials, and highlights the need for a new theoretical thinking on the management of internationalisation of economic transactions.

In order to reduce the risk of business operations international managers and Chief Executives (CEOs) are increasingly seeking support through cross-border professional networks, business partnerships, strategic alliances and contractual joint ventures. These social and business

links established by managers blur the boundaries of the international firms, and generate economic activities in a much wider heterogeneous field of social, political, and economic interactions.

The formation of business partnerships and alliances, the dynamics in partner relations, and the associated issues of trust, commitment, learning, exchange of information and technology, sharing of experience and resources, raise numerous questions that undermine the robust economic rationale for strategic decision making. The relational approach developed by the Uppsala project on networks is a response to the vacuum created by the transaction cost theory in relation to collaborative business activities and long-term contractual relations in industrial markets (Easton, 1992, Hakansson and Johanson, 1992).

Within the relational paradigm Ford and Rosson analyse the relationships between export manufacturers and their overseas distributors, and acknowledge that there are a number of dimensions of interorganisational relations that are subject to internationalisation. These are: formalisation through multinational contracts; standardisation and adaptation through establishment of roles and routines that span beyond national cultural boundaries; reciprocity in sharing of risks and benefits, and dealing with conflict across borders (Ford and Rosson, 1997). According to the authors, the behaviour of network participants is determined by three main factors – their international experience, the uncertainty they face in different locations and markets, and their immediate interests. Ford and Rosson also propose five distinctive developmental states of business relationships: new, growing, troubled, static, and inert (Ford and Rosson, 1997).

3. The Nature of Business Networks: Definition of the Term and a Conceptual Framework for Business Network Analysis

Before we engage in analysis of the international business networks, it is important to introduce the main concepts from network theory that can be used to explain global business activities and network transactions between interdependent economic actors. The use of the word ‘network’ spreads over a range of phenomena. The main examples are: a) a *communication net* (as in telecommunications); b) *interconnected desktops*, or technical operational devices for information processing (as in computer network); c) a *social structure of ties*, facilitating relations and exchanges between individuals (as in a social network); d) *interrelated economic agents* involved in a repetitive exchanges of products, services, market information, and economic benefits and payments (as in business network); e) *inter-linked resources, activities and actors* (as in industrial markets). What is common between these five distinctive conceptualisations of the term ‘network’ is that they all refer to a formation which facilitates exchanges between its members.

Business Networks are sets of transactions based on structural and relational formations with dynamic boundaries that comprise of interconnected elements (actors, resources and activities); Networks accommodate the contradictory aims pursued by each actor, and facilitate joint activities and repetitive exchanges that have specific directionality and flow of information, commodities, heterogeneous resources, individual affection, commitment and trust between the network members.

Each discipline dealing with a network phenomena has made its attempt to define the term. However, it remains a nebulous linguistic notion, inclusive of almost any intended meaning, and often used in a metaphorical sense. In review of a number of definitions of networks (Knoke and Kuklinski, 1982; Knoke and Guilarte, 1994, Hakansson and Johanson, 1992) we would like to establish a definition for business networks that would reflect the nature of the relationships between business organisations.

Each network has limited resources, and different members have different access to these resources. We use the term 'resources' in a broad sense, including information, financial capital, human capital, social capital, organisational capabilities, technology, knowledge, and other intangibles. The unique feature of networks is that they accommodate inequality within their boundaries. Each member has different capabilities and different access to the network resources. This inequality is further enhanced by the division of labour and the specialisation pursued by each individual firm in the business network.

The boundaries of a network are situational and have a temporary character. New members are co-opted, and some old members are denied contracts, or other opportunities for transactions and participation in the network. The flexibility vs. rigidity of a network is pre-determined by the flexibility of its members and the contracts between them, rather than by the boundaries themselves.

The assumption of symmetrical relations is utilised uncritically by the three main traditions in network analysis: positional (based on the structural paradigm in social network analysis), relational (based on the work by the IMP research at the Uppsala University), and cultural (based on the work by Latour [1987] and Callon [1986, 1992] on heterogeneity in actor-networks). The positional tradition is represented by the structuralist paradigm (Knoke and Kuklinski 1982, Burt, 1982, 1992, Wellman & Berkowitz, 1988, Nohria and Eccles, 1992, Krackhardt 1992), with their emphasis on structure, form, and action within networks; social and communication network analysis; structural holes in relational networks; and the strength of weak ties. One of the advancements made by the structural analysis is to recognise the embeddedness of market transactions in the structure of social relations.

The relational approach, developed by the IMP Group (1997), puts emphasis on supplier networks and industrial markets, and introduces an alternative conceptual framework that enriches the dyadic model of relationships. According to their interaction model, network research should focus simultaneously on three aspects: the participants, the interaction process, and the environment within which interactions take place. The interacting parties are conceptualised as the individuals, and the organisations they work in, with the size, structure, strategy, experience, and technology employed by these organisations. The interaction process in networks is also operationalised as the dyadic relationships between interacting parties, and the episodes of interaction (including products, services, information exchanges, financial payments, as well as social exchanges that reduce the uncertainties). Finally, the environment is conceptualised as comprising of the market structure, the market dynamics, the position of each firm in the value chain, the internationalisation of the market exposure (IMP group, 1997).

Easton (1992) looks at the preconditions for establishment of business relations, and identifies a number of factors such as: mutual orientation and complementarity of objectives, ability of firms to exploit network resources, and the dependence of firms on existing buyer-supplier relationships. The relationship itself is measured by its longevity, the nature of the bond between firms (product, technology, financing, strategic objectives), shared information, and other

network resources. According to Easton (1992), the structure of these relationships derives from the division of work among firms, and the boundaries of the network.

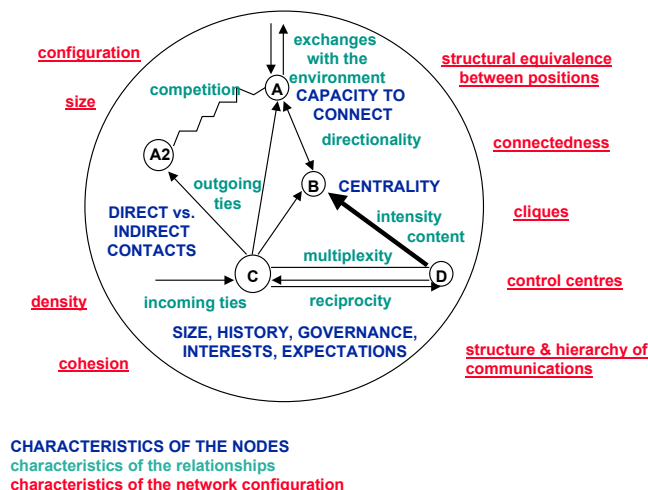
Hakansson and Johanson (1992) acknowledge three overlapping network structures in the transaction chain in industrial markets: the network of actors, the network of resources exchanged by them, and the network of inter-linked activities. The authors also identify four forces that bind actors in business networks together: functional interdependence, power structure, knowledge structure, and intertemporal dependence, or the history, memories, investments in relationships, knowledge, and routines of existing interactions. Although Hakansson and Johanson (1992) acknowledge, that the model is voluntaristic, and not deterministic, and this makes it difficult to lay solid research foundations, its main advantage is that it reflects the reality of repetitive business transactions and long-term relationships in industrial markets.

Some managerial theories have also attempted to develop the relational approach and have emphasised on the business relations, with a focus on issues of power relations, actor's choices and strategies, domination between inter-linked economic agents (Mintzberg, 1983), and asymmetry of relational exchanges and transactions (Wellman & Berkowitz, 1988).

In a recent work on choices and selection Paolo Ramazzotti and Marco Rangone (2000) conclude that the behaviour of the actors (purposive or not) affects the selection mechanism itself via learning and knowledge creation. Therefore, the interaction of actors in a network modifies the very framework for interpretation of market information in a network, and the way companies assess and respond to market signals. The authors also confirm that key market players affect customer preferences and decisions which undermines the very principle of autonomous selection by the market, and is another example of embeddedness of business transactions, and the use of power and domination in the market place.

The lack of a formal hierarchical structure and a chain of command in business networks does not mean that transactions and exchanges within a network don't have prescribed directionality. They are subject to positional relations and depend on the position of each network member, the priorities set by these actors, and the distribution of control between them. Positional relations could be observed in all types of social, technical and business networks, such as supplier chains in which all partners negotiate individual outcomes and attempt to maximise the benefits from the exchange, or to re-position themselves for future negotiations.

Fig. 1. Network Characteristics



To demonstrate the characteristics of the international business networks, and the use of concepts from network theory we have constructed a hypothetical model of interconnected firms across borders (Fig. 1.). Some of the actors are directly connected (A-B), while others remain indirectly related (A-D). Some of the nodes occupy more central position (like B, or C) than others. We use this model to analyse further the relationships between actors in a business network, and the network configurations that emerge following different choices of a mode of foreign market entry.

3.1. Characteristics of the ‘nodes’

This category includes all measurements and characteristics that describe: the *actors* (agents, or member) of a business network; the *centrality* of one or more of them; the *direct vs. indirect contacts* between them; their *capacity to connect* all others and therefore making those dependent; and their capacity to determine the minimal number of steps needed for one to connect to all other network members. In addition to these structural properties of the actors, there are a number of individual properties that affect their behaviour, and how they engage in network relationships and transactions. Examples of individual properties of economic actors are: *size* and *history* of the firm, *ownership* and *corporate governance*, *assets* and *accumulated resources* (including knowledge, capital and market access), *interests*, *values*, and *expectations*. The heterogeneity of the actors stems mainly from their individual characteristics and specific institutional form, as well as from previously established relations and presence in various markets and strategic configurations.

The nodes in a business network are occupied by individual firms, or other institutions and private agents that are assumed to have distinctive boundaries. The difficulty in analysis of international business networks is that in many cases firm boundaries are blurred by shareholding interests, commodity flows, and resource commitments, that spread across and penetrate the entire network. The centrality of a firm derives either from the number of in-coming ties (an *information broker* [B]), or from the number of outgoing ties (a *co-ordinator* [C]). The power of a broker derives from the ability to re-locate and re-distribute information and resources throughout the entire net, while the power of a co-ordinator derives from the ability to allocate performance tasks, contracts, or other resources within the net, and to determine priorities for business operations of the other network members. Obviously both agents will have different impact on network transactions and the structuring processes, including the dynamic selection of suppliers, buyers, and partners, and the ‘membership status’ and position of the peripheral members. The direct ties between core firms are based on common interests, shared resources, interconnected commodity links, cross-ownership, and long term contracts between individual agents. Indirect ties occur with peripheral members that are connected through intermediaries, or other agents with stronger capacity to establish new links, positioned downstream or upstream the value chain.

A detailed analysis of the individual characteristics of the network members would contribute significantly to explanation of the participation of specialised through division of labour companies, and the specific distribution and concentration of resources throughout the network.

3.2. Characteristics of the relations between network members

This group of characteristics includes the following categories: *content*, *multiplexity*, *directionality*, *transitivity* and *intensity* of the links between network members; *reciprocity*, or relational *symmetry* experienced by individual members; *incoming vs. outgoing relations* in terms

of sending or receiving links; *relations and exchanges with the environment*; and *competition* between network members for the resources available in a specific network configuration. Hakansson and Snehota (1992) distinguish also between a 'single actor function' in dyadic relationships, and a 'network function' as the balance of functions in all business relationships maintained by an actor. Each business relationship has three dimensions: actor bonds, activity links, and resource ties.

The content and intensity of the exchange link could vary by contract, by the position of the firm, or by market demand in flexible contracts, and is measured by the repetitiveness of the transactions between two companies, including the content of what they actually exchange, and the form of payments agreed upon. The reciprocity becomes an important characteristic in relational contracts that are build over a period of time and encompass a variety of informal exchanges, unilateral commitments, ability to satisfy mutual interests, or to provide equal access to resources. This is particularly important for joint ventures, as in most cases there is an inequality in participation stemming from the division of labour between the strategic partners.

The directionality of a business tie is determined by which party has more interest to prolong the existing business relationship, and how the two partners negotiate the terms and conditions for the exchange. The existence of a link between two firms does not explain by itself what resources and commodities have being exchanged, or the complexity of the transaction itself. Usually an additional information is required regarding exchanged resources and rewards, or shared activities before we are able to conceptualise the transaction. Members in a network could be in competition with each other for resources and information. Firms with different status attract ties with different content, intensity and reciprocity, and their unique relationships are pre-determined by the individual characteristics of these firms, by their location and position in the network, associated set of relations, and by the overall network dynamics.

3.3. *Characteristics of the entire network configuration*

The analysis of the entire network structure is assisted by the following concepts: spatial configuration of individual *positions*; *structure* and *hierarchy of communication* links between the nodes; *connectedness* of the agents, and *efficiency* of transactions and exchanges (Krackhard, 1994); the formation of *cliques and social circles*; the emergence of *control centres* within and outside the network and the concentration of *power* around nodes and groups of actors; the overall *size* of the network (or the number of participants in it); network *density* (measured by the proximity in roles and positions of different members); *structural equivalence* between positions (in terms of responsibilities and influence); and the *social cohesion* between actors (in terms of shared beliefs, values and understanding) (Wellman & Berkowitz, 1988, Knoke & Guillard, 1994). Examples of cohesion in a business network will be shared standards and specifications, and shared managerial practices between firms. It is expected that large and international business networks will have much lower level of cohesion than small and nationally based ones. Hakansson and Snehota (1992) conceptualise the entire network structure as composed by two elements: *network governance* (or all actors and their exchange relationships), and *production system* (or the network of interdependent production activities and resource flows controlled by the actors). The overall configuration of the network is determined by the influence, which the focal actors exercise across different industries and national borders, and by the spread of business operations across markets, along with the linkages with suppliers, buyers, and partners. In our theoretical discussion further we use examples of different choices of foreign market entry, and types of

business networks where the configuration depends on the type of relationships established by the leading actors.

4. Models of Relationships in International Business Networks

One of the distinctive features of international business organisations is that they resemble a complex net of business units that are integrated within a number of value chains and spread across different industries and different countries. The most distinctive example is the MNCs, where the business headquarters and individual subsidiary units represent the 'nodes' in the network. Although entrepreneurial small business networks and family business networks have a history of cross-border operations, there is a very limited research on their incremental internationalisation (Coviello & Munro, 1997). The internationalisation of utilities is also an under-research area (Ebberts & Todeva, 2001). The main literature focuses on the internationalisation of corporate activities (Contractor & Lorange, 1988), buyer-supplier networks in industrial markets (Hakansson & Johanson, 1992), R&D alliance networks (Doz, Olk & Ring, 2000), and a little coverage of the Keiretsu and Chaebol networks (Anchordoguy, 1990, Gerlach, 1992), and inter-governmental counter-trade networks (Fletcher, 1996).

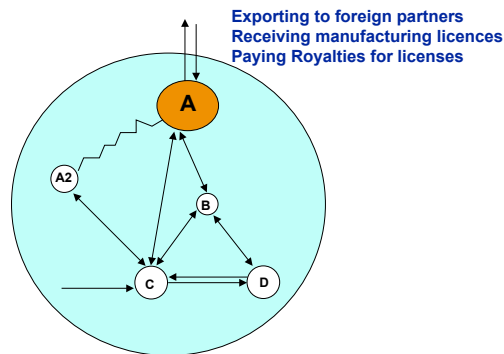
Initially, the three leading modes of foreign market entry were considered to be exporting, licensing, and FDI. Subsequently it became apparent, that the MNCs can choose between internalising (via mergers and acquisitions) and co-operating across borders (Madhok, 1998). The forms of co-operation extended the field by introducing a range of alternative strategic options that derive from the choice of ownership mode, and the choice of organisational form for the new international business venture. Todeva and Knoke (2002) suggest a typology of inter-organisational relations and strategic alliances that includes eleven types of co-operative business formations in addition to the vertical and horizontal integration that is taking place within MNCs, and the direct market exchanges. These forms are: joint ventures; equity investments; co-operatives; R&D consortia; strategic co-operative agreements; cartels; franchising; licensing; subcontractor networks; industry standards groups; and action sets (Todeva & Knoke, 2002). Lee Davis (1997) refers to a different typology of inter-firm co-operation: knowledge networks, business networks, licensing and joint ventures, user-producer relationships, and complex multi-faceted partnerships. Another very comprehensive typology of modes of foreign market entry is introduced by Young (1989). Overall 10 distinctive types of cross-border co-operations are suggested: 1) exporting, 2) licensing, 3) franchising, 4) management contracts, 5) turnkey contracts, 6) international subcontracting, 7) contractual joint ventures, 8) equity joint ventures, 9) wholly owned subsidiaries, and 10) industrial co-operation agreement, which usually includes the listed above methods in 2, 4, 5, 6, 7, as well as the counter-trade agreements. In summary of these typologies we identify 4 distinctive types of relationships in international business networks: representative, hierarchical, autonomous partnerships, and interdependent partnership relationships.

4.1. Representative Relationship:

The initial form of internationalisation is based on remote access to foreign markets with minimal resource commitments, and the use of representatives. Exporting relationship (Fig. 2.) could be described by the connection, which the hypothetical firm (A) has with a partner, or a distribution network in a foreign country. In this exchange process, (A) transfers commodities across national boundaries and receives in return some form of financial compensation, or other products / services in a barter exchange with the local firms (B and C). The terms of this exchange

are determined by the condition of the foreign market, the capacity of firm (A) to co-ordinate and finance transactions, and the organisational capabilities and production capacity of the local partner organisations that participate in the operation (A2, B, C, D). This exchange assumes that the foreign partner of (A), who is importing the commodities, is a member of another network in the foreign country, and (A) acts as a broker, or a bridge that secures connectedness within the global commodity chain. As a broker (A) represents the interests of both sides of the commodity chain (exporters and importers), for a fee.

Fig. 2. Representative Relationship - *Exporting and Licensing*



Examples of firms that act in this capacity are the trading firms, or other small firms that use one of the three forms of incremental internationalisation: *direct sales* to psychically close markets, *contracts with distributors* in foreign markets, and *product development for a vendor*, who sells in foreign markets (Coviello and Munro, 1997). The choice between these three forms of exporting depends on the international experience and exposure of the firm, its internal and external capabilities to reach new customers, and the legislative environment, which regulates trade barriers, import and export taxes, and trade licenses issued by governments (particularly related to export controls, such as in the defence sector, or other commercially and security sensitive businesses).

Licensing could be described by the incoming tie from the environment to firm (A). It is important to note that the licensee (A) receives the right to produce certain goods or services through its own business network (A2, B, C, D), and usually carries the responsibilities to guarantee to the licensor a financial compensation. The content of the licensing relationship could cover a wide range of contractual arrangements related to the transfer of rights and resources between the partners including co-ordination and financing of the international business operation. This relationship determines the content of the other business linkages that the licensee (A) maintains within its own business network.

The three main factors that affect the choice between export vs. licensing agreements identified in the literature are: host country conditions where the technology is to be licensed, the stage in the technology life cycle, the characteristics of the licensor firm, and the compensation structure (Preet, Aulakh, Cavusgil, & Sarkar, 1998). The same authors also look at the realignment of the incentives to both licensors and licensees in order to minimise their ability and motivation to engage in opportunistic behaviour. Alternative means of the licensor to increase control are two: 1) administrative involvement in decision-making and influence on activities performed by the licensee; and 2) the establishment of new hierarchical organizational forms, i.e. joint ventures,

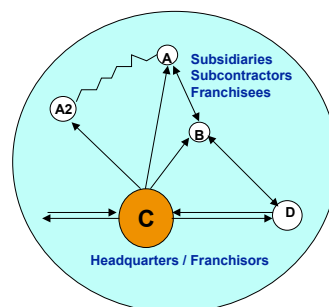
that allow new unilateral and bilateral co-ordinative processes between the independent firms, and can substitute for direct governance (Gencturk et. al., 1995).

4.2. *Hierarchical Relationship:*

The hierarchical relationship in international business is usually exhibited by structural configurations with direct line of control such as MNCs, or subcontracting and franchising arrangements. The relationship between headquarters (C) and wholly owned subsidiaries (A, A2, and B) are based on clear line of subordination and majority control. In spite of the intensity of activities and resource exchanges, the control of the international business operations is by the headquarters, which finance and co-ordinate all transactions, exchanges, and partnership relations. This model represents the so-called ‘Ego centered networks’ (Burt, 1982), where the boundaries of the network, the structure and content of relationships, and the autonomy of individual members depend on decisions from the headquarters. FDI in a wholly owned subsidiary could be: market oriented (substituting imports), cost-oriented (utilising low labour and other input costs), and resource oriented (aiming at a vertical integration of the multi-national company).

The differentiated network structure of MNCs has been acknowledged first by Ghoshal in his doctoral Thesis (1986). A number of typologies subsequently have been proposed to capture the variety in scope, responsibilities and strategic importance of the MNC's portfolio of subsidiaries (Ghoshal & Nohria 1989; Roth & Morrison 1992). In addition to the variety of forms of acquiring subsidiaries, authors have looked at the variety in operational relationships, and particularly headquarters granting mandates to subsidiaries (Birkinshaw, 1996).

Fig. 3. Hierarchical Relationship – Wholly Owned Subsidiary, Franchising, and Subcontracting



James Taggart (1997) revisits the integration-responsiveness paradigm and particularly the integration of activities by MNCs in response to global pressures to reduce overall costs and to maximise returns. According to Taggart (1997), the balance between global integration, global strategic co-ordination, and local responsiveness determines four types of subsidiaries. The first one is the quiescent subsidiary, or those independent overseas affiliates, that have virtually no headquarter control, that keep their input and output markets independent from the MNC network, and engage both in local adaptations and independent exports (i.e. low integration and low responsiveness). The second type is the autonomous subsidiary with low network linkages within the MNC network, some sharing of technology with sister subsidiaries at a fairly low level of central control (i.e. low integration and high responsiveness). The third cluster is comprised of the active subsidiaries with high level of integration, servicing MNC parent's customers world-wide,

and high local responsiveness. The fourth type of receptive subsidiary resemble high integration and low responsiveness (Taggart, 1997).

The international subcontracting is usually used where the integration within the MNCs is not possible/ preferable, or in cases of outsourcing of business operations (Fig. 3, firms C, D & B). In this example (C) is the leading firm that places orders and supplies (B) and (D) with the specifications for their operations. Firm (C) can subcontract in principle all of its business functions, including manufacturing, marketing, procurement, financing, strategic planning, R&D, and various other high-value-added business activities.

The issues of subcontracting were initially raised in the literature as part of the analysis of Japanese industrial sourcing which viewed subcontracting as a movement toward collaborative manufacturing based on problem-solving principles (Nishiguchi & Brookfield, 1997). Subsequently Webster, *et.al.* (1997) defined the vertically disintegrated supply chain (where production is subcontracted down through a series of levels from the original principal to several independent enterprises), and contrasted it with the vertically integrated supply chain (where a single enterprise retains ownership and/or control over the others). Downsizing and outsourcing are two strategies that devolve business functions within the value chains controlled by the MNCs. These relationships though remain hierarchical, as the 'principle' holds the decision-making powers over the subcontracted activities.

Franchising also can be described by the position of firm (C) (Fig. 3). The franchisor (C) is supplying (A) and (A2) with trade-marks, know-how, management and financial assistance. If the contracts with the franchisees are standardised, (A) and (A2) are in equal position, and they may face direct competition for a market share where there is an overlap of their target customers. Figure 3. shows also their dependency on the franchisor. The content of a franchising relationship is based not only on the exchange of resources, information, and financial payments, but also on the commitment made by individual agents, the 'reputation' of the franchisor, and the individual contribution of specific knowledge and strategic capabilities. The payments comprise of a broad range of heterogeneous forms, including financial compensations in the form of fees and royalties, or loyalty and compliance with certain company regulations with benefits for the franchisor.

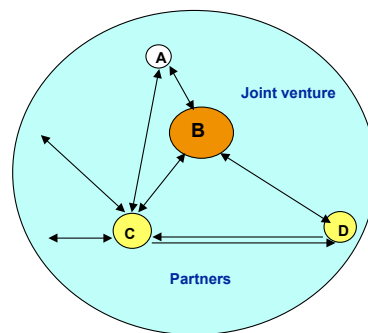
The franchising form of business organisation is designed to ensure standardisation not in 'industrial' co-located settings, but in relatively small and geographically dispersed business units, particularly related to the service sector - fast food, transportation, retail and distribution. It is termed also 'customer service' form, where a number of management functions such as sales, invoicing, debt collection, and some aspects of quality control remain within the franchisor, leaving the franchisee to concentrate mainly on customer service delivery (Stanworth & Stanworth, 1999).

The franchising contract gives a lot of scope for opportunistic behaviour by the principle franchisor. Dahlstrom and Nygaard (1999) investigate the franchisee-franchisor relationships in the Norwegian distribution system of a multinational oil refiner, and the structure of transaction costs incurred by the franchisee in order to protect itself from the franchisor. Among the main costs positively associated with increased opportunism by the franchisor are: the negotiation and bargaining costs when contracts are re-negotiated; the monitoring costs over scheduled deliveries and payments; the maladaptation costs embodied in communication and co-ordination failures. The balance between inter-firm cooperation and formalisation of procedures and role responsibilities is seen as a key to effective franchising relationship.

4.3. *Autonomous Partnership Relationship:*

The contractual joint ventures and equity joint ventures are very common mode of foreign market entry in addition to the mergers and acquisitions undertaken by large MNCs. This type of relationship could be interpreted in the context of the link between (C) and (D) (Fig. 4.). The co-operative efforts of the two companies result in the establishment of a joint venture (B) - either as a new business venture, or as an investment project in a third company under the direct control of (C) or (D). Usually the joint venture is secured by contracts that determine how assets, risks and profits are shared, as well as identifying mutual interest of the partners, and conflict resolution procedures.

Fig. 4. Autonomous Partnership Relationship – *Joint Ventures*



The distribution of equity, or the control over (B) may be related not only to the financial contribution of each partner, but also to contribution of technology, know-how, brand name, other intangible assets, access to world markets. It is evident that the network of suppliers established by (B) will be directly influenced by the terms and conditions established by the contracts with (C) and (D), including the level of autonomy in its strategic decision making.

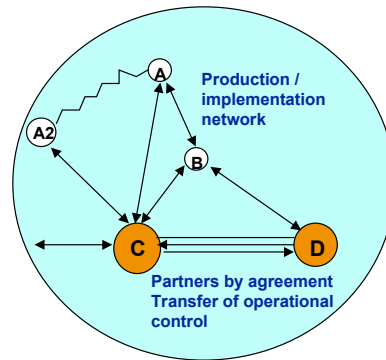
The joint ventures are seen as a form of strategic alliance between independent firms that aim at enhancing their strategic capabilities through co-operation. Joint ventures are also seen as investment forms used by MNCs from developed countries to enter developing countries (Austin, 1990). The choice between equity and non-equity joint venture is a function of the access to capital and internal capabilities, as well as a response to environmental uncertainties and the risk conditions of the host country (Pan and Li, 2000).

4.4. *Interdependent Partnership Relationship:*

Interdependent Partnerships are an under-researched area, and substantially difficult to explain using current theoretical frameworks. An industrial co-operation agreement is illustrated by the link between (C) and (D), where (C) could be a government, while (D) could be a MNC. Industrial co-operation agreements are complex configurations that include a combination of relational forms, such as licensing, know-how transfer, contractual joint ventures, turnkey projects, or more complex multi-lateral agreements.

Examples of industrial co-operation agreements are the Airbus project in the European Community (a partnership between aerospace and aircraft manufacturers and Governments from EU countries), and different counter-trade agreements, such as the defence aircraft industry in Australia, or the rehabilitation of coal washery plants in Vietnam - deals supported by governments, where payments are agreed in the form of barter, offsets, counter-purchase, and buy-back (Fletcher, 1996).

Fig. 5. Interdependent Partnership Relationship – Industrial Co-operation and Counter-trade Network Relationship, Management Contract and Turnkey Contract



A turnkey contract is usually used for construction of new production facilities, and is illustrated by the position of the hypothetical firm (D) (Fig. 5.), which holds the responsibility for the design of a new plant (B), for the provision of technology and know-how, for the installation and later on the maintenance of the equipment. The completion of production unit (B) is usually managed by an engineering firm (D) on behalf of an investor (C). It is clear that these firms perform fundamentally different roles in the business network, and have different control over resource flows. Sometimes turnkey contracts may include ‘product-in-hand’ or ‘market-in-hand’ agreements, which includes a whole range of additional responsibilities - from training of personnel, to the sale of part of the project output. The network member (C) could be a government, which is the case of many oil-producing developing countries, or could be a large MNC or a local investor. The large size of turnkey deals usually include a variety of payments - from direct financial compensation, to ownership shares, or counter-trading with the output from the new plant.

The management contract could be shown by the position and the ties between the firms (C) and (D) (Fig. 5.). If (D) releases operational control to C, the directionality of links between (C) and (A), (A2), and (B) will be determined by the power and autonomy granted to (C) through its management contract with (D). The length of the contract between (C) and (D) will determine the structure and continuation of the network relationships of (C) with the other partners. Although there is not much academic research on management contracts, the latter are a popular form for businesses to acquire management services such as: facilities management, warehouse management, fund management. Among management contracts are also a variety of individual compensation agreements with CEOs already integrated by the firm, and contracts with business organisations and consultancy firms that can also enhance the managerial capabilities of a company. In case of large investment projects in globalised industries these contracts span across borders and stretch the boundaries of international business law.

All three types of complex multi-faceted and interdependent partnerships are project based business networks that involve asymmetric commitments by different partners, and are based on complementarity of knowledge and capabilities. While there is a general consensus on the motives for establishment of co-operative business alliances (sharing risk, generating new business, opening development opportunities, making use of complementary skills and resources, access to markets and distribution channels, prevention of firms to team up with more dangerous

competitors) (Young, 1989), there is still not enough discussion on the content of these partnerships and the specific network formations that enhance the variety of dependencies between firms.

All examples of foreign market entry demonstrate that the links between network members could be both national and international, and business networks could spread across borders on the same principles, as within particular national market.

5. Conclusions

The existing research on networks put emphasis on three groups of characteristics that determine different levels of analysis - the *actors*, the *content of relations*, and the overall network *configuration*. All three groups of network characteristics identify factors that influence the performance of firms in the entire net. The first group includes structural aspects of the network that derive from the position, the history, and the strategy of individual firms. The second group includes characteristics that describe the dynamics in networks, driven by bi-lateral and multi-lateral relations. The third group includes characteristics that are universal by nature and allow development of typologies of network configurations: hierarchies, structural processes and control mechanisms

One of the fundamental barriers to network analysis is the duality of networks - being simultaneously structures, as well as dynamic processes of exchanges and transactions between partners. The structuralist paradigm attempts to define basic principles that explain how network members occupy certain positions that link them together in a common structure, and how these ties facilitate exchange of resources. However, this analysis is of limited value to practising managers who need not only to construct relationships in the real business world, but also to fill these relations with content.

Analysis of the content of network relations requires a much more holistic approach. In this paper we discussed the fact that the content of a dyadic relationship is determined by the two partners involved in it, and their other network relationships, which spread across borders. Both actors usually define their individual strategies and exchange information about their intentions. The contract between them evolves as a negotiated strategy for mutual co-operation. The content of the relationship includes: a) the individual intentions of the partners, b) the negotiated strategy between them, and c) the exchange, or the transaction itself. This complexity requires a more in-depth analysis of the set of relations maintained by each partner, rather than merely mapping existing dyadic business links as structural characteristics of the network.

The paper advocates an interdisciplinary approach to international business network research that integrates distant fields of academic enquiry such as the internationalisation theory, the theory of strategic alliances, sociology of organisations and networks, and international business strategy.

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