



Network partner diversity, network capability, and sales growth in small firms☆



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ABSTRACT

Network partner diversity, which is the extent to which a firm possesses diverse network partners, could be beneficial to firms. Increased levels of network diversity, however, may result in declining sales growth. The study proposes that network capability can help manage the scope of diverse relationships effectively and by doing moderate inverted U-shaped relationship between network partner diversity and sales growth. Building on survey data and prospective five year sales growth data from archival sources, the study finds that an increased level of network diversity has a negative effect on sales growth, but network capability moderates the relationship.

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1. Introduction

An emerging research stream within the inter-organizational literature focuses on the influence of network diversity on firm performance (Swaminathan & Moorman, 2009; Wincent, Anokhin, Örtqvist, & Autio, 2010). Reassessing network diversity of partners is particularly relevant to small firms because they may lack resources to develop and maintain multiple ties. Many firms lack the strategic and tactical resources to enhance their network positions (Ahuja, Polidoro, & Mitchell, 2009) and have less advantageous network positions to achieve firm performance. Although a network of non-redundant specialized actors increases valuable exchanges in knowledge and resources (Reagans, Zuckerman, & McEvily, 2004), under increasing network diversity, small firms may lack the requisite resources and routines to identify effectively, transfer, and assimilate resources from diverse network participants. Extending prior work on network partner diversity (Swaminathan & Moorman, 2009), the present study suggests that the diverse knowledge available under such increasing diversity lacks complete exploitation because of limited

managerial cognitive capacity, especially in small firms; high coordination costs with diverse partners; and limited resources available to firms. Together, for small firms, higher levels of network partner diversity lead to decreasing returns in sales growth in terms of an inverted-U shaped relationship where downsides are increasingly difficult.

To this background, the present study further posits that firms can mitigate the declining sales growth from network partner diversity through network capability, namely the ability to maintain ties and to access and use network resources (Anand & Khanna, 2000; Kale, Dyer, & Singh, 2002; Walter, Auer, & Ritter, 2006). Rothaermel and Deeds (2006) propose that firms are likely to require similarly high levels of alliance management capability, or the ability to manage alliance networks, to mitigate marginal network positions and form relationships with resource complementary partners. This relationship is particularly interesting to investigate, because research is limited on firm-level characteristics, such as the role of network capabilities in reaping performance benefits from external network relationships (Shipilov, 2006).

Although this is not the first research that discusses the limitations of networks (Swaminathan & Moorman, 2009; Wuyts, Dutta, & Stremersch, 2004), the present study argues that examining the decreasing returns of network partner diversity and assessing the mitigating effects of network capability contribute to understanding the benefits and management of network diversity in small firms. Drawing from prior studies (Baum, Calabrese, & Silverman, 2000; Walter et al., 2006), because using objective secondary data is particularly relevant for the examined relationships, the study relies on archival performance data. Thus, taken together, the present study provides theoretical and empirical insights into the

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complex nature of the relationship between network partner diversity and firm performance for small firms and explores the moderating influence of network capability on the proposed relationship.

2. Theoretical background and hypotheses

2.1. Network partner diversity and sales growth

Network partner diversity represents the degree to which the firm's network relationships with partners involve firms that possess non-redundant knowledge, skills, and capabilities (Swaminathan & Moorman, 2009, p. 54). Interacting with diverse network participants, such as competitors (Rothaermel & Deeds, 2006), suppliers (Sako, 2004), and customers (Dyer & Singh, 1998) can help firms manage the diversity of information (Koka & Prescott, 2008; Lee, 2007) from external sources to create new and valuable technological combinations (Capaldo, 2007; del Mar Benavides-Espinosa & Ribeiro-Soriano, 2014). This interaction improves the market potential and financial value of the firm (Banbury & Mitchell, 1995; Ciravegna, Majano, & Zhan, 2014; Kim & Lui, 2015). Interactions with different types of external actors facilitate discovery of new opportunities (Shipilov, 2006) and enable firms to use a variety of instrumental, normative, and procedural information. Therefore, network diversity is particularly important for firms that lack the internal resources and routines to acquire and exploit divergent information. In addition to the above benefits, network partner diversity further improves a firm's ability to enhance flexibility.

Although network partner diversity can have positive influences (Parida, Westerberg, & Frishammar, 2012), increasingly diverse network participants could lower sales growth in small firms. First, at higher levels of network partner diversity, small firms face increasing challenges toward acquiring diverse and novel information and resources. Network partner diversity increases the cost of identifying and assimilating knowledge. Owing to lower absorptive capacity and increasingly heterogeneous participants, firms find increasingly difficult to acquire, assimilate, transform, and exploit diverse knowledge (Casaneva, Castro, & Galán, 2013), which derive from interacting with knowledge sources that are farther from the familiar knowledge base of a small firm (Martin & Mitchell, 1998). With a decreasing knowledge overlap, decoding and interpreting distant knowledge are especially challenging for small firms (Szulanski, 1996).

Second, limited knowledge repositories and less established knowledge routines can further restrict small firms' attempts to transfer and assimilate diverse knowledge. Learning from partners in diverse network configurations largely depends on the extent to which incentives and organizational goals align (Dyer & Singh, 1998). As network diversity increases, firms get entangle in inefficient network structures. In such structures, the probability for internal conflicts increases because network partners have divergent goals. In addition, small firms possess lower levels of influence, leading to a reduced ability to exploit diverse knowledge to their advantage. Thus, to manage knowledge transfers successfully, small firms must invest significant internal resources (regardless of the deployed contracting or trust-building devices), which becomes increasingly difficult and costly for firms when engaging with multiple diverse partners (Szulanski, 1996). This leads to the first hypothesis. H1: The relationship between network partner diversity and sales growth follows an inverted U-shaped curve.

2.2. Network capability and firm financial performance

Having diverse network relationships is not enough to improve performance. Instead, firms need to develop and use network relationships (Kale et al., 2002). Network capability, which is "a firm's ability to develop and utilize inter-organizational relationships to gain access to various resources held by other actors" (Walter et al., 2006, p. 542), enables firms to be better equipped to take advantage of increasingly diverse networks (Ritter & Gemünden, 2003).

Firms with network capability can improve their overall positions in a network and develop a superior ability to manage interorganizational relationships (Hagedoorn, Roijakkers, & Van Kranenburg, 2006). Network

capability is distinct from concepts such as the quality of information, network redundancy, or cohesion that are necessary to maintain the strong relationships necessary to build trust and increase the richness of network exchanges. Instead, according to Walter et al. (2006), network capability encompasses a broader process ranging from the initial identification of a prospective network participant to developing and exploiting network relationships. The present study builds on prior studies and proposes that a firm's network capability appears in four interrelated components, namely coordination, partner knowledge, relational skills, and internal communication (Walter et al., 2006). Taken together, these mutually reinforcing components form a strong network capability.

Firms with network capability can help successfully establish and maintain network relationships with attractive and influential external actors. Such interorganizational relationships develop legitimacy, which in turn positively influences firm performance (Stuart, 2000). In addition, firms with high network capability tend to receive information about competitors' movement, which helps them take the necessary risks and quickly respond to changes in the market (Ritter & Gemünden, 2004). In addition, through activities oriented toward developing relationship skills, by improving internal communication, and increasing partner understanding, a firm can reduce the probability of indulging in network relationships with key customers, suppliers, or other strategic actors that may have potential but also could lead to higher costs. Extending the relationships between network capability and firm performance from past studies in established firms (Anand & Khanna, 2000; Kale et al., 2002; Rothaermel & Deeds, 2006) to small firms leads to H2. H2: Network capability associates positively with sales growth.

2.3. Interaction of network partner diversity and network capability

Drawing from hypothesis 1, the present study highlights that at higher levels of network partner diversity, firms incur costs associated with identifying and assimilating distant knowledge and coordinating diverse network ties. Because a firm's ability to manage and use diverse network relationships successfully represents a critical condition for reducing the costs associated with higher levels of network partner diversity (Rothaermel & Deeds, 2006; Walter et al., 2006), the present study discusses the mitigating effects of network capability on an increasingly negative relationship between network partner diversity and sales growth.

2.3.1. Enhancing the benefits of network partner diversity

First, network capability represents internal routines that help firms become aware and informed about "who knows what and where critical expertise resides within each firm" in the network (Dyer & Singh, 1998, p. 665). This perspective provides the critical initial steps toward effective knowledge transfer and developing a common understanding with firms from diverse backgrounds and industries. In addition, owing to the presence of advanced relational skills and internal communication, networked firms can sustain a collaborative environment where allying firms establish direct, intimate, and extensive relationships (Cohen & Levinthal, 1990). Second, network capability helps establish trust, reciprocity, and a positive exchange climate in firm's interorganizational relationships to reduce costs at high levels of network diversity (Adler & Kwon, 2002). Emphasizing on partner knowledge, networked firms are aware of their partners' organizational goals and reasons for engagement (e.g., incentives). By building network interactions around such an understanding, firms can create trustful operational relationships (Walter et al., 2006). Furthermore, by combining relational skills with internal communication routines, networked firms can enable effective communication and cooperation, whereas reducing the likelihood for conflicts, free-riding behavior, and transaction costs (Dyer & Hatch, 2006).

2.3.2. Mitigating costs of network partner diversity

Firms with high network partner diversity can mitigate increasing search and coordination costs through higher levels of network capability. Because of the importance of combining new and diverse knowledge,

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