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Embeddedness and growth of small businesses in rural regions

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ABSTRACT

This paper explores the development of local small businesses in rural peripheral regions compared to businesses in urban settings, and the impact of the local business' location and level of embeddedness on its growth, measured by the number of employees. The study was conducted using a mixed-method sequential methodology, with a quantitative survey of 613 small rural and urban businesses in Israel, followed by 13 in-depth interviews with rural entrepreneurs who were selected from the quantitative sample.

This study found an advantage of double-layered network embeddedness employed by rural business owners, i.e. both local and outside of the region, for the growth of small and medium sized enterprises (SMEs). The contribution of this study is expansion of the concept of extra-local embeddedness to enhance growth of SMEs in rural-peripheral regions.

The main theoretical contribution of this paper is the description of double-layered network embeddedness employed by rural business owners, who are embedded in local and regional networks, alongside extra-regional and national (extra-local) networks, in an attempt to overcome some of the distance-related obstacles of their location. Furthermore, our findings suggest that this type of embeddedness, as well as the embeddedness of family members in small businesses, can enhance the growth potential of the local businesses, as does the location of the business in the owner's home or in its close proximity. We propose a spatial model of the embeddedness of small rural businesses at various levels of proximity.

1. Introduction

Rural areas in developed countries have typically undergone a twofold transformation process over the last few decades: the transformation of an agricultural region to a multi-functional one, where residents have varied livelihood sources, and agriculture has become only one of many (Hoggart, 1997; Sofer, 2004; Ngo and Brklacich, 2014; Sofer and Saada, 2016); and the transformation in population composition due to incoming migration of new, non-agricultural residents, who leave urban regions and move into formerly-agricultural communities (Charney and Palgi, 2014).

These transformations affect rural regions, and change, among other things, their employment status and occupational composition. New residents, as well as returning residents, have different prospects for their agricultural land, beyond the importance of the connection to the soil and the land. The agricultural parcels of land are now perceived as a financial resource, offering a variety of livelihood options besides agriculture, including the establishment of small enterprises (Buhalis and Cooper, 1998; Sofer, 2004; Schnell et al., 2015).

In this study, we distinguish between businesses located in rural regions, and those located in urban regions. Studies have shown that small businesses operating in rural regions, away from urban centers or big cities, have different attributes, such as local ties, and different development activities (Sofer and Saada, 2016). Geographical distance can significantly affect the level of businesses' exposure, i.e. their ability to reach potential clients and suppliers. We assume that network embeddedness can help entrepreneurs overcome some of the distance-related obstacles. The current paper will examine network activity of rural entrepreneurs, their level of embeddedness in these networks, and the effect of their activity on the growth of small businesses in these regions, compared to the same influence over businesses in urban regions.

Our findings suggest that the location of a business near the home of its owner positively affects its growth, as does the embeddedness of family members, and particularly the life partner of the business owner. We distinguish between the embeddedness of business owners in intra-regional networks vs. extra-regional ones, and find that the latter has a pronounced positive effect on business growth in rural areas.

Furthermore, the findings reveal double-layered embeddedness, in both local networks and national financial-business networks, which

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operate in large urban centers. The findings provide further insights into the impact of local and extra-local embeddedness on the future growth potential of small businesses in rural areas and of the rural location of a business on its growth potential, and emphasize the importance of embeddedness in local and external networking. Finally, we present a model that summarizes the embeddedness patterns of small businesses in rural regions, and present recommendations for policy makers. The study findings will influence the future planning and development of rural areas, an issue rarely researched in recent years.

The paper is structured as follows: the next section introduces the concepts of embeddedness and network activity. Here we explore the different actors in these networks, their patterns of activity, the networks' contribution to the actors, their spatial and functional characteristics, and the significance of embeddedness for business owners, while referring to knowledge and information flow, collaborations, and the contribution to business success. The following section explores the research population, the traits of contemporary Israeli rural regions, and the employment and occupational changes in these regions. The paper proceeds with a description of the mixed method methodology used in the study, followed by presentation of our findings, a discussion of the results and conclusions and possible implications for practitioners and policy makers.

2. Theoretical background

The term *embeddedness* refers to an actor's level of activity in different kinds of networks. It was first used in the context of sociological and economic approaches (Myrdal, 1957; Granovetter, 1983; Swedberg, 1993), characterizing economic activity as a by-product of social relations and interactions between different elements. Embeddedness reflects the array of social relations that characterizes economic relations (Granovetter, 1985). The theory of embeddedness suggests that economic activity is driven by interests and dynamic systems of social relations between elements with varied needs; hence, social relations affect the motivation to develop collaborations and economic activity (Johannisson, 1987; Uzzi, 1996). The first of these refers to exchange networks, encompassing a firm's commercial relations with customers and suppliers. Second, communication networks incorporate the organizations and individuals which provide a firm with contacts and knowledge to inform its business activities. These might include consultants and advisors, industry bodies and government agencies (Szarka, 1990:12). Embeddedness in networks exposes actors to information, ideas, and shared values, and promotes collaboration, particularly among primary groups and small societies. Valuable embeddedness is characterized by trust and includes processes of innovation and the spreading of ideas (Breton-Miller and Miller, 2009). The networks in which one is embedded contribute to the development of professional knowledge, increasing cooperation and power balance between actors in the same field (Gribic, 2007; Özen et al., 2016).

The development of networks is the result of improved communication channels and business owners' economic mindset, leading to the creation of complex, multi-layered relationships between actors, groups, and institutions, regardless of geographic or physical limitations (Taylor, 2010). The level of one's activity in these networks can testify to the level of economic integration of a business owner in the market, and even signify the level of their economic success (Schnell et al., 2015). Most of the activity in these networks is symmetric; every other actor is embedded in the network to promote shared activity. The application can be personal and specifically directed, or rather general and inclusive of all the network's actors. The nature of the shared activity may be spreading formal or informal knowledge, voicing opinions, asking for professional advice, or inviting members to take shared action (Buckley, 2012).

In contrast, embeddedness in contemporary literature refers to vertical network activity as well. In vertical models of embeddedness, large, economically powerful entities affect the rules of conduct and force small firms to change their business practices. This type of embeddedness characterizes the activity of smaller businesses and second-level manufacturers, like suppliers and subsidiaries active in a global economy (Goyal et al., 2014; Bryman and Bell, 2015).

The theoretical definitions of embeddedness offer a distinction between the analytical approach – which examines embeddedness characteristics, the definitions of network activities, and the motivations of members to encourage network cooperation (Zukin, 1990; Uzzi, 1996; Bryman and Bell, 2015) – and the practical approaches – which examine the network activity in practice, and particularly the growth of a network, its spreading through space, the number of actors and the impact of the activity on business growth and partnerships (Jack and Anderson, 2002; Pallares-Barbera et al., 2004).

The types of activity in a given network, as well as the scope and depth of the relations between its actors, are highly significant, affecting business decisions and encouraging new collaborations between actors of different types. Pathak et al. (2007) and Huggins and Thompson (2013) perceived network activity and the level of embeddedness as part of a business' socio-economic capital. Thus, a business with a superior level of networking and embeddedness will have greater growth potential (Casciaro and Piskorski, 2005; Gulati and Sytch, 2007; Hagedoorn and Frankort, 2008).

Network embeddedness may include direct, constant contact between actors aimed at performing tasks, making concrete decisions, and making short-term deals; it may also include indirect ties – mainly the creation of new interactions with unfamiliar actors, which may lead to significant connections in the future. These interactions expose the network actors to the knowledge and innovation available inside the network, and promote future collaborations, which might turn into concrete actions in the future (Huggins and Thompson, 2013). Network relationships are based on general familiarity; a dynamic based on long-term connections and constant examination of other actors embedded in the network. By being embedded in a network, the entrepreneur is able to create a variety of relationships and have different connections and interactions (Putnam, 1995; Pathak et al., 2007). Gilsing et al. (2008) and Granovetter (1983, 2005) both made use of the term Centrality – the level of embeddedness of a specific actor – based on their number of network contacts. They found a strong correlation between the level of R&D and the centrality of actors, partners and members with different interests; an embeddedness network can provide information about its strategic traits and thus encourage others to collaborate with it. By mapping the networks of a specific business, it is possible to predict its level of financial activity and long-term growth rate (Adler and Kwon, 2002; Choi and Kim, 2008).

Tregear and Cooper (2016) focused on the embeddedness of businesses in rural areas. They suggested that network embeddedness in rural communities allows sharing knowledge and bringing people closer together, thus empowering both individuals and the community. They found that interpersonal relationships between actors are particularly important for rural entrepreneurs compared to their urban counterparts. It was found that in traditional societies, small business owners tend to rely more on family- and community-based embeddedness, rather than interactions with outside elements (Bowler et al., 1996; Hinrichs, 2000; Schnell et al., 2015).

Korsgaard et al. (2015) distinguished between “entrepreneurship in the rural” and “rural entrepreneurship”; while the former represents entrepreneurial activities with limited local embeddedness, local embeddedness is measured by the local use of five consistent variables: sales, labor, other inputs, capital, and information (Smallbone et al., 2003; Sheller and Urry, 2006; Bosworth, 2009; Kalantaridis, 2009).

Hinrichs (2000) and Kalantaridis and Bika (2006) explored different embeddedness patterns across industries and showed that entrepreneurs in rural regions working in local production and services tend to use local networks, while art and production entrepreneurs tend to extend their use of networks beyond the local sphere.

Mackinnon et al. (2004) described activity networks related to the