

HOW RELATIONAL CAPABILITIES MATTER? ORGANIZATIONAL CONTEXT AND PERFORMANCE OF INTERNATIONALLY ORIENTED SMES

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This article sheds light on the organizational context enhancing development of relational capabilities and examines the significance of relational capabilities for SMEs' financial and non-financial performance. The firm's relational capability is measured separately in customers' and suppliers' networks. This study is based on a sample of 67 SMEs from the five most internationalized industries in Slovenia. Research hypotheses are tested with linear regression models. The results support our prediction that fostering internal social capital, coupled with the usage of economic motivators, augments a firm's relational capability in a supplier network, which in turn is associated with better performance outcomes, both financial and non-financial. The results on relational capability in a customer network with respect to performance are less conclusive, indicating that vertical ties of internationally oriented SMEs (with suppliers and customers) are not of equal importance.

JEL Classification: M16, F23

Introduction

The phenomenon of cooperative relationships has become one of the most important areas in strategic management research in recent decades. It is broadly accepted that in a networked economy, in which pressures from globalization and technological change are more and more evident, value creation processes take place not only at the level of individual firms but also at the level of networks. Gnyawali and Madhavan (2001) define networks as cooperative relationships in which firms are embedded and which influence the flow of resources among them. Rich literature on cooperative relationships demonstrates that they enable firms to acquire important resources (incl. technology, knowledge, and financial resources), gain access to new markets, increase responsiveness and flexibility, achieve greater efficiency of operations and in turn improve performance (Yli-Renko et al., 2002; Lorenzoni and Baden Fuller, 1995; Lorenzoni and Lipparani, 1999). However, research on relational capabilities of SMEs originating from the CEE region is still rare. Cooperative relationships are particularly important for firms originating from transition markets, which follow the path of international growth. In comparison to their counterparts

from developed economies, they often lack experience and resources and thus they must find ways of compensating such deficiencies (Mathews, 2006). In this respect the relational capability, defined as the capability to interact with other firms that "accelerates the lead firm's knowledge access and transfer with relevant effects on company growth and innovativeness" (Lorenzoni and Lipparani, 1999, p. 317) is of critical significance as it influences the flow of resources among firms in networks.

We seek to make two important contributions to the understanding of relational capabilities of internationally oriented SMEs. First, by combining resource-based theory and the relational view, we hope to contribute toward a better understanding of organizational context (i.e. firm-specific factors) that promotes development of the firm's relational capability. We focus on internal social capital, economic motivation policy and decision-making style. Second, we examine the impact of relational capabilities on SMEs' performance. We differentiate between financial (profitability and efficiency) and non-financial (marketing and technological competences) performance. Thus, two research questions are addressed:

- 1) Does organizational context (internal social capital, economic motivation policy and decision-making style) influence the level of relational capabilities of SMEs?
- 2) Does a firm's relational capability support financial and non-financial performance?

The article is structured as follows. We first discuss the theoretical framework where we integrate the resource-based view and the relational view in order to develop research hypotheses. In the following section, we detail the data selection procedure and then we provide the results of the analysis. We conclude with a discussion on the implications and limitations of our findings.

Literature Review and Hypotheses

This study combines the resource-based view (RBV) and the relational view to shed light on the context supporting development of relational capability and its association with performance. Dyer and Singh (1998) noticed that the relational view and the RBV are to some extent in opposition, as the RBV claims that sources of competitive advantage are tangible and intangible assets that have specific qualities (valuable, rare, inimitable, non-substitutable) and belong to a firm (Barney, 1991), whereas the relational view posits that ownership and control of the rent generating processes are collective (Dyer and Singh, 1998). However, the two theoretical approaches can be seen as complementary because specific resources and capabilities that are sources of competitive advantage (the RBV) may result from processes of cooperation with external partners (the relational view). Moreover, the firm's ability to leverage such processes as generators of intangible assets, particularly knowledge, depends on the organizational context, which determines the firm's capacity to absorb and use the knowledge embedded in external relationships (Szulanski, 1996). In this study three aspects of organizational context and their significance for development of relational capabilities are examined: internal social capital, economic motivation policy and decision-making style.

The significance of the firm's internal social capital for its ability to store knowledge has been suggested by numerous researchers. Yli-Renko and colleagues define internal social capital as "the extent and quality of relationships between individuals and units within a given firm" (Yli-Renko et al., 2002, p. 283). They posit that internal social capital influences the process of organizational learning – acquiring, creating and employing new knowledge. Organizational learning is further enhanced by internal routines that make it possible for a firm to develop, store and apply new knowledge (Nelson and Winter, 1982; Cohen and Levinthal, 1990). Internal social

capital facilitates learning because it improves the efficiency of internal communication. Moreover "shared systems of meaning established through rich internal communication also enable the firm to quickly assess knowledge items and to discard irrelevant ones, thus improving its efficiency of search heuristics" (Yli-Renko et al., 2002, p. 283), which are applied by firms before new knowledge is codified. In that way internal social capital enables a firm to internalize what it has learned from external partners and improves efficiency of the transfer of knowledge (Nahapiet and Ghoshal, 1998). In brief, we posit that the internal social capital of a firm allows for better usage of external knowledge and increases its relational capability:

H1: The higher the level of internal social capital, the higher the level of relational capability (both in a supplier and a customer network).

Although decisions on partner search and selection are typically made at the level of managers, the critical role in the absorption and usage of new knowledge, and thus in creation of relational capability, remains in employees' hands. As they are involved in day-to-day contacts with representatives of external partners, they determine the efficiency of the external information gathering process, which Johnson and Vahlne (1977) have shown when examining the processes of internationalization of small Swedish firms. Given that one of the barriers to knowledge transfer is a lack of motivation on the part of the recipient of knowledge (Szulanski, 1996), it is reasonable to consider motivation of employees as one of the factors influencing the firm's relational capability. Thus, the following is hypothesized:

H2: The higher the level of employees' motivation, the higher the level of relational capability (both in a supplier and a customer network).

The location of the decision-making authority in an organizational structure should also influence the firm's relational capability. A highly centralized decision-making style implies that only a CEO (or the owner) has the right to make key decisions, and the rest of the managers and employees are only executing them. Such a high level of centralization imposes limitations on employees' possibilities to apply new knowledge (they have no right to make decisions), and it also lowers their motivation (Shipton et al., 2002). On the contrary, a decision-making style that encourages employees' active participation may result in organizational benefits common to decentralization. In such firms, it is more likely that employees are involved in work, take up new challenges and identify with organizational objectives. Decentralization may be an effective mechanism that allows an organization to establish and maintain close customer relationships and enhance knowledge of customer needs

(Van Gorder, 1990). Decentralization leads to the situation in which employees are more likely to support the process of information exchange and assimilation and therefore it influences the quality of this flow. In sum, it is hypothesized that decision-making style (centralized vs. decentralized) impacts a firm's relational capability:

H3: The higher the level of centralization in decision making, the lower the level of relational capability (both in a supplier and a customer network).

Apart from testing hypotheses on the relationship between organizational context and relational capabilities, we also examine their significance for financial and non-financial performance. Gulati and colleagues (2000, p. 207) argue that "a firm's network allows it to access key resources [...] that have the potential to maintain or enhance a firm's competitive advantage". Similarly, Ireland and colleagues (2002) posit that strategic alliances provide not only access to resources but they are also a source of learning and in turn competitive advantage. Firms involved in alliances with innovative partners tend to exhibit stronger performance (Baum et al., 2000). In the theory overview, Lorenzoni and Lipparani (1999) indicate that partnerships are motivated by the need to achieve production efficiency, access to new markets and skills, achieve time compression in the development of new products and the search for new technological opportunities. Research evidence shows that internationally oriented firms benefit from participation in both home-based and foreign-based networks. Reuber and Fisher (1997) observed that ability to establish cooperation with foreign partners has led to a higher level of SME internationalization. Also Zhou and colleagues (2007) confirmed that networks "help internationally oriented SMEs to go international more rapidly and profitably" (2007, p. 673). Analyzing Canadian biotech startups' performance, Baum and colleagues (2000) provided broad support for the notion that alliance network composition affects the firm's early performance. For example, alliances with pharmaceutical companies and universities lead to higher rates of patenting and growth in revenue. Other research indicates that the lead firm's relational capability based in a supplier network may lower total coordination and production costs (Lorenzoni and Lipparani, 1999). Thus we hypothesize that firms possessing a capability to establish and maintain cooperative relationships with suppliers and customers also achieve financial benefits, i.e. higher profitability and efficiency:

H4a: The higher the level of a firm's relational capability (both in a supplier and a customer network), the higher the level of financial performance in terms of profitability (ROA).

H4b: The higher the level of a firm's relational capability (both in a supplier and a customer network), the higher the level of financial performance in terms of efficiency (VA per employee).

Firms possessing relational capability may also expect non-financial benefits, based on knowledge transfer and development of organizational capabilities, particularly international marketing capability and product capability. For example, Ellis (2000) observed that "knowledge of foreign market opportunities is commonly acquired via existing interpersonal links rather than collected systematically via market research" (2000, p. 443). Elango and Pattnaik (2007) noticed that learning within the network (from other network members in the home country) supports development of capabilities for international operations. We expect that firms characterized by higher levels of relational capability possess also higher international marketing capability. The second organizational competence that may benefit from close, cooperative relationships with business partners is product and production capability, which reflects firms' technological knowledge. Lorenzoni and Lipparani (1999) argue that one of the motives of inter-organizational cooperation is to achieve time compression in the development of new products and the search for new technological opportunities, which depicts the product and production capability. Thus, a firm's relational capability that enhances access to and transfer of external knowledge may lead to development of product and production capability:

H5a: The higher the level of relational capability (both in a supplier and a customer network), the higher the level of non-financial performance in terms of technological capabilities.

H5b: The higher the level of relational capability (both in a supplier and a customer network), the higher the level of non-financial performance in terms of marketing capabilities.

Methodology: Sample and Measures

Research was conducted on a sample of 67 small and medium¹ Slovenian exporters, operating in five industries with the highest average share in Slovenia export in years 2003-2007: manufacture of machinery and equipment; manufacture of

1 According to the Slovenian companies act from 2006, a small or medium enterprise is one that fulfills two out of three criteria: (1) the number of employees is between 11 and 250; (2) the level of net sales is between 2 000 001 and 29 200 000 Euros; (3) the level of assets is between 2 000 001 and 14 600 000 Euro. Other categories of firms are either micro or large enterprises.

motor vehicles, trailers, etc.; manufacture of chemicals and chemical products; manufacture of basic metals; and manufacture of furniture. The sample covers 27.8% of the SME population in these five industries. The rationale behind the selection of export oriented SMEs results from the notion that intangible assets that can be acquired through cooperative relationships with foreign partners are significant for the internationalization process of firms originating from emerging economies (Mathews, 2006). Also, such firms typically have limited tangible assets and limited institutional support, which they have to compensate for with knowledge acquired from foreign partners (Bruton et al., 2008; Meyer and Peng, 2005). Between late 2008 and April 2009, 67 telephone interviews, using a pretested questionnaire with measurement scales based on literature review, were conducted with the chief managers/CEOs of these firms. Firms in the sample are described in Table 1.

Table 1: Characteristic of firms in the sample (N=67)

	Average	S.D.	Range
Age of firm (years)	15.91	7.09	2 – 34
Number of employees	79.95	59.51	13 – 278
Foreign sales to total sales (%)	57.78	27.64	3-100
Net sales (million Euro)	7.48	5.65	2.02 – 33.22

Internal social capital was measured with four items (Yli-Renko et al., 2002; Nahapiet and Ghoshal, 1998). Respondents were asked to evaluate, on a five-point scale, the following items concerning a firm's internal cooperation: (1) there is close continuous cooperation between different departments of the organization, (2) employees' jobs consist of a great variety of different kinds of duties, (3) group work is very important in the firm, (4) employees are rotated between different jobs in the firm. The factor analysis indicated that the items' loadings were between 0.439 and 0.774. The construct has a low Cronbach's Alpha of 0.503, but it is satisfactory in exploratory studies (Suaraz-Ortega and Alamo-Vera, 2005). Economic motivation policy was controlled with the log of average monthly salary per employee. Although the measure is imperfect, it is often used as a proxy for employee motivation (Rynes et al., 2004). It also allows for objective comparison between companies. Regarding decision-making style, respondents have been asked who is responsible for strategic decision making (the owner/CEO or a group of top managers) and what is the role of employees in key decision making (whether they are informed, consulted or they actively participate). According to the answers to these two questions, six situations of

decision-making style can be identified, from most centralized (decisions are made solely by the owner/CEO, employees are informed), to least centralized (decisions are made by the top management team, employees actively participate).

Relational capability was measured separately in suppliers' and customers' networks. Respondents were asked to indicate: (1) the proportion of close, cooperative suppliers (or customers) of total number of suppliers (or customers); (2) the perceived value and significance of information acquired from their partners (they assessed separately on a five-point scale information acquired from suppliers and customers). As these two items were measured on different scales, they were first standardized and then summed to create a single score, separately for relational capability in a supplier network and in a customer network.

Financial performance was measured by profitability (return on assets) and efficiency (the log of value added per employee). Values of the performance indicators were taken from the GVIN database.

Non-financial measures of performance were product and marketing capabilities. The product and production capability was operationalized by five items (Andersen and Kheam, 1998). Respondents were asked to indicate, on a five-point scale, the extent to which they agreed with each of the following statements: (1) the technology of the firm's products is superior to that of competitors, (2) the firm has the highest product quality in the industry, (3) the firm's products have the best warranty/service arrangements in the industry, (4) the firm has the most advanced production equipment in the industry, and (5) the firm has a reputation of a technologically advanced company. The factor analysis indicated that loadings of five items that constitute the variable (product capability) were between 0.489 and 0.795. A further reliability analysis showed that the construct had a Cronbach's Alpha of 0.707 indicating a good reliability.

International marketing capability was measured by five items (Andersen and Kheam, 1998, Yli-Renko et al., 2002): (1) the extent of analysis done when selecting foreign markets, (2) the extent of systematic selection of entry mode, (3) the extent of analysis of foreign competitors, (4) the extent of analysis of foreign customers, and (5) the extent of analysis of foreign distributor channels. The loadings of the all five items were between 0.799 and 0.868. The construct has a Cronbach's Alpha of 0.888 indicating a high reliability.

In this study, three control variables were also employed – the firm's age, size (controlled with the log of total number of employees) and industry (controlled with dummy variables). Correlations for all variables are shown in Table 2.

Table 2: Correlations and descriptive statistics

Variables	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.
1. Internal social capital	1										
2. Economic motivation policy	-.119	1									
3. Decision-making style	.024	.106	1								
4. Relational capability (suppliers)	.379***	.262**	-.015	1							
5. Relational capability (customers)	.334***	.065	-.072	.720***	1						
6. ROA	.128	.254**	-.019	.266**	.193*	1					
7. VA per employee (log)	.001	.701***	-.052	.302**	.093	.610***	1				
8. Product capabilities	.345***	.226*	.032	.350***	.085	.030	.199*	1			
9. International marketing capability	.093	.147	-.211*	.295**	.200*	.090	.232*	.089	1		
10. Company size	.056	-.368***	-.251**	.047	.175	-.254**	-.319***	-.089	.128	1	
11. Company age	-.113	.122	-.070	.113	.022	-.249**	.005	.187*	.189*	.352***	1
Mean	15.57	3.04	3.13	0.00	0.00	3.82	4.40	18.31	15.91	1.79	15.91
Std. Deviation	2.32	.12	1.58	1.35	1.46	7.29	.19	3.04	4.18	.32	7.09
Min	9.00	2.75	1.00	-3.28	-3.47	-12.02	3.98	11.00	7.00	1.11	2.00
Max	20.00	3.33	6.00	2.61	2.81	36.96	5.02	25.00	25.00	2.44	34.00

Note: *** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$

Analysis and Results

Regression models have been used to test the research hypotheses. The results are presented in Table 3. Due to the fact that two constructs of relational capability in a supplier and in a customer network are significantly and highly correlated (see Table 2), they cannot be included in one model – thus separate regression models (models 3-6) for each of the constructs have been run.

Model 1 tests hypotheses 1-3 on the relationship between firm-specific factors and relational capability in a supplier network. Model 1 is significant ($F = 3.397$, $p = 0.002$). Two out of three firm-specific factors are significant and their coefficients are, as expected, positive. These are: internal social capital ($p = 0.001$) and economic motivation policy ($p = 0.005$). The third organizational factor, decision-making style, is insignificant ($p = 0.914$). Therefore in the context of supplier network, H1 and H2 are confirmed, and H3 is rejected. Model 2 tests the hypotheses (1-3) on the relationship between firm-specific factors and relational capability based in a customer network. It was run twice due to the fact that the initial version of model 2a, and also control model, were statistically insignificant (respectively $F = 1.697$, $p = 0.111$; $F = 0.983$, $p = 0.445$). After exclusion of dummy variables for industry, Model 2b is significant ($F = 2.512$,

$p = 0.039$). According to the results, internal social capital ($p = 0.006$) positively impacts the level of the firm's relational capability (customer network). The economic motivation policy ($p = 0.126$) and decision-making style ($p = 0.705$) are both insignificant. In the context of customer network only H1 is confirmed, and H2 and H3 are rejected.

Models 3a and 3b estimate the assumption that profitability (measured by ROA) grows together with the level of relational capabilities in a supplier and a customer networks (H4a). Both are significant (Model 3a: $F = 4.333$, $p = 0.001$; Model 3b: $F = 3.564$, $p = 0.003$). Relational capability based in a supplier network ($p = 0.001$) and in a customer network ($p = 0.011$) is statistically significant, confirming the hypothesis H4a. Models 4a and 4b test the hypothesis H4b - that an increase in the level of relational capability is associated with an increase in efficiency (measured by the log of VA per employee). Both are significant (Model 4a: $F = 4.161$, $p = 0.001$; Model 4b: $F = 2.880$, $p = 0.012$). Relational capability in a supplier network is significant ($p = 0.003$), while relational capability in a customer network appears to be insignificant ($p = 0.141$). Thus, H4b is only partially confirmed.

Models 5a and 5b estimate the assumption that product and production capability grow together with the level

Table 3: Estimates for the linear regression models

Independent variables	Rel. capability (suppliers)	Relational capability (customers)		ROA		VA/EMPL		Product capability		Int. marketing capability	
	Model1	Model 2a	Model 2b	Model 3a	Model 3b	Model 4a	Model 4b	Model 5a	Model 5b	Model 6a	Model 6b
Internal social capital	0.398***	0.326**	0.341***								
Economic motivation policy	0.374***	0.203	0.203								
Decision-making style	-0.012	-0.037	-0.046								
Rel. capability (suppliers)				0.376***		0.351**		0.300**		0.237*	
Rel. capability (customers)					0.301**		0.189		0.071		0.152
Company size	0.152	0.249	0.237	-0.189*	-0.237*	-0.335**	-0.361**	-0.178	-0.180	0.095	0.072
Company age	0.044	-0.068	-0.051	-0.136	-0.090	0.099	0.133	0.273**	0.295**	0.040	0.065
Industry 1	-0.232*	-0.142		0.334**	0.304**	0.379	0.340**	-0.054	-0.100	-0.027	-0.050
Industry 2	-0.287**	-0.233*		0.318**	0.273**	0.244	0.176	-0.174	-0.257*	-0.072	-0.111
Industry 3	-0.053	-0.099		0.150	0.173	0.314**	0.331**	-0.166	-0.156	0.183	0.195
Industry 4	0.010	-0.054		0.394**	0.404**	0.231*	0.232*	0.168	0.159	-0.204	-0.201
Adjusted R2	0.246	0.087	0.103	0.261	0.214	0.251	0.166	0.164	0.081	0.101	0.069
F	3.397***	1.697	2.512**	4.333***	3.564**	4.161***	2.880**	2.854**	1.830*	2.058*	1.697

Note: Standardized regression coefficients are shown. *** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$

of a firm's relational capabilities (H5a). Both are significant (Model 5a: $F = 2.854$, $p = 0.012$; Model 5b: $F = 1.830$, $p = 0.098$). Relational capability in a supplier network is significant ($p = 0.015$), while relational capability in a customer network appears to be insignificant ($p = 0.568$), only partially confirming the hypothesis H5a. Models 6a and 6b test hypothesis H5b – that an increase in the level of relational capabilities is associated with an increase in international marketing capability. Only model 6a is significant ($F = 2.058$, $p = 0.063$). Relational capability in a supplier network ($p = 0.061$) positively impacts the level of international marketing capability. Therefore, hypothesis H5b is partially confirmed.

Control variable effects – Firm size and age appeared to be insignificant at explaining the level of relational capability (both in supplier and customer networks); however, industry is important with respect to that. Firm size is negatively related to both financial performance indicators. Larger firms are less efficient in creating additional value and have lower profitability. As predicted by Porter (1980), industry impacts financial performance. Firm age occurs to be significant only in case of product capability. According to the results, older firms are characterized by a higher product capability.

Conclusions and Managerial Implications

At the beginning of the article we have posed two important questions regarding the relational capabilities of SMEs originating from the CEE region. Building on the literature on cooperative relationships that suggests that close ties with external partners provide a number of benefits for the firm's resource base, capabilities, growth and performance, we have sought to identify organizational factors that enhance development of relational capabilities in the customer and supplier networks. Specifically we have asked: does organizational context (internal social capital, economic motivation policy and decision-making style) influence the level of relational capabilities of SMEs?

Our study provides support for the relationship between two factors of organizational context and relational capabilities in a supplier network, while the significance of only one factor was observed with respect to relational capabilities in a customer network. The research demonstrates that internal social capital is crucial for the formation of relational capabilities in both groups of partners. This finding bears important practical implications for managers in CEE. They should pay attention to development of internal social capital, taking responsibility for devising and implementing routines that support internal communication and teamwork. Thus, we support Yli-Renko, Autio and Tontti who argue

that “social capital should be seen as a resource that can and should be actively managed and harnessed, not as something that accrues over time as a by-product of the firm’s other activities” (Yli-Renko et al., 2002, p. 301).

The economic motivation policy appeared to be related to the capability of inter-organizational cooperation but only in the case of one group of partners. The study’s findings confirmed the hypothesis that the more intensive the use of economic motivators, the higher the level of a firm’s relational capability to develop a network of close, cooperative relationships with suppliers. It demonstrates that employee (economic) motivation is an important factor enhancing the development of a firm’s relational capabilities. It also supports the notion that (being involved in every day contacts with partnering organizations) employees on lower levels of organizational hierarchy have direct influence on the process of exchange and assimilation of new knowledge. Thus managers’ focus on organizational factors that impact employee motivation is justifiable and well-founded in the context of relational capabilities. It is also interesting to notice that the average level of monthly salary is positively and significantly correlated with profitability (ROA), efficiency (VA per employee) and product capability (see Table 1). However, the relationship between economic motivation policy and relational capabilities in a customer network was not observed, which may result from the sample selection. All examined firms are strongly oriented on export – just one firm has a foreign sales to total sales ratio (FSTS) lower than 5%, while the average FSTS for all firms in the sample is 57.8%. Therefore, it can be assumed that the majority of SMEs use export intermediaries, which could influence the results.

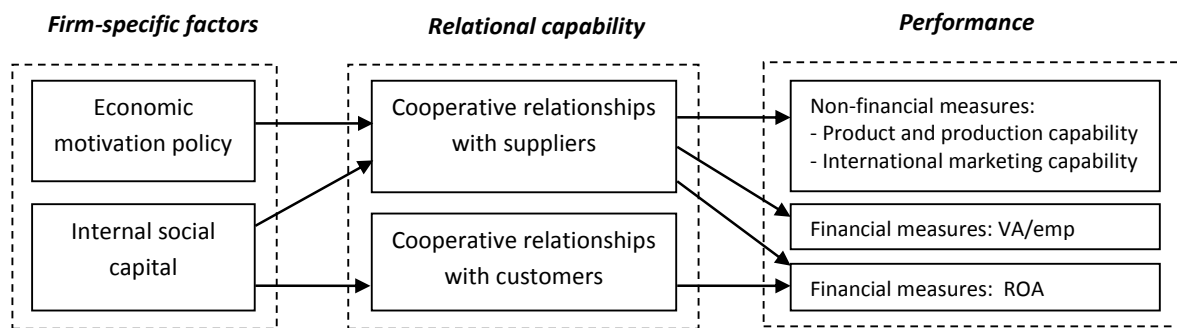
In case of the third organizational factor (decision-making style), we did not observe its significance for relational capabilities, either in the supplier or in the customer network. It was assumed that managers (owners/CEOs) would impact the firm’s relational capability through decision-making style as it is one of the factors influencing organizational climate and commonly linked with motivation theories (theory X, Y or Z, of which the latter two underline the role of teamwork and internal knowledge-sharing values). Despite the lack of expected results, we still do believe that focusing on qualities of owners/CEOs from the CEE region and as well as on management processes would make sense, because managers play a crucial role in influencing firms’ behaviors in the area of inter-organizational cooperation. They are responsible for development of external relationships (searching, selecting and initiating cooperation with external partners) and by doing so they determine the quality of the partners in the network (Ireland et al., 2002). Also Lorenzoni and Lipparani (1999) claim that

inter-firm networks can be deliberately shaped and designed by managers. However, we argue that in the search for specific managerial qualities, researchers have to go beyond simple characteristics (such as a manager’s age, education level, and even foreign language fluency and prior foreign business experience)². Future research should focus on the cognitive qualities of CEOs as the significance of the top managers’ attitude and perceptions for firms’ behaviors have been argued and confirmed by previous studies (e.g. Obloj, et. al. 2010; Nadkarni and Perez, 2007; Suarez-Ortega and Alamo-Vera, 2005).

The second question posed in the article is the following: does a firm’s relational capability support its financial and non-financial performance? In order to provide the answer we have examined how the relational capabilities of internationally oriented SMEs contribute to their performance not only in terms of profitability and efficiency, but also in terms of the development of technological and marketing capabilities, which are of crucial importance for a firm’s growth and survival. The study’s findings clearly indicate that the relational capabilities of internationally oriented, small and medium manufacturers are important organizational competences, and that cooperative relationships in a supplier network provide more benefits for the firm’s knowledge base than capability to cooperate with customers. Close, cooperative and information intensive ties with suppliers are statistically significant predictors for a firm’s financial performance, measured by profitability (ROA) and efficiency (VA) ratios. They also support development of a firm’s capabilities concerning technology (product and production) and international marketing capability. In contrast, we observed only one, but undoubtedly important, significant relationship between relational capability in a customer network and a firm’s profitability (ROA).

On the one hand, the study’s findings reveal that through cooperation with external partners (suppliers) and maintenance of close relationships with them, firms achieve not only better financial results but also develop crucial capabilities that are sources of new knowledge and improvement of financial outcomes. On the other hand, an interesting question arises: why doesn’t relational capability in a customer network have a positive influence either on efficiency or on non-financial measures of performance? A similar phenomenon was also observed in earlier research. For example, Baum et al. (2000) examined the relationships between

2 We checked the mentioned characteristic of CEOs in our sample of internationally oriented SMEs and none of them were statistically significant (or even close to statistical significance) in terms of their association with relational capability (measured by external cooperative relationships separately with customers and suppliers).

Figure 1: Organizational factors, relational capability and performance of internationally oriented SMEs

Note: all shown relationships between variables are positive (+)

network composition and startup performance in the Canadian biotechnology sector. They observed that ties with different groups of partners (e.g. potential competitors, pharmaceutical and chemical firms, universities, research institutes etc.) have different influence on startups' performance. Interpreting our results, which indicate that firms in the sample developed much more knowledge-intensive relationships with suppliers than with customers, we see two possible explanations. First, all examined firms are manufacturers – it is possible that they are oriented more on fostering relationships with suppliers, in which they see more opportunities to generate additional value and knowledge transfer. Second, a vast majority of the examined firms are intensive exporters, possibly relying on export intermediaries, which could significantly influence the results. All significant relationships identified by our study are presented in Figure 1.

A possible limitation of the study results from not differentiating between home-based and foreign partners (both customers and suppliers) that constitute firms' networks. Nonetheless, we believe that such an approach is acceptable. Previous research has shown that internationally oriented firms may benefit from both foreign-based and domestic-based networks (Reuber and Fisher, 1997; Zhou et al., 2007), and all examined firms operate on domestic and international markets. Other limitations that should be acknowledged to accurately interpret the results of this research are due to the constraints of cross-sectional studies. Our results suggest only statistically significant relationships of organizational context, capabilities and performance. Also, the study is based upon a relatively small, diversified sample of SMEs and a relatively straightforward statistical analysis. Therefore we do not claim that our findings can be generalized to all firms, in all types of markets, in all countries. However, we believe that our empirical findings related to the link between social capital and motivation and a firm's

relational capabilities, and its performance, have a strong conceptual appeal, and pave the way for their additional verification in different contexts within CEE.

In summary, this study makes several contributions to the RBV and the relational view by (1) identifying important firm-specific factors that influence the process of development of relational capability, (2) exploring the relationships between relational capability and financial and non-financial performance, and (3) focusing on CEE's small and still emerging economy.

The findings of our study show that vertical ties that firms develop are not of equal importance for internationally oriented, manufacturing SMEs originating from Slovenia. While cooperative relationships with suppliers are good predictors of both financial and non-financial measures of performance, it does not apply to customer relationships. It implies that for small and medium firms from transition economies cooperative ties with suppliers may be a much more important source of knowledge than it has been assumed so far.

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