

# Perspectives for Managers

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## Building the Right Networks for Business Performance

Do you have the right network to maximize your business's performance? Relationships in business are important. But different configurations of relationships, or networks, are more or less effective depending on the people in the network, the reputation of your company and the complexity of your business environment. This article explains how the best network structure and the best people for your network depend on your situation and objectives. To think strategically about your networks, you should ask the question: "Do you have the right people in the right network, according to your environment and goals, to maximize your company's performance?"

to value-chain management, operating in 120 countries around the world with 42,000 employees. The first business segment focuses on global logistics support while the second provides local consulting services. We interviewed 101 senior managers in 54 country business units representing 42 countries about their business relationships outside their company. Based on these interviews we constructed country business unit networks and analyzed their relationship with operating margin as the measure of performance. We found that having the right network *does* matter. The results of our research and its implications for managers are the focus of this article.



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### Business networks: A key factor in international business success

With today's pace of globalization, companies of all sizes and from all parts of the world are increasing their participation in international business – through direct investments, joint ventures and alliances, licensing arrangements, importing/exporting and direct marketing. Given the speed of change and the intense competition in the marketplace, it is critical that these international activities succeed and pay off as quickly as possible.

Substantial research has been done about international business strategy: choosing the right entry mode, finding the right location and setting up the right organization structure. Managing business networks is one important part of successful execution in international business, however little research has been done in this area. In order to understand the relationship between networks and performance in foreign investments, we focused on two business segments of one multinational company providing professional services related

### Different network types for different situations

Networks can link individuals, business units, whole companies, or any other type of group. No matter which group is the focus of the network, there are three basic types of network structures: entrepreneurial, closed and sponsor networks.<sup>1</sup> Each network type has its own strengths and weaknesses depending on the situation.

- In **entrepreneurial networks**, few of the people in the network are connected to each other. They allow contact with a large number of individuals or groups for maximum access to information, and the person or group in the middle controls to whom the information flows.
- **Closed networks** have many of the contacts connected to each other. They establish safety and security because everyone in the network is tied together, increasing trust. Network members who try to pull away from or betray the network face the threat of being ostracized from the group.

- **Sponsor networks** are those where the individual or group is linked closely to a sponsor and shares many of the sponsor's contacts. The individual or group builds on the established reputation of the sponsor for access to information and control.

**The right network structure: Depends on your reputation and business environment**

Reputation and business environment are two important factors to consider when deciding which of these network structures relates to better performance.<sup>2</sup> In our research, we studied these factors at the country business unit level of the company, however we believe that the ideas behind the results described below may be extended more broadly to individuals and groups.

**Sponsor networks to establish your reputation**

Reputation is an important asset for all companies, and a company's reputation may be more or less established depending on the country or industry segment where it does business.

To define the reputation factor in our research, we asked respondents 14 questions related to their company's reputation. The results grouped into 3 key reputation factors:

- **Internal endorsement:** maintaining strong employee morale, support for the

company's objectives, and a belief that the company is a good place to work.

- **External endorsement – business practices:** the quality and integrity with which a firm deals with its clients and the local business community.
- **External endorsement – image:** establishing positive relationships with business writers and a strong brand image (e.g. through advertising, public relations, networking efforts).

We found that all these aspects of reputation were related to profitability.

For a company that needs to establish its reputation, a sponsor network is the recommended network structure to build its reputation rapidly. For example, one respondent was in the process of launching a new product in his country and was building his network around a sponsor with well-established contacts in that business. Another person reflected back that when her business segment was started in her country, the company built its business with consultants who had established relationships with clients in that country. The company was leveraging the consultant's contacts to establish the new unit's reputation.

**Entrepreneurial networks for less complex environments; Closed networks for more complex environments**

The certainty, rate of change and degree of trust in the environment also relate to the choice of the most effective network

structure. Based on these criteria, we used an international database to create a business complexity scale for each country. For example, countries such as Argentina, Indonesia and Russia were defined as having a more complex business environment, while countries having a less complex business environment were Singapore, Switzerland, the United Kingdom and the United States. For a country business unit with a good reputation, the best network structure depended on the complexity of the business environment. In a less complex business environment, an entrepreneurial network related to higher operating margin while in a more complex business environment, a closed network related to higher operating margin.

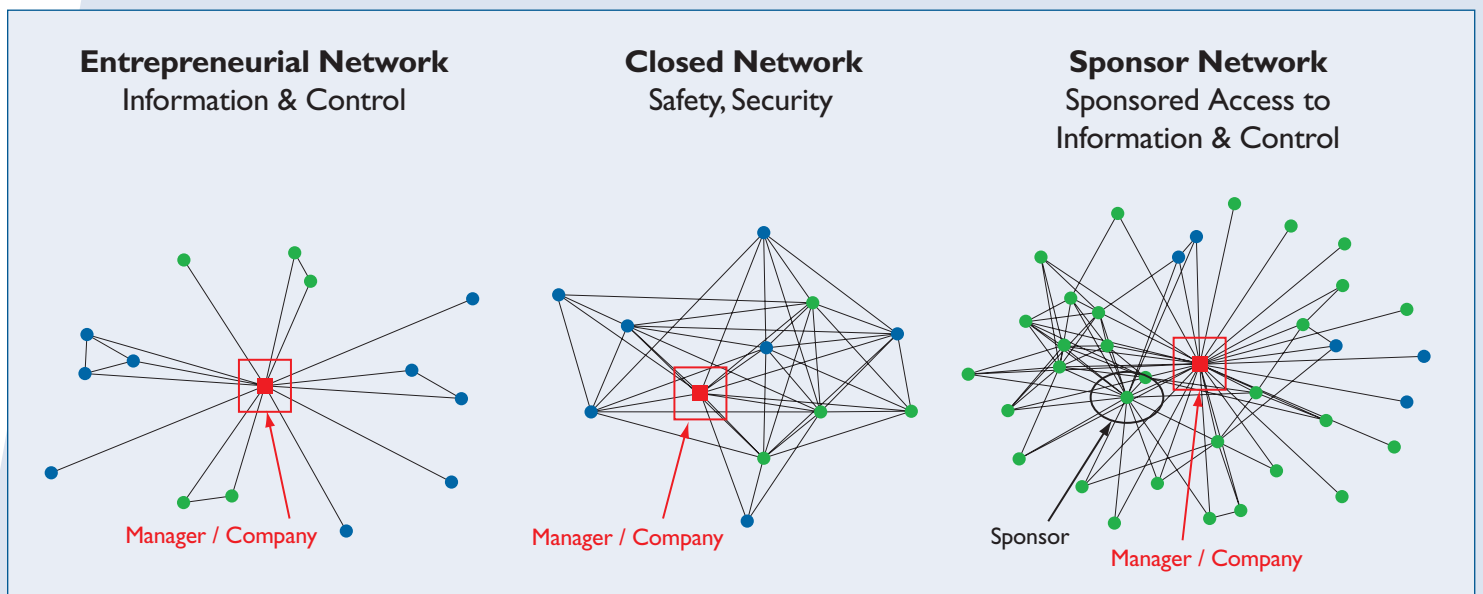
**Building the best network structure**

As a manager, you should therefore assess your company's situation and then consider which type of network structure you need to succeed in that situation. While control over network structure is not completely in your hands, it is important to try to influence the structure as much as possible.

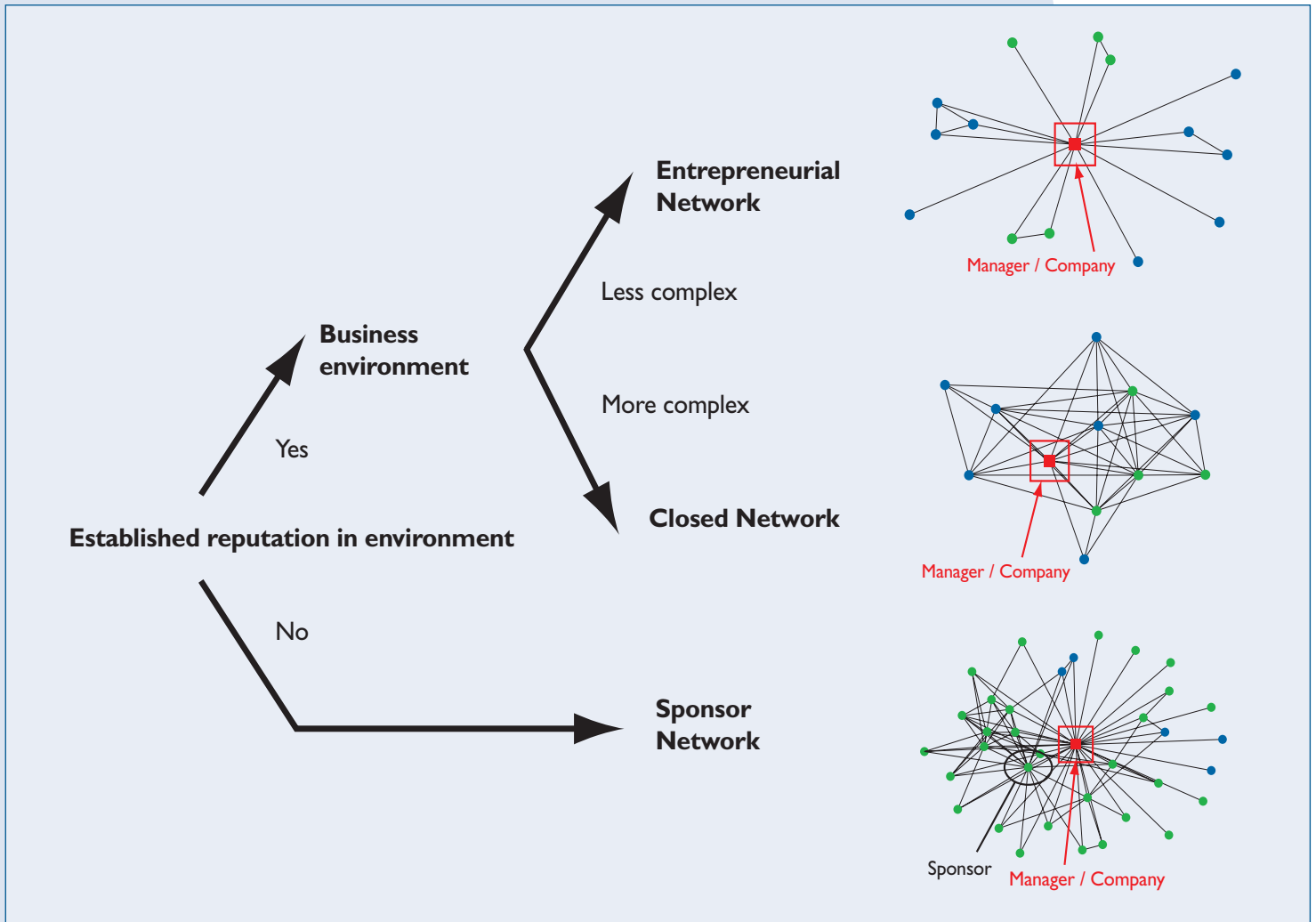
The decision tree for thinking about your network structure is shown opposite.

**“Who” is in your network: The strongest relationship with performance**

Another interesting finding is that “who” is in the network had the strongest relationship



Network structures and their benefits



Choosing the right network structure to maximize performance

with operating margin. Country business units with a larger percentage of contacts that were customers and suppliers (who contribute directly to revenue and profits, identified by the green circles in the graphs above) corresponded to higher profitability. Having a larger percentage of key account contacts in the network also corresponded to greater profitability. These results reinforce two fundamental marketing principles: focus on your customer and focus on key accounts that generate a substantial portion of your firm's business. What is surprising about this result is just how strong the relationship was between the people in the network and operating margin.

You should therefore have contacts in your networks that align with achieving your objectives. For example, if your objective is revenue and profits, your network should contain a larger percentage of customers

and suppliers and any other category that would contribute directly to profitability. If your objective is new information for innovation, your network should contain people who can provide new insights into your industry and products, perhaps sources outside your traditional circle such as academics, journalists or other industry sources. The main point is to make sure that a majority of your network contacts are people who can provide information that contributes to reaching your objectives.

**Applying the research: New market entry, international marketing, HR**

The research results can be applied in many international business settings including new market entry, international marketing and human resources decisions.

**New market entry: Selecting the right entry mode and partner**

When deciding to enter a new market, think first about your company's reputation in that market and then select the most effective entry mode.

If your company needs to establish its reputation, an alliance or joint venture using the network of a strategically selected partner may be the most effective strategy. If so, evaluate whether both the structure and the composition of your partner/acquiree's network fit the needs of the business environment, and if the partner can act as a "sponsor" in the new country so that your company can build on the sponsor's network to establish your own reputation.

For a company with an established reputation, a greenfield investment with the appropriate networking strategy for the environment may be the most effective



strategy: entrepreneurial networks for less complex environments and closed networks for more complex environments. For example, a small firm with a less established brand image may first need to establish its reputation and building the right sponsor network is an important part of this process. In contrast, a brand such as Philips or Coca-Cola probably has a strong reputation in any market it enters, so it could immediately structure its networks to match the needs of the business environment.

#### **International marketing: Develop tactics to match the business environment**

In international marketing, understanding business environment differences may help to maximize network marketing efforts. For example, in complex markets such as Argentina, networks are likely to be closed. It may be difficult to penetrate the shell of these closed networks without the help of an established sponsor contact. However, once introduced into the network, communication within the network may be very efficient because there is a focused group of well-connected customers. In a less complex business environment like the United Kingdom, it may be easier to contact individual members in the entrepreneurial network, but the network has holes so people are less likely to be connected to each other. It may be easy to gather information through this loosely connected network, but it may be more difficult to establish rapid communication to all network members. As a result, mass marketing tactics may be more effective in communicating to customers than word of mouth through the network.

#### **HR: Match employee networking skills with environmental needs**

An executive who knows how to network in one environment may need coaching to adapt to networking in a different environment. For example, a

manager skilled in building networks in an entrepreneurial environment (e.g. the United States or a young business) may need guidance to understand networking in a closed network environment (e.g. Russia or a mature business) and vice versa. It is important to select people with networking skills that fit the business environment or to coach managers with different networking skills about how to adapt to their new environment. In addition, creating executive teams with complementary networking skills may be an effective strategy. For example, an expatriate may be good at establishing sponsor networks to build reputation and bridge to the international environment, which when combined with locals who are good at building networks right for the local environment, may produce an effective network structure for the country business unit as a whole.

#### **Do you have the right network to maximize your performance**

Now, ask yourself some questions to apply what we've learned to your own situation.

- First, what is the reputation of your company? Do you need a sponsor to help you establish your company's reputation?
- Second, how complex is your business environment? Are the people in your network connected in a structure that matches the needs of your environment: an entrepreneurial network for a less complex environment or a closed network for a more complex environment? To achieve the right network structure, one manager we interviewed in a highly complex environment told us he was introducing his tennis instructor to his private banker, and both to his partners in various projects, specifically to close some of the holes in his network to increase predictability and trust.

- Finally, what is the objective of your unit: profitability? innovation? market share? Which types of contacts outside your company can give you information and advice to achieve your objectives: for example feedback to improve your company's day to day operations; ideas on strategy, new products, new services; and sources for general industry information? Are the people in your network the right contacts to contribute to your objectives?

In other words: "Do you have the *right people* in the *right network*, according to your *environment* and *goals*, to maximize your company's performance?" And if not, what can you do today to start building your networks more strategically?

<sup>1</sup> Burt, R.S. (1992) *Structural Holes: The Social Structure of Competition*, Cambridge, MA: Harvard University Press; Coleman, J.S. (1988) Social capital in the creation of human capital. *American Journal of Sociology*, 94: 95-120.

<sup>2</sup> Burt (1992); Lawrence, P.R. & J.W. Lorsch (1967/1986) *Organization and Environment*, Boston, MA: Harvard Business School Press.

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