

THE EFFECT OF COMPANIES' SIMULTANEOUS EMBEDDEDNESS IN DIFFERENT LOCAL AND GLOBAL NETWORKS – A SME PERSPECTIVE

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Abstract

The purpose of this paper is to present a comprehensive analysis of the problem of companies' simultaneous embeddedness in different local and global networks and to assess the positive and negative effects it has on these companies. The analysis is conducted from the perspective of small and medium enterprises (SME).

This paper primarily adopts a conceptual approach to the problem based upon a critical review of pertinent literature. The paper applies the concept of embeddedness and the network approach to the analysis of SME activities from an international perspective.

This paper's main contribution to the subject is the analyses of small and medium sized companies from the perspective of the level of embeddedness of their activities both in local and global business networks, regardless of other characteristics such the share of exports in sales. Moreover, small entities selling solely in the local market are entangled in dependencies, which in turn have a significant impact on their operations and results achieved. The outcome of the paper is a conceptual model, which contributes to the IMP research. Attention is paid to the both positive and negative effects.

Keywords: embeddedness, industrial network, internationalisation, small and medium enterprises, network effects

Work-in-progress paper

INTRODUCTION

In the era of globalization, the internet, the European Common Market, more and more commonly used outsourcing and/or offshoring, the differences between companies' activities conducted on a local and international scale are diminishing. Moreover, even companies that are not conducting their business in foreign markets may also be subject to internationalisation through relationships with foreign suppliers or by cooperation (that is inward connections [Welch, Luostarinen 1988]). Local small entities, unprepared for international activities, are forced to compete, coexist or cooperate [Bengtsson, Kock, 1999] with global players, entering as competitors, into their local market. This is accompanied by both potential benefits (for example a larger market, the potential for development), as well as negative effects (for example despite the lack of preparation and a desire to be a purely local entity, the need to work alongside global players such as local subsidiaries of multinational corporations, as well as increased risk to supply chains).

All of the aspects mentioned above are the reason why it can be noted that modern companies of all sizes are simultaneously embedded in different local and global networks of relationships, irrespectively if they are directly active or not on foreign markets. Their activity becomes embedded in both local and global networks of relationships. Therefore, the complexity of the problems associated with managing and maintaining competitive advantage well as creating relationships is increasing.

In the research related to the internationalisation theory, the idea of embeddedness [Granovetter 1985, Uzzi 1996] is generally used to analyse the activities of multinational corporations, that is large and very large entities, in the local environment [Forsgren, Holm, Johanson 2005; Whitaker et al. 2011; Nell, Ambos, Schlegelmilch, 2011; Hilvo, Scott-Kennel 2012]. However, the research into companies' international activities, in terms of the theory of embeddedness, doesn't cover the activities of small and medium sized enterprises or purely local companies (that is in terms of non-sociological embeddedness). The adoption of the network approach, however, provides a holistic view of internationalisation and simultaneous embeddedness in local and global networks, covering both large and small (medium) entities as well as companies operating solely in their home market.

Based upon these premises, the purpose of this paper is to present a comprehensive analysis of the problem of companies' simultaneous embeddedness in different local and global networks and to assess the positive and negative effects it has on these companies. The analysis is conducted from the perspective of small and medium enterprises (SME). The findings in this paper draw upon both internationalisation theory and IMP research.

This paper primarily adopts a conceptual approach to the problem based upon a critical review of pertinent literature. Further deductive work should be based upon a critical analysis of studies of the theoretical approaches to companies' internationalisation processes, the network approach, embeddedness as well as network effects. The analysis of companies' behaviour includes the assessment of positive and negative effects of embeddedness in global and local business networks. This analysis, combined with conceptual work, leads to the development of a conceptual model.

CONCEPTUAL FRAMEWORK

The conceptual research framework embraces three main elements: 1) the concept of a company's embeddedness and especially embeddedness in business networks, 2) the processes related to internationalisation and globalisation which impacts this, as well as 3) the

resulting positive and negative effects of such embeddedness at a company level (see Figure 1)¹. The analysis is conducted from the perspective of small and medium enterprises (SME).

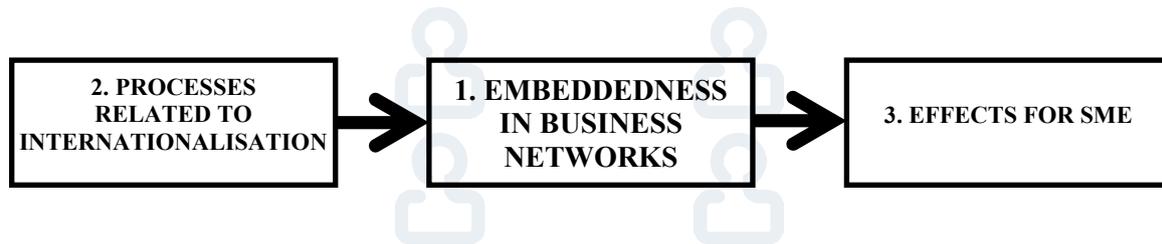


Figure 1. Conceptual framework

This article sequentially analyses the elements presented as part of the conceptual framework.

EMBEDDEDNESS IN BUSINESS NETWORKS

Embeddedness, as a concept rooted in sociology, is the idea that firms are connected by networks of personal relations and economic behaviour is embedded in networks of interpersonal relations [Granovetter, 1985, p. 496, 504]. Embeddedness is a state of being located or secured within a larger entity or context. Thus, the economic life of a company or market is territorially embedded in its particular social and cultural relations: in place-specific characteristics, infrastructure, operating environments and production conditions. Local embedding means matching practices, routines and resources specific to certain standards for a given location [Granovetter 1985, Uzzi 1996].

Embeddedness has three dimensions [Gulati, Gargiulo 1999]:

- relational, linked to social ties and specifically to trust resulting from previous cooperation (the impact of the quality of cooperation).
- structural, linked to the ties surrounding all entities (the impact of the structure of the ties).
- position, linked to the location of the entity in the network (the impact of position within the relationship).

The embedded concept can be tied to network analysis as a collection of relationships or in a larger context.

A business network (an industrial network) constitutes collection of long-term formal and informal relationships (direct and indirect) which exist between two or more entities [Håkansson, Snehota 1989]. A business network is a set of repetitive transactions based upon structural and relational formations with dynamic boundaries comprising interconnected elements (actors, resources and activities) [Todeva 2006, p.15]. A system of relationships is often characterised as being decentralized and informal. The business network is an effect of historical cooperation, whereby through cooperation and a series of interactions, entities

¹ Of course, the existence of inverse relationships (the impact of embeddedness in business networks on a company's internationalisation process and/or the impact of embeddedness on the embedding process itself as well as internationalisation) or feedback loops is not excluded, however at this stage of the conceptual approach only the interdependencies presented on figure 1 will be analysed.

adjust to each other, create cooperation norms and build trust [Turnbull, Ford, Cunningham 1996, p. 44-62; Ford, Håkansson, Johanson 1986, p. 26-41].

The network approach stresses the significance of all the contacts (network relationships) a company has with its surrounding environment which constitute an extended network (a business network). The company is analysed in the context of its relationships (links concerning actors/entities, activities and resources) and its position held in the network, which can be linked back to the three dimensions of embeddedness [Granovetter 1985, Uzzi 1996].

There are numerous different types of networks [Todeva 2006, p. 161; Ratajczak-Mrozek, Malys 2011] and for this reason several can exist simultaneously as different parts of a business network [Halinen, Törnroos 1998, p.189]. Organisational actors are embedded in multiple networks and positions which makes the analysis complicated. The concept of embeddedness may be used to analyse firms' multiple dependencies (both positive and negative) on various types of networks. In this way, companies may be seen as embedded in different kinds of networks of relationships (not only interpersonal, social as stated by Granovetter).

In terms of business networks, the concept of embeddedness is analysed from the perspective of network dynamics and evolution. Embeddedness is seen as an explanation of change and development in business networks [Halinen, Törnroos 1998], also in the context of the evolution of international relationships (including how they develop, function, and change over time) [Fletcher, Barrett 2001]. Classical analyses of embeddedness within different settings is dominant and includes different types of networks, such as social, market, regional, technological, institutional, and infrastructural networks, as well as underlying temporal, spatial and representational dimensions [Fletcher, Barrett 2001, p.561].

Where relations extend beyond the local, country framework, the networks become global networks, i.e. networks including foreign entities also. Network relationships may be established and maintained at the local level, the country level or broader – at the international level encompassing foreign entities [Ratajczak-Mrozek 2012, p. 37].

International embeddedness, in terms of business networks, is often analysed from a spatial perspective – a type of embeddedness (spatial embeddedness) or referring to a vertical dimension (vertical embeddedness) [Halinen, Törnroos 1998]. Spatial embeddedness refers to the spatial levels of industrial activity within a specific business setting (including the international dimension). It suggests that business actors may be internationally, nationally, regionally and locally embedded in different types of networks [Halinen, Törnroos 1998, p.195]. Under spatial embeddedness, business transactions are seen as embedded in networks of relationships that cross national borders and are embedded in different national business environments (in each country of involvement) that include social networks, technological networks, regional networks, infrastructural networks, institutional networks and market networks [Fletcher, Barrett 2001, p. 562].

Vertical embeddedness, however, refers to the relations between different identifiable levels in a network. Vertical levels can be distinguished geographically (for example international, national, regional and local), on the basis of channel structure (for example supplier, manufacturer, distributor and customer) or within a specific business (industry, company, company unit/department and individual). According to this dimension of embeddedness, companies are connected with different vertical levels. If, for example, a company cooperates with other companies in the same region in order to acquire financial support from the European Union, as a result it becomes embedded in international networks. [Halinen, Törnroos 1998, pp.196, 197].

In the research related to internationalisation theory, the idea of embeddedness is generally used to analyse the activities of multinational corporations, that is large and very large

entities, in the local environment [Forsgren, Holm, Johanson 2005; Whitaker et al. 2011; Nell, Ambos, Schlegelmilch, 2011; Hilvo, Scott-Kennel 2012]. Multinationals are seen as differentiated networks that are connected to external networks in multiple ways and on multiple levels, which turns into embeddedness in external networks [Nell, Ambos, Schlegelmilch 2011, p. 498]. Research into the analysis of multinationals mainly shows that there is a focus on the embeddedness of subsidiaries within their local environments [Forsgren, Holm, Johanson 2005; Ghoshal, Bartlett 1990] and, to a lesser extent, on the phenomenon of headquarters linkages in the local context which creates an embeddedness overlap (the problem of simultaneous existence of linkages by parent and subsidiary to the same local actors is an embeddedness overlap) [Nell, Ambos, Schlegelmilch 2011]. However, the research into companies' international activities is lacking in terms of the theory of embeddedness in the case of the activities of small and medium sized enterprises or completely local companies (other than the typical sociological embeddedness theory), which will be discussed in the subsequent sections of this paper.

PROCESSES RELATED TO INTERNATIONALISATION AND GLOBALISATION –A DRIVING FORCE OF CHANGES WITHIN SME EMBEDDEDNESS

A company's internationalisation is usually analysed from the perspective of a given enterprise's internationalisation process [Mc Gaughey 2007]. Studies of the internationalisation process have produced models and concepts of a company's internationalisation. Taking into account the characteristic features of the individual concepts, they can be divided into four main groups [Whitelock 2002]: the Uppsala model [Johanson, Wiedersheim-Paul, 1975; Johanson, Vahlne, 1977; Johanson, Vahlne, 2009], the eclectic paradigm [Dunning, 1998], the network approach to internationalisation [Johanson, Mattsson, 1988] and the strategic approach [Reid, 1983]. According to these concepts the internationalisation process of a given company may be autonomous (the Uppsala model and eclectic paradigm), be affected by external entities (the network approach) or be determined by external factors within the external environment (the strategic model).

The concept of a company's internationalisation usually refers to its expansion in to foreign markets. Traditional ways of viewing internationalisation have described the process as being mainly an activity driven by the desire to penetrate overseas markets [Fletcher, Barrett 2001, p.562]. In such cases, the company faces an unknown environment, as well as various unfamiliar foreign entities, such as buyers, distributors and competitors. Thus, it is possible to refer to the embeddedness of specific firms within specific foreign markets in different settings (i.e. social, market, regional, technological, institutional, and infrastructural networks).

But we can note that nowadays even companies that are not conducting their business in foreign markets may also be subject to internationalisation through relationships with foreign suppliers (importing, inward activities) by cooperation or global competition. Moreover, some additional shortcomings of the traditional approaches to internationalisation are observed: inward activities may lead to outward activities and vice versa (for example when the overseas franchisee becomes the franchisor in other country), international behaviours can include situations in which inwards and outwards activities are linked, as often happens with strategic alliances, countertrade and cooperative manufacturing [Fletcher, Barrett 2001, p. 562]. Internationalisation is no longer just an outward-driven activity. Companies also become internationalised by undertaking import-led activities and activities in which "inward" and "outward" activities are linked [Fletcher 2001, p. 25]. Even companies that are not conducting their business in foreign markets may also be subject to internationalisation

through relationships with foreign suppliers or by cooperation (that is inward connections [Welch, Luostarinen 1988]). What is more, local small entities unprepared for international activities, are forced to compete, coexist or cooperate [Bengtsson, Kock, 1999] with global players entering as competitors into their local market.

The network approach to internationalisation is a theory which creates certain foundations for this type of analysis. According to this model, the process of a company's internationalisation is defined as the establishment, maintenance and development of formal and informal relationships with network participants on foreign markets [Johanson, Mattsson 1988, p. 287]. This model stresses the importance of developing long-term interactions with entities from the foreign environment [Blankenburg, 1995]. The analysis therefore also incorporates individual firms (internal resources) as well as the network to which they belong (market resources).

The inclusion of relationships with international entities means that internationalisation can be viewed from the perspective of companies which are not active on foreign markets. It can be stated that the classification of a company as an "international firm" depends upon relations, taking in to account both inward and outward connections. This means, however, that additional aspects of the internationalisation process should be highlighted, namely in terms of the level of advancement in the process itself. This variable (advancement of internationalisation) should take in to account both outward connections (for example, the number of foreign markets where the firm is active, foreign market turnover, profits earned on foreign markets, the level of investment and the size of foreign assets, the length of time that the company has been active on foreign markets), as well as inward connections (for example, the number of international suppliers, the number and value of foreign contracts)². The network model of internationalisation therefore allows us to view the network in an international dimension regardless of the size of the company (including those operating only locally). See figure 2.

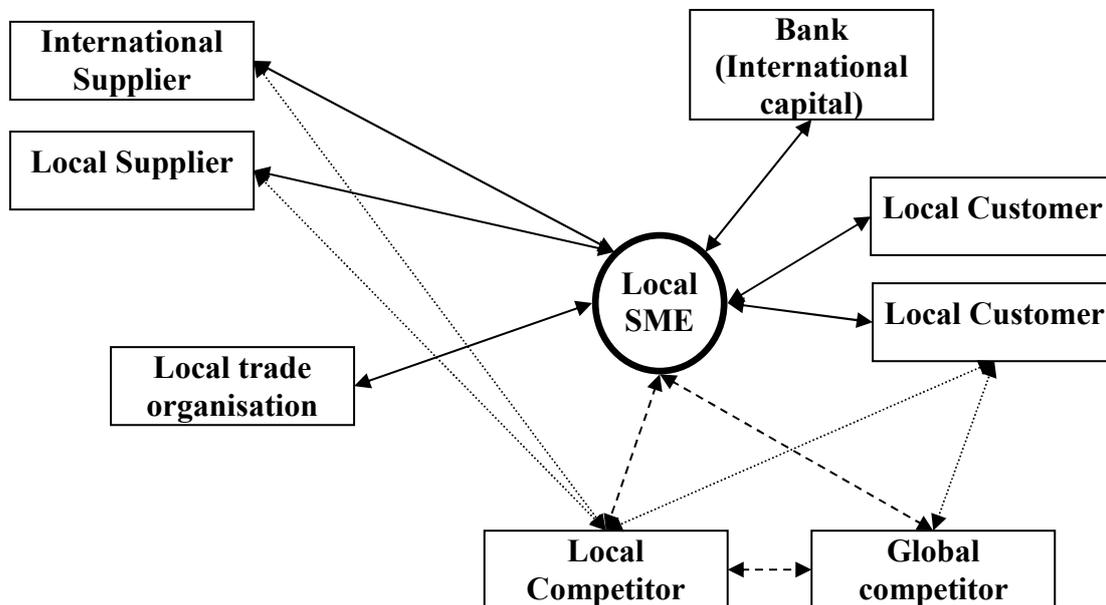


Figure 2. Entrepreneurial small business network – the local and international dimension

² In describing the "advancement of internationalisation" variable, we have pointed to its tangible components. The construction of a comprehensive such variable would require, however, the inclusion of aspects linked to the quality of the relationship as well as informal relationships and competition.

Figure 2 shows the entrepreneurial small business network map (it is an expansion of the presentation included in [Todeva 2006, p. 162], here the local and international dimensions have been added), From the perspective of “purely” Local SME activity, this does not suggest a lack of contact with the international environment. It can therefore be said that the differences between companies’ activities conducted on a local and international scale are diminishing.

Analysing the presented network from a global networks perspective (that is when the relations are extended beyond the local, country framework) as well as local networks (that is when the relations are within the local, country framework) it can be stated that SMEs are simultaneously embedded in different local and global networks The adoption of the network approach allows us to analyse companies regardless of their size. We can refer to large and small (medium) sized entities as well as to those operating solely within their local markets. An issue requiring analysis is the level of this embeddedness as well as the level of a company’s internationalisation (derived from the level of embeddedness in global networks). Moreover, the significant interdependencies and cross-effects among these different networks require analysis. In keeping with the earlier analysis, SME can belong to several different networks. This means that SME can belong to various different local and global networks which overlap.

As Fletcher and Barrett point out [Fletcher, Barrett 2001, p. 562] business transactions are embedded in networks of relationships that cross national borders and these relationships, in turn, are embedded in different national business environments (that is in each country of involvement) as well as in the global business environment (that is, that of the World Trade Organisation and various regional trade groupings)³. There is also the issue of how to manage often overlapping relationships and dependencies, especially from the perspective of an SME which possesses limited resources. This question therefore applies to the effects which are generated as a result of the simultaneous embeddedness in local and global business networks.

All the aspects mentioned above are the reason for which it can be noted that modern companies of all sizes, including SME, are simultaneously embedded in different both local and global networks of relationships, irrespectively if they act or not directly on foreign markets. Therefore, the complexity of the problems associated with managing, maintaining competitive advantage, creating relationships are increasing (see Figure 3).

³ Fletcher and Barret analyse this issue from the perspective of embeddedness in different national or international social networks, technological networks, regional networks, infrastructural networks, institutional networks, and market networks and its influence on international relationships evolution over time.

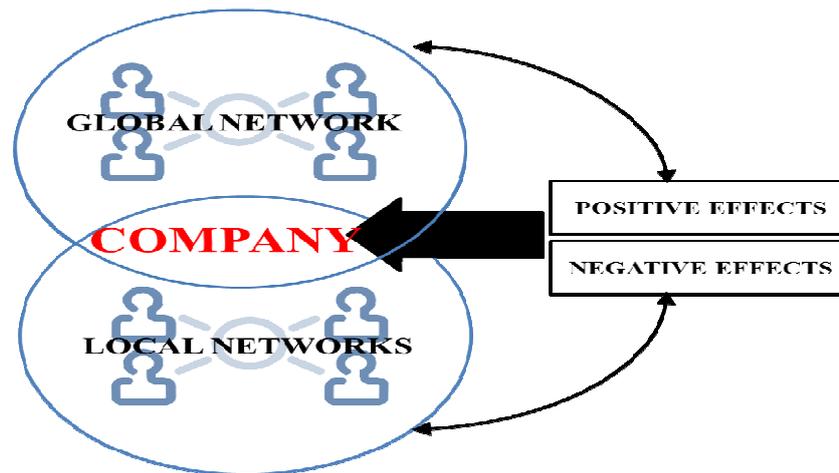


Figure 3. SME embeddedness

Figure 3, which presents a conceptual model of SME embeddedness, embraces two main elements: 1) a company's simultaneous embeddedness in both global and local networks and 2) the positive and negative effects of such embeddedness considered at the company level. A company's simultaneous embeddedness in global and local networks is accompanied by both potential benefits (for example a larger market, the potential for development), as well as negative effects (for example despite the lack of preparation and a desire to be a purely local entity, the need to work alongside global players such as local subsidiaries of multinational corporations, as well as increased risk to supply chains), which will be discussed in the next section of this article

THE EFFECT OF SIMULTANEOUS EMBEDDEDNESS

In order to better understand how companies act in interrelations created by simultaneous embeddedness in both local and global networks, it is necessary to gain an understanding of the effects that such embeddedness creates. This involves a wider range of factors, which impact actors, resources and activities. It is important to discuss both potential benefits (opportunities), as well as negative effects (constraints) of such embeddedness.

The potential positive effects of an SME's simultaneous embeddedness in different local and global networks can be considered from the perspective of synergies resulting from local activities (local networks) and global networks. The development of network links can be analysed at a local level (even just limiting the analysis solely to the SME sector) as well as in terms of links between the SME and large global players. Both situations can be beneficial for SME. Local means increasing strength thanks to synergy effects for smaller players, whereas global means connecting to a global network (not necessarily formally) and deriving benefits on an even larger scale.

The most important benefits from building relationships include [Ratajczak-Mrozek 2012, p.40]:

- access to resources and capabilities, including access to knowledge,
- increasing the innovativeness of the company and its products,
- cost reduction,
- reducing operational risk,
- increasing bargaining power against other entities,

- the benefits of specialisation,
- increased market range (at the local and international scale).

The above mentioned benefits are possible to obtain at both local and global scale.

Networks accommodate the contradictory and complementary aims pursued by each member and facilitate joint activities and repetitive exchanges that have specific directionality and flow of information, commodities and heterogeneous resources.[Todeva 2006, p.15] Network relationships enable the acquisition of resources which are at the partners' disposal and also generate the ability to obtain resources unavailable thus far to any of the parties. Thanks to network relationships, companies are open to both domestic and foreign external resources.

Owing to the exchange of resources and knowledge within a global business network, it is possible to increase the innovativeness of the company and its products. Vertical relationships (with suppliers and customers) [Håkansson, Lundgren 1995, p. 307-309] and horizontal relationships (with research institutes, competitors or complementary companies) [Håkansson, Lundgren 1995, p. 308; Thomas, Ford 1995, p. 271], as well as social networks (Davies and Koza, 2001, p. 95-102), influence the company's innovation.

Network relationships may additionally have a positive effect, among other things, on the course of production and the logistic processes inside the company, which together contribute to an increase in the level of effectiveness, increasing bargaining power against other entities, as well as to cost minimisation and risk reduction. Thanks to local and foreign relationships, a company may specialise in business activities in those areas of the value chain which allow it to gain competitiveness to the greatest degree [Cravens, Piercy, Shipp 1996, p. 204; Christopher, Payne, Ballantyne 2002, p. 121] [Ratajczak-Mrozek 2012, p.41].

The benefits related to expansion should also be noted. This refers both to gaining new local customers and to the expansion on foreign markets through relationships with foreign entities, i.e. company's internationalisation. This in turn contributes to achieving economies of scale.

These benefits can be achieved by the firm thanks to both global networks and network relationships in local networks. Moreover, local embeddedness ensures better adaptation to local requirements and global embeddedness ensures that firms can derive benefits through international development (e.g. advanced knowledge, greater possibility to reduce costs).

In considering an SME operating locally yet embedded in global networks, two main types of entities and constraints related to them must be discussed: suppliers and competitors.

One of the trends in changing modern supply chains is increasing competition. The effect of the vendor being located at great distances competing directly with local suppliers. On the other hand, global players enter the local market, with whom the local SMEs are forced to compete. For small players, the transition to a global market means an increase in risk, which they either do not realize or are unable able to manage. SMEs are increasingly exposed to risks of global supply chains [Juettner, Ziegenbein 2009]. It is harder for them to manage risk than big players, because they lack adequate resources, structures and processes. For global players who enter into cooperation with local firms there is also an increased risk [Norrman, Jansson 2004].

For a small company, despite the lack of preparation and a desire to be a purely local entity, there appears to be a need to work alongside global players such as local subsidiaries of multinational corporations. This raises the question of how to manage relationships with these large and significantly more powerful counterparties in order to at least not lose market share or profits. Here we can refer to coexistence, cooperation, competition and co-competition as four basic types of relationships linking competitors [Bengtsson, Kock 1999, p. 178-193].

Specific types of action taken in relation to competitors are chosen by the firm depending upon its goals, market position and resources. Firms which do not require external resources and have a strong market position prefer to act purely in a competitive way. Firms which require external resources and have a weak market position, are more inclined to cooperate. In turn, entities with a weak market position which do not show any interest in cooperation form relationships based upon coexistence. However, firms with a strong market position which are deprived of strategic resources aim to form relationships based upon competition. [Bengtsson, Kock 1999, p. 178-193]. In terms of cooperation or competition with global competitors there is at least the fear of global players assimilating and taking over the research and development of small firms.

Finally we come to the important question: how local entities should operate within global networks and how they can become an important part of them. Companies seen from a simultaneous embeddedness perspective appear to act in an inherently unstable and uncertain environment with significant competition from both local and global players (and unbalanced strength on both sides). The question is how to manage within such complex interdependencies.

CONCLUSIONS AND FURTHER RESEARCH

This article proposes a conceptual framework for the analysis of the problem of simultaneous embeddedness among SMEs in different local and global networks.

The discussions in this article constitute an initial conceptualization stage linked with the realisation of a three year research project which during its course should shed light on how internationalisation and network relationships facilitate the formation of embeddedness, its effects, but above all how exactly these effects form and how they should be managed.

This paper's main contribution to the subject is analyse small and medium sized companies from the perspective of the level of embeddedness of their activities both in local and global business networks, regardless of other characteristics such the share of exports in sales. It is also stressed that small and medium enterprises selling solely in the local market are entangled in global network dependencies, which in turn have a significant impact on their operations and the results they achieve. The analysis of the effects caused by this simultaneous embeddedness shows numerous dependencies and managerial issues which should be taken in to account by a single company.

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