

Strategic linking and networking of Croatian SMEs

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Abstract

The Croatian SMEs if, want to survive in the global economic environment, must necessary define the areas in which can achieve the superior world results and on them base their complete business. The idea of specialization on the core competences of enterprise is demanding externalization of all wherein the SME does not possess the leading position on the market and at the same time focusing on that part of business in which SME is realizing the competitive advantage. Croatian SMEs need to develop and cultivate the collaborative connections with their partners and involve strategic linking and networking concept. Intellectual capital has become the dominant form of capital in the modern business and its recognition and development is required. The process of strategic linking and networking in Croatian SMEs is slow and followed by the strategic mistakes that are bringing the enterprises to the crisis and collapsing. The intensive use of the conception of strategic linking and networking in Croatian SMEs on the micro-level enables SMEs faster and painless transformation, while on the macro-level it would raise the competitiveness of whole Croatian economy.

The purpose of this paper is: to unite and to expand the existing cognitions about the concept of strategic linking and networking, propose the universal model for the process of transformation of implementing the concept of strategic linking and networking in Croatian SMEs, and to point on the guidelines which should follow the processes of strategic linking and networking in Croatian SMEs in the future. Also, the aims of this paper are: by scientific and analytical methods to examine the application degree of the strategic linking and networking in the Croatian SMEs, formulate the results of investigation, indicate what the SMEs and entrepreneurs should undertake to prepare for strategic linking and networking or create the brand new virtual enterprise how they could succeed and advance themselves in the competitive business surroundings.

The data that will be received from the surveys, the actual picture about the degree of usage of strategic linking and networking of Croatian SMEs will be fortified. The results of research will indicate on the preconditions which are necessary for the creation of strategic networks and virtual enterprises in Croatia. Moreover, the models that Croatian SMEs need to implement will be defined, if they want to follow current business and organizational conceptions. The SMEs that, for the assistance in the strategic linking and networking will

apply results of this research, and engage the external consultants will faster and painless bear the organizational changes and easier adapt to the turbulent conditions, which are ruling in the global economy.

1. Introduction

Small and medium sized enterprises present an important factor regarding economic development. They play a critical role in economic growth, reducing unemployment, and promoting flexibility and innovation in an economy due to their ability to quickly adapt to ever changing market conditions because of their lean structure and the active involvement of their human resources. Nevertheless, SMEs are characterized with some disadvantages as well. Even though they are very dynamic they are also highly exposed to threats caused by insufficient investment capability and resources. Due to limited resources, both financial and nonfinancial nature, SMEs lack appropriate organizational characteristics, such as the lack of functional expertise, concentration of risks, shortage of information for identifying market opportunities, and diseconomies of scale (Wincent, 2005). Therefore, in order to overcome these obstacles SMEs are forced to rely on cooperation with other organizations, in the sense of building a strategic SME networks. Strategic SME network refers to the group of firms that combine efforts to achieve competitive advantages that would be very difficult to achieve individually. Through such a process they can partly resolve previously mentioned problems by gaining competence, building resources, sharing risks, undertaking quick market movements, and making joint investments (Dickson and Hadjimanolis, 1998). Therefore, SMEs can profit a lot by participating in this form of cooperation.

In this article authors will define the concept of strategic SME networks, present a distinction among different types of cooperation between the SMEs, such as clusters, industrial districts, alliance constellations and virtual organizations, and the strategic SME network and elaborate the effects of networking process on the behaviour of network members. Also, the article will present the current situation of strategic networking of Croatian SMEs. Research that was conducted on the sample of 104 randomly selected enterprises will try to answer the questions regarding the forms of the relationships among member firms, markets from which their partners came from, amount of the estimated impact of cooperation on the level of firm's revenue, who were the facilitators for linking the member firms together and level of satisfaction with this kind of cooperation.

2. Literature review of strategic SME networks

Literature defines strategic networks of small and medium sized enterprises in many ways. Jarillo (1988) defines the term strategic networks as an arrangements between distinct but related organizations that through their mutual cooperation gain or sustain competitive advantage with regard to their competitors outside the network. These interfirm network organizations are characterized by a special kind of relationship, a certain degree of reflexivity and a logic of exchange that operates differently from that of markets and hierarchies. Human and Provan (1997) suggested that strategic SME networks could be defined as intentionally formed groups of small and medium sized companies in which the firms are geographically proximate, operate within the same industry, potentially sharing inputs and outputs, and undertake direct interactions with each other for specific business outcomes. The fact that the firms are close to each other means that they can combine core competence and resources to accomplish organizational objectives that would otherwise be difficult or impossible.

The purpose of strategic SME networks is to create a forum for direct and joint business activity among membership firms as well as indirect services such as lobbying. Strategic SME networks enable members to contribute inputs and also benefit outputs from one another. Firms in these networks share competence and resources so that each firm can reach goals through participation. Therefore, cooperation and relations are fundamental for value creation, i.e. competitiveness (Human and Provan, 1997).

Strategic SME networks have two important functions. For customers, the strategic SME network represents a large company that provide complex products, and for membership firms on the other hand, network presents a place where learning and resource exchange can be used for development, innovation, and strategic renewal (Mezegar, Kovacs and Paganelli, 2000). Therefore, one function of the network can be seen as an interaction among the network and outside environmet and the other one as a close interaction between membership firms.

In his work Treziovski (2003) by synthesizing the literature reveals some of the most important networking practices that are significantly associated with an effectiveness of strategic SME networks. They are as follows:

1. Product/service is produced by mutual assets of several firms located at key points of the value chain.
2. Network members share information, cooperate with each other, customize their product or service, and demonstrate goodwill and trustworthiness.
3. Network members provide a unique response to the need of its value chain partners, by which reflecting the firm's distinctive competences.
4. Voluntary behaviour that improves the final product or service is expected from network participation rather than simply fulfilling a contractual obligation.
5. Networks learn to operate without exclusionary behaviours and to compete without seeking unfair advantage.
6. Benchmarking when adopted, as a component of a cooperative approach to organizational change, can be a powerful means of building shared understanding and culture of participation.
7. Better and closer relationships with suppliers and customers can contribute strongly to a company's performance across a range of areas such as costs, quality, reliability and timeliness of input delivery.
8. Structures, cultures and procedures that encourage dynamic change, flexibility and knowledge sharing across functional areas have to be included in organizational strategies. Organizations are potentially unable to realize the possible strategic benefits of information technology if they do not have internal systems integration, thus limiting the transfer of data across functions.

When comparing SME networks to other types of interorganizational arrangements like joint ventures, federations, and trade associations it could be said that they very much conceptually differ among each other. Creation of SME networks generally occurs in order to provide a place for joint business activities among multiple network members as well as additional indirect services that the membership includes. Firms remain independent while working together for mutual objectives. Therefore, SME networks pursue organizational objectives through coordinated interactions of many individual firms. In contrast, the primary purpose of trade associations and federations is most often to provide indirect services for their participating firms such as lobbying and promotion, while joint ventures typically pursue the objectives of two organizations through creation of a separately managed venture (Human and Provan, 1997).

3. Types of SME networks

When referring to strategic SME networks literature provides similar concepts of cooperation between small and medium sized enterprises such as clusters, industrial districts, alliance constellations and virtual organizations. Therefore, the distinction between these concepts need to be addressed so that the meaning of strategic SME networks could be more comprehensive.

- **Clusters.** A cluster is defined as a sectoral and geographical concentration of competing, complementary, or interdependent enterprises and industries that do business with each other and/or have common needs for talent, technology, and infrastructure. The firms included in the cluster may be both competitive and cooperative. They may compete directly with some members of the cluster, purchase inputs from other cluster members, and rely on the services of other cluster firms in the operation of their business. Cluster members benefit from their collaboration in the sense that it helps them to specialize, to attract a pool of specialized workers, availability of inputs, fast exchange of new and innovative ideas, access to distant markets, etc (Van Winden and Woets, 2003).

- **Industrial districts.** Industrial district is a region where the business structure is comprised of small locally owned firms that make investment and production decisions locally. Scale economies are relatively low, preventing the rise of large firms. Within the district, substantial trade is transacted by long-term contracts or commitments between buyers and sellers. An industrial district emerges when a cluster develops more than specialization and divisions of labour between firms; the emergence of collaboration among local economic groups within the districts, enhancing local production and sometimes innovation capability and the emergence of strong sectoral associations (Rabelloti, 1995).

- **Alliance constellations.** Alliance constellation is a set of firms that cooperate with each other in a multilateral relationships and also competes in a particular competitive domain. The firm relationships are looser than if they were merged through some kind of ownership structure, but tighter than if the firm's would have only short-term transactions among each other. Therefore, alliance constellation is a strategic alliance of firms that share common goals, such as promoting products under one brand, expanding market share, gaining industry acceptance for a technical standard, by taking on a variety of forms like joint bidding, R&D consortia, production joint-ventures, co-marketing network, etc (Gomes-Casseres, 2004).

- **Virtual organizations.** A virtual organization is a network of independent companies, suppliers, customers, competitors, linked by information technology to share skills, costs, and access to one another's markets. Such organizations are usually temporary (but not need to be) formed on the basis of a cooperative agreement with little or no hierarchy or vertical integration and can . Members sustain their legal autonomy but they approach the market as a unique legal entity with the relationships based on trust, mutual understanding and agreements, joint information systems and data bases. This flexible structure minimizes the impact of the agreement on the participants' individual organizations and facilitates adding new participants with new skills and resources. Usage of information technologies allows the communication, synchronization of all business activities and transfer of needed informations between the members, therefore business activities in virtual organizations is not dependent on geographical proximity (Kolakovic, 2006).

Therefore, the distinction between different presented concepts of SMEs cooperation and strategic SME network can be easily seen in the sense that clusters and industrial districts are geographically determined while that does not has to be the case with strategic SME networks. Virtual organizations are mostly short-term relationships among firms while SME network partnerships are long-term oriented. Also, alliance constellations present cooperation between SMEs but could include a large firms also, while strategic networks refer only to interrelations among small and medium sized firms.

4. Networking effects on the SME behaviour (pros and cons)

Much of the literature and research consider that entrepreneurs purposefully engage into networking activities in order to gain a competitive advantage which implies that network participation offers an array of advantages. Jarillo (1993) and Castells (1996) state that network participation allows greater flexibility for seizing business opportunities, faster reactions and partnerships with other firms with complementary strengths and capabilities. Inzerilli (1990) has described by using a transaction cost perspective how a trust-based social context reduced opportunism and facilitated success among small firms in northern Italian industrial districts. Brusco and Righi (1989) and Lorenzoni and Ornati (1988) confirmed the importance of environmental factors for small firm growth through networks. Also, networks play an important role concerning innovations due to a strong international competition and

rapid technological development that pushes firms in producing new products, developing new processes and accessing new markets. Therefore, participation in a network enables a firm to concentrate on its core capabilities, and provides access to other firm's resources (such as specific know-how, technology, financial means, products, assets, markets etc.) which in turn helps them to improve their competitive position. However, Biemens (1992) states that participation in networks also generates some disadvantages such as increased dependency for weaker partners and the associated dominance of the stronger, higher co-ordination costs, increased management time, and the potential loss of secrecy over innovative developments. Human and Provan (2000) research points out that when participating in an SME network and when operating with partly independent members that can be competitors, membership firms face external challenges such as free riding, opportunism, and uncertainty of outcomes. Also, firms are faced with a variety of limitations in their behaviour mostly because micro and small firms work together with larger firm, medium sized in this context, whose size determines the behavior inside as well as outside SME networks, thereby creating implications both on the network-level and on firm-level, i.e. firm's performance.

5. Overall situation of SMEs in Croatia

Small businesses are extremely important and certainly most dynamic segment of Croatian economy. Its share of the total number of companies in Croatia is 99.4% and they account for 64.3% of the total number of employed persons in Croatia. Small businesses are one of the most important impetuses of the overall economic development which stimulates private ownership and entrepreneurship, employment growth and significantly contributes to increase of production and exports. Enterprises in Croatia are by size divided on small (0-50 employees), medium-sized (50-250 employees) and large (250+ employees) and by the owners' structure on private, mixed and public.

Table 1: Business in Croatia in 2007

	No. of Entrepreneurs	Share in no. of entrepreneurs (%)	No. of employees	Share in no. of employees (%)	Share in profit in (%)
Small Entrepreneurs*	81.467	97,5	410.103	44,6	35,0
Medium-sized Entrepreneurs*	1.590	1,9	181.214	19,7	18,7

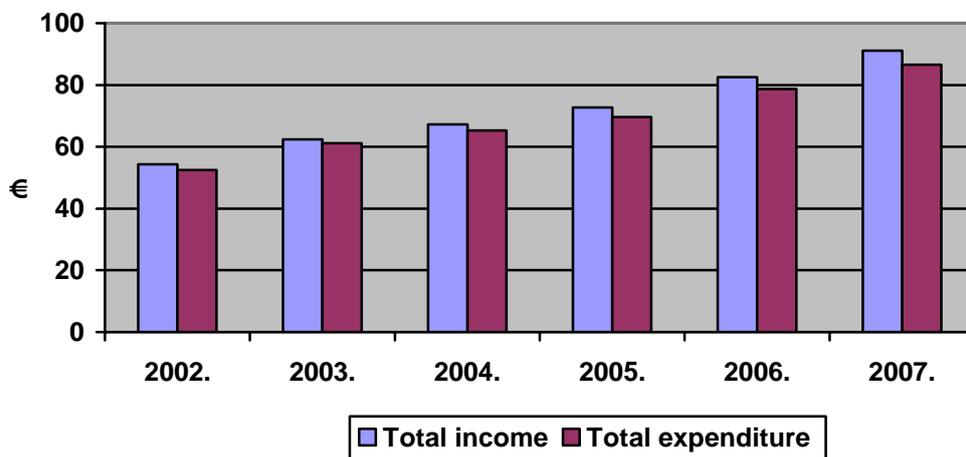
Large Entrepreneurs*	475	0,6	328.856	35,7	46,3
Entrepreneurs-Total	83.532	100,0	920.173	100,0	100,0
Small Business	83.057	99,4	591.317	64,3	53,7

Source: Croatian Chamber of Economy

*companies-legal entities

According to Croatian Chamber of Economy's report on economic movements in 2007 there was an increase in the number of entrepreneurs and employments which led to a positive trend of business results. Total incomes increased faster than total expenditures, which also made them more valuable than total expenditures.

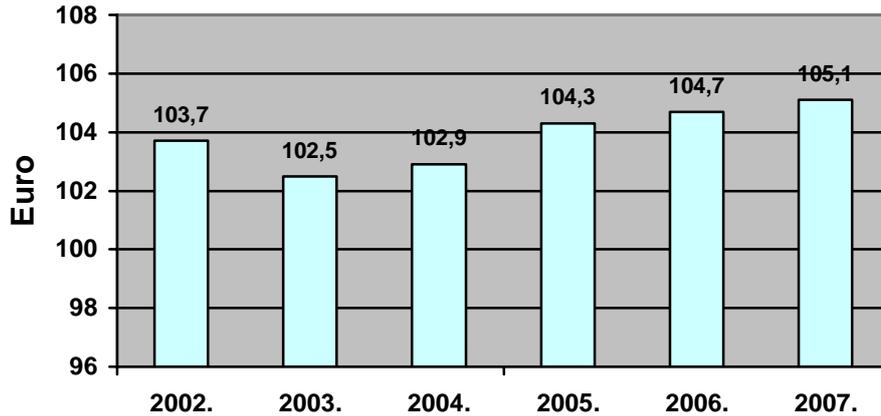
Graph 1: Total incomes and total expenditures of entrepreneurs from 2002 till 2007 (billion €)



Source: Croatian Chamber of Economy

Moreover, both indicators register a more dynamical growth than in the previous years. The total income in 2007 was 91.1 billion €, which represents a growth of 10.5% in comparison with 2006. Total expenditures amounted to 86.6 billion €, which means that they had increased by 10.1% in comparison with 2006. The relation between incomes and expenditures, that is the coverage of expenditures by incomes, was 14.6 billion € and therefore bigger than in 2006, when it was 7.5 billion €. At the same time, a positive trend continued in investments in long term assets. This indicator showed the fastest growth dynamics in comparison with all other indicators. In the year 2007 8.9 billion € were invested, which is 39.9% more than in 2006.

Graph 2: Income of entrepreneurs on 100 euro of expenditure in 2007



Source: Croatian Chamber of Economy

Considering TEA index¹, the total entrepreneurial activity index, Croatia has a relatively low TEA index of 7.3 (GEM 2007). The same is characteristic for other countries in the region: in Serbia the index is 8.6, in Hungary 6.9, in Romania 4, Slovenia 4.8 and Austria 5.3. It is obvious that Croatia is in a similar position as other countries in the region, but it is important to emphasize that an increase in the efforts to make entrepreneurial business more effective is highly needed, which would in turn lead to a faster economic growth.

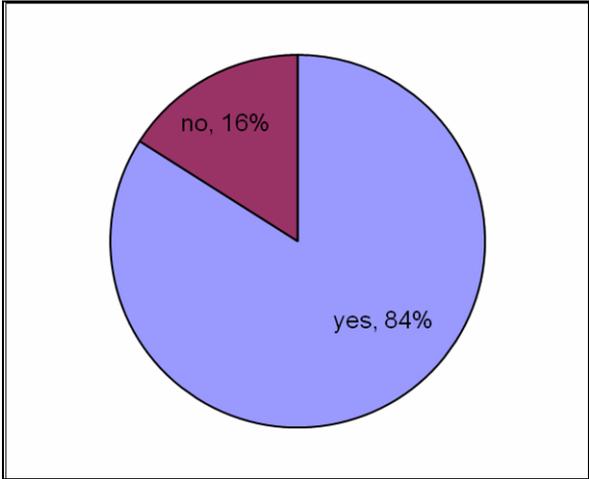
6. Research methodology and the results

Data were collected by means of mail survey questionnaire completed by owners or their general managers of each firm surveyed located across Croatia. The sampling frame was taken from the Croatian Chamber of Economy (CCE). Questionnaire was sent to a total of 1,000 SMEs, of which 104 returned their response, which gives the response rate of 10,4 percent. Among the analyzed firms 20% were micro enterprises, 56% were small and 24% were medium enterprises. Regarding the ownership structure of the analyzed enterprises 84% were private, 11% had mixed ownership structure and 5% were public enterprises. While considering their primary business activity 1% were in the agriculture, hunting and forestry sector, 31% in manufacturing, 15% in construction, 2% in transport, storage and communication sector, 19% in wholesale and retail sale, 6% in hotels and restaurants, 8% in financial intermediation sector and 18% of the analyzed enterprises could not specify their primary business activity.

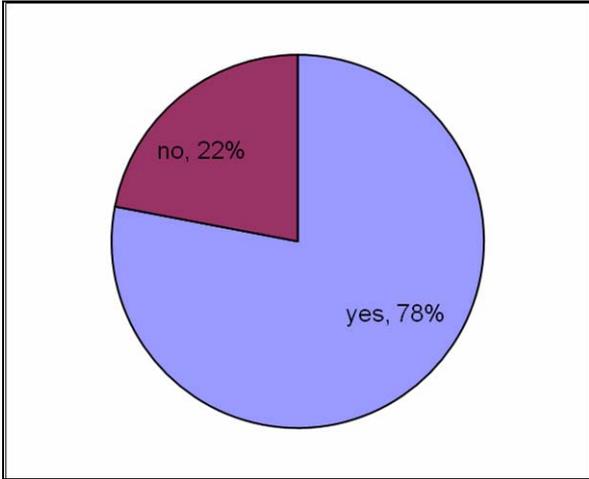
¹ TEA index presents the number of new entrepreneurs on 100 adults aged 18 to 64, in other words, of the owners of a firm which has been in business for over 42 months.

Recent works of Riquelme (2002) and MacGregor (2004) showed that enterprises tend to adapt and use e-business within a networking environment. Therefore, data from table 2 clearly supports the above mentioned statement because 84% of the analyzed enterprises have their own Web page and 78% have adopted e-business.

Graph 3: SMEs that have a Web page



Graph 4: SMEs that adopted e-business



Studies of Mazzarol et al. (1999) and Smith et al. (2002) have shown that smaller SMEs have a tendency towards a formal networking arrangements then larger SMEs due to the inadequate marketing penetration, lack of technical expertise, small working capital and so forth. From table 3 could be seen a tendency to support previously stated findings from the literature.

Table 2: Use of Internet technologies of Croatian SMEs

	Micro	Small	Medium	Total
Have a Web page				
Yes	18%	53%	13%	84%
No	4%	9%	3%	16%
Have adopted e-business				
Yes	15%	47%	16%	78%
No	6%	11%	5%	22%

Moreover, it can be seen from the table 3 that those enterprises that do not participate in any kind of networking activities even have no tendency for future networking activities, while those who do have some kind of cooperation with other members of the network indicate very high level of satisfaction with this kind of a business activities.

Table 3: Participation in and the level of the satisfaction of networking activities

	Micro	Small	Medium	Total
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Participation in linking or networking activities				
Yes	12%	38%	14%	64%
No	8%	18%	10%	36%
If no, does intend to network with other enterprises				
Yes	3%	14%	6%	23%
No	19%	36%	22%	77%
If yes, satisfied with this form of cooperaton				
Yes	17%	55%	22%	94%
No	3%	3%	0%	6%

Regarding the markets from which business partners of the analyzed enterprises that participate in the networking activities come from, table 4 clearly shows that Croatian SMEs cooperate most with the national firms (29.21%) and firms from the European Union (29.21%) which is mostly referd to the small and medium sized firms, while the micro firms (less than 10 employees) have the tendency to cooperate with the local and regional firms.

Table 4: Markets from which business partners come from

	Micro	Small	Medium	Total
Local	4.49%	12.36%	0.00%	16.85%
Regional	5.62%	7.87%	4.49%	17.98%
National	6.74%	13.48%	8.99%	29.21%
European Union	3.37%	19.10%	6.74%	29.21%
International (not including EU)	0.00%	2.25%	4.49%	6.74%

Table 5 clearly states that the estimated percentage of total revenue that the firms have realized through their cooperation is mostly lower than 25%. Less than 10% of the total revenue realized 31.34% of the analyzed firms, while 26.87% of the firms have realized between 10% and 25%.

Table 5: Percentage of the total revenue that is realized through cooperation

	Micro	Small	Medium	Total
< 10%	5.97%	16.42%	8.96%	31.34%
10% - 25%	7.46%	13.43%	5.97%	26.87%
25% - 50%	1.49%	8.96%	4.48%	14.93%
50% >	1.49%	10.45%	1.49%	13.43%
not sure	1.49%	10.45%	1.49%	13.43%

Regarding the type of the strategic networking relationship from table 6 can be seen that most of the companies use outsourcing contract (34.78%) as a mean of business relationship, than long-term marketing agreements (21.74%) and joint-venture with other SMEs represent the third most used type of a networking relationship (14.13%).

Table 6: Types of the strategic networking relationships

	Micro	Small	Medium	Total
Long-term marketing agreements	6.52%	9.78%	5.43%	21.74%
Outsourcing contract	8.70%	19.57%	6.52%	34.78%
Licencing	0.00%	5.43%	0.00%	5.43%
Joint-venture with other SME	2.17%	9.78%	2.17%	14.13%
Joint-venture with large companies	0.00%	2.17%	1.09%	3.26%
Equity investment	0.00%	3.26%	3.26%	6.52%
Other	2.17%	7.61%	4.35%	14.13%

Table 7 shows that market information (30.77%), technology (25.64%), and worker skill training (17.95%) represent the most important assistances received by the analyzed firms from their networking partners. Findings from tables 6 and 7 are in accordance with the findings of Tambunan and Weaver (1998) who analyzed the formation of SME strategic alliance relationships in Indonesia. They have also concluded that the most important types of strategic alliance relationships are long-term marketing agreements and outside contracting, while the most important assistances received by the firms from their networking partners are technology, market information and worker skill training.

Table 7: Kinds of assistance received by the firms from their networking partners

	Micro	Small	Medium	Total
Technology	5.98%	15.38%	4.27%	25.64%
Design concept	0.85%	5.98%	1.71%	8.55%
Down payments for products	2.56%	5.13%	2.56%	10.26%
Workers skill training	3.42%	11.97%	2.56%	17.95%
Market information	4.27%	18.80%	7.69%	30.77%
Information on bank credit	0.85%	4.27%	1.71%	6.84%

When considering the facilitator who provided need help in joining firms together it can be seen from table 8 that creation of networks of Croatian firms mostly depend on other companies with who they deal with (32.46%), customers (15.79%) and trade shows (12.28%).

Table 8: Who assisted in facilitating the firms networking and linking

	Micro	Small	Medium	Total
Trade publications	0.00%	3.51%	1.75%	5.26%
Trade/professional associations	2.63%	3.51%	0.88%	7.02%
Government program	0.88%	0.00%	0.88%	1.75%
Customer	1.75%	11.40%	2.63%	15.79%
Trade shows	4.39%	5.26%	2.63%	12.28%
Financial institutions	0.88%	0.88%	1.75%	3.51%
Other companies we deal with	4.39%	20.18%	7.89%	32.46%
Distribution network	1.75%	7.02%	2.63%	11.40%
Venture capital fund	0.00%	0.00%	1.75%	1.75%
Other	2.63%	5.26%	0.88%	8.77%

It is also very interesting to notice that government programs count for only 1.75% exactly the same as the venture capital funds which implies that the government programs have not delivered the desired results. Considering venture capital funds as a form of facilitator in bringing firms in which they have invested into together it is not a great surprise mostly because of the reason that venture capital financing in Croatia is at its infancy stage. Only couple of funds exist in Croatia and they have limited amount of funds on their disposal, therefore they have invested by the end of 2007 in only 53 companies (Cipic-Bragadin, 2007)

7. Conclusion

Turbulent business environment of the 21st century, in which the ways of doing business are characterized by the rapid and severe changes, obtrude structural changes in the entrepreneur's behaviour where the knowledge and implementation of the new technologies have become dominant and necessary condition not just for the entrepreneur's success but also for the development of the entire economy. Prosperity in this new and quickly changing environment can realize only those entrepreneurs which can faster and more efficiently adapt their firms to the newly created market situations through the usage of information and communication technologies in their businesses. This could be best perceived through the strategic linking and networking where the reason for cooperation lies in the desire for achieving sustainable competitive advantages.

Through linking and networking SMEs are able to realize much better business results by dividing the production process into several stages and therefore achieve the ability to engage their limited resources to those activities that they do the best. Therefore, by linking and networking, where the process of compiling of knowledge, skills and resources of different firms occurs, SMEs realize competitive advantages through specialization, cooperation and increased flexibility. The range of SME cooperation varies from joint-venture agreements where two or more companies have same share in the venture, short-term contracts (regarding the development of new product, acquiring certain part of the market share, etc.) to the long-term agreements where new organization forms are created (like strategic alliances, partnerships, networks, clusters, virtual organizations, etc.).

When considering an emerging economy like Croatia where the key objectives are industrial development and increased employment, policy-makers often focus on efforts to favor small and medium firms. SME networks are of great significance in emerging countries, mostly because areas with consolidated systems of specialized firms in the forms of networks and clusters are more likely to increase employment and contribute to making the local economy more vibrant and more attractive to foreign direct investments.

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