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**CONSEQUENCES OF POLITICAL IMPACT ON SME'S
INTERNAL ACTIVITIES, COMPETITIVENESS AND
BUSINESS DEVELOPMENT**

ABSTRACT

In this world of globalization and post-crisis the change in market conditions and an unstable business economy increase the uncertainty for business actors. Employing data, from a survey of Swedish Small- and Medium-Sized Enterprises (SMEs), the current paper provides new evidence of the extent to which political decisions impact on SMEs internal activities, competitiveness and on their business development. Moreover, the paper observes the coercive and supportive political institutional impact on such. The paper is based on a mail-survey that was sent out to SMEs, which resulted in 134 usable surveys. The data were analyzed using partial least squares (PLS) to test the hypotheses.

Keywords Business-government relations, political institutions, competitiveness, internal activities, business development:

INTRODUCTION

In this world of globalization and post-crisis the change in market conditions and an unstable business economy increase the uncertainty for business actors. EU policies appear in a multilevel governance system characterized by complex interactions between local and national governments, heterogeneous sets of interest groups and a vast number of different EU agencies Falkner, (2000). Granovetter, (1985); Uzzi, (1997) assert that business is a social phenomenon that is embedded in a system that consists of both economic and social factors; interpersonal relations always exist and affect the effectiveness of firm strategies. This call for a further understanding of how international institutions affect business firms in this time of turbulence. The existing literature on the interaction between large firms and government institutions in international business studies refers mostly to multinational enterprises (MNEs) and their behaviour towards non-business actors when entering foreign markets (see for example Hadjikhani & Håkansson, 1996; Hadjikhani, 2000; Hadjikhani & Ghauri, 2001; Hadjikhani & Thilenius, 2005; Welch & Wilkinson, 2004), corporate political strategies (Hillman & Kleim, 1995; Hillman et al. 1999; Shaffer & Hillman, 2000, Bonardi et al. 2005) and organization studies (Kautto, 2007; 2008). Political systems and processes are complex and it is impossible for firms to understand all of its aspects and procedures (Hillman et al, 1999). Uncertainty in the business-government boundary creates large transaction costs for firms (Williamson, 1991). Political actors have institutional legitimacy among voters, the media and others. They are supposed to create political values and norms that reflect the interests on non-business and business actors in the society. Governments act within a system involving conflicting actors who belong to a variety of business, social and independent groups (Hadjikhani, 2000). Consequently, one has to see these two markets as integrated and not as two separate markets. There is interdependency between the actors in these two markets. Business actors are dependent on the decisions made by political actors to do their business in terms of performance, trade (import/export), regulations related to production and to intervene in markets to correct market failures etc. Political actors are dependent on business firms as they contribute to GNP, job creation and technological development. However, the decisions made by political actors regarding rules and regulations are not always in line with the expectations and the existing routines of business firms. In such a situation, business firms try to influence political actors. There are a few studies in SMEs and their behaviour and how they manage their political environment in a national and/or international context (see for example Bengtson, 2009). Other studies, in which they rarely

touch upon, sometimes mention SMEs and state that they have no resources and therefore adapt to rules and regulations and not having sufficient resources to pursue political activities towards political actors such as MNCs (see Hadjikhani & Ghauri, 2001). These earlier empirical studies have convincingly shown the coercive influence by institutional actors on SMEs and with this fact, that SMEs adapt, and with the fact that there are over 23 million SMEs in the European Union, there are none studies of the consequences of adaptation on SMEs in particular. Researchers like Corbetta and Montemerlo, (1999) have stated on the central role of SMEs in both Europe and USA for their contributions to GNP, employment and wealth creation, still the research on SMEs relationship with political organizations is left almost untouched. Consequently, there is a need for further appreciation on how international organization influence local SMEs and the effect on their internal activities, competitiveness and business development. This paper will do just that.

The paper is constructed as follows: first the theoretical framework will be presented along with the hypothesis. Thereafter, in the method section, a brief review of the project and sampling procedures will be presented followed by the results and finally a discussion and some concluding remarks.

SUPPORTIVE AND COERCIVE ACTIONS

Socio-political actors use their legitimate power to influence the market by making decisions and implementing market rules that affect firms homogeneously Lee et al. (2007). However, firms are not homogenous, there are differences in size, resources, knowledge, industry etc. and consequently, firms react differently. In this context, Swedish firms are embedded in both the Swedish and the European institutional environment. They need to handle both the national environment as well as the supranational, EU. Scott (2001) discusses different levels of institutional environments; organizational field and the societal field. Organizational field in this context refers to the business network and the business partners whereas the societal field refers to institutions and other actors in society that have an impact on the organizational field. Scott (2001) and Jansson (2007) stress that there is a highly dependency between actors in both these fields. That is on how political actors influence business actors through their regulative power and how business actors try to influence actors in the societal field to improve their capabilities and gain support in their organizational field. The effect of political institution can be studied by their coercive and supportive actions towards the business firms Hadjikhani and Thilenius, 2005). While large business firms have organized units and commit

resources towards the political organizations, SMEs have to undertake costly, adaptive actions Prashantham, (2005); Hadjikhani and Ghauri, (2001; Hadjikhani *et al.*, (2006). The coercive impact refers to legislative rules that firms need to follow when political actors by their legitimate power apply restriction on the firms' activities (Hadjikhani & Sharma, 1999). New or changes in existing rules and regulations can be:

- New regulations or directives
- Changes in existing rules and regulations
- Re-classification of existing rules, regulations or directives

The rules, regulations and directives that are mentioned here are all general and not for a specific industry or country. There are no distinction between rules, regulations and treaties in this paper; hence, they are all operationalized as EU rules. The adaptation cost due to a coercive action made by policy makers consist of administrative cost; administration of rules and giving information, financial cost; fees and taxes regarding the rules to authorities, material cost; investments in production due to the rule. The negative effect due to a coercive action can also have effects on firms way of doing business, such as effects on their business relationships, competitiveness etc due to a change. Political supportive impact on the other hand, is when its effect on the business actors is positive, in terms of financial support and subsidies (Hadjikhani & Sharma, 1999).

INTERNAL ACTIVITIES

As business firms are dependent on government regulation or contracts for economic survival (Masters & Keim, 1985; Pittman, 1988) business firms need to follow rules, no matter where these originate from. Following rules or adapting to new or changing rules and regulations are costly for firms. The internal activities in this paper refer to SMEs marketing activities, purchasing activities and price setting of products and services. These are one type of activities that are sensitive for changes and that could have an effect on business firms' relationships with customers and/or suppliers. Within a network, firms are dependent on their relationships with their connected business actors. In fact, "... *certain activity is tightly linked to some other activities and loosely linked to others. Consequently, there are a great number of relationships between activities... All such changes are associated with costs of adjustment which are not, however, necessarily born by those performing the activities*" Håkansson & Johanson (1992, pp. 31). A supportive impact could have a positive effect on SMEs internal

activities in terms of development of existing relationships, establishing new relationships, decrease in production cost, increased competitiveness etc. Whereas a coercive effect can influence the above mentioned in a negative way. Thus, the hypotheses for internal activities are as follows:

Hypothesis 1: The supportive impact will have a positive effect on SMEs internal activities

Hypothesis 2: The coercive impact will have a positive effect on SMEs internal activities

COMPETITIVENESS

Authors like Malmberg et al (1996) discuss the notion of competitiveness as something that has been triggered due to the rapid globalization of markets and firms and which has increased competitive pressures in region, nation and firm level (see for example Krugman, 1994; Minford, 2006; Snowden & Stonehouse, 2006). The term competitiveness has different dimensions and Arto (1987) mention three types, namely cost-competitiveness, price-competitiveness and non-price-competitiveness but choose to include all three dimensions into one; “*total competitiveness*”. Going back to Porter (1980) and his five forces of industry competition; threat of new entrants, threat of substitute products, bargaining power of suppliers, bargaining power of customers and competitive rivalry within an industry, these forces play a crucial role in this world of globalization, not to mention the EU. The fact that one of the main goals with the EU has been free competition and free movement of people and goods, this has opened up for more market actors and products as well as decreased country barriers. The work with the free trade within the European single market has undoubtedly its effect on local firms, perhaps more in particular small firms with less resource to handle uncertainty and change. Government entities have the power to shape the competitive environment Hillman et al. (1999). Thus, what is important is to study how local SMEs relate and handle its competitiveness due to supportive and coercive impacts from the EU as it no longer is just national rules, regulations and threats but highly dependent on its environment characteristics, both business and political. There are some studies on why government policy is important to firms’ profitability (Keim & Baysinger, 1988; Schuler, 1996; Shaffer, 1995). Business development in this paper refers to the facilitations of product development and abilities for technical development in the SME’. Changes in internal activities and competitiveness will possibly have an effect on SMEs business development depending if the political impact is supportive or coercive. The following hypotheses are:

Hypothesis 3: The supportive impact will have a positive effect on SMEs competitiveness

Hypothesis 4: The coercive impact will have a positive effect on SMEs competitiveness

Hypothesis 5: the mediating effects of SMEs internal activities in relationships between supportive/coercive will have a positive effect on SMEs business development

Hypothesis 6: The effect of coercive impact on SME competitiveness will most likely have a positive effect on SMEs business development

METHOD

Sample section and data collection

This research is a part of a broader project aiming at increasing our knowledge on the relationship and interaction between business actors and non-business actors. In this context, a questionnaire was designed to collect data on a variety of topics related to these issues. All variables were measured on a five-point Likert scales, measuring from completely agree to completely disagree. The chosen setting for this study was Sweden and particularly SMEs. Following the EU definition of SMEs, of firms with more than 10 and less than 50 employees, a turnover of a maximum of 10 million Euros, a sample frame was drawn. The sample was drawn from a Swedish database covering all Swedish firms. During the sampling process there were no consideration taken to the geographical dispersion of the sample unit. The questionnaire was pre-tested and some minor modifications were made to correct phrasings and ambiguous questions to exclude erroneous indicators. The data collection was done the late quarter of 2008 in Sweden. The language was Swedish. An introductory letter was attached to the questionnaire with information about the purpose of the study, the contributions to research and the practical knowledge that it will bring to the business community. Some additional information about the sampling procedures on how the anonymity of the respondents will be taken into consideration, how the results are going to be used and also information about how to fill in the actual questionnaire was also included. A pre-paid envelope for returning the questionnaire on completion was also sent along with the self administered mail questionnaire. Finally, data from 134 SMEs were collected. The response rate for the survey was approximately 15 percent. However, a non response error evaluation was performed and the results showed that there were no significant differences between industries or geographical spread or any differences between those that had answered and those that had not answered the questionnaire.

Data analysis technique

There are a large number of alternative analytical techniques to analyze data. The method used in this paper is Partial Least Squares Path Modelling (PLS). There are a number of reasons why SmartPLS 2.0 (Ringle et. al 2005) was more appropriate than other techniques, given the sample. PLS, is a technique built on structural equation modelling as is more appropriate when sample sizes are small, exploratory and/or assumptions of normal distributions are not satisfied (Chin & Newsted, 1999). PLS is best suited when testing relationships within a model, better fitted when theory is weak and testing is exploratory whereas LISREL for example is better suited for testing a theoretical model. Although, PLS path modelling is recommended in an early stage of theoretical development in order to test and validate exploratory models, Henseler et al, (2009). Empirically, there are just handful existing articles studying SMEs relationships with political actors (see for example Bengtson, 2009; Hadjikhani et al. 2009). The data that has been used in this paper is exploratory and the sample size is 134. Employing PLS for analysis, models are tested in two parallel analyses (see Henseler et. al 2009): step 1: the outer model is assessed by comprising the reliability and validity of the reflective constructs. Step 2: the inner model is assessed which involve specifying a structural model which is explained by the variance of the endogenous constructs, effect sizes and predictive relevance. The results in the following section will follow these two steps accordingly.

Results

In table 1, all indicators of latent variables and constructs are displayed together with their mean, standard deviation, factor loading, the reliability coefficient and the average variance extracted (AVE) of latent variables. The output from the statistical analysis indicates that the measurement model is satisfactory. Following Comrey & Lee (1992), factor loadings above .71 are considered excellent, .63 as very good and loadings below .32 as poor. As can be seen in table 1, all factor loadings are excellent to very good, ranging between .6 and .9

Table 1: Means, standard deviations and factor loading for all constructs

Factor, reliability and AVE	Indicator	Mean	SD	Factor loading
Supportive actions	EU's goal is to improve our businesses...	2.89	1.063	.77
Composite reliability: 0.84	EU has created new business opportunities...	2.79	1.271	.84
AVE: 0.64	We often get support from EU in our businesses...	2.08	1.081	.79
Coercive actions	The costs for our business has increased due to...	2.71	1.193	.85
Composite reliability: 0.79	We feel forced to adapt our business to fit with EU rules...	2.73	1.283	.78
AVE: 0.56	No matter what EU rules, they always have a negative effect on our business...	2.04	.995	.60
Internal activities	EU has had great impact on our marketing...	2.20	1.038	.89
Composite reliability: 0.87	EU has had great impact on our purchasing activities...	2.35	1.153	.90
AVE: 0.69	EU has influenced the price setting of our products/services...	3.14	1.169	.68
Competitiveness				
Composite reliability: 0.88	EU has had an impact on our competitiveness...	2.83	2.33	.89
AVE: 0.79	EU has decreased the firms ability to compete with other companies...	1.302	1.098	.88
Business development				
Composite reliability: 0.83	EU has facilitated product development...	2.22	2.63	.85
AVE: 0.71	EU has positivley influenced our abilities for technical development...	1.045	1.119	.83

To check for internal consistency reliability, e.g. estimate the reliability based on the indicators intercorrelations (Henseler, 2009), composite reliability has been applied in this paper. According to Henseler et al (2009) Cronbachs Alpha (traditional criterion for internal consistency) tends to provide a strict underestimation of the internal consistency reliability of latent variables in PLS path models and it is therefore more appropriate to apply composite reliability as this measure takes into account that indicators have different loadings, and can be interpreted in the same way as Cronbachs Alpha. Following Nunnally & Bernstein (1994), values above .7 are seen as satisfactory in an early stage of research as values above .8 in more advanced stage of research are seen as satisfactory. From the output in table 1, all composite reliability values range from .79 to .88 and thus satisfactory. For the assessment of validity in PLS, two types of validity are normally examined: the convergent validity and the discriminant validity Henseler et al (2009). Fornell & Lacker (1981) suggest AVE as a criterion for convergent validity and recommend for every construct, an AVE value of at least 50 percent of the variance should be explained. The AVE reported in table 1 confirms that all measures demonstrate satisfactory convergent validity.

For the second subtype of validity, namely discriminant validity, it is assessed both at the item level and at the construct level. In assessing the discriminant validity among the latent variables, the square-roots of the AVE of each latent variable was calculated in the PLS-algorithm and compared to the correlations among the same latent variables. The AVE of each variable should be larger than the latent variables highest squared correlation with any other latent variable.

Table 2: latent variable correlation matrix: discriminant validity –squared latent variable correlations (off-diagonal elements) versus sqrt AVE (diagonal elements)

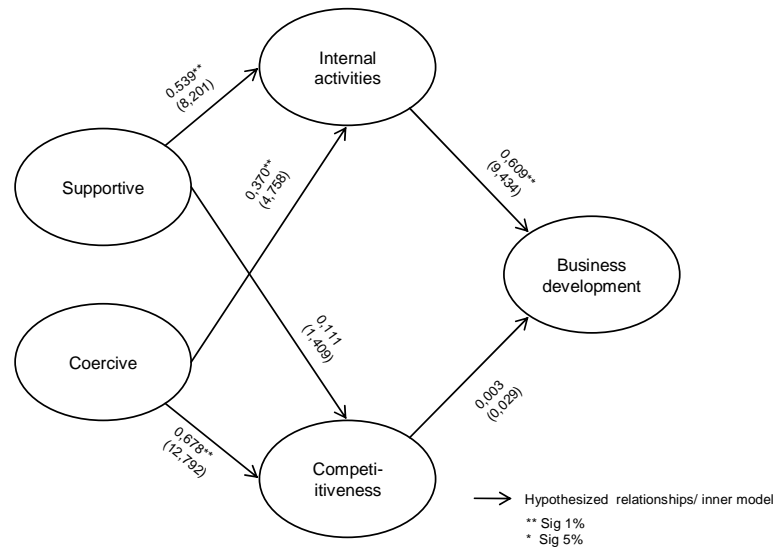
	Business development	Coercive actions	Competitiveness	Internal activities	Supportive actions
Business development	.84				
Coercive actions	.25	.75			
Competitiveness	.21	.68	.89		
Internal activities	.61	.37	.34	.83	
Supportive actions	.61	.01	.12	.54	.80

Notes: Diagonal entries are the square root of AVE and correlation coefficients.

The diagonal elements should be larger than the off-diagonal elements to be estimated satisfactory. In table 2 above, all latent variables are larger than the correlations among them and therefore, looking at table 2, discriminant validity is established.

The second step, assessing the inner model was comprised by a standard boot-strapping re-sampling technique with 1000 re-samples consisting of 134 cases to determine the significance levels of each estimated path in the structural model. The results from the output are displayed in figure 1 below. R^2 values are presented as they give an indication of the predictive ability of the independent variables. The model shows R^2 values for the endogenous latent variables in the inner path models as: Internal activities (.431), competitiveness (.474) and business development (.372) and thus considered to provide adequate evidence of the predictive ability of the model.

Fig. 1: Path estimates, t-values and levels of significance



All the estimates of the path relationships are positive. The t-tests disclose that hypothesis H1 (t-value 9.201), H3 (t-value 4.758), H4 (t-value 12.792) and H5 (t-value 9.434) are all

significant at the 1 percent level. However, hypotheses H2 (t-value 1,409) and H6 (t-value 0.029) were not supported.

DISCUSSION

The aim of this paper was to study how international organization influence local SMEs and the effect on their internal activities, competitiveness and business development. The study showed that SMEs internal activities were strongly affected by the supportive impact from the EU. Meaning that SMEs took advantage and made use of the business opportunities and support that the EU institutions offered and improved and/or developed their marketing and purchasing activities as well as a positive influence on SMEs price setting of products and services. However, the results showed that supportive incentives did not have a significant effect on SMEs competitiveness. Interestingly, the coercive effect had a very strong significance on SMEs competitiveness. Meaning that SMEs competitiveness has substantially decreased due to a coercive impact and the same goes for the internal activities of the firm. The data used in this paper shows that SMEs perceive the coercive impact from policy makers strongly negative to their businesses.

The results showed a strong relationship between SMEs internal activities and their business development. The positive changes from EU have a great impact on firms. However, an implication is that SMEs need to make better use of the supportive incentives. Politicians on the other hand need to be better at reaching out to these types of firms. The coercive impact on the other hand was not significant. Another issue that arise is that impacts of transnational institutions such as the EU upon firms may vary dramatically from one industry to another because some parts may be making more progress of 'EU-nization' than others in integrating the markets. However, the data in this paper is aggregated without taking into account possible variance of firm level perception about EU according to different industries. Thus, economical competition is not seen as the only competition but political resources such as knowledge about the political market becomes as important and yet another condition amongst others for survival in the market

CONCLUSIONS

There are few academic empirical studies that investigate the effect of political decisions in terms of support and coercion on SMEs business activities. The paper explores a timely question: How has the EU been affecting SMEs? It is not difficult to intuitively anticipate that the evolution in the past two decades or so of EU as the transnational political institution has significantly changed the way business in Europe is conducted. It is, however, far more difficult for us as researchers to concretely and articulately capture its impact upon firms and their capabilities. In this respect, the paper provides an important contribution by undertaking a quantitative analysis of firm level perceptions of impacts of the European integration process upon their abilities to conduct business. The gathering and the analysis of the data from more than 130 Swedish SMEs provide rich insights into the question. There is also a potential for the paper to contribute beyond the analysis of the current European topic to a much broader and generalized debate about the impact of political institutions upon capabilities and strategies of firms.

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