Strategic Linkages and Competitive Advantage:

Action Research on Small Enterprise Networks in India
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by

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TOWARD AN EFFECTIVE BUSINESS DEVELOPMENT SERVICE MODEL

Poverty alleviation, employment growth, and private-sector development are at the top of India’s development agenda, and with them an emphasis on promoting a vibrant micro and small enterprise (MSE) sector. In no country is the health of small business more important than in India, with its high poverty levels and burgeoning population. In India today, 3.1 million “Small Scale Industry” units employ 17 million people and account for about 40 percent of industrial production. The informal sector is larger still, with an estimated 26 million microenterprises supporting more than 45 million workers. 1 It is these largely informal-sector enterprises that generate the bulk of new jobs. They are particularly important to the economic prospects of poor women.

Given the speed of liberalization in the Indian economy, small enterprises are at risk today. The microenterprise network research project currently under way in the country (described in more detail below) is an effort to refine a modernization process that responds to the vast scale of the small-firm economy and makes efficient use of limited donor and public agency resources. In this paper, we argue that none of the familiar models of small-enterprise development can meet these tests and that a new organizational technology is needed to enable these vulnerable enterprises to achieve a sustainable competitive advantage.

The organizational technology at the heart of this action research project is the business network. As we will see, economic theory and successful business practice provide a strong rationale for this form of interfirm cooperation. Firms, small and large, increasingly compete by cooperating in groups—joining together in networks to achieve collectively what none can achieve alone. Businesses grow when they position themselves in the right networks or systems of enterprises, leveraging their own capabilities with those of others to achieve the levels of efficiency, flexibility, and innovation the market now demands.

Alliance-building and effective networks increasingly underlie the success of major corporations, and it appears that the smaller the firm, the more important its network ties. In fact, network strategies are essential to micro and small enterprises—especially as policymakers open domestic markets to international competition.

This paper presents the case for action research on enterprise networks in India. It describes the concepts on which the project is based, sets out the hypotheses that guide the project team’s work, outlines the roles of partner organizations, and discusses the team’s research objectives and methods. The basic intent of the project is to help the U.S. Agency for International Development (USAID) answer the following questions:

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1 The Indian Central Statistical Office census covers three categories of tiny firms: Own Account Enterprises, Non-directory Manufacturing Establishments (1 to 5 employees), and Directory Manufacturing Establishments (more than 5 and fewer than 50 workers). Informal-sector firm numbers are estimates based on sampling. In this research project, the focus primarily is on microenterprises, both formal and informal, defined by USAID as firms with 10 or fewer employees.
How do micro and small enterprises interact with other firms, including business services providers, in business systems, and how can more strategic forms of cooperation be stimulated?

What are the principal impediments to increased cooperation between micro and small enterprises and how are they best addressed?

What is required to induce MSEs to specialize—that is, to focus on “core competencies”—and learn to rely on partners and specialized providers of business services to fill out their business systems?

Can NGOs and other types of private-sector organizations be found that can use project assistance to engage entrepreneurs and establish effective networks?

Are suitable network brokers available to be trained by partner organizations, and can they translate network organizing into a sustainable business development service? What subsidies may be needed to make network development a sustainable business development service?

What are appropriate investment strategies for donors convinced that business networks are a necessary element in any strategy for micro and small-enterprise competitiveness and economic growth?

The microenterprise network research project in India is part of USAID’s Microenterprise Best Practices Program, managed by Development Alternatives, Inc. The project goal is to learn more about the factors involved in promoting effective networks among MSEs in India as a first step toward refining the methods and tools needed to have a significant impact on the vast MSE sector in the developing world.

**MSEs at Risk**

There is little question that small firms are at risk in increasingly turbulent markets. The television- and movie-influenced convergence of consumer tastes and the increased flexibility of multinational corporations are crowding out traditional goods and traditional suppliers in many markets. Liberalization policies and World Trade Organization regulations are radically changing business environments. In India, import restrictions no longer protect

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2 A business system is a chain of value added that begins with a product-market decision and proceeds through a series of procurement and production operations to reach end users via specific channels. In small-firm clusters, each link in the chain is usually a separate enterprise. Business development services may or may not be involved.
national locomotives, and subsidies are being withdrawn even from the Gandhi-inspired handicraft sectors that provide a livelihood to hundreds of thousands of workers. In many villages and cities, small-scale entrepreneurs crowd into sectors characterized by low entry barriers, forming numerous nearly-identical businesses. In Dakshinpuri, a resettlement colony on the edge of Delhi, 54 women-owned microenterprises compete for Salwar suit (women’s garments) orders from several hundred neighborhood households. Their fabrics come from the same market stalls. The design of the clothes they make is fixed by tradition. The Salwar suit market may be growing, but nongovernmental organization—led microfinance and entrepreneurship-development programs add rapidly to the number of competitors. The result is a saturated market, price-based competition—and, inevitably, self-exploitation.

Further east, in the city of Aligarh, a cluster of several thousand microenterprises has supplied India with locks for generations. These little firms make their own tooling and use hand-operated machines to manufacture the intricate brass parts from which a vast variety of padlocks, bicycle locks, and mortise locks are made. Although these firms have links to large distributors and national markets, they are not much better off than the apparel makers in the Delhi slums. In Aligarh, unequal bargaining power enables traders and wholesalers to make tiny suppliers bid against one another, maintaining downward pressure on wages. To make matters worse, Taiwanese and Chinese firms have now entered the Indian market. With modern lock designs and automated production techniques, they undersell and outsell Aligarh’s microenterprises. The tiny firms there, like those in Dakshinpuri, are unable to respond to this competitive challenge.

In a remote Rajasthan village, dozens of landless workers eke out a living making simple shoes from local leather. There is little division of labor, and the work is done almost entirely by hand. Weekly production and incomes are low. To complicate matters, cheap, imported sneakers and low-cost Western shoes now compete for the customer’s trade. Efforts to help the workers move into the production of alternative leather goods, such as desk accessories and bags, founder because of quality issues. To be competitive, these microentrepreneurs need access to better leather—which comes from Tamil Nadu, on the other side of the subcontinent.

In many cities in the developing world, decentralized industrial estates have been built to remove manufacturing from urban cores. On the outskirts of New Delhi, Okhla Flatted Factories is now home to 230 tiny light-engineering, electronics, plastics-molding, and related companies. Although a few make proprietary products, most are subcontractors to big Indian corporations like Maruti Udyog and Tata Industries across the river in Noida. These firms sell machine time—a commodity in great supply in this city of 14 million—to

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3 Changes in trade policy since 1991 have removed more than 550 items from the list of products reserved for small enterprises, essentially putting an end to the “quota raj” industry protection system. India’s entry into the World Trade Organization sets the stage for the removal of restrictions on the rest by 2002. The expectation is that foreign multinationals will flood into these protected markets. For a discussion of the impact of liberalization, see the Report of the Expert Committee on Small Enterprises, The Ministry of Industry, Government of India, July 1997.
customers who provide them with materials and specifications. Massive competition for orders results in tight margins, effectively preventing investments in new machinery. Already two or three generations behind in production technology, these firms face a clouded future.

Whether serving local consumers or jockeying for position in large-firm supplier chains, Indian MSEs today face some complex challenges, including the following:

- Large numbers of competitors crowding into sectors with low barriers to entry;
- Sophisticated goods from industrialized countries appearing in local markets;
- Increased customer expectations regarding product quality and performance; and
- Rapid changes in production materials and technologies.

Limitations of Business Development Services

Ordinarily in situations such as these, an effort is made to increase the supply of business development services (BDS), often coupled with subsidies to stimulate demand. In the settings described above, however, this traditional response seems deeply flawed, for several reasons:

1. The traditional BDS delivery model focuses intently on the individual firm. Individual service delivery is expensive and makes inefficient use of scarce resources, including consulting capabilities and entrepreneurs’ small cash reserves. Ultimately, it is doubtful that public and/or donor funds can be stretched to cover the needs of the millions of MSEs in India.

2. BDS investments in this environment have not been cost-effective. Recently, the Committee of Donor Agencies for Small Enterprise Development stated that there is a “shared recognition that traditional interventions…have not achieved the objectives of donors and governments.”

Low rates of BDS utilization and impact in the past are attributed largely to the absence of free-market price signals and the crowding-out effects of government-run BDS services. Following this reasoning, the proposed solution is private-sector–led markets for BDS in which, according to BDS market theorists, even microentrepreneurs will be “discerning consumers” of services.

If it were correct to say that undistorted markets would direct BDS resources to the poor, we should expect to find flourishing BDS markets in regions where there has been little or no public-sector or donor assistance for small enterprise, but we do not. Market failure will continue to be a fact of life as far as BDS for small-scale entrepreneurs are concerned.

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4 The self-criticism is severe: too many BDS projects, it is said, have been supply-driven, with donors and governments offering what they believe MSEs ought to have. At the same time, projects have had limited outreach and little stability, waxing and waning in response to enterprise-development fashions and the availability of funds. Sustainability remains a receding target as donor and government subsidies distort both the demand and supply sides of the BDS market. See *Business Development Services for Small Enterprises: Guidelines for Donor Interventions*, 2000 Edition, prepared by the Committee of Donor Agencies for Small Enterprise Development, World Bank Group, Washington, D.C.

3. Finally, the real world of business is not much like the microeconomist’s model of atomistic firms in Hobbesian competition. In reality, firms small and large compete by cooperating in groups. These groups are both more and less conscious and vary in complexity from local business systems to the supply chains of automakers and the global alliances in the electronics industry. Only if the small firms in Dakshinpuri, Aligarh, Okhla, and Rajasthan position themselves in the right networks can they leverage their own capabilities with those of others to achieve the levels of productivity, flexibility, and innovation the market now demands. BDS alone cannot induce these changes. The inherent limitations of small-firm size—among them shallow management depth, lack of research and development capacity, weakness in marketing, and restricted access to capital—create handicaps too great for individual tiny enterprises to overcome. The costs and risks of specialization, productivity, and differentiation become manageable only when these firms enter into supportive alliances, that is, business networks.

**Overcoming the Limitations of Size**

Carl Liedholm and Donald Mead have argued that the evolution of the global market toward increasing complexity and specialization leaves tiny firms with only two choices: grow into vertically integrated firms or find “an alternative pattern whereby the different steps [in production and distribution] take place in separate enterprises linked through the market.” However, they go on to note that, “Small firms cannot easily grow...because of high internal transactions costs and high organizing costs; they cannot easily raise their productivity in ways that involve market transactions with other firms to obtain goods and services because of high external transactions costs.” For Liedholm and Mead, the foreseeable result is that small firms must continue to operate at low levels of productivity. As we will see, however, this need not be so.

Although transformation into vertically integrated firms or stable incorporation into the supply chains of market leaders are options for only a limited number of small enterprises, there is a third possibility: the creation of interfirm networks—an organizational technology all small firms can use to minimize external-transaction costs and reduce the need to incur internal-transaction costs. The network is a form of business collaboration that lies midway along the continuum between spot-market linkages and total integration. In simple terms, a

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6 Women-owned enterprises will encounter even greater difficulties, as they often face limitations of mobility, gender-specific product markets, high rates of illiteracy and innumeracy, and social insecurity. For a discussion of this point, see Jeanne Downing, “Gender and the Growth and Dynamics of Microenterprises,” GEMINI Working Paper No. 5, September 1990.


8 Liedholm and Mead, op. cit., page 16. Internal-transaction costs reflect the inherent small-firm limitations discussed above; external-transaction costs are generally associated with small-numbers bargaining, opportunism, and the cost of making and enforcing contracts.

9 For a full discussion of this continuum and the transaction costs that affect firms’ decisions about where to locate themselves along it, see Oscar E. Williamson, Markets and Hierarchies, Free Press, New York, 1975.
network is nothing more than a group of firms that cooperate in order to compete—but it is a uniquely effective means of escaping from the limitations of small size and an essential strategy for MSEs in India and similar environments.

We know from experience in developed countries that networks coalesce around common needs and opportunities. Through participation in service networks, dozens or even hundreds of firms can share the costs of market intelligence, quality testing and certification, materials purchasing, or financial management. Out of these service networks blossom production networks, in which MSEs cooperate to supply profitable markets.

In general terms, networks provide three critical benefits to small firms:

1. Networks reconfigure enterprise value chains, creating economies of scope.

   In networks, complementary capabilities can be combined to produce new product lines. In a network program for Denmark, which is discussed in greater depth further on, the Microenterprise Best Practices Project concentrated on organizing networks to create new products and services for export markets. Here are two examples out of several hundred. In the first, 11 apparel manufacturers formed a group called CD-Line to exploit their complementary capabilities in the production of suits, shirts, accessories, and knitwear. They now successfully market an integrated line of what they call “image clothing” (uniforms) to large European companies. In the second example, seven companies involved in shipbuilding, marine fittings, fishing equipment, and electronic navigation systems networked with a bank and a private research center to develop a state-of-the-art trawler for the international market.

2. Networks reduce the risk of specialization, enabling MSEs to achieve scale economies and productivity growth.

   Specialization within networks improves overall factor productivity. In a project with agricultural equipment companies in northern Argentina, networks were organized to develop farm implements for the difficult soil conditions found in the nearby Brazilian province of Mato Grosso. Their joint market-research and engineering-design exercises led to the realization that their small firms were much too highly integrated vertically and that almost no production process reached minimum efficient scale. This soon led to greater manufacturing specialization, increased interfirm subcontracting, competitive prices, and solid export sales.

3. Networks generate management economies.

   By sharing costs within a network, small firms can afford quality services (making BDS markets feasible). Economic theory notes the large firm’s advantages in “management economies”—the ability to spread the high cost of sophisticated administrative, financial, and marketing activities over a large volume of business transactions. Networks built around joint management services are the only way most tiny companies can use BDS to improve internal operations and achieve focus. CITER, which serves the knitwear
industry in Italy’s Emilia-Romagna region, is perhaps the best-known example. This 600-member network routinely brings the most sophisticated international market research to a cluster of MSEs located in an agricultural area far from major fashion centers. It also negotiates for its members with the multinational corporations upon which they depend for the fibers and machinery used in their work.

LEARNING FROM NETWORK REGIONS

The study of networks and efforts to derive lessons from them for economic-development practitioners had its start in the early 1980s. At that time, the rapid growth of Emilia-Romagna and nearby regions of north-central Italy came to the attention of European and American scholars. Particularly striking was the fact that the sharp rise in wealth and fall in unemployment followed a period of crisis in which small firms replaced large ones as drivers of the economy. The tens of thousands of small enterprises created in the 1970s quickly figured out how to link diverse capabilities in order to serve high-end markets. Economist and former Italian prime minister Romano Prodi aptly likened the efficient systems of production in which these MSEs participated to “a magnificent Tinkertoy” able to shift nimbly from market to market by reorganizing its components into new networks in response to changing customer demand. Study revealed that a combination of strong business associations, technological prowess, and a learned propensity to compete horizontally while cooperating in vertical networks were behind the unexpected phenomenon.

Among the lessons drawn from these Italian industrial districts was that small firms, appropriately equipped and linked together in efficient business systems, could function like the best of big corporations—without losing their flexibility or their roots in local culture. For example, it was found that small companies cooperating in networks were able to do the following:

# Share the mounting costs of BDS (for example, ISO 9000 certification);
# Access the expensive technologies they all need;
# Meld capabilities to produce sophisticated goods and services;
# Aggregate production to serve large customers and markets;
# Learn from one another (something they are more likely to do than learn from outsiders); and
# Increase market share and export earnings.

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10 Most important among them is the Confederazione Nazionale dell'Artigianato (CNA), which brokers links between entrepreneurs and handles management functions such as payroll and tax preparation, enabling tiny firms to concentrate on production. The CNA has also played a central role in the design of the region’s much-discussed sectoral service centers, of which CITER is an example.

11 See, for example, S. Brusco, “Small Firms and Industrial Districts: The Experience of Italy,” in D. Keeble, E. Wever (eds.), New Firms and Regional Development, London, Croom Helm, 1986. Since this time, effective industrial districts have been discovered and studied in France, Sweden, Spain, Taiwan, and Japan.

Over time, a learned propensity to network dramatically improved the adaptive capacity of the entire region, transforming ordinary enterprise clusters into Marshallian industrial districts¹³ capable of competing successfully in global markets.

A PLANNED NETWORK INTERVENTION

With more and more regions and countries coming to depend on the small-enterprise sector for employment generation, the good news from Italy soon led to a series of experiments aimed at promoting interfirm cooperation. The earliest occurred in the United States, but the best-known is the Danish national network project, launched in 1989.

The impetus for this project was a combination of a growing trade deficit and the prospect of the removal of trade barriers with the opening in 1992 of the European Community’s Single Market. A study done for Denmark’s Ministry of Industry by the Copenhagen office of the American consulting firm McKinsey & Company had framed the national debate around the issue of “critical mass.” The fundamental problem, said McKinsey, was that Danish companies were too small to compete in an open European market. In an effort to create critical mass, the Danish government had relaxed antitrust regulation, and a substantial amount of jawboning was going on with major manufacturing and banking companies. However, little progress was being made toward the mergers the government wished to promote.

After the surveying of small manufacturing companies scattered over Denmark’s agricultural provinces, it became evident that some of the strategies seen in the manufacturing centers of northern Italy represented an alternate route to critical mass for Danish industry. If Denmark lacked industrial locomotives, it did nonetheless have 7,300 manufacturing establishments, each with 6 to 99 employees. These small to midsize firms were well-equipped, enjoyed a well-educated work force, and had a good grasp of the process of globalization under way in manufacturing markets.

At a seminar about the European Single Market, the following case was presented to the minister of trade and industry and to representatives of Danish business organizations:

. . . there are two choices: build big firms (and do it quickly, before open competition in Europe puts the cost of gaining initial shares of new markets beyond reach)—or make existing, largely small firms perform like the best of big ones. Both of these policies aim at the same end result—sufficient production, marketing, and financial strength in enough industrial sectors to stand up to the competition we can all see coming down the road. The strategies these policies require are, however, vastly different. In my view small firm dominance of manufacturing does not preclude building a world-class economy. It is not size

¹³ Alfred Marshall, in his Principles of Economics (London, 1890, pp. 271 ff.), provides the classic description of industrial districts—areas where networking is fundamental business strategy. According to Marshall, key advantages include rapid dissemination of innovations, growing specialization, significant external economies, and a stable labor market.
that counts, but competence. If individual small firms are weak and vulnerable, networks give them strength.\textsuperscript{14}

Shortly thereafter, the Danish Ministry of Trade and Industry announced its intention to promote network cooperation among small and medium-sized enterprises. At that time, a team was formed at what is now the Danish Technological Institute to develop a national network project. Its principal features included a media campaign to make networks a central part of the nation’s business discourse, involvement of business leaders in all aspects of the program, a training program for network brokers who were to guide the process, and challenge grants for innovative networks.

In March 1989, the ministry announced the following set of incentives for MSEs entering networks:

Small and medium-sized enterprises constitute a substantial part of Danish trade and industry. . . . [I]t is therefore indispensable, inter alia, to mobilize the resources of small and medium-sized enterprises to strengthen the competitive power of Danish trade and industry. The basis of network cooperation is a joint effort in utilizing resources in one or several areas.

Companies entering upon network cooperation participate on equal terms with other companies of their own choice, and the individual companies themselves are responsible for the form and development of cooperation. . . . Once a potential network has been identified, the company’s external costs of examining the realistic basis for creating the network will be financed 100 percent; however, normally with no more than 75,000 kroner per network [US$10,000]. . . . Once the decision to establish a network is made, a subsidy of up to 50 percent of the external costs may be granted for determining the detailed framework of network cooperation. . . . On the basis of an operating budget and plan of action and after recommendation from the [network project] Steering Group, a subsidy of up to 50 percent for the first year and up to 30 percent for the second year may be granted for the establishment of the network...\textsuperscript{15}

The basic rules for obtaining a network grant were straightforward: a minimum of three firms must apply jointly; the network must deal with strategic business issues; and the results of collaboration should be increased exports. The reaction of industry was, at first, less than enthusiastic. Popular opinion insisted that the Danes’ fierce individualism, reflecting a “yeoman inheritance” (Denmark was a nation of family farms until the 1950s), would make networking unviable.


\textsuperscript{15} The ministry’s budget for the network project was 150 million kroner, the equivalent of US$25 million.
Changing Business Culture

Steps one and two in creating a culture of cooperation among businesses in Denmark were participation and information. The ministry’s operating arm, the Agency for Industry and Commerce, first organized a private-sector steering committee. Then, together, they used any and all conceivable means to reach MSEs in every sector and every city and town. The industry steering committee used press releases about industry cooperation, television talk shows, presentations to trade associations, and eye-catching direct-mail pieces to reach out to entrepreneurs. Spokespeople whose business acumen was widely recognized were used extensively to legitimate the unfamiliar concept of cooperation in business. Within a couple of months, debate in business circles was intense about the possibilities and pitfalls of manufacturing networks. At that point, the steering committee placed an advertisement in Denmark’s largest newspaper, Jyllands-Posten, asking, “Who Will Be Denmark’s First Network Brokers?” The response was strong.

Recruiting and Training Network Brokers

Forty people drawn from private consulting firms, government technology transfer centers, local economic-development organizations, trade associations, accounting firms, and commercial banks were selected by the committee from among the many who applied for the training program. Each candidate selected paid a substantial tuition to enter the program. Brokers were chosen based on their knowledge of business and their commitment to the network project’s goals. The training program was organized as a series of intensive, two-day seminars, separated by four- to six-week periods of fieldwork. At the heart of the seminars was a set of case studies dealing with network structures and functions, organizing techniques, conflict resolution, group strategic planning, and market development. The objective of the fieldwork assignments was to turn knowledge quickly into action, building pilot networks to convince skeptical manufacturers.

Denmark’s Successful Brokers

The results were extremely encouraging. Less than 18 months later, at the end of the project’s first phase, more than 3,000 of Denmark’s 7,300 manufacturing firms were actively involved in one or more networks. Their sectors included food processing, clothing, furniture, metalworking, machinery, and many others. Some involved few firms, some many. Both formal (joint ventures) and informal networks were created. As the number of

16 In the later phase of the project, the number of networks more than doubled, and their scale increased as well.

Among the more unusual networks created under the program was one in which small landscape contractors teamed up to develop golf courses in Eastern Europe. See C.R. Hatch, “The Ties That Bind: Networks and the Making of Denmark’s Competitive Edge,” Entrepreneurial Economy Review, Washington, D.C., Spring 1991. A discussion of the Danish project is also contained in J. Humphrey and H. Schmitz, “Principles for Promoting Clusters & Networks of SMEs,” UNIDO Small & Medium Enterprises Programme, Vienna, October 1995.
networks grew and the impact on exports became evident in late 1991, the Ministry of Trade and Industry withdrew, declaring, “Networking has taken on a life of its own in Denmark.”

At the conclusion of the project, Denmark’s successful network brokers were told:

The scale is new, and scale is everything. We are no longer talking about a handful of exemplary firms that collaborate or a few model networks. Today thousands of Danish companies are exploring networks as a means to solve common problems and prepare for a barrier-free Europe. More will be involved tomorrow as the inexorable logic of network cooperation in a turbulent market environment sinks in. We set out to build a self-renewing industrial system based on continuous learning and mutual aid. . . . You have proven that rapid business culture change is possible.

Because the Danish network program was able to introduce cooperation into a resistant business culture in a surprisingly short time, most later projects have used its basic design—an information program, challenge grants for model networks, and training to create a supply of catalysts (network brokers). As a result, it has been demonstrated that networks are an appropriate business strategy in industrialized nations wherever firms face resource limitations or encounter difficulties in reaching minimum efficient scale in critical operations. We still have much to learn, however, about networking microenterprises in developing countries.

**Microenterprise Networks in India**

In an effort to understand the factors involved in creating effective networks among micro and small enterprises, Development Alternatives, Inc. (DAI), under its USAID-funded Microenterprise Best Practices (MBP) Project, is conducting an action research program involving several clusters of tiny firms in India. Although the basic objectives and many of the tasks are similar to those in Denmark, it will be necessary to modify the model substantially to fit conditions encountered there. The following chart describes some of the more significant adaptations being pursued and the reasons behind them:

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17 Talk given by the author at the Danish Technological Institute, Copenhagen, 1990.
18 Projects using the Denmark design have been successful in Australia, New Zealand, Portugal, Spain, Norway, and parts of the United States.
<table>
<thead>
<tr>
<th>Nature of Difference</th>
<th>India MSE Environment Compared with that of Denmark/Europe</th>
<th>Project Adaptations to be Explored</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scale</td>
<td>Immense territory; inadequate transportation infrastructure; vast numbers of MSEs, many in rural areas.</td>
<td>MSE access through local partner organizations; Internet-based training and mentoring.</td>
</tr>
<tr>
<td>Enterprise strength</td>
<td>Most firms are undercapitalized and equipped with outdated technology.</td>
<td>Increased emphasis on specialization to promote collective efficiency and targeted modernization investments.</td>
</tr>
<tr>
<td>Access to BDS/legal status of enterprises</td>
<td>India has a huge informal sector outside the system of public-sector business assistance and bank financing.</td>
<td>Brokers will have to create both supply of and demand for BDS; consider registration of networks to make them eligible for financial assistance.</td>
</tr>
<tr>
<td>Business culture and linkages</td>
<td>Ethnic, religious, and caste lines may be obstacles to cooperation; legal system does not inspire confidence. Few MSEs are involved in trade associations.</td>
<td>Brokers must learn to recognize and build on established bases of association, and may have to move slowly, from low-risk service to higher-risk production network projects.</td>
</tr>
<tr>
<td>Market orientation/basis of competition</td>
<td>Local-market orientation more common than in Europe; most microenterprises have little national-market or export experience. Competition is typically based on low wages and low prices rather than differentiation and quality.</td>
<td>Educate partners and firms regarding impacts of deregulation and World Trade Organization accession; study successful MSE exporters; benchmark competing imported products.</td>
</tr>
<tr>
<td>Training and skill</td>
<td>Considerably lower education and literacy levels.</td>
<td>Redesign training materials and outreach efforts.</td>
</tr>
<tr>
<td>Broker availability</td>
<td>Unlike in Europe, the market for MSE business consulting services is small; in relation to need, there may be few individuals available with broker skills.</td>
<td>Subsidies will be needed to attract candidates. Expand broker training to include key management, finance, and marketing concepts; inventory existing BDS; train nongovernmental organization social-service providers to understand business strategy.</td>
</tr>
<tr>
<td>Targeting of projects</td>
<td>In Denmark, all traded-sector firms were targeted. In India, screening procedures will be needed to ensure efficient use of resources.</td>
<td>Research is required on industry structure, available skills and equipment, business systems, the nature of competition, and so on prior to targeting.</td>
</tr>
</tbody>
</table>
PROJECT OBJECTIVES

The aim of the work in India is to refine a sustainable methodology that will help small firms grow and make more substantial contributions to job creation through network cooperation. A secondary objective related to the promotion of specialization and productivity is to increase the demand for, as well as the availability and quality of supply of, BDS. At the same time, the project sees network formation itself as an innovative business development service.

In pursuit of these objectives, the project work plan calls for:

# Targeting representative groups of micro and small enterprises in order to study their business systems and learn how to introduce network strategies efficiently;

# Selecting partner organizations to leverage the limited staff and resources MBP can provide;

# Developing the materials needed to provide training to selected partners and, through them, network brokers;

# Designing efficient subsidy schemes to stimulate demonstration networks and attract an initial group of network brokers;

# Providing technical assistance to partners, brokers, and pilot networks; and

# Conducting research on effective methods and tools needed to ramp up network development to national scale.

PROJECT MODEL

Kenneth Arrow once wrote, “Every commercial transaction has within itself an element of trust. . . .” Yet he also said, “It can be plausibly argued that much of the economic backwardness in the world can be explained by the lack of mutual confidence.” The MBP network project in India aims to learn how to set in motion processes that breed the mutual confidence needed to overcome backwardness. In the network model, self-interest among entrepreneurs leads to interfirm cooperation. Repeated exchanges encourage a norm of generalized reciprocity. Dense networks end up contributing not only to the economic goals of entrepreneurs, but also to the accumulation of social capital and the creation of a basis for long-term growth.

In the pursuit of its objectives, the MBP network project combines the experience of DAI’s project team, local partners with established relationships with target MSEs, and newly

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minted network brokers to introduce an organizational technology—business networks—through the following delivery model:

**MBP Team**
- Methods
- Training/mentoring
- Research

**Partners**
- Knowledge of enterprises
- Recruitment and supervision of brokers
- Research support

**Network Brokers**
- Study business systems
- Organize networks
- Deliver BDS

**Enterprise Clusters**

**PROJECT PARTICIPANTS**

The following section describes the selection criteria for each of the elements shown in the diagram above, discusses the project team’s hypotheses and assumptions regarding each, and outlines anticipated research results.

**Local Partners**

The MBP project in India will work with private-sector partners to test processes for building effective networks and improving the BDS marketplace. To begin, the team will invite to participate a selected group of nongovernmental organizations (NGOs) with a history of
serving micro and small enterprises. NGO partners are expected to arrange access to target enterprises, provide contacts with a variety of BDS resources, and second staff to function as “meta-brokers.” Meta-brokers are responsible, in turn, for recruiting, training, and supervising network brokers.

Under memoranda of understanding with the MBP project, partners are expected to:

1. Prepare a written plan describing the number, locations, and sectors of targeted firms and a description of the development obstacles these enterprises face.
2. Provide qualified staff (meta-brokers) to recruit and train one or more network brokers, using curricula and materials developed by the MBP team. Meta-brokers must be prepared to provide continuity in regard to project goals, contacts with external business resources, and general oversight to fledgling brokers and their initial networks.
3. Encourage brokers to develop and implement sound personal business plans, and supervise the use of subsidies aimed at achieving sustainability.
4. Be Internet-equipped in order to access training materials and link meta-brokers and brokers to DAI and other project partners and brokers.
5. Meet with the MBP team several times over the project period and attend at least one meeting of all project participants.
6. Provide feedback on meta-broker and broker training approaches and materials.
8. Work with the MBP project team to adapt and improve its initial approach in anticipation of increasing the present project to a significant scale.

NGO selection in this phase emphasizes organizations able to test and develop a new consulting product that they may be able to offer on a sustainable basis. Partners will learn to master a new business development service—one that can strengthen existing enterprise-assistance efforts or add a new dimension to an organization’s capabilities. This opportunity to be trained in network development strategies requires only the NGO’s willingness to invest a certain amount of staff time and energy.

The benefits of project participation to partner organizations are potentially significant in terms of new skills and new business development. In this pilot phase, the project seeks partners that wish to contribute to the development of a new consulting product that they can offer sustainably in the future.
Brokers: Selection and Training

Partners will recruit, train, and place brokers in micro and small-enterprise settings. In the network project, meta-brokers recruit, train, and supervise brokers who work directly with firms. An objective of the India project is the development and testing of training methods and materials for use by meta-brokers and brokers. In this experiment, we will use the Internet to disseminate course materials, support mentoring from DAI staff and consultants, simplify reporting, and encourage communication among project participants. Broker training emphasizes guided fieldwork with target firms. The focus is on developing the skills needed to identify group business opportunities and build networks. Readings cover sector and firm competitive analyses, successful network models, and network management issues. Field assignments include business system mapping, enterprise benchmarking, market research, focus group planning, investigation of BDS use and availability, and network organizing. The preparation by brokers of sustainable business plans is the final step in the training program.

Brokers are expected to disseminate network concepts, promote communication among local firms, identify new business opportunities, and work to connect groups of firms with those with whom they need to cooperate—suppliers, customers, product designers, exporters, training institutions, private-sector BDS providers, and public-sector industry services programs. It is hoped that brokers will use their training and connections to become BDS “paraprofessionals,”20 providing fee-based services and building ever-larger networks to maximize their incomes.

Brokers’ basic tasks are as follows:

# Analyze firms and sectors to determine their networking potential, identify competitive challenges, and define bases for network cooperation;

# Identify and disseminate “best practices” in key areas of individual and network business management;

# Increase communication among firms through focus groups, seminars, and strategic planning sessions;

# Manage risk and build trust, moving firms steadily from group services, such as common materials purchasing, joint use of expensive equipment, and shared BDS, to joint product development, production, and marketing;

# Identify new markets for network firms;

# Assist in preparing business plans and challenge grant proposals (see below);

# Provide some BDS and access other services for group purchase;

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20The term is Dorothy Riddle’s. See her “What Do We Know About BDS Markets?” paper for the April 2000 International Conference on Business Services for Small Enterprises in Asia.
# Identify underserved BDS market demand and prepare plans for sustainable broker practices; and

# Gather research data and report to the project on the network process.

## WHAT MAKES A GOOD NETWORK BROKER?

Brokers are selected and trained to form sustainable network practices that work with growing numbers of tiny firms. Broker trainee sources include recent business graduates, retired businesspeople, BDS consultants, and dynamic entrepreneurs. From experience in developed countries, the following criteria have been developed to assist partners in recruiting and evaluating brokers:

- Is able to relate to microentrepreneurs on a personal level (not too dissimilar in background);
- Brings a useful business skill to the target enterprise cluster;
- Is able to analyze (decompose and describe) intrafirm business processes and interfirm business systems (value chains);
- Has an aggressive, can-do attitude;
- Is realistic about risks, costs, and time requirements; and
- Has an entrepreneurial personality; that is, the individual sees business opportunities for both networks and himself/herself.

### Target Enterprises

In order to develop a replicable methodology, work will be done in a variety of business sectors and settings, including women-owned firms serving local markets, urban service businesses, and groups of subcontractors involved in corporate supply chains. Within these settings, the project will target entrepreneurs establishing new enterprises, established firms looking to grow, and businesses based on both modern technology and handicraft techniques. An outcome of the research will be a better understanding of the characteristics of enterprises that take advantage of opportunities to enter networks.

The project team assumes that entrepreneurs in India know a great deal about their problems and opportunities: given a chance to cut costs or increase revenues without excessive risk, they will do so. Hence, the team uses profit opportunities as the principal incentive and uses broker services and matching grants to encourage experimentation with new products and markets. Importantly, the project team views trust as something gained through cooperation (rather than the other way around), and sees the existing interfirm division of labor as evidence of a basic willingness to cooperate.

The team assumes also that, outside of simple operational services such as couriers and accounting assistance, BDS are rarely available or affordable. Therefore, in most settings in India, it will be necessary to stimulate both demand and supply. By aggregating enterprise purchasing power in networks, the project hopes to create more attractive markets for BDS.
providers. Increased use of BDS by tiny firms becomes feasible through cost-sharing—the larger the network, the lower the individual cost. A major research issue is how to make BDS a routine part of enterprise operations.

**Subsidies and Challenge Grants**

**Broker Subsidies**

The project foresees that attracting suitable broker candidates and evolving new, sustainable forms of network BDS may require short-term subsidies. The rationale for using subsidies to increase the demand for or supply of business services is well understood. In the case of network brokers, however, a few additional comments may be in order. First, there is no evidence yet in the business communities the project will target that network brokering is a sound way of making a living. Further, trained brokers are expected to spend most or all of their time nurturing enterprise networks. A basic salary must be provided from an outside source until network participants come to value the broker’s services—and have increased their revenues to a point at which they can afford to pay brokers’ fees.

**Challenge Grants**

Networks and network brokers are new concepts in the world of microentrepreneurs. The project must overcome firms’ initial perceptions of risk and stimulate experimentation by offering challenge grants to significant network projects. These grants will be in the range of US$500 to US$1,000, and awards will be competitive.

Challenge grant use is restricted to strategic activities such as joint product or process development, combined marketing efforts, or novel ideas regarding sharing of equipment or consultants. The application process is designed to generate the largest possible degree of network thinking among target firms. Brokers and project staff will work with applicants to refine and expand their initial concepts. It may be possible to implement some of the proposed network projects with little, if any, grant investment—by connecting firms to existing BDS, financial institutions, and additional business partners.

**Anticipated Deliverables**

The project’s research reports will be intended to guide donors and others involved in planning and implementing small enterprise development projects in India and similar settings. The research program will make use of participant observation, structured interviews, participant questionnaires, and reviews of Indian MSE literature to prepare the following reports:
How MSE Business Systems Work

This paper will draw on data from broker-prepared business system diagrams and interfirm cooperation charts; BDS use and availability reports from clients and partners; MSE literature on similar sectors; and structured interviews with entrepreneurs regarding strategy, business objectives, information sources, attitudes about cooperation, and so on to present the project team’s findings regarding the following questions:

# How do micro and small enterprises interact with other firms, including business services providers, in business systems, and how can more strategic forms of cooperation be stimulated?

# What are the principal impediments to increased cooperation between micro and small enterprises, and how are they best addressed? What can be learned from the ways in which this constraints have been addressed in other countries?

# What factors, for example, gender, sector, product composition, business age, size, location, and/or entrepreneurial motivation, best predict openness to cooperative strategies?

# What is required to induce MSEs to specialize—that is, to focus on “core competencies”—and learn to rely on partners and specialized providers of business services to fill out their business systems?

Technical Note on NGOs in Enterprise Development

This paper will compare the cultures, goals, and capabilities of partner organizations – including an entrepreneurs’ association, a private consultancy, and NGOs - that are participating in the India network project. It will be based on partner interviews with key staff, network brokers, and client enterprises, and a review of literature on BDS facilitators and providers. The paper will address these questions:

# What characterizes NGOs and other types of private-sector organizations that are capable of using project assistance to engage entrepreneurs and establish effective networks?

# What are the pros and cons of each type of partner organization in terms of outreach, impact, and commitment to the poor?

# NGOs are often the only available assistance providers. How can they learn the business skills necessary to provide effective business development services?

# What incentives are needed to recruit network brokers and enable them to build sustainable BDS practices?
Networks: Key Strategy for Microenterprise Growth

This paper will provide a detailed discussion of network strategies for donors and enterprise-development program managers. It will include a critique of the project in India, propose a new model, and include discussions on:

# MSE limitations and need for network strategies;
# Network typology and fit with MSE/informal sector conditions and business systems;
# Overcoming constraints and avoiding pitfalls in network development: experience in developed and developing countries;
# Trust building in MSE clusters;
# Discussions of the costs and benefits of network interventions compared with competing enterprise-development approaches, such as subsector analysis, cluster development, and BDS market development; and
# Investment strategies for donors, governments, and multilateral lenders.

Preliminary Network Project Design Guidelines

This technical report will take the form of a brief manual for project managers and BDS facilitators, providing them a practical introduction to network project planning. It will address the following:

# Basic research requirements (business systems, existing forms of cooperation, BDS use and availability, and so on);
# Network assessment methods for sectors, clusters, and regions; minimum conditions for network development;
# Participatory planning: involving stakeholders in network development;
# Partner assessment criteria (lessons from the second paper above) and capacity building;
# Broker skills, incentives, and recruitment procedures;
# Broker training curriculum and sample materials;
# Revenue sources for network broker sustainability;
# Project phasing; and
# Performance measurement.

**Concluding Comments on Networks and Competitive Advantage**

In a network system, tiny firms solve their day-to-day management problems with the help of nearby BDS providers. They sharpen their specialized production skills through contact with one another, with customers, and with the best consultants. They come together around new market opportunities identified for them by entrepreneurial brokers. They exploit these opportunities so long as revenues exceed costs. Then, they are free to regroup in response to new signals coming from markets around the world.

Flexibility is widely said to be essential to competitiveness in the present economic environment. If we extend the idea of flexibility from the individual enterprise to the business system as a whole, we begin to see that a regional economy made up of a great many skilled firms that readily link together in networks can attain something very much like hyperflexibility. This is a critical goal for developing economies, and the team expects the project to contribute to an understanding of the processes that lead to interfirm cooperation on a broad scale.