

## Network Organisations are an adequate response to a rapidly changing business landscape, but the potential advantages are often not yet being fully exploited



Theresia Theurl

The Volksbanken and Raiffeisenbanken in Germany have their own magazine: Bankinformation. In the October 2004 issue I read a very interesting article by Professor Theresia Theurl of the University of Münster. The article explains why networks, if shaped and managed in a professional way, are such a good response to the rapid changes in the business landscape. The article was written with the German cooperative banking system in mind, but you will see that it is also applicable for the other Unico banks, both individually and as a group. Together with Professor Theurl, the article was edited specially for the readers of the Qb. I thank Professor Theurl for her willingness to contribute to our Bulletin (the Editor).

### Network organisations well equipped to face growing competition

A growing part of the economic net output is now created in networks and through cooperation with network partners. This trend is evident in all sizes of enterprise and applies worldwide, throughout all business sectors. There are signs that the 21st century will bring an organisational revolution for entrepreneurial activities. Which is not surprising, since companies are now operating against a background of challenging basic conditions that require new answers and responses. This is especially the case for small and medium-sized enterprises rooted in their regional and local environments. Unlike the global players, they cannot relocate their base and production facilities at will. The cooperative financial group is also a network, i.e. it is set up in keeping with the times in terms of its basic organisational structures.

### The business landscape for financial services is changing rapidly

The competitive environment in which enterprises find themselves has become more intense in all sectors. The internationalisation of business and the advances made in information and communication technology have led to the emergence of global markets that put pressure on companies operating in niches, geographically restricted markets, or protected positions. On top of this, there are regulatory stipulations imposed by the state, which are frequently associated with additional costs. Establishing cost advantages and optimising the value chain is therefore becoming increasingly important for enterprises. However, there is also evidence of fundamental changes on the demand side. Customers are now much more prepared to change providers if this means they can attain economic advantages in the short term by doing so. They are less interested in individual products combined by them

independently and more interested in an overall solution for their special individual needs. Examples of this include provisions for retirement, the provision of assets during people's lives, and housing. Furthermore, desires and needs differ to a greater or lesser extent depending on the individualisation of societies. These developments are also putting companies under increasing competitive pressure. It is a matter of providing appropriate solutions that are capable of binding customers. Many other changes are currently taking place, resulting in an overall situation that also requires specialisation with large production units as well as a large variety of individualised solution packages. The change in the entrepreneurial environment is very rapid in this regard and also very complex. The developments outlined above apply especially to financial services.

#### Individualised solutions

The requirements for the organisational forms appropriate for this environment can be clearly demonstrated: they must be able to provide customers with extensive individual packages of solutions to their problems. They must have optimised their value chain, which is synonymous with specialising in their strengths, exploiting economies of scale and avoiding friction at the interfaces. Moreover, secure access must be guaranteed to resources, services and skills that are not available in one's own company but that are necessary for the provision of a marketable product. These requirements cannot be met by most medium-sized enterprises whatever the sector, while large concerns often have to bear incentive and coordination costs, giving rise to a conflict with the individual economic efficiency targets. Seen against this background, the appropriate organisational response is precisely that which also ensues in practice: cooperation between independent enterprises in networks, which is the same as shifting corporate boundaries. Horizontal demarcation results through the decision on which products and services are to be produced. The vertical boundaries are determined by the value-added levels present in the company, i.e. the depth of value added.

#### Networks can be based on various principles

Networks should emerge as the sum of rational calculations and should be

understood by the cooperating enterprises as a strategic microeconomic decision to improve competitiveness. Several mechanisms are effective in this regard:

- **Economies of scale** include cost-related advantages associated with larger production quantities. They are brought about by cost reductions, overhead synergies, as well as learning curves and the effects of experience.
- **Economies of scope** stand for network synergies, especially through access to the strengths, technologies and resources of the partner enterprises, which increase the value of their own results or make them possible at all.
- **Economies of skills** are becoming increasingly important in the knowledge society. New solutions can be found as well as innovations brought about by combining specialist knowledge from the enterprises that cannot be traded through markets.
- **Economies of risks** express the notion that individual economic risk items can be reduced in networks through diversification, pooling and risk cover.
- Finally, **economies of governance** can offer advantageous incentive structures and safeguards compared to large hierarchies and companies going it alone.

Furthermore, successful networks can give rise to **regional and structural add-ons** where they enable them to remain in the market and create jobs and tax revenues.

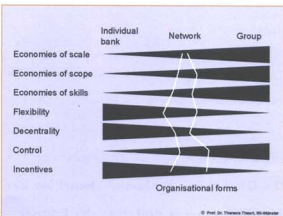
**The competitiveness of the overall network always results from the network-supported performance of the individual enterprises.**

#### Networks can only attain their potential if certain conditions are met

Networks can therefore make it possible to combine the current scale requirements on the one hand and local presence, proximity to the customer and being de-centrally organised on the other hand. Decisions can be made at the point where entrepreneurial responsibility can also be assumed. At the same time, efficiency can be ensured in the preparation of services. On top of this, networks can be loose, or alternatively, institutionalised in a more centrally organised group.

**The big plus offered by networks, however, is their flexibility, which enables them to quickly adapt to a complex and rapidly changing environment**

Finally, enterprises with different strengths and strategic orientations find their place, provided it is clearly agreed which rights and obligations this corresponds to. The big plus offered by networks, however, is their flexibility, which enables them to quickly adapt to a complex and rapidly changing environment. This sounds almost like an ideal world in terms of organisation. On the other hand, a large number of networks are not able to exploit the potential. Empirical studies have shown that failure is caused by three factors:



- Institutionalisation errors are made at the beginning, where there is a failure to agree on clear rules for the cooperation and further development of the network.
- There is frequently a failure to stabilise the delicate inner life of networks, i.e. building trust to make it possible to correctly assess the partners.
- A third factor is the neglect of efficient network management.

### The challenge of network management

Efficient network management can facilitate the substitution as well as the establishment of stabilisation mechanisms. Requirements have to be met in this regard which go beyond the management of clearly configured enterprises:

- It is necessary to **manage complexity**, with networks differing to the extent of whether complexity is to be reduced or utilised as productive input.
- One of the central tasks, moreover, is **the management of boundaries and limitations**, especially with regard to interfaces between the partner enterprises.
- The **management of heterogeneity** has to cope with the fact that common and opposing interests exist, as well as short and long-term goals and diverging corporate cultures.
- Furthermore, the **density of relationships** has to be managed. Multiple relationships exist between individual players, finding expression in compliance with stipulated formal and informal conduct, in service and performance relationships as well as in financing flows and other relationships.
- **Internal network competition** also has to be organised. This can be done formally using invitations to tender or limiting the scope of activity, or informally

with the use of a rule vacuum if it has not proven possible to agree on rules. In extreme cases, the rules are violated.

### Dominant players make network management more complex

Network management is especially challenging in the case of dominant players and a hierarchical structure should be avoided. Within networks, all kinds of attractive business models are developed. Sometimes these business models are based on the combination of advantages exploiting economies of scale; at other times they are based on an attractive combination of core competences of different units in the network. This may lead to different configurations between the various network partners. Multi-layering also has to be managed, i.e. cooperation in the (vertical) value chain as well as organisation of the internal relationship in the form of the provision of resources, communication and exchange of services. Added to this, there are many external and internal informal relations that can evade control. Finally, it is necessary to manage the organisational dynamics, i.e. the further development of the network.

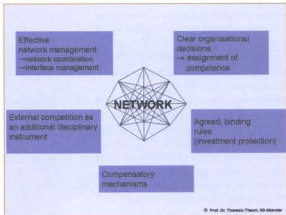
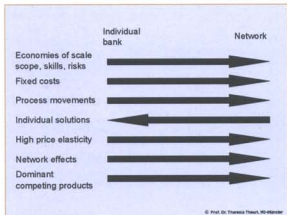
### Cooperative financial network

The beginnings of a network have long been present in the cooperative financial group. However, the opportunities and challenges of such an organisational form have not been adequately investigated as yet. **The aim is to improve the competitiveness of the overall financial group in a situation of intensive competition while at the same time opening up the possibility of independent positioning and corporate structure for each individual player** (banks and affiliated

enterprises). The prerequisite for this is to identify and utilise the advantages of scale, synergies and competences throughout the value chain. It is a case of attaining size while being able to remain small and local by preserving organisational freedom of movement in relation to one's own value added intensity. With regard to the competing requirements of size and local presence, a network is not a mixture of difficulties: rather it is an optimal solution. The requirements for success must be borne in mind in this regard.

### Rules and management

A network with the proven tradition of the cooperative financial group has internal stabilisation mechanisms that do not first have to be established cost-intensively in a lengthy process. The institutionalisation that has developed over a long period of time should, however, be examined against the background of the current basic conditions – especially with regard to the clarity of the assignment of competences. It is self-evident that cooperation within a network of the individual banks, central banks, affiliated enterprises and associations necessitates rules that have to be devised and agreed on by the partners. Those rules have to be clearly transparent and binding with regard to the content and consequences. They are the prerequisite for the making of specific investments and thus also represent the protection of investment needed. However, they are also a requirement to the extent that rules cannot be defined by individual players according to their particular situation and interpreted by them in the case that no rules are applicable for a certain area. Networks also need compensatory mechanisms



because none of the partners may be systematically disadvantaged by decisions that are taken. A network must, after all, face up to external competition. However, the key challenge for a network is to define rules that urge the partners to provide superior services to their clients.

### The network is managed both by the coordinator and the member banks

Networks have interfaces and each interface has two sides: one must be formed by the network's organiser or coordinator, the second by the interface management of the individual bank or affiliated enterprise. The more accurately the individual bank defines, monitors and integrates its interfaces into its own management, the more successfully it will be able to operate in a network and the greater its organisational freedom will be. As the individual bank is linked to its partners via these interfaces, possibilities for further strategic development result both for the bank itself and for the overall network. The coordination of interests in the network, the organisation of joint projects, the screening of trends, suggestions for strategic development and the representation of interests vis-à-vis politicians are tasks to be assigned to a network coordinator or manager in addition to the operational coordination of the network.

### Economic success depends on the entrepreneurial approach and the quality of management

A network in this configuration enables individual players to develop their own organisational perspective and derive their strategies from this. These strategies are reflected in the organisational structure of the individual bank and therefore in the

choice of value-added intensity and the definition of the "bank's boundaries". The interfaces to the network are established with the decision as to which part of the value chain itself is to be covered by the local bank. In the course of this, it is also decided which products and services are to be obtained from the network. As a consequence, the individual economic success of a bank is determined by:

- the quality of the management of the value chain of the bank itself
- the quality of the management of the interfaces between the bank and the network
- the quality of member or customer relationship management.

### Entrepreneurial freedom can be used to match local demands

A network organisation in which the individual bank is integrated permits different structural options. This gives rise to entrepreneurial decision-making freedom that would not exist without a network. The individual banks can develop different strategies according to their strengths and surroundings and exploit their individual core competences in marketing and with regard to knowledge of the market and customers. It is they who decide on the extent to which they wish to make use of the marketing and management instruments developed jointly in the network and the products that result, since the network organisation facilitates consistent outsourcing for all those activities that do not fall in the area of the bank's own core competences (product-seeking) or for which it suffers scale-related cost disadvantages (scale-seeking). The network does not rule out the possibility of services also being organised in a scale-related way and

throughout the group. In addition to the cooperation throughout the value chain, the network can also be used for cooperation agreements or mergers with other banks at the same level in the network. This results in horizontal as well as vertical entrepreneurial organisational possibilities.

### The competitiveness of the cooperative banking network can be improved significantly when the potential of the network is really exploited

The organisational freedom gained for the individual partners does not weaken the network; rather the network is strengthened by the flexibility and incentive benefits resulting from "economic laws" that ensure that an efficient division of labour develops in the cooperative financial network. The allocation criteria established by entrepreneurs in their decisions can be clearly identified in this regard: economies of scale, scope and skills, fixed cost shares, process shares, network effects, price flexibility, existence of dominant competing products and the importance of individual solutions from the customer's viewpoint. Seen against this background, the "critical mass" needed for the utilisation of integrated solutions is always achieved. The cooperative financial group has always been a network of enterprises and is therefore a very modern organisational form. It is necessary, however, to take greater account of this element in a proactive way and to communicate the associated consequences and translate them into action. Only then can the advantages be gained in the form of improving the competitiveness of the overall network and its elements.

The time and discussion required for such a process should not be overestimated if it is prepared and presented in a professional way. Acknowledging the cooperative financial group as a network means, on the one hand, wanting to utilise the incentives of decentralised and responsible entrepreneurship and, on the other hand, recognising the effectiveness of economic laws against the background of the given basic conditions.

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