

2 Setting the scene

This chapter sets the scene for the remainder of the report by defining cooperation (Section 2.1) and providing a brief overview of how much cooperation is occurring (Section 2.2). The changing role of cooperation in Australian industry is then briefly examined in terms of its frequency and its use as a business strategy (Section 2.3). Finally, the chapter is summarised in Section 2.4.

2.1 Defining business cooperation

2.1.1 The cooperation continuum

What exactly do we mean by ‘business cooperation’ and ‘cooperative business arrangements’?

Business cooperation in this study is about firms looking outside the firm boundaries to supply a need, either that the firm cannot meet itself or which can be supplied more efficiently and effectively by others. The common theme with all cooperative arrangements is that they involve some degree of working together for a common aim and embody the concepts of sharing resources and jointly undertaking tasks.

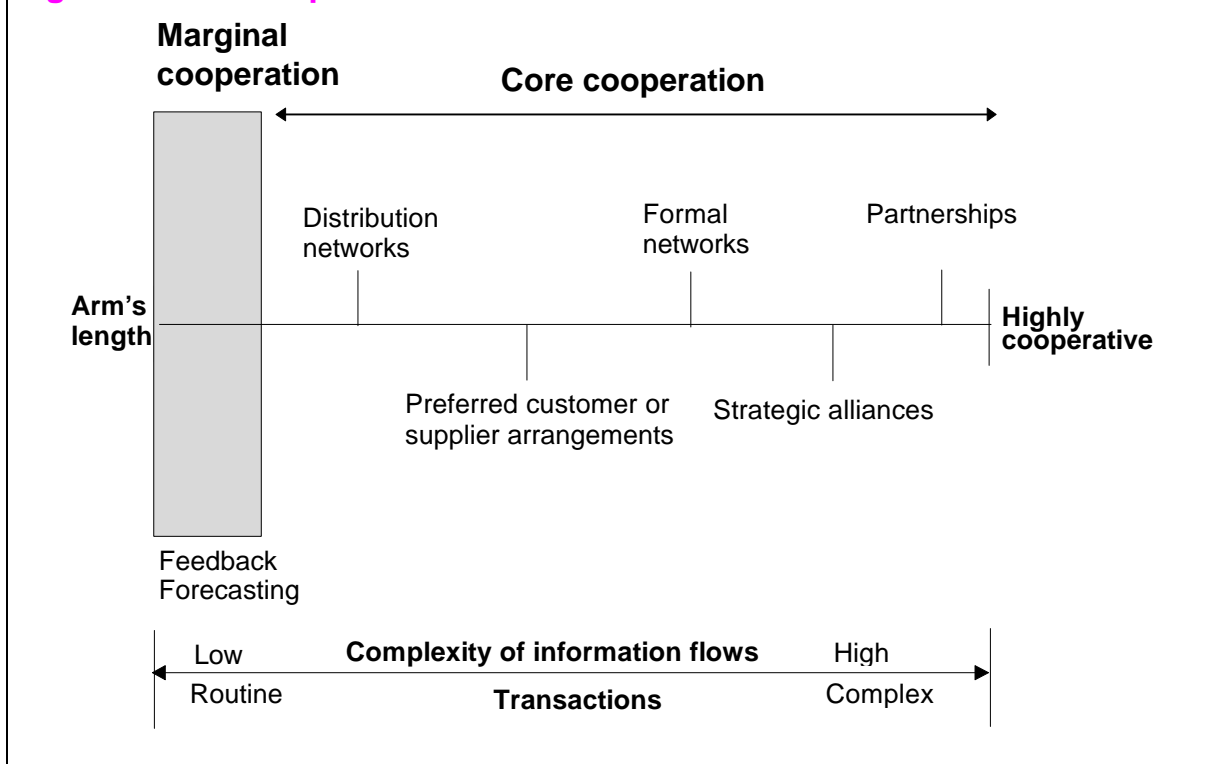
However, it is often difficult, at the boundaries, to distinguish cooperative from non-cooperative behaviour – trying to tell a cooperative firm from a non-cooperative firm is somewhat like trying to distinguish a trunk from a nose. These uncertainties about the boundaries of cooperation pose a problem for any rigorous study of firm linkages. We must set the limits of what we are studying.

We know that relationships between firms range along a continuum from cursory and arm’s length in character, to close and highly cooperative¹ (Figure 2.1). For example a pure market transaction, where the only exchange is money for a good or service bought, is an arm’s length transaction. On the other hand, two firms working closely together on a research project and sharing staff and facilities is highly cooperative. In between there is a vast region.

For the purposes of this study, we regard any form of relationship outside arm’s length – that is anywhere on the cooperation continuum – as cooperative behaviour or business cooperation. We formally define business cooperation as *special relationships between at least two firms that are beyond normal market transactions and have some permanence*.

¹ The forms of cooperation shown on the continuum are indicative of their proximity to ‘arm’s length’ and ‘highly cooperative’. However, the diagram is not intended to show these precisely or to make definitive judgements about the degree of cooperation occurring in individual modes along the continuum.

Figure 2.1 Cooperation continuum



The continuum distinguishes ‘core’ and ‘marginal’ forms of business cooperation. Examples of core cooperative arrangements can be partnerships, joint ventures, business networks and preferred customer and supplier agreements. The forms of cooperation shown on the right hand side of the continuum are solid examples of cooperative business arrangements – they tend to involve more complex information flows and elaborate transactions than arm’s length relations or very simple linkages.

However, business cooperation can also take much more subtle forms. ‘Marginal’ business cooperation includes such things as feedback, forward planning and forecasting. Forecasting, for example, might involve a supplier discussing with a customer the expected output of the customer over a 12-month period. There is no contract, no agreement on price and no legal obligation for the customer to buy specified amounts (or even buy at all from the supplier in question). However, both supplier and customer can benefit from this form of cooperation, so long as there is an understanding that ‘in the normal course of events’ the two firms will continue to do business with each other. The supplier has reasonable expectations of production levels and organises resource use accordingly - improved production processes can increase efficiency and reduce costs. The customer, on the other hand, expects to have a certain level of inputs available at the time required.

At the extreme left hand end of the cooperation continuum, the boundaries between marginal cooperation and arm’s length arrangements can be hazy. In reality, there is no single line which distinctly delineates the two and the classification of an arrangement as a cooperative one will often depend on the specific circumstances.

Even some of the apparently ‘core’ forms may not really involve cooperation. Distribution networks are good examples. If a firm has a distributor which simply receives its goods and sells them to retailers, there is

no cooperative business arrangement as defined above. The firm and its distributors are working on an arm's length basis. On the other hand, business cooperation *would* be present if the distributor were to provide advice on how the supplier could enhance the product, or improve delivery and distribution. The firms are working closely together for their mutual benefit.

The aim of the study is to examine the *significant* forms of cooperation used by firms. For this reason, we do not examine sporadically shared information or very short term and circumscribed links in this report, even though these are unquestionably cooperative.

2.1.2 The boundaries of cooperative behaviour

We wanted to understand how some of our results changed when we varied the boundaries of what we defined as *significant* cooperative behaviour. Both face-to-face interviews with around 40 firms and a follow-up telephone survey of 100 firms (see Appendix A) revealed how sensitive an audit of cooperative behaviour is to changes in these boundaries.

The follow-up telephone survey was particularly revealing as this involved firms which indicated in the mail survey that they had *no* cooperative business arrangements. However, when it was indicated to firms that cooperation could include various soft forms of arrangements, half of these firms revealed that they actually had cooperative arrangements. Not surprisingly, this 'new found' cooperation was primarily either at the left hand extreme of the cooperative continuum, where it is hard to distinguish standard commercial arm's length relationships from those which involve cooperation, or involved highly informal forms of cooperation such as *ad hoc* information sharing.

If the definition of cooperation embraces these marginal areas, the number of firms recorded as cooperating rises markedly. This sensitivity to minor changes in definition partly explains why different studies have found such variations in the proportion of firms which cooperate.

Taxonomy is the art of subtle but valuable distinctions. If we make our definition of business cooperation broad, then we would describe so many behaviours as cooperative that the term starts to lose descriptive value. If, on the contrary we use a much narrower definition, we would be like a botanist interested in understanding trees but only ever looking at oaks!

In this study we have focussed on forms of cooperative behaviour we think are useful to analyse – that is we have concentrated on a core of cooperative behaviours as described in the mail survey (Appendix A). Unless otherwise stated, wherever we use the term 'cooperating firms' this refers to firms with at least one **core** cooperative arrangement (as shown in Figure 2.1). Or to apply a more colourful metaphor to our taxonomic problem – noses have to be pretty long before we call them trunks!

Box 2.1 Defining business cooperation

Business cooperation (incorporating business linkages and networks) is defined as special relationships between at least two firms that are beyond normal market transactions and have some permanence.

The types of cooperative arrangements are varied. However, they can be grouped into two main types 'core' cooperation and 'marginal' cooperation.

In this study we have focussed the analysis on the substantive, or core, forms of business cooperation. 'Cooperating firms' in the study are firms with at least one core cooperative arrangement.

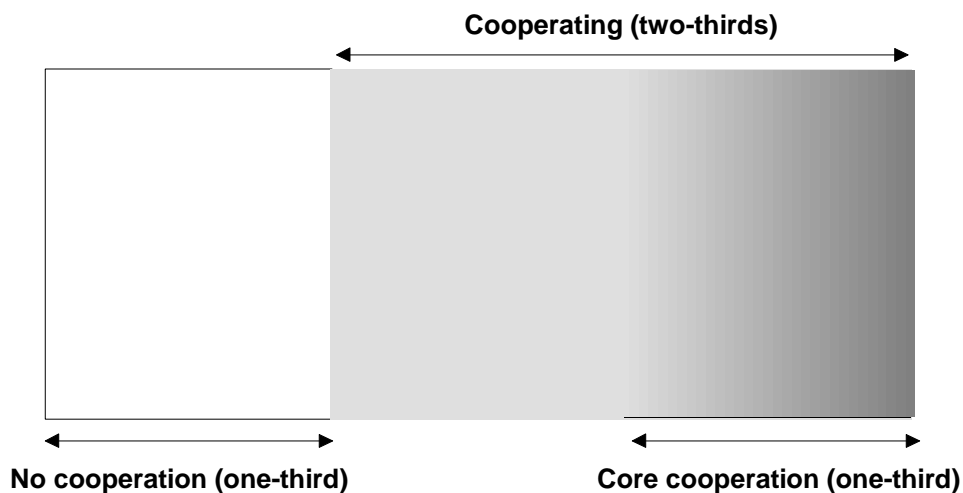
2.2 How much cooperation is occurring and in what forms?

2.2.1 How extensive is business cooperation?

The results of the mail survey indicate that around 40 per cent of Australian manufacturing firms are currently involved in core forms of business cooperation. However, this figure overestimates overall cooperation among Australian firms. When the non-respondent and telephone follow-up survey results are taken into account, it is estimated that the ‘true’ proportion of firms engaged in core cooperation may be around one-third (see Appendix A).

Accordingly, it can be stated with a reasonable degree of certainty that close to one-third of Australian manufacturing firms are currently involved in substantial forms of business cooperation (Figure 2.2).

Figure 2.2 Extent of business cooperation in Australia



Source: BIE survey

The proportion of firms involved in *any* form of business cooperation (that is, core *or* marginal cooperative arrangements) is less certain. However adjusting the mail survey results, to reflect the findings of the non-respondent and follow-up telephone surveys, leads to the conclusion that up to two-thirds of firms engage in either core or marginal forms of business cooperation (see Appendix A).

The implication of these findings, of course, is that one-third of Australian manufacturers are not involved in any form of business cooperation at all. These firms apparently conduct *all* their business operations on an arm's length basis.

As noted in Section 2.1.2, the analysis of ‘cooperating firms’ in this report, unless otherwise stated, refers only to those firms with core cooperative arrangements. This is essentially because the bulk of the analysis is based on the mail survey results, in which firms tended to ignore marginal forms of business cooperation.

The proportions of cooperating and non-cooperating firms in the remainder of this report are based on mail survey responses only and are *not* adjusted for non-response bias. This means the ‘all industries’ average

extent of cooperation in subsequent chapters is 40 per cent and not one-third as shown in Figure 2.2. All comparisons must be made against the 40 per cent bench mark².

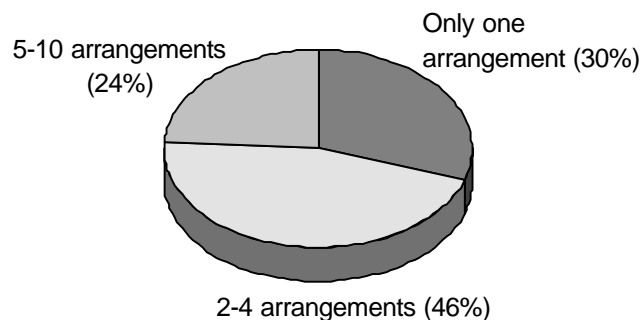
2.2.2 How many arrangements do firms have?

The number of arrangements that firms have is a key indicator of how firms approach cooperation. Do most firms have several, or do most have just one important arrangement?

To allow for comparisons, firms have been split into three groups according to the number of their cooperative arrangements – those with only one arrangement, those with two to four, and finally those with between five and ten arrangements (Figure 2.3). Those with more than ten arrangements have been excluded from analysis as it is unlikely that all these would be cooperative business arrangements (that is, some are probably arm's length relationships). The mean number of arrangements for one firm to have is close to three; however, around 30 per cent have only one and one quarter have between five and ten.

It takes a certain degree of skill to be able to balance the competing needs and demands of a multiple number of cooperative business arrangements. Each cooperative arrangement requires a certain input of resources such as time and money. This means that for a firm of a given size there could be a hypothetical maximum number of arrangements it would be feasible to enter at the one time. The case of Australian company Pan Bio illustrates this point (Box 2.2).

Figure 2.3 Number of cooperative arrangements^(a)



Note: (a) There were 53 firms who claimed to have more than 10 arrangements, but these have been excluded as it is believed they have included many arm's length relationships with customers and suppliers.

Source: BIE survey

Box 2.2 Pan Bio – Know your limits

Pan Bio is a privately-owned Australian company in the Sci/med industry which has been growing at over 50 per cent per year for the last five years. Its impressive performance resulted in Pan Bio being a regional winner in the Queensland Small Business Awards.

The Managing Director of this successful company noted the benefits the company had gained through working with other companies and particularly through its upstream links.

² The scale of the non-response survey necessary to provide the bias adjustments for every different kind of firm or cooperative arrangement would be prohibitively large. Rather than to impose the across-the-board downward adjustment representing the difference between one-third and 40 per cent (regardless of whether it actually describes the bias for a particular group of firms), we consider it better to use the unadjusted data.

Market direction has been provided by multinationals and other international contacts, while close relationships with ‘lighthouse’ customers and their CEOs often result in new product development ideas.

However, he made the cautionary note that he felt his company, like many others, needed to be careful not to get involved in so many cooperative arrangements that it would be unable to meet all the associated commitments.

Source: BIE interview

2.2.3 Which cooperative arrangements are most prevalent?

The analysis of cooperation in the report is focused on the firm – for example, what proportion of firms have formal arrangements. But there is another way of looking at the data – that is, from the perspective of the arrangements themselves. Thus we might ask, of all the cooperative arrangements identified in the survey responses, what proportion are formal and informal?

This way of looking at arrangements may be useful as it indicates which types are most commonly used. Table 2.1 gives the proportion of total cooperative arrangements in a number of categories.

The only even split is between formal and informal arrangements. All the other types of arrangements demonstrate a leaning by firms towards a particular type. Customer links are slightly more common than supplier arrangements, while arrangements with firms other than customers/suppliers are least common.

Table 2.1 Summary of arrangement types

Type of arrangement ^(a)	Proportion of arrangements ^(b)
Formal	50
Informal	50
Customer	40
Supplier	33
Other	27
One other firm	84
Two or more other firms	16
Overseas firm	11
Domestic firm	89

Note: (a) These terms are explained in the Glossary.

(b) These figures have been weighted by industry

Source: BIE survey

The majority of cooperative arrangements comprise just two firms (84 per cent). These one-to-one arrangements involve firms cooperating with a customer, or a supplier, or some other firm such as a distributor or competitor.

Not surprisingly, the vast majority of business cooperation occurs with other domestic companies. Only 11 per cent of arrangements involve an overseas partner. However, this is likely to be an underestimate as

survey respondents were not questioned about the number of arrangements they had involving overseas partners³.

The prevalence of the various types of cooperative business arrangements is shown in more detail in Appendix C.

While we analyse business cooperation in subsequent chapters in terms of both firms and arrangements, our principal focus is on firms. This is because policy makers are interested in how *firms* use cooperation, and in the associated benefits and costs.

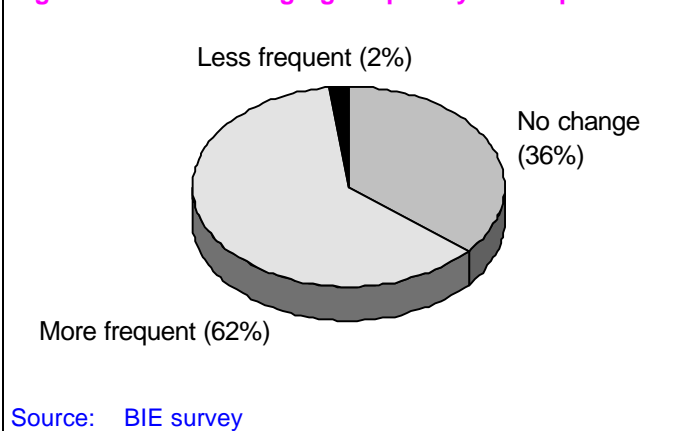
2.3 The changing role of business cooperation

2.3.1 Changing frequency of cooperation

Has cooperation suddenly become more widespread, or has the current level of cooperation always occurred? Perhaps business cooperation is only a short term fad? Respondents to the BIE survey were asked for their views on the changes in the frequency of cooperative business arrangements.

Figure 2.4 presents an overview of the changing role of cooperation. Around two-thirds of respondents believe that cooperative arrangements are now used more frequently in business.

Figure 2.4 The changing frequency of cooperation



Firms give different reasons for the rising tide of cooperation. Some firms think it is a function of the industry in which they are located. Others relate it more to the firm's stage of development. For example, an established firm winning major new contracts might decide it was high time it built up relationships and trust with its suppliers.

Another view coming through from the firm interviews is that firms are having to try harder to compete and survive and that cooperation is part of that increased effort. Whereas in the 1980s many firms thought

they could do things alone, they now realise that they cannot do everything efficiently by themselves (Box 2.3).

Box 2.3 The need to work with other firms

NetComm Ltd is a designer, manufacturer and marketer of high performance PC communications products and telecommunications access services for the Internet information super highway. Since the company's establishment in 1982, NetComm has built itself into a specialist provider of sophisticated communications products and services. It is the clear market leader in its industry segment.

³ Firms were only asked to indicate whether they had overseas-based firms in any of their cooperative arrangements.

Part of NetComm's success has been built on its cooperative arrangements with other firms. In its earliest days the company believed it could succeed by going it alone, but later came to recognise the importance of a few critical linkages (supplier arrangements and joint ventures). NetComm noted that with technology moving so fast it was imperative for firms to form cooperative arrangements to keep pace with developments. Individual firms generally do not have the required resources, the intellectual capacity or the necessary management skills to be able to succeed alone.

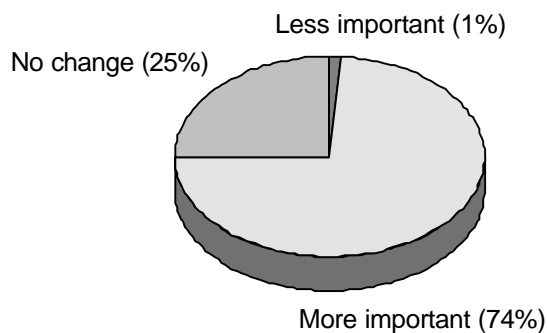
Source: BIE interview

2.3.2 Cooperation as a business strategy

Cooperative arrangements are becoming more common than previously. But how many firms regard cooperation as an important part of their overall business strategies?

Figure 2.5 shows that almost three-quarters of cooperating firms do in fact believe that cooperation has become more strategically important. Most other firms think that cooperation is no more or less strategically important than in the recent past, with only 1 per cent thinking it less important than before.

Figure 2.5 The changing strategic importance of cooperation



Source: BIE survey

The other interesting question relating to the increased frequency of cooperation is how much of this is due to conscious decisions on the part of firms to pursue closer cooperation with other firms. Just because cooperation is now seen as being more strategically important does not necessarily mean firms went hunting for closer ties in the first place. Is there a feeling by some firms that a greater emphasis on business cooperation in their industry came about incidentally during the course of business?

The majority of the firms interviewed noted that most or all of their cooperative arrangements had come about as part of an overall strategy. Strategic decisions were taken, for example, to

'lock in' preferred suppliers or to build a close relationship with a key customer. Alliances with firms other than customers and suppliers were almost always planned and carefully executed. Occasionally, though, some very good and enduring partnerships arise fortuitously in the course of business (Box 2.4).

Box 2.4 How cooperative arrangements begin

Seekers Australia Ltd is a successful Western Australian manufacturer of swimwear and casual wear with a reputation for fine quality products. The company has won design awards in four of the past five years.

Seekers is a major player in the Australian market but developed a business plan to look for the potential to increase its sales overseas. As part of this plan it sought cooperative arrangements with companies in various countries including the USA, New Zealand, Thailand

and South Africa. Some of these involve overseas companies manufacturing Seekers' products under licence, but most are with distributors.

One of Seekers' key cooperative arrangements, however, arose through the recommendation of a leading Australian retail chain handling Seekers' products. The retail store indicated to US swimwear giant, Jantzen, that it was impressed with Seekers and suggested Jantzen should approach the West Australian firm to negotiate a licensing agreement for the Australian market.

Source: BIE interview

2.4 Summary

This chapter provides the setting for the remainder of the report. We have defined what we mean by business cooperation and cooperative arrangements – special relationships between at least two firms that are beyond normal arm's length transactions and have some permanence.

We found that around one-third of firms are involved in substantial or core forms of cooperation, while up to two-thirds of firms engage in some form of cooperative activity (that is, core or marginal forms of cooperation). Accordingly, one-third of Australian firms are not involved in any form of business cooperation at all. These firms apparently conduct all their business operations at arm's length.

On average, cooperating firms have three core cooperative arrangements – but approximately 30 per cent of firms have just one arrangement and 25 per cent have five to ten arrangements. The vast majority of business cooperation occurs in the form of one-to-one arrangements (that is, involving just two firms) and most is with other Australian firms. Arrangements with customers are the most common form of cooperation.

We also noted the important strategic role of business cooperation and how firms are increasingly turning to cooperation. While some cooperative arrangements arise incidentally in the course of business, the majority come into existence as part of an overall business strategy. Three-quarters of cooperating firms believe cooperation is now more strategically important than previously. In addition, almost two-thirds believe that cooperative arrangements are now used more frequently in business.

Now that we have set the scene, it is time to look beyond these basic facts and consider why firms should want to cooperate, which ones will cooperate most and how different firms cooperate in different ways. These issues are the subjects of the following three chapters.