



## The Social Capital and Firm Performance: Evident from Indonesia Small businesses

Aluisius Hery Pratono<sup>1\*</sup>, Ruswiati Surya Saputra<sup>2</sup>, Jatie K. Pudjibudojo<sup>3</sup>

<sup>1</sup>Faculty of Business and Economics, Universitas Surabaya, Indonesia, <sup>2</sup>Othman Yeop Abdullah School of Business, Universiti Utara Malaysia, Malaysia, <sup>3</sup>Faculty of Psychology, Universitas Surabaya, Indonesia. \*Email: [hery\\_pra@staff.ubaya.ac.id](mailto:hery_pra@staff.ubaya.ac.id)

### ABSTRACT

This study aims to contribute to the social capital (SC) theory through examining the direct impact of SC and moderating impact of marketing capability (MC) on firm performance (FP). This study proposes a structural equation model and tests the hypothesis through generalized structured component analysis with random survey on small medium enterprises in Indonesia. The approach allows to analysis the element of SC: Network, trust and cognitive as well as the elements of MC: Pricing capability, product development, and marketing communication. The result indicates the SC and MC provide complementary effect to the FP.

**Keywords:** Social Capital, Firm Performance, Marketing Capability

**JEL Classifications:** D21, L30, M31

## 1. INTRODUCTION

The role of social capital (SC) on the firm competitiveness has long been an interest to entrepreneurial studies. However the transformation process from SC to firm performance (FP) has raised debates. Major literatures argue that SC plays pivotal role on firm competitiveness through providing valuable information access (Kwon and Adler, 2014) a high level of mutual of trust (Li et al., 2013). Previous empirical studies also confirm that SC has a significant impact on innovation and supply channel (Alguezaui and Fillieri, 2010), work environment (Duffy et al., 2012) and value creation (Afuah, 2013).

On the other hand, some other studies provide evident that SC does not have significant impact on FP for some reasons, e.g. the age of firm (Pirolo and Presutti, 2010), organizational capacity (Jansen et al., 2011), various level of institutional context (Stam et al., 2014) and also spillover effect that comes from homophile solidarities, which express similarities (Kwon and Adler, 2014).

This article has intention to contribute to the debate by investigating the impact of SC on FP. To understand the complex relationship

between SC and FP, this study involves marketing capability (MC) as a mediating variable. In addition, this study has intention to understand the impact of each element of SC and MC through generalized structured component analysis.

## 2. LITERATURE REVIEW

### 2.1. SC Theory

The concept of SC mainly springs from social network theory, which is considered as valuable resource to FP. The concept of SC has been emerging from social to individual perspective as. Bourdie ponders profitability of SC as a private good, while Coleman considers SC as a public good, which becomes an element of social structure (Häuberer, 2011; Denrell et al., 2013). Hence, this concept becomes popular when the World Bank pays attention on declining public participation (Putnam, 2000).

In the context of firm (Parra-Requena et al., 2012), argue that SC constitutes to three main elements: Network structure, trust, and cognitive. Other studies highlight the role of trust, norms and networks, which promote coordinated actions in order to foster happiness and life satisfaction (Lim and Putnam, 2010). The

dispute on dimension of SC has been increased including the role of social ties on providing information and solidarity (Kwon and Adler, 2014).

In strategic alliance literatures, firm size is essential to their bargaining power within an alliance. The equilibrium of a matching market relies on positive assortative matching, which implies on high bargaining power (Mindruta et al., 2016).

## 2.2. Hypothesis Development

Hypothesis 1: SC has direct effect on FP: SC has become major concern in social network theory with aims to understand the social relationship as well as economic transaction. In the organization context, strong SC provides positive work environment (Duffy et al., 2012) and greater life satisfaction (Lim and Putnam, 2010). SC can be a major key for FP through innovation as well as supply management channel (Pratono, 2016). Greater SC allows firms to manage their relationship with other firms, which implies on cost and risk (Alguezaui and Fillieri, 2010) and FP that is essential to monitor the outcomes of their organizations in order to gain more profit (Garg, 2013).

Hypothesis 1.1: Network structure is main element of SC: Network structure provides opportunities to firms to acquire information (Broadbridge, 2010), which brings impact on their performance. The development of network structures is associated with development stages of organization, which indicates their resources since early stage of development (Johnsson and Lindbergh, 2013). The dense and cohesive network structure can generate information exchange and call for marketing capacity as mediator to drive performance (Rouziés et al., 2010). Duffy et al. (2012) identify a risk of moral disengagement, such as condemnation and loathing, due to cognitive justification. A cognitive brings a constraint to utilize SC due to exponentially level of SC (Oldroyd and Morris, 2012). Another example is strong cohesive work group bring about dominant voice and views, which affected inferior group, such as woman in workplace (Broadbridge, 2010).

Hypothesis 1.2: Trust is main element of SC: Trust dimension is the core content of SC, which enable a social order. In organization context, social exchange relationship relies on inter-personal trust, which can reduce uncertainty in relationship and enhance the quality of social exchange. This implies on ability to access information, support and resources (Schaubroeck et al., 2013). The affect-based trust refers to emotional dimension embedded in confidence (Schaubroeck et al., 2013). In the context of business communication, perceived social identity may come from synchronization of communication style, such as gesture, voice and posture (Ludwig et al., 2013).

Hypothesis 1.3: Cognitive is main element of SC: Cognitive dimension refers to collective conscience and identity of the group, which can bring efficient interaction. Information and resources are more accessible among people with a collective identity. This dimension is associated with common codes and languages, which spring from repeated social interaction (structural dimension), which can create trust and mutual commitment (Alguezaui and Fillieri, 2010).

Collective identity may come with a complex challenge. Diversified cultural background among the workforce in business organization has been emerged with issue of organization performance. Cultural diversity may be more relevant to boast performance when learning orientation among members of a network is greater (Pieterse et al., 2013). However, a set of cognitive with moral disengagement allows members of a network to commit acts, such as social undermining or self-condemnation (Duffy et al., 2012).

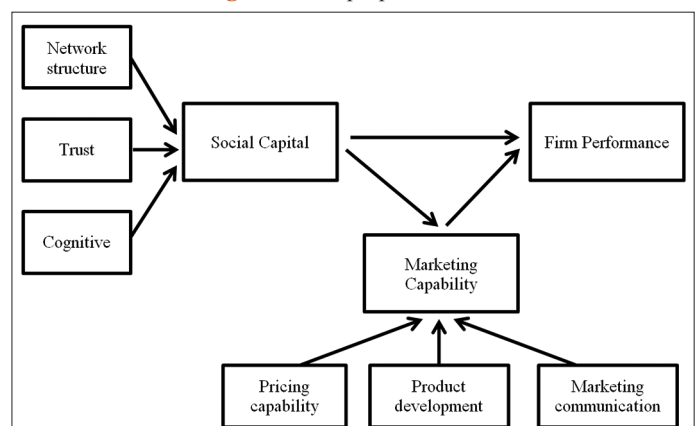
Hypothesis 2: MC provides mediating effect that may strengthen effect of SC on FP: It is essential to business organization to invest on social networks to boost their performance, however it does not always the case. MC can provide mediating effect to explain the relationship between structural SC and marketing performance (Parra-Requena et al., 2011).

Hypothesis 2.1: Pricing capability is main element of MC: Pricing capability refers to the ability of a firm to set price for their product to gain high revenue in the market (Murray et al., 2011). One possible reason why a firm has greater pricing capability or market power lies on scale economies, which implies on efficiency to manage resources as well as information (Lira et al., 2012). In a highly competitive market, firms experience high interdependency on pricing strategy. Firms with heavily dependent on costumers have less differential pricing (Limehouse et al., 2012) (Figure 1).

Hypothesis 2.2: Product development is main element of MC: The concept refers to capability of firms to develop new product to meet customers' demand (Murray et al., 2011). This concept is believed to provide firms with a greater level of differentiation in order to gain a competitive advantage. When carried out product development, firms pay more attention not only on product functionality but also its implications in which owning such products may make consumers feel different from others (Lukas et al., 2013).

Hypothesis 2.3: Marketing communication is main element of MC: Marketing communication indicates the expansion of MC from the advertising to customer relationship approach. As sales process involves a conversation, marketing communication is a

Figure 1: The proposed model



response to market signals on the spot adjustments. The small firms have advantages on developing word of mouth approach to gain positive externality.

### 3. METHOD

This research uses quantitative method with cross-section design. The information required to answer the research questions refers to quantify relationship among observed variables with family business as unit analysis. This survey is equated with a list of distributed questionnaires through random sampling method. To generalize the result, this research employs a random selection procedure in order to ensure sample representation for the observed population. Data collection was taken in Surabaya Indonesia with random selected respondents. Based on data based published by Directorate General of Trade, Ministry of Trade and Industry, this research randomly selected 800 respondents and send them questionnaires. From 390 respondents who provided contribution, 54% respondents represent single-family ownership, 24% are partnerships, and the rest are limited corporations. There is no respondent with go-public companies.

### 4. RESULTS

Table 1 shows that network structure, trust and cognitive significantly contribute to SC. Similarly, pricing capability, product development and marketing communication provide significant impact on MC variable. The elements provide significant impact with greater coefficients than 0.9. The trust provides greatest coefficient with 0.95, which indicates as the strongest contribution to SC ( $H_{1,2}$ ), followed by cognitive and structure with 0.93 and 0.90 respectively ( $H_{1,1}$  and  $H_{1,3}$ ).

Similarly, pricing capability, product development, and marketing communication are considered to be relevant to the latent variable of SC ( $H_{2,1}$ ,  $H_{2,2}$ ,  $H_{2,3}$ ). However, the goodness of fit testing shows that model is quite fit. FIT 0.58 shows that the model can explain 58% of the variance in the observed variables. Goodness

of fit indices exceeds 0.90 implies that the model is acceptable. Standardized root mean residual (SRMR) as absolute fit indicator is 0.105, which indicates that model is nearly perfect. A model should have SRMR smaller than 0.08 for a good fit model.

The bootstrap calculation shows that SC has significant impact on performance (FP) with  $t = 7.48$  and  $P < 0.01$ . This implies that  $H1$ , which explains the relationship between SC and FP is confirmed. The bootstrap also show that relationship between SC and MC has  $t$ -test of 14.74 and  $P < 0.01$ . This indicates  $H2$  is accepted and SC has significant impact on FP. In addition, the impact of SC and FP has significant impact with  $t$ -test = 6.18 and  $P = 0.01$ . Hence,  $H3$  is accepted, which implies that there is partial indirect effect on SC on FP. Specifically, the role of MC on the relationship between SC and FP shows complementary mediating effect  $0.443 \times 0.641 \times 0.369 = 0.1047$  (Zhao et al., 2010).

Trust provides abundant contexts in small medium enterprises. While financial slack is considered to be the most challenging issue to small businesses (Bradley et al., 2011), the businesses still can seize business opportunities and gain competitive advantage by exploiting social network structure, trust and cognition. While larger networks is not main factor which can attract customers and develop market power (Afuah, 2013), this study shows that trust provide greater contribution to the context of SC.

This study presents empirical result that explains structural relationship between SC and competitive advantage in which MC provides mediating effect. Apparently, terms “partial” and “full” are associated with effect size of a mediating effect. Current practices suggest that significant indirect effect can be observed even if  $c'$  is not significant, this research considers that a wide range of indirect effect level (Rucker et al., 2011). Instead of claiming that the result shows partial mediating effect, this research considers that the effect of MC as mediating variable can be computed by  $0.641 \times 0.369$ , which is equivalent to 0.236.

### 5. CONCLUSION

Nurturing small businesses should consider the role of SC. While the businesses are considered with limited financial resources and out of dated technology, it is important to pay more attention on SC as intangible resource, which can turn into performance. This refers to the strong relationship among the stakeholders, including employees as well as business partners. This resource can promote knowledge acquisition and innovation (Martínez-Cañas et al., 2012) as well as positive work environment (Duffy et al., 2012).

This study confirms the combination between resource-based theory and SC theory that SC determines the capacity of firms to control market price over its marginal cost. The result indicates that SC is a valuable resource, which allows small businesses to gain competitive advantage. As the main elements of SC, networks, trust and cognitive allow the firms to gain competitive advantage. Hence, firms performance does not only relies on their MC but also from SC.

**Table 1: Path coefficients**

Path	Estimated coefficient	Standard errors	Critical
SC>Performance	0.443	0.059	7.48*
SC>MC	0.641	0.043	14.74*
MC>Performance	0.369	0.060	6.18*
SC>Structure	0.902	0.013	71.46*
SC>Trust	0.954	0.006	160.12*
SC>Cognitive	0.939	0.008	117.66*
MC>Pricing capability	0.848	0.019	43.78*
MC>Product development	0.812	0.025	32.96*
MC>Marketing communication	0.738	0.029	25.77*
Model fit			
FIT	0.580		
AFIT	0.577		
GFI	0.990		
SRMR	0.105		
NPAR	111		

\*Significant at 5%. SC: Social capital, MC: Marketing capability, GFI: Goodness of fit, SRMR: Standardized root mean residual, NPAR: Non parametric test, AFIT: Adjusted FIT

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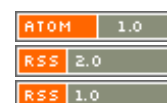
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