

Association between Social Capital and Transaction Cost: An Empirical Study of Small Enterprises in Sri Lanka

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Background

Small Enterprises (SEs) are considered as the driving force of employment creation, engine of economic growth and the backbone of economic development of a country (Fatoki, 2011). Recognizing the importance, successive governments of Sri Lanka devoted their attention towards the development of SEs. A large body of government institutions provide various supports in order to develop SEs (Vijayakumar, 2013). However, the critical issue in the sector is the low performances compared to the large firms (Vijayakumar, 2013). According to the Nooteboom (1993), higher transaction cost is one of the reasons for the low performances recorded in SEs sector as compared to the large firms.

Research Problem

According to the transaction cost economics, business firms aim at attaining the lowest transaction costs which can be mediated by either market or hierarchy (Williamson, 1979, 1985). Premaratne (2002) explained that SEs in LDCs have some limitations to apply transaction cost governance mechanisms. Hierarchical governance is either impossible or extremely difficult to apply because small firms, being small and isolate, are inherently lacking in resources. On the other hand, market governance is also cause of increasing transaction cost of SEs due to two reasons. First, lack of knowledge and experience limits SEs to access and assess information to make rational decisions (bounded rational). Second, SEs suffer hazard from opportunistic behaviour of exchange partners due to the lack of knowledge and business experience. Thus, governance of transaction cost using market or hierarchy is so difficult for SEs particularly SEs in Sri Lanka as well. Instead, SEs use informal and personal relationships in order to obtain necessary resources, information and other moral support (Premaratne, 2002). These relationships do not have formal and written agreement but these relationships based on social network, interpersonal trust and relational norms (Social Capital). Therefore, it is important to study *how social capital affects the minimization of transaction costs particularly SEs in Sri Lanka?*

Objectives

The main objective of this study is to explore the effect of social capital on transaction cost of SEs in Sri Lanka. Specific objectives are: a) to study the effect of social capital on the mitigation of bounded

rationality of small enterprises, and b) to examine the effect of social capital on the mitigation of opportunism of SEs.

Research Methodology

Both qualitative and quantitative methods (mixed method) were applied to collect and analyse data. Qualitative data was collected studying six cases (SEs) and quantitative data was gathered from 96 SEs. Data was collected having face to face interviews for a questionnaire. This study defines SEs as employment less than 10 persons engaged and considers only manufacturing industries. Data were collected from owners of SEs considering that they are the most knowledgeable persons who manage SEs. In order to analyse qualitative data, content analysis was used. Quantitative data was analysed employing logistic regression model using Minitab computer package. Criteria for analysing social capital were based on three dimensions: structural, relational and cognitive. Bounded rationality is measured using two items: capacity to access information and assess information which leads to mitigate the bounded rationality. Opportunism of exchange partners is measured using four items: sincerity, truthfulness in dealings, good faith bargaining, and breach of agreement engaged in by the exchange partner.

Key Finding

The study tested six hypothetical relationships between different dimensions of social capital (structural, relational and cognitive) and sources for transaction cost (bounded rationality and opportunism). Result shows that strong structural form of social capital of SEs (network density) associates negatively with bounded rationality ($p = 0.003$). Relational form of social capital (interpersonal trust) has a significant negative relationship with bounded rationality ($p = 0.000$). Cognitive form of social capital (shared goal) has also associate negatively with bounded rationality ($p = 0.000$). Case study results confirmed that ability of SEs to access and assess information to make more rational decision have been improved due to the use of social capital that lead to mitigate bounded rationality.

Considering the association between social capital and opportunism, strong network ties associates negatively with business opportunism ($p = 0.000$), interpersonal trust has a significant negative relationship with opportunism (suppliers' $p = 0.000$ and buyers' $p = 0.000$) and shared goal has also associate negatively with opportunism ($p = 0.046$). This results justified by the case study which shows that the capacity and ability of SEs to access and assess information to make decision to avoid opportunism of exchange partners have been improved due to the maintenance of strong social capital. SEs have capacity to maintain a strong social relationship with manageable number of network members with regular interaction, expecting to obtain information. SEs believed that developing a strong social capital is a valuable asset and they devoted time and money to maintain it,

since social capital generates numerous valuable benefits which are not available in the open market to purchase.

Conclusion

Based on the analysis, the following conclusions are made. First, the study reveals that the different dimensions of social capital highly contribute to mitigate opportunism and bounded rationality which leads to minimize transaction cost of SEs. Second, the study further reveals that SEs use alternative governance mechanism based on social capital rather than the market or hierarchical governance to mitigate their transaction cost, developing and maintaining strong network relationship and interpersonal trust with network members because almost all the transactions of SEs are based on informal and verbal agreements and social relationship.

References

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