

Effect of Social Capital on Mitigating Transaction Uncertainty of Small Enterprises in Sri Lanka

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Introduction

Small Enterprises (SEs) have higher Transaction Uncertainty (TU) due to asymmetrical information (Ahmad & Seet, 2009). They do not have capacity to collect and evaluate information to predict future behaviour of business environment on one hand and they fail to avoid the hazards from opportunism of exchange partners on the other hand (Nootboom, 1993; Zaheer et al., 1998). Therefore, Transaction Costs (TC) is very high and as a result, the failure rate of SEs is also very high (Agwu & Emeti, 2014; Carmel and Nicholson, 2005). SEs use informal and personal connections in order to get required information and resources (Bhagavatula, 2009; Lu et al., 2007; Priyanath & Premaratne, 2015). Such relationships generate different values such as inter-personal trust, relational norms, and common understand etc. which are called as Social Capital (SC) (Bhagavatula, 2009; Lu et al., 2007; Nahapiet & Ghosh, 1998). One of the key benefits of SC is that it facilitates to access information which allows to mitigate TU (Henningsen & Henning, 2013). However, a complete academic work particularly SEs pertaining to examine how different dimensions of SC affect the mitigation of TU represents a significant gap in the literature. Therefore, this paper attempted to explore how SC affects the mitigation of TU.

Literature

TU is defined as the circumstances surrounding an exchange which cannot be specified ex-ante (i.e. environmental uncertainty) and the performance which cannot be easily verified ex-poste (i.e. behavioral uncertainty) (Williamson, 1991). Environmental uncertainty is defined as the inability to predict changes in relevant factors surrounding future transaction while inability to predict future behavior of exchange partners is referred as behavior uncertainty (Carey & Lawson, 2011). TU arise due to asymmetrical information occurred in imperfect market (Dyer, 1997). SEs use their informal and personal connections in order to get required information (Priyanath, 2017). These connections are based on network relationships with business partners, supportive

network and the others (Priyanath & Premaratne, 2017). Literature describes that the network relationship generate Social Capital (SC) (Adler & Kwon, 2002; Burt, 1992). SC is the value and resources that generated from inter-personal relationships. SC has three dimensions; structural, relational and cognitive (Nahapiet & Ghoshal, 1998).Resources that generate due the pattern of relationships among individuals are called as Structural Social Capital (SSC) (Nahapiet & Ghoshal, 1998).The Relational Social Capital (RSC) refers as resources that generate from the value of relationships among individuals (Bhagavatula, 2009).Cognitive Social Capital (CSC) is the resources that provide shared vision or common understand among network members (Nahapiet & Ghoshal, 1998).

In the literature, a few researchers analyzed the relationship between SC and TU. Exchange partners fulfil all of his responsibilities and obligations correctly and are honest, fair and perform their role properly and adequately, it affect the decrease of TU (Heide & John, 1992). Network relationships have ability to reduce TC associated with behavioral uncertainty communicating and passing information about dishonest and cheated partners (Lu, 2007).When network members have the same perceptions about their mutual performances, they supported each other exchanging their ideas and helping them to avoid uncertainties (Tsai & Ghoshal, 1998).Therefore, the researchers hypothesized that;

H1 - *SSC of SE relates negatively to the TU of SE.*

H2 - *RSC of SE negatively relates to the TU of SE*

H3 - *CSC of SE negatively relates to the TU of SE.*

Methodology

Quantitative approach is employed to study the research problem and the survey method was selected to gather data. Only owner manager manufacturing SEs, which are classified according to 2 digit levels, were selected to gather data. SEs are defined as 'establishment with 5 - 24 persons engaged'. Multi-stage sampling method was adopted to determine the sample. Using the sample frame (14,185 of SEs), 373 of units were decided using the sample size determination formula developed by Krejcie and Morgan (1970).Data were collected for the questionnaire conducting face to face interviews. Partial Least Square - Structural Equation Modeling was used to test the hypothetical relationships. Measurement model was evaluated employing reliability and validity tests and the efficiency of the structural model was evaluated by multi- collinearity issues, R^2 , effect size (f^2) and predictive relevance (Q^2). The smart PLS (version 2) software was used to analyze data.

Results

With regard to the influence of SSC on TU, results show that SSC of SEs has a significant impact on the mitigation of TU by 23 percent ($\beta = -0.231$), the regression coefficient is positive significant (t-value = 4.98). Thus, hypothesis H1 is strongly proved by empirical data. Scholars provide similar finding that strong network relationship reduces TU. The results further shows that the RSC significantly affects the decrease of TU by 37.7 percent ($\beta = -0.377$ and t-value = 7.43). Thus, the hypothesis H2 is strongly proved by the survey data. Many scholars have provided similar findings highlighting that

the strength of relationships among parties affects the decrease of the TU. The strong relationships among the members mitigate the information asymmetries by allowing more open and honest sharing of information and thereby mitigate TU. Considering the influence of the CSC on TU, the results show that it significantly affects the decrease of TU ($\beta = -0.268$ and $t\text{-value} = 4.10$). Thus, the hypothesis H3 has strongly proved by the results. The members of network have the same perceptions about their mutual performances, they supported to each other exchanging their ideas and helping them to avoid TU.

Conclusion

The results revealed that all the dimension of SC have significant negative impact on TU. The study has made several contributions to the knowledge. First, the study synthesized all the dimensions of SC and TU into a new framework and thus extends the knowledge about the relative efficacy of theories into a different economic and social context. Second, this study makes important contributions to the literature by providing empirical evidences related to SC and TU of SEs in Sri Lanka. Third, the critical issue faced by SE sector is that the sector has higher mortality rate due to the limitations mostly reflected by TC. The study extends the application of the SC theory with the TC economics to understand an alternative solution for this critical issue. The study recommends that mechanism should be developed to generate strong SC between SEs and new exchange partners (organizing network formation activities such as seminars, trade fairs etc., providing information about reliable or guaranteed exchange partners through a webpage of responsible agency) in order to mitigate TU of SEs.

Keywords: Social Capital; Small Enterprises; Transaction Uncertainty

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