

## SOCIAL CAPITAL AND PERFORMANCE OF SMALL BUSINESS IN MALAYSIA

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**Abstract:** *Globalization, financial and economic development and crisis have contributed some pressure to the growth and survival of small companies. To be competitive in the global as well as national economic, the performance of small business is very essential. However, they are reported to face many problems and many have bankrupt or failed. Applying Resource-based Theory, intangible resources are expected to 1 performance of small businesses. Thus, this study examines the supplier and customer trust relationships as social capital on performance of small businesses. The samples of small-sized manufacturers are taken from Malaysian SMEs 2010 Directory using stratified random sampling. A total of 215 questionnaires that answered by owner-managers is analyzed. The result has shown that buyer-supplier trust has shown a positive significant influence on non-financial performance. On the other hand, buyer-seller trust has no significant influence on non-financial performance of small businesses.*

**Keywords:** *Social Capital, Performance, Buyer-seller, Buyer-supplier*

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### Introduction

Performance of small business is the most crucial problems to the business as well to the nation. Among their problems are slow in growth, survival, failures and also bankruptcy. In term of failures, Malaysian Statistics has reported that about 75.7% of Small and Medium-sized Enterprises (SMEs) failed in the first year of operation and approximately 60% failed each year. Consequently, not more than 22% of SMEs survived through the next 5 years, only 10% survive beyond 10 years and only 4% achieved success in their business (Shariffudin et al., 2004). The failure of SMEs occurred more during the economic crisis. During financial crisis and depression, more SMEs were slow in growth momentum, collapsed and bankrupt. Thus, the high rate of failures, slow in growth, and hard to survive have led to the failure to achieve the economic targets and government's visions.

Consequently, performance of SMEs is an important issue to developing and developed countries due to their huge establishment mode of business. For example, out of the total number of establishments, SMEs represent 99.5% in New Zealand (Prescott, 2004), 99.9% in Holland (Bijmolt & Zwart, 1994), 95% in Philippines (De la Pena, 1995), 99% in The United States

(Aharoni, 2001), 90% in Singapore (Ghosh, Liang, Meg & Chan, 1998), and 99% in the EU (Lakis, 2004). In Malaysia, overall SMEs account for 99.2% or 548,387 of all enterprises (MITI, 2007). Based on Department of Statistics' Census on Establishment and Enterprises, there are a total of 552,929 companies in Malaysia and 548,387 or 99.2% are SMEs. Thus, the statistics have proved the huge establishment and predominant mode of SMEs in Malaysia.

One of the factors contributes to the small business collapse is the failures of business activities with business customers and suppliers. Declining product demand (Whah, 2010), delaying payment collection and rising cost of raw materials (SMIDEC, 2008), demanding customers, delaying credit collections (Zainudin, 2008), lacking of trust and confidence of customer and supplier (Abdullah et al., 2009), lacking of reliable suppliers and skills in debt collection are among the problems faced by SMEs concerning their customers or supplier. The problems would be reduced by having good external business relationships. In the past literature, trust as dimension of social capital is studied more in the marriage, friendship, groups and community relationships as compared to business relationship. However, within the entrepreneurial literature, business trust relationship was significantly associated with business formation, maintenance, and cooperative relationship. Thus, this study is examining supplier and customer trust relationships and expected to provide the great influence to the performance of small businesses.

## **Literature Review**

### **Performance**

Non-financial measures are becoming important to small and medium-sized business performance indicator. Their measures usually deal with time, flexibility, quality and satisfaction (Cooper & Artz, 1995). This is aligned with the multiple constituency approach which examines the nonfinancial performance dimension takes into account the notion of satisfaction in business goals. Though still new, this latter type of studies has shown a very significant result. For example, Cooper and Artz (1995) examined the extents to which entrepreneurs are satisfied with their business in their third year of business ownership. The study on 287 entrepreneurs conceptualized entrepreneur satisfaction as a basic measurement of performance and found that the satisfaction emphasizing economic goals. Another study conducted by Hoque (2004) examined the association between business strategies, environmental uncertainty and performance. The study measured performance using only non-financial measures containing twelve non-financial assessments including customer satisfactions and response time, employee satisfaction, development and training, on-time delivery, suppliers and workplace relation. The study argued that non-financial measures might help managers to recognize changes in their businesses and affirm achievement of performance goals. Thus, both Cooper and Artz (1995) and Hoque (2004) have strongly associated business non-financial performance measures with strategies.

### **Social Capital**

The study of social capital in business relation is still lacking as compared to the other relationships. This section tries to discuss three empirical studies investigated the impact of social capital on business relation. First, a study conducted by Tsai and Ghoshal (1998) investigated the impact of the social interaction like personal contact, the trust and trustworthiness based relationships and shared code or shared paradigm on the innovation value creation of the firms. The surveys were answered by three managers of 15 business units of a large multinational

electronics company. The study found a strong support of social capital on value creation of the firm. Second, a study by Nahapiet and Ghoshal (1998) associated organizational advantage with three dimensions of social capital. Applying the Resource-Based Theory, the study examined separately the relational, cognitive and structural social capital on the creation and exchange of knowledge and found that organizations were able to develop high level of organizational advantage with these three dimensions of social capital. The more recent study by Watson and Papamarcos (2002) investigated the role of human relationship on the firm productivity. Trust, the interpersonal relationship between employees and management of 469 sales professionals from the leading medical services firms showed that trust, communication, and employee focus significantly direct affected on organization commitment.

According to Resource Based Theory (RBT), business resources are important for business to grow and gain profit. Social capital including business relation between customer and supplier is among the important business resources that contribute to the performance of SMEs. Having good external business relationships would reduce the problems between business and their customers and suppliers. Among the problems faced by SMEs concerning their customers or suppliers are declining product demand, delaying payment collection and rising cost of raw materials, demanding customers, delaying credit collections, lacking of trust and confidence of customer and supplier, lacking of reliable suppliers and collecting the debt. In entrepreneurial literature, buyer-seller relationship was significantly associated with business formation, maintenance, and cooperative relationship. However, as for now, none of the studies have associated both supplier and customer trust relationships with the small business performance.

Network ties and position have been noted as socially complex resources of sustained competitive advantage (Barney, 2000). According to Barney, network ties and position that refers as social capital has been constructed as one of the entrepreneurial resources. For example, Ireland et al. (2003) noted that social capital helps the firm gaining access, controlling of resources and absorbing knowledge. On the other hand, Batjargal (2000) have viewed that social capital is related to entrepreneurial success. According to him, social relationships are to neutralize the liability of the new entrepreneurial firms, enable entrepreneurs to marshal tangible resources, and formulate and implement the right strategy in the right industry to determine venture survival and growth. The extensive networks also enable entrepreneurs to locate clients and suppliers who are socially bounded and provide a flexible room for negotiations. These relationships facilitate sales stabilization and enable the entrepreneur to purchase raw materials and other production inputs at the stable prices. This would positively influence profit margin and eventual growth of the business. Thus, this study is examining the relationship between social capital that is both customer and supplier business relationships to the performance of small businesses.

### **Social capital and Business performance**

Buyer-supplier relationships as a dimension of social capital is associated with firm and sale performance. For example, a study conducted by Zaheer et al. (2005) on dyadic exchange relationships of 107 electrical equipment manufacturers and their component suppliers used fairness, trustworthy and reliability to measure buyer-supplier trust relationship. The study found that the buyer-supplier trust clearly associated with firm's performance. Another study by Claro and Claro (2008) investigated on 132 distributors companies on the impact of mechanisms of trust (calculative, affective, belief) with producers or suppliers channel relationships and associated

with firm's performance. The study found that managers in the distribution companies seek trust relationships to overcome potential problems such as opportunistic behavior in business relationships. Lastly, Johnson and Grayson (2005) examined the relative impact of service provider expertise, product performance, firm reputation, and satisfaction in influencing customer's perception of trust in a service provider. The sample of 349 customers found the significant relationship between trust and sales effectiveness. Generally, the three studies provided the significant impact of buyer-supplier trust relationship on firm's performance.

Another dimension of social capital is the relationship between manufacturer and their customers such as distributors, agents, salespersons, retailers or final customers. These buyer-seller relationships associated the trust with various outcomes such as performance (Hua et al., 2009). For example, Nooteboom et al. (1997) had examined the impact of trust on relational risk that was the size of loss and probability of loss. The study investigated on 97 suppliers in microelectronics assembly industry and found that trust has a negative effect on risk in the form of perceived probability of loss. The study used trust habitualization and institutionalization to measure the level of suppliers' trust on their customers. Another study, Sanner (2005) investigated on 140 suppliers of the dependence and trust between supplier and industrial customers. The study concluded that trust promoted information exchange, supported trust development, reduced the risks in an exchange of the parties, shaped strategy, opened up possibilities in markets and products as well as governed systems linking parties. The last type of studies is investigating both buyer-supplier and buyer-seller trust relationships. Doney and Cannon (1997) studied both the direct impact of supplier on buying firms and trust of industrial buyers on firm's current supplier firms and its salesperson. The study used different trust measurements to measure the two relationships. The study on 210 firms in industrial manufacturing found that trust of supplier firm and the salesperson influence a buyer's anticipated future interaction with supplier.

In conclusion, previous studies on buyer-supplier and buyer-seller trust relationships have associated with various firm's performance such as market, future interaction, sales, strategic decisions, a long-term relationships. On the other hand, lack of trust or deteriorating trust was found to reduce the long relation in corporate culture and preclude business. Obviously, the building of trust in supplier and customer relationships have done good things to organization and deteriorating in trust has damaged the business. Reviewing previous studies on supplier and customer trust and entrepreneurial trust, few gaps are discovered. The studies on trust and entrepreneurial are still lag in the literature, and at the exploratory stage and qualitative type of studies. Furthermore, most of the studies examined on one type of interorganizational relationships, either supplier-buyer or buyer-seller. As for now, only Doney and Cannon (1997) examined the trust in supplier-buyer and buyer-seller relationship. Regarding the importance roles of both supplier and customer to small businesses, this study simultaneously emphasizes on both relationships. Thus, this study explores the trust relationship between small manufacturers with their suppliers and customers.

## Methodology

### Sampling

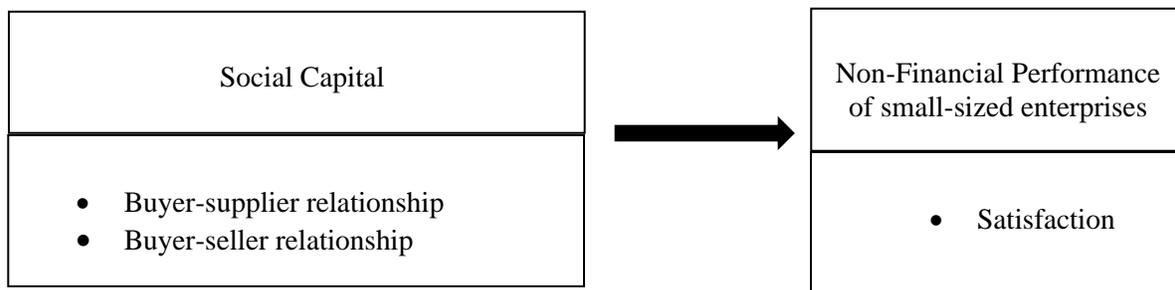
This study uses firm or enterprise as unit of analysis and the data used is the primer data. The primer data is the data collected using questionnaires and answered by owner-managers. This study defines owner-managers as managers who are also the owners or majority owners of the enterprises. They are the key decision makers of the enterprises who represent the enterprise in achieving the firms' goals. To accomplish the study, the questionnaires used are the adopted questionnaires from the previous studies. The total of 215 questionnaires is answered by respondents through emails or via internet. Each of the emails contains one set of questionnaire and a letter to a person concern. The questionnaires are sent to the selected respondents at a point of time. Thus, this study is a cross-sectional study.

### Framework of the study

This study uses Resource based theory to build the framework. Resource-based theory (RBT) focuses on how a firm sustains competitive advantage and how superior performance can be attained relative to other firms in the same market by acquiring and exploiting unique resources of the firm (Barney, 1991). A study in Malaysia by Farinda, Kamarulzaman, Abdullah and Ahmad (2009) has built business networking as one of the SMEs external resource or capability. The study examined the association between business networking and business performance and claimed that business network has gained competitive advantages through flow of information. Generally, the social capital through interpersonal or organizational relationships are likely to create potential absorptive capacity (Ireland et al., 2003).

Below is the theoretical framework of the study.

#### *Theoretical framework*



Social capital is constructed using two dimensions namely buyer-supplier trust and buyer-seller trust relationship. The hypotheses are as follows:

H1 Buyer-supplier trust relationship has a positive relationship with the satisfaction of small-sized enterprises.

H2 Buyer-seller trust relationship has a positive relationship with the satisfaction of small-sized enterprises.

### Measurement

The independent variable, social capital is measured using two dimensions namely buyer-supplier trust and buyer-seller trust relationship. The total of 14 items of the buyer-seller trust and buyer-supplier trust scales were subjected to Principal Component analysis (PCA) using SPSS version 18. The reliability of the scale has shown a Cronbach alpha coefficient of .77 on buyer-seller trust scale and .77 on buyer-supplier scale.

This study focuses on two types of trust that are buyer-supplier and buyer-seller trust relationships. The instrument of buyer-supplier relationships emphasis on credibility, benevolence and integrity dimensions of trust, while, buyer-seller relationships emphasis on benevolence (habitualization) and integrity (institutionalization) dimensions of trust. However, this study uses different instruments in measuring these two relationships despite of their different interest and emphasis.

On the other hand, this study measures non-financial performance using single dimension consist of four items pertaining satisfaction in business sales, profit, overall satisfaction and likelihood of going into the same business again. The 4 items of the non-performance scale was subjected to Principal Component analysis (PCA). The reliability of non-financial performance has shown a Cronbach alpha coefficient of .903. Thus, the performance of factor analysis and reliability on non-financial performance were valid and reliable. Non-financial performance is measuring the satisfaction on company's sales, profit, and overall satisfaction

### Result

#### Testing for Validity and Reliability

Principal Component Analysis (PCA) is performed on large scale of items in order to get a smaller size to measure the scale. Two variables of social capital of this study were tested for validity and reliability and the result are as below:

**Table 1: Result of Factor Analysis and Reliability Test for Social Capital**

Construct	Operational variable (Items in the questionnaires)	Factor Loading		Cronbach Alpha
		1	2	
Buyer-Seller Trust	Because we have been doing business so long with this customer, all kinds of procedures have become self-evident	.716		.772
	Because we have been doing business so long with this customer, we can understand each other well and quickly	.640		
	In our contract with this customer we never had the feeling of misled	.612		
	In this relation, both sides are expected not to make demands that can seriously damage the interest of the other	.740		
	In this relation, the strongest side is expected not to pursue its interest at all costs	.649		

	In this relation informal agreements have the same significant as formal contract	.669		
Buyer-Supplier Trust	We believe the information that this vendor provides us This supplier is genuinely concerned that our business succeeds When making important decisions, this supplier considers our welfare as well as its own We trust this vendor keeps our best interest in mind		.606 .757 .788 .846	.770
	Eigenvalues Eigenvalues % of variance Total variances	28.39	24.34 52.73	
	Kaiser-Mayer-Olkin (KMO) Chi-Square Significant		.785 606.98 .000	

The study found that each of the social capital dimensions also has shown different strength of contributions to the relationships. Both buyer-supplier and buyer-seller trust make positive unique contributions to explaining the satisfaction of small enterprises with beta coefficient of .128 and .056 respectively. However, only buyer-supplier is found to be significantly contribute to the equation with  $p=.092$  (sig. value  $p < 0.1$ ). However, buyer-seller trust is found to be insignificant contributed to the equation with  $p = .424$ . It can be concluded that the buyer-supplier significantly influence the satisfaction of the small-sized enterprises but not buyer-seller trust relationship.

This study suggests that buyer-seller trust relationship is insignificantly contributed to the small business satisfaction. This means that customer, distributors or retailers' trust relationships which defined as credibility, benevolence and integrity do not provide any positive impact to small business non-financial performance. However, this study suggests a significant contribution of buyer-supplier trust relationship on the satisfaction performance of small businesses. The importance of buyer-supplier relationship to business performance or success is explained by numerous of previous scholars.

### Conclusion and contribution

The social capital resource of small businesses of this study is constructed using two dimensions, namely, buyer-seller and buyer-supplier trust relationships. These business trust relationships are between the manufacturers and their important customers and suppliers. These involve the context of suppliers' credibility, benevolence, and integrity, and customers', distributors' or retailers' credibility, benevolence, and integrity that affect exchange outcomes. This study has shown the high mean score for both customer trust and supplier trust relationships. These imply that both customers and suppliers play the important roles to small manufacturers.

However, this study suggests a partially positive relationship between social capital and non-financial performance of small businesses. This study suggests a significant contribution of buyer-supplier trust relationship on the satisfaction performance of small businesses. The importance of buyer-supplier relationship to business performance or success is explained by numerous of previous scholars. For example, Zaheer et al. (1995) have claimed the important of buyer-supplier relationship on small-firm and organizational success, while Humphreys, Li and Chan (2004) have claimed the relationship with competitive advantages. Consequently, some of the past studies have found the significant contribution of buyer-supplier relationships on few of non-financial performance outcomes. Among the non-financial performance outcomes were improvement of new product, quality level and design (Goffin, Lenke, & Szejczewski, 2006), reduction in cycle time within supply chain (Handfield & Bechtel, 2002), reduction in transaction cost, and open communication between buyer and supplier (Humphreys et al., 2004).

In Malaysia, a study by Abd Rahman (2008) has found a positive association between buyer-supplier relationships with manufacturers' performance. However, the study was conducted on the mixture of advanced technology of small, medium and large manufacturers in Malaysia. The study associated buyer-supplier relationships with technology and implementation performance of the firms. Thus, buyer-supplier relationships have been associated with various measurement of firm's performance which could probably increase the satisfaction on firm's performance.

This study provides the finding where buyer-supplier trust relationship influences non-financial performance but not buyer-seller relationships. It implies that small manufacturers emphasized more on purchasing relationships (buyer-supplier) than selling relationships (buyer-seller). Having trust to suppliers mean that small manufacturers believe that suppliers' welfare consideration, honesty, trustworthy, promises, information, concerned on business succeeds and interest provide the impact to performance of small manufacturers non financially. Thus, the result has supported the Resource-based theory where supplier trust relationship as intangible asset or resource of small businesses led to the satisfaction of the firms' performance. This study has supported few of the past studies such as Zaheer et al (1995) who studied on 107 electrical equipment manufacturers and found that buyer-supplier fairness, trustworthy and reliability was associated with firm's performance. Consistently, an engagement in buyer-supplier relation can be interpreted as competitive resource strategy and represented as one of the most important intangible assets of the small firms.

This study has shown few contributions. First, is a model of small business performance using the Resource Based Theory (RBT). The social capital, the intangible resource that influences small-sized business performance is considered very a new relationship to the literature. Thus, this study has strengthen the significant important of social capital to a small business. Another distinctive contribution of this performance model is providing management strategies for the industries and business to be more competitive in the economic challenges. The model also provides the insight to the important of business relationships as business practices.

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