

# Social Capital

the benefits, potential costs, and prospects

By Moses Acquah

The concept of social capital—and its role in the process of enterprise development and growth on one hand and the economic and social development of nations on the other—has received strong research interest in most social science fields from sociology and economics to management. Broadly defined, social capital is the actual and potential resources embedded in networking relationships that are accessed and used by actors (e.g., managers of business enterprises) for actions (e.g., conduct of enterprise business activities). The social capital literature has focused on either internal or external social capital. While internal social capital deals with the structure and social networking relationships among actors (i.e., individual members) within a system or organization, external social capital focuses on the structure and social networking relationships between an organization and

its important external stakeholders (e.g., customers, government officials, community leaders, and employee association leaders).

The social capital concept is based on the adage that it is not only *what* you know that affects your performance but also *who* you know. It builds on the assumption that actors derive benefits from their social networking relationships. The conventional wisdom from most of the social capital research is that social capital is desirable because it is always beneficial to organizations.

Contrary to conventional wisdom, the effects of social capital on business activities and performance is more complex than postulated, and evidence exists to suggest that social capital does not always benefit the outcomes of business activities by enhancing performance. The nature of the relationship between social capital and enterprise performance

is critically dependent on the agents with whom firms develop social networking relationships. I want to use my research about social capital in Ghana to discuss the benefits, potential costs, and the prospects of using social capital for supporting the strategic organization of small and medium enterprises' (SMEs) activities and enhancing their performance in Ghana.

## Ghana's Socioeconomic & Political Environment

When it became the first sub-Saharan nation to gain independence from British Colonial rule in 1957, Ghana was one of Africa's most successful economies. It had one of the most developed infrastructures in West Africa, one of the most educated and skillful workforces on the continent, and a rich natural resource base, which once made her the largest producer of cocoa in the world



and one of the largest exporters of gold.

Recent free-market economic reforms have nurtured an economy that is relatively open, but real institutional change and business infrastructure development have been slow because they have been constrained by cultural norms, social beliefs, and existing bureaucratic procedures and processes. Thus, organizations in Ghana still face significant challenges in terms of their ability to competitively obtain the necessary resources through arms-length transactions. Ghana has had a stable political climate for more than a decade, but corruption is still pervasive because of the presence of red tape and regulatory meddling in the economic and business environment by politicians and bureaucrats.

The political climate in Ghana is characterized by the “winner takes all” syndrome, where the supporters



of the political party in power are the primary beneficiaries of any resource allocation by the government. The institutional framework for implementing and enforcing the laws facilitating the exchange of resources not only is weak but also favors the

supporters and sympathizers of the political party in power.

Interpersonal relationships and ties are strongly embedded in the social system of Ghana, which is highly collectivistic in nature. Traditional Ghanaian society is organized around kinship groups and collectivist communities, in which the clan and extended family play an indispensable role in creating the norms, values, and behavioral conduct acceptable to the society. The traditional social system in Ghana resembles a series of concentric circles in which the lineage or extended family is at the core. Revolving around the extended family is the web of personal and social relationships within the traditional social organization, which is made up of the clan, the community, and the tribe or ethnic group. The social system or organization (i.e., the extended family, clan, community, and tribe) is governed by kings who exercise traditional political and sociocultural authority with chiefs (i.e., lower level kings) and heads of extended families. Individuals who belong to a particular social system, therefore, exhibit strong loyalty to that social organization and its traditional political and sociocultural authority.

Interpersonal and social interactions, connections, and relationships among members in the social organization are highly emotional and cherished to the extent that the needs of the social group are valued over those of the individual. The social system is thus a corporate organization with a specific identity and membership that owns and manages property; enforces social norms, values, and expected behaviors among group members;

and applies social sanctions to members who deviate from the cultural norms. Individuals in the social organization are bound together through various social benefits and obligations and, therefore, are committed to one another by norms of reciprocity and equity. Individuals in the social organization who dishonor this cultural norm are at risk of not only losing their reputation and image but also disgracing their extended family. The behavior of an individual within the social organization is seen as a reflection of the moral character not only of that individual but also of the individual's entire extended family and, sometimes, ethnic group.

Today, Ghana has formal political, economic, and legal institutional structures that govern the conduct of economic and business activities. These formal institutions, which follow British Common Law traditions, are expected to be used for the implementation and enforcement of regulations, laws, and conduct of arms-length business transactions.

However, the laws and regulations enacted by these formal institutions are poorly implemented and enforced, so managers and entrepreneurs in Ghana rely on the connections and relationships they have developed with individuals—both within and outside their social organizations—who have power and authority to help them obtain the resources they require for the strategic organization of their business activities. Modernization and social change in Ghana, which came with the creation of the new nation-state, have created a tension between an individual's allegiance to the social norms, cultural values, and

behaviors expected by the traditional systems and to the formal laws and regulations of the new nation-state. However, Ghanaians' ties to their traditional social and political networks are never severed, making them an important substitute for the often inefficient and ineffective implementation and enforcement of the formal bureaucratic arms-length rules and regulations governing business activities.

### Benefits To SMEs

Personal and social connections and networking relationships provide a pervasive means of obtaining resources for the conduct of business activities by small-scale entrepreneurs in Ghana within an uncertain business environment; weak financial, regulatory, and institutional environment; political favoritism; and a deeply ingrained cultural tradition that is based on strong interpersonal relationships and allegiance to the extended family, clan, and community. Small-scale entrepreneurs, therefore, develop social capital through their social networking relationships with other enterprises (e.g., suppliers, customers, and competitors, community leaders, politicians, and government bureaucratic officials).

The benefits of social capital to small-scale entrepreneurs and SMEs in Ghana include the following: First, developing social relationships with politicians can provide access to resources and information that could be used for the strategic organization of business activities. In Ghana, because of inefficient legal enforcement systems and weak financial institutions, politicians and government bureaucratic

officials have considerable power in allocating resources and providing access to information. Despite the liberalization and privatization of most financial institutions and the development of private finance and credit institutions, access to finance through arms-length transactions is still difficult, and developing net-

former state-owned enterprises, SMEs have intensified their networking relationships with the officials of the government in power to navigate the underdeveloped and discriminatory market environment.

Second, community leaders (e.g., traditional kings and chiefs, and religious leaders, both traditional

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working relationships with politicians and government bureaucrats places an entrepreneur or the manager of an SME in an advantageous position to obtain financial resources. With a large public sector, most business contracts are determined and awarded by the government.

Bureaucratic officials also control the regulatory and licensing procedures and processes. In fact, because of the "winner takes all" syndrome in the Ghanaian political environment, developing ties with the officials of the political party in power is a sure way of obtaining access to resources and information for business activities in the form of access to finance, business contracts, regulatory information, and even help with the business registration and licensing process. With strong networking relationships between government officials and large enterprises, which are mostly

and contemporary) are the guardians of societal norms, shared understandings, and expectations, which define socially acceptable practices and behaviors in a community's business environment. Developing social relationships with these community leaders provides a lot of benefits to SMEs. Community leaders are very influential in garnering resources and providing access to valuable information and knowledge. Community leaders offer information about business opportunities, provide access to land for construction and agricultural purposes on favorable terms, and establish links to sources of financial resources and markets for the products of SMEs. They also play a very important role as advertising agents either through personal recommendations or by word of mouth, and provide legitimacy for SMEs and enforcement of business contracts



among SMEs in their communities. Family members, through their social relationship with community leaders, are also instrumental in helping small-scale entrepreneurs and managers recognize the potential opportunities in their communities as they provide continual support.

Third, when SMEs in Ghana develop ties with top managers of other businesses, with entrepreneurs of larger businesses, and with businesses that are suppliers or customers to the SMEs, they benefit from positive spillover effects, in terms of knowledge flow between enterprises, that are used to improve productivity and performance. Social capital embedded in the social networking relationships with managers of other SMEs who are in the same line

can also be an effective source of information about new technology, complementary resources, and opportunities to gain an advantage and mitigate threats in a business environment where the competitive landscape is skewed in favor of those with established connections.

### Potential Costs To SMEs


Although social capital provides several benefits to small- and medium-sized enterprises, some research has shown that there may be significant costs to developing ties that lead to social capital.<sup>1</sup> For instance, Portes and Sensenbrenner were among the first researchers to argue that while community leaders may act as bridges between small-scale enterprises and the larger community by spreading

and its function as a “mutual aid assistance society,”<sup>2</sup> in which an individual has both the obligation and responsibility to support the community and the right to receive assistance when needed, implies that successful SME managers are constantly called upon to be the savior of the community by providing jobs, loans, etc., to community leaders who helped them secure access to economic resources.

Moreover, social capital from social ties with some government officials can be costly to SMEs. My research in Ghana shows that social networking relationships with government officials can be separated into those with politicians and those with bureaucratic officials, and their impacts on performance are completely different. While capital from social relationships with bureaucratic official is beneficial, that with politicians not only can be costly to SMEs but can even hinder their ability to pursue new opportunities that may improve performance. By providing SMEs with privileged access to economic resources for the strategic organization of their business activities, politicians can also either extract and/or appropriate the value they help the SMEs to generate. In Ghana, ties with politicians provide an SME with access to finance from a government-affiliated financial institution or the award of a major business contract, but the SME has to contribute a certain percentage of the funds toward the cause of the government’s political party before the receipt of the loan or the commencement of the contract work.

### Prospects for SMEs

The business environment in most emerging economies is character-



## Personal and social connections provide a pervasive means of obtaining resources for the conduct of business activities.

of business, different lines of businesses, suppliers, and customers can provide a lot of benefits to an SME. Customers can provide information about preferences in the market on which SMEs should focus in the production and marketing of their products or services. Suppliers can provide quality raw material, financial resources and credit services, and other services that can help SMEs improve their efficiency and effectiveness in their operations. Competitors

information and providing access to community resources, community leaders may also expect favors from the small-scale enterprises and entrepreneurs that may overburden those enterprises and hinder rather than improve their performance.

Although my own research from Ghana does not indicate that the ties SME managers develop with community leaders hurt their businesses, the Ghanaian community’s focus on the norms of reciprocity and equity



ized by a weak or nonexistent market mechanism for facilitating arms-length transactions and resource allocation among firms and the existence of an extensive reliance on a redistributive mechanism for resource allocation by the government. The social system is embedded with strong interpersonal relationships and strong loyalty to and trust in the traditional political and sociocultural authority. With this background, there are significant prospects for developing and using social capital for the strategic organization of SME business activities.

First, social capital has the ability to ameliorate the potential inefficiencies and ineffectiveness inherent in the implementation and enforcement of laws and regulations that are sup-

posed to facilitate arms-length transactions. This is even more important in economies where many business transactions between SMEs and buyers or suppliers are too small and the parties are sometimes too poor to use the legal system to redress any wrongdoing. SMEs can use the social capital from the ties they develop as a contract-enforcing mechanism.

Second, social capital can be used to enforce obligations between an SME and its suppliers and customers. This is because the shared norms, values, and trust embedded in the social system and the social sanctions meted out to those who dishonor this cultural norm are powerful incentives that have the potential to align the interests of SMEs and their suppliers

or customers for a mutual benefit.


Third, SMEs can use social capital to collaborate with competitor SMEs to obtain and share complementary resources and capabilities. Collaborating with your competitors through strategic alliances, outsourcing agreements, marketing relationships, etc.—which has been called “coopetition”—is an effective way of gaining access to information about new technology, the creation and exploitation of knowledge and learning.

Fourth, SMEs should focus more on the social capital embedded in the ties they develop with their customers, suppliers, and competitors and minimize the social capital from government officials. Research shows

that as economies become liberalized and adopt a free-market system, the benefits from ties with government officials gradually wanes away. In fact, research from Ghana's young liberalized economy shows that SMEs benefit more from their social rela-

Indeed, social capital has beneficial as well as detrimental effects on SMEs in emerging economies.

The nature and impact of social capital on SMEs' activities and performance is critically dependent on the agents with whom firms develop




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tionships with managers from other firms more than they do from government officials and even community leaders.<sup>3</sup> This indicates that there is the potential for SMEs to rely on their peers to obtain critical resources, capabilities, information, and knowledge in order to exploit opportunities and/or minimize the threats in their market environment. Moreover, they will be less dependent on the government for resources and capabilities for their business activities.

### Conclusion

The social capital literature, with data from emerging economies overwhelmingly supports the view that social capital is desirable because it is always beneficial to organizations. But the impact of social capital on SMEs' business activities and performance is more complex than postulated. My research from Ghana demonstrates that significant evidence exists to show that social capital is not always beneficial to SMEs.

networking relationships. A broader characterization of social capital to include community leaders and the separation of government officials into politicians and bureaucratic officials clearly indicates that social capital is not always beneficial. While the preponderance of evidence from the empirical literature in emerging economies has consistently confirmed that social capital embedded in the social relationships with top managers of other firms is beneficial, it is not so with the social capital embedded in the ties with community leaders and politicians. Social capital from both community leaders and politicians has the potential to benefit SMEs, but these agents can also appropriate significant portions of the value they help SMEs create. 

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### Endnotes

1 Moses Acquaaah, "The Direct and Contingent Effects of Organizational Networking Relationships on Performance in Ghana" (paper presented at the Annual Meeting of the Academy of Management,

Atlanta, Georgia, 11–16 August 2006); Alejandro Portes and Julia Sensenbrenner, "Embeddedness and Immigration: Notes on the Social Determinants of Economic Action," *American Journal of Sociology* 98, no. 6 (1993): 1320–1350; Martin Gargiulo and Mario Benassi, "Trapped in Your Own Net? Network Cohesion, Structural Holes, and the Adaptation of Social Capital," *Organization Science* 11, no. 2 (2000): 183–196.

2 Henry M. Cudjoe, "Is Culture and Obstacle to Development in Ghana? A Critique of the Culture-Development Thesis As It Applies to Ghana and South Korea," in *Critical Perspectives in Political and Socioeconomic Development in Ghana* (African Social Studies Series), ed. Wisdom J. Tetteh, Korbla P. Puplampu, and Bruce J. Berman (Leiden: Boston Brill Academic Publisher, 2003), 335–363.

3 Moses Acquaaah, "Managerial Social Capital, Strategic Orientation, and Organizational Performance in an Emerging Economy," *Strategic Management Journal* 28, no. 12 (2007): 1235–1255; Abigail Barr, "Social Capital and Technical Information Flows in the Ghanaian Manufacturing Sector," *Oxford Economic Papers* 52, no. 3 (2000): 539–559.

### ABOUT THE AUTHOR

*Moses Acquaaah* is an associate professor of business administration at the University of North Carolina, Greensboro. His research focuses on networking relationships, competitive strategy, human factor, and family business issues in sub-Saharan Africa. Acquaaah previously worked at a major university in Ghana preparing socio-economic reports of the catchment areas of rural banks for the Bank of Ghana, and he was also involved in the monitoring and evaluation of micro-projects in Ghana that were financed by the European Union and the World Bank. Acquaaah serves on the boards of the *Journal of African Business* and the *International Journal of Information Security and Privacy*. He received his doctorate in organizations and strategic management from the University of Wisconsin-Milwaukee.

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