

# Social Capital, Business Stage, Business Type, and Indonesian SMEs' Performance: A Multi-group Approach

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## Abstract

**Purpose:** This study aims to test the relationships among social capital, business stage and business type in predicting firm performance of Indonesian SMEs.

**Design/methodology/approach:** Explanatory research by using multi group analysis was employed to answer the research questions.

**Findings:** The results prove that social capital positively affects firm performance, both in creative and non-creative businesses, and also in businesses in any stages of life cycle.

**Research limitations/implications:** This current study only looks at the demographic aspects of SMEs in Indonesia in the context of the type and life cycle of the business.

**Practical implications:** Indonesian SMEs need to maintain the power of their social capital through customers and suppliers to improve firm performance even though they are in a generally unfavourable economic situation.

**Originality/value:** By utilising multi-group analysis, it is found that in the context of Indonesian SMEs, any type of business and in any stage of the life cycle, social capital positively affects firm performance.

**Paper type:** Research paper

**Keywords:** Social capital, Business stage, Business type, Firm performance, Indonesian SMEs, COVID-19 pandemic

### **Introduction**

The COVID-19 pandemic crisis has hit lives for the past year and a half in Indonesia. The pressure of the COVID-19 pandemic crisis is being felt by the business sector, especially Small and Medium Enterprises (SMEs). Several studies have demonstrated the pandemic impact on SMEs (Dai et al., 2021; He & Harris, 2020; Waiho et al., 2020). Research by Dai et al. (2021) also shows that millions of SMEs in China were forced to close for months because of the pressure. Failure to respond to a pandemic situation will put the company under great business problems (Manuel & Herron, 2020).

Every effort is made to keep SMEs survive. The Indonesian government has formed a special committee to deal with the issue of the pandemic and economic recovery. Through the Ministry of Finance of the Republic of Indonesia, the Indonesian government has also allocated a budget of IDR186.8 trillion specifically to support SMEs during the COVID-19 pandemic (Kemenkeu, 2021). SMEs also receive financial assistance from local and international NGOs (Song et al., 2020). Besides, Adam and Alarifi (2021) stated that SMEs need to focus on reducing financial expenditures. The close relationship between SMEs, government, and NGOs can be understood as a form of social capital.

Social capital is a social relationship that exists as a result of social interaction and can be an asset for individuals and companies (Nahapiet & Ghoshal, 1998). Many studies have discussed the impact of social capital on firm performance (Akintimehin et al., 2019; Analia et al., 2020; Dai et al., 2015; Felício et al., 2014). Akintimehin et al. (2019) also states that social capital has positive direct impact on firm performance. Analia et al. (2020) confirm that social capital can improve the performance of SMEs. Even social capital has also been proven to have an impact on the type of leadership and firm performance (Subramony et al., 2018). Social capital is also able to increase knowledge sharing and affect performance improvement (Kim & Shim, 2018).

To gain a deeper understanding, this study tries to answer two questions. First, does social capital affect the firm performance of SMEs during the COVID-19 pandemic crisis? There is a literature gap on how social capital impacts firm performance during the COVID-19 pandemic. Analia et al. (2020) examines social capital by looking at three dimensions, namely networking, trust, and a shared vision. The research is still carried out on a small scale and does not relate to the context of the pandemic. The issue related to pandemic or crisis is very interesting to study because SMEs have limited capital while the pandemic has drained everything. The answer to this research question has an important impact on SMEs in order to survive the crisis.

Second, is there a difference between the type of business and the stage of the company on the effect of social capital on firm performance? The type of business and the stages of the company become a distinguishing characteristic between one business and another. These two characteristics will determine the policy direction taken by a business in dealing with problems. These characteristics will also ultimately determine the firm performance. Setini et al. (2020), Liu (2018), and Widjajanti and Sugiyanto (2018) show that the creative industry is able to encourage the emergence of creative ideas and innovations to face various challenges. Businesses with different stages will also have different strategies in dealing with a challenge. A business policy at an established stage will be different from a business at a growth stage (Chen et al., 2021a). Therefore, it is very interesting to study how the differences between these two characteristics may affect the relationship between social capital on firm performance.

This study aims to investigate the relationship between social capital, business stage and type of business in predicting firm performance. This research provides both theoretical and practical contributions. First, social capital theory is proven to improve company performance. Second, this study adds novelty in terms of methodology in the use of multi-group analysis to examine the moderating effect of business type and business stage on the effect of social capital on firm performance. Third, this research provides a practical contribution for stakeholders to be able to synergise with SMEs in improving performance through social capital. In terms of the structure of the paper, after the introduction, a literature review, hypothesis development, and methods are presented, then followed by the findings, discussion and conclusion, and implications. At the end, limitations and suggestions for future research are explored.

## **Literature Review**

### ***The Social Capital Theory***

Bourdieu (1985) defined social capital as a potential and actual resource associated with a durable network of reciprocal relationships. Economic variables are often not considered in social capital theory, whereas economic factors affect social and institutions trust, especially during times of economic crisis (Caïs et al., 2021). According to social capital theory, relationships between individuals are valued in order to maintain social trust and network coordination, which enables mutual benefit cooperation (Alonso et al., 2020). The value of trust and coordination is the main element of social capital, which develops in line with the interaction between individuals and institutional support. Social capital consists of 3 (three) dimensions, namely relational, cognitive, and structural dimension (Abboubi, 2021).

The relational dimension consists of trust, reciprocal norms, and identification. Trust describes the belief that intra-individual behaviour will be mutually beneficial so that involved the individual's willingness in the interaction. Meanwhile, the norm of reciprocity creates cooperative value in an interaction where there is value for mutual benefit to each other. Identification is a process in which individuals perceive themselves as one part of other individuals. A high relational level indicates high social capital which is integrated and creates public associations. Relational dimension affected knowledge management and its conversion (Shin et al., 2020).

The second dimension, namely the cognitive dimension, consists of a shared vision and a shared language (Nahapiet & Ghoshal, 1998). A shared vision describes a common vision that describes the collective aspirations of a group of individuals. Meanwhile, the shared language includes the same interests, backgrounds, and experiences to create effective communication between the individuals involved. It will create a common understanding and information among stakeholders in social interaction. The third dimension, namely the structural dimension that initiates in creating opportunities to acquire and position relevant knowledge (Zainoddin et al., 2020). This dimension has a high social interaction relationship, where high communication, emotional attachment, and reciprocal activities describe the realisation of social interaction.

## **Hypotheses Development**

### ***Social Capital and Firm performance***

Social capital could be defined as values or norms based on beliefs, prevailing norms, and social networks in society. Social capital applies in community groups that are dependent on each other and are owned communally. It shows that interpersonal relationships create value for individuals because they provide resources that could be used to achieve expected outcomes. Buendía-Martínez and Monteagudo (2020) state that social capital is a set of trust interpersonal networks driven by the norm of reciprocity and mutual cooperation, besides it

has a strong relationship with social involvement and participation in community associations. Social capital has complex dimensions, in general, consists of structural dimensions, relational dimensions, and cognitive dimensions (Khoury et al., 2021; Setini et al., 2020; Abboubi, 2021). The structural dimension includes the development of network structures and relationships between social components. Meanwhile, the relational dimension relates to the value of commitment and trust, and the cognitive dimension includes the organisational vision that is determined together with the interests of the social component.

The use of various types of capital, financial, natural, and human resources, as well as technology, does not guarantee the achievement of optimal firm performance. Social capital is a crucial component as an asset and an instrument that could be conceptualised as a form of organisational culture. SMEs are often encounter some obstacles in accessing information so that references for making decisions are still limited. The ability to build a social network is the main driver in realising social capital, where it allows SME companies to be able to access a lot of information and resources (Sanchez-Famoso et al., 2020; Sarwar et al., 2021). The synergy of social capital with the company's strategy would form an organisational culture that initiates an increase in the company's firm performance so that it affects the company's firm performance (Afum et al., 2020; Ha & Nguyen, 2020; Nuryanto et al., 2020; Prasetyo et al., 2020).

Through social capital, companies have easier access to financial, intellectual, and cultural resources which become necessary elements to achieve efficient firm performance and create a sustainable competitive advantage. The existence of social capital would encourage innovative business value which become a crucial element to increase firm performance (Ali & Anwar, 2021; Samad, 2020). The implementation of social capital through the development of new business models by involving more socially valuable resources could encourage value increase of sustainability and economic growth in a wider impact. Internally, this will have an impact on improving the company's firm performance. Supporting those ideas, the first hypothesis is proposed as follows:

H<sub>1</sub> : Social capital has a positive significant effect on SME's firm performance

### ***Business Type and Firm Stage in the Causality Effect of Social Capital and Firm Performance***

Types of business lead companies to different strategies and decision making. Social capital as a factor that affects firm performance is implemented differently in each type of business because the pattern of innovation is different in each type of business (Lyu & Ji, 2020; Presutti et al., 2020). The pattern of business development is strongly influenced by the type of business itself because it is also determined by external factors such as the business environment and market preferences. The type of business could be categorised as creative and non-creative sectors. The Indonesian Agency of Creative Economy defines the creative industry sector as a business category for industries that sell products with creative values and do not exploit natural resources. Generally, this industry starts from individual businesses that are likely to expand more widely (Kemenparekraf, 2021).

There are 16 (sixteen) creative industry sectors in Indonesia, namely culinary, fashion, craft, TV and radio, publishing, architecture, application and game development, advertising, music, photography, film-animation-video, performing arts, product design, art visual, interior design, and visual communication design. The creative industry sector, as a sector that is quite popular among the wider community that encourages economic innovation and contributes socially through the implementation of social capital (Bhowmik et al, 2020). Creative industries'

products are familiar to people's lives need. They implement social capital because they have higher social linkages than the non-creative sector.

In relation to optimal firm performance, the creative industry encourages the emergence of creative ideas and innovations to deal with market demand, so the strategy and decision-making involve broader information (Setini et al., 2020). The pattern of implementing social capital in optimising firm performance is set differently in each type of business. This is determined by the characteristics of the business, the nature of the product, and market preferences. Based on the discussions, we propose the second hypothesis as follows:

H<sub>2</sub>: The effect of social capital on SME's firm performance is different between creative and non-creative sector

Companies also go through a life cycle in four stages, namely start up, growth, maturity, and stagnant (Pham & Pham, 2020). In each stage of the cycle, companies have general and specific characteristics related to the implementation of the governance system and the resources. At the start-up stage, the company is in the final stages of preparation for opening a business, including conducting employee training. At this stage, sales begin to be generated with a complete business plan. Regular income begins to be obtained in the growth stage, where cash flow is positive and profits are increased. In growth stage, management needs to emphasise revenue management, customer service, dealing with competition, and managing human resources.

Business expansion begins at the maturity stage which is marked by the addition of locations or the development of facilities, it is also shown by the introduction of the second line of main products or services. Product stability has been achieved at this stage and is generally at a higher level of professionalism. Revenue trends are relatively flat, so cash flow is stagnant, with loyal customers and a consistent employee structure. The ability to encounter business competition is a problem that is highly emphasised at this stage, so companies usually invest in new technologies and markets. In the final stage, namely the decline stage, the company experienced a decline in the level of revenue, profit, and cash flow due to failure to extend its business cycle. This failure can occur due to the inability to adapt to the business environment. The firm life cycle theory illustrates that the company goes through stages of development in a linear manner from the beginning to the end, where strategy, structure, and decision-making patterns are carried out according to the stages they go through. In the context of causality between social capital and firm performance, the firm stage greatly determines the decisions taken by the company in terms of implementing social values in the company's activities. At the growth stage, where revenues and profits are increased, the company's decisions related to the implementation of social capital are also more aggressive.

The integration of social capital in the company's strategy has begun to be carried out on a large scale through the implementation of social values in company activities, where this program has a positive impact on firm performance (Bai et al., 2020; Han & Kim, 2020; Park, 2021). Companies in the maturity stage begin to experience cash flows that tend to stagnate, even in some companies starting to decline slowly, so that the decision to implement social capital tends to be lower than companies in the growth stage (Chen et al., 2021b). In this stage, the company's investment focused on product development and the discovery of new market opportunities so that investment in social capital tends to decrease. In this case, the impact of social capital on firm performance is different at the growth and maturity stages, where at the growth stage the impact is greater than that of companies in the maturity stage (Han & Kim, 2020; Park, 2021). According to these ideas, we present our third hypothesis as follows:



H<sub>3</sub>: The effect of social capital on SME's firm performance is different between the SMEs in growth stage and SMEs in maturity stage

The relationships between variables can be seen on Figure 1 as follows.

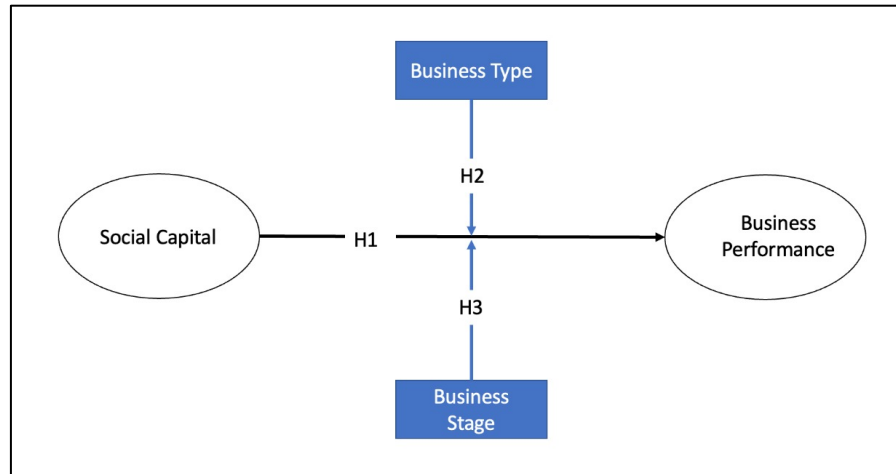


Figure 1: Model Development

### Methods

The purpose of this study is to examine the relationship among social capital, business stage, and business type on determining the performance of small and medium enterprises (SMEs) in Indonesia. The explanatory research design was conducted to fulfil the purpose. A survey was conducted to collect data. The population of the study is the owner or manager of SMEs in Indonesia, thus a simple random sampling with convenience technique was used to select the samples for this research. A total of 155 questionnaires provided complete data to be further analysed for this research.

The first section of the questionnaire is used to capture the demographic profile of the respondents, and the second section is used to examine the variables observed in this study. The most critical information collected from the first part of the questionnaire was how long the SMEs have been established and in which industry does the SMEs currently compete (creative or non-creative industry). Among 155 respondents collected, 49% of them have established their business around 1 to 6 years. Meanwhile, 54% of the respondents run businesses that compete in the creative industry sector.

The Partial Least Square (PLS) was employed to analyse the data collected from the second section of the questionnaire. The analysis included in this study were: the outer model analysis and inner model analysis, and the hypotheses testing. The outer model analysis consists of convergent and divergent validity testing, and the uni-dimensionality test. The outer model analysis consists of the Goodness of Fit (GoF) index which is used to measure the robustness of the proposed model. Hypotheses testing for the direct effect of social capital on business performance is determined by comparing the t-statistics results with the t-table on a 5% significance level ( $t=1.960$ ). The moderating effect of business stage and business type on this research were evaluated by the Multi-Group Analysis (MGA).

Table 1: Demographic data

Variables	Category	%
Revenue	Rp 300.000.000 - Rp 2.500.000.000	83.74
	Rp 2.500.000.000 - Rp 50.000.000.000	16.25
Business Age	Less than 1 year	9.03
	1 – 3 years	10.32
	4 – 6 years	11.61
	7 – 9 years	18.70
	More than 9 years	50.32
Employees	Less than 10 people	82.26
	10 – 20	6.40
	21 – 30	1.47
	31 – 40	0.98
	More than 40 people	3.94
Business Type	Business creative	54.19
	Non-Business creative	45.80

### Findings

This section will cover the findings we found from the data collected from the second part of the questionnaire. The collected data was analysed with SmartPLS 3.2.

#### Outer Model Analysis

The outer model analysis for this research was consists of a convergent and discriminant validity test, and the uni-dimensionality test. Two items from social capital (SC8 and SC9) were having outer loading scores below 0.7 thus the two items were removed from the model. After the removal, the remaining items were having an outer loading score above 0.7 with an AVE score above 0.5 thus validated the convergent validity. The discriminant validity was tested by comparing the AVE square root on the correlation among the variable on the model. The result of the comparison shows that each AVE square root of each variable is larger than their correlation with other variables, confirming that there is no discriminant validity issue on the model. Finally, the uni-dimensionality test was conducted to determine if the proposed model was uni-dimensional. We examine the score of composite reliability for this model and found all of the composite reliability scores for each variable were above 0.7, thus confirming that the proposed constructs were uni-dimensional.

Table 2. Outer Model Evaluation

Construct	Item	Outer Loading	Composite Reliability	AVE	Fornell-Larcker	
					SC	BP
Social Capital (SC)	SC1	0.827	0.930	0.597	0.773	
	SC2	0.854				
	SC3	0.816				
	SC4	0.819				
	SC5	0.811				
	SC6	0.785				
	SC7	0.761				
Firm performance (BP)	BP1	0.817	0.933	0.700	0.308	0.837
	BP2	0.856				
	BP3	0.722				
	BP4	0.909				
	BP5	0.877				

Construct	Item	Outer Loading	Composite Reliability	AVE	Fornell-Larcker	
					SC	BP
	BP6	0.826				

### Inner Model Analysis

To examine the Goodness of Fit (GoF) scores for the proposed structural model, we need to determine the predictive relevance ( $Q^2$ ) scores of both variables. The criteria of a good predictive relevance are the score of  $Q^2$  should be more than zero. According to the score of  $Q^2$  for all the variables on the proposed model, we concluded that our proposed model has good predictive power. Finally, the GoF was measured by following Tenenhaus's suggestion. According to the suggestion, our proposed model could be categorised as a medium fit (GoF more than 0.25 but below 0.36). The result confirmed that our proposed model could be fit to examine and describe the relationship between variables within it.

Table 3. Structural Model Evaluation

	SSO	SSE	$Q^2$
BP	930	399.579	0.570
SC	1395	639.999	0.503
<b>GoF = <math>\sqrt{AVE \times R^2} = 0.248</math></b>			

### Hypothesis Testing

Following the result from the path analysis, the first hypothesis proposed for this research is accepted. Social capital is indeed one of the determinants of firm performance. However, according to the Multi-Group Analysis (MGA), we could not support both the second and third hypotheses. Thus, we couldn't prove that there will be different effects of social capital on firm performance on small and medium enterprises (SMEs) that competed in creative or non-creative industries. We also couldn't prove that there is any different effect of social capital toward firm performance on SMEs that were on their growth or maturity stage.

Table 4. Hypotheses Testing

Hypothesis	Path	Coefficient	Sig	Remark
H1	SC → BP	0.328	0.000	Supported
H2	SC x BT → BP	-0.77	0.514	NS
H3	SC x BS → BP	0.155	0.277	NS

### Discussion and Conclusion

Kanini and Muathe (2019) have confirmed that social capital is one of the essential forms of capital itself, which companies must not forget if they want to stay in business. As a study with the genre of critical literature review, this study suggests that future research in the capacity of examining the relationship between social capital and firm performance, needs to raise this topic in developing countries with middle or low incomes levels, with small businesses in large numbers, as well as informal businesses. In addition, it is also suggested that it is necessary to consider adding the variables of business innovation and operational business environment as a mediation or moderation between the relationship of social capital and firm performance. Current research conducted on SMEs in Indonesia has captured this opportunity and has shown that social capital has a positive effect on firm performance, both financial and non-financial. The type of business and also the business life cycle of the SMEs are used as moderating variables to see aspects of innovation carried out by SMEs and how the business environment



can have an impact on the relationship being tested. The innovation aspect here is seen from whether the SME business is in the creative business type or not. While the business environment is seen from the aspect of the business life cycle, which is the growth or maturity stage.

These results prove that social capital positively affects firm performance, both in creative and non-creative businesses, and also in any business life cycle. Whatever the type of business and wherever the business is in its cycle, it is proven not to be something that needs to be considered so that firm performance can be maintained through social capital. Social capital is important as an effort to improve firm performance (Wirba et al., 2017; Obonyo, 2017; Kiprotich, 2014). Lyu and Ji (2020) also emphasised that social capital and firm performance have a positive and significant relationship on business in China in a meta-analysis study. This study also identifies from previous research articles that the positive and significant relationship will be stronger if it is supported by the presence of high technology in the company and low level of marketisation. However, the relationship between social capital and performance also depends on what performance measurement and what dimensions are used in the study. Thus, different types of business and types of social capital will give different results. However, the final result of the study by Lyu and Ji (2020) also shows that the moderating role of industry type does not affect the relationship between social capital and firm performance in China. This supports the findings of the current study which gave similar results.

In the research of Sulistyono and Ayuni (2020) it was stated that social capital can positively and significantly influence the innovations carried out by SMEs in Indonesia, and after that innovation will have a positive impact on the company's competitive advantage. This means that the company's innovation, which in the current study is seen from the perspective of the type of business, namely creative or non-creative business, may not be a moderating variable but mediate between social capital and company performance. The same result was also obtained by Purwati et al. (2021), Meflinda et al. (2018) and Samad (2020) in the same research context. Thus, it can be seen that in the context of SMEs in Indonesia, business innovation as stated in the type of business is a positive impact of the existence of social capital, where innovation will then lead to overall company performance.

Therefore, the type of business cannot be seen as part of social capital itself, but as a result of the existence of social capital. Furthermore, it means that SMEs in Indonesia need to take advantage of social capital to be able to develop their businesses so that they can be included in the category of creative industries with high innovation in order to maximise their firm performance. This is because social capital has been very strongly embedded as part of SMEs in Indonesia, such as the spirit of mutual cooperation (Lukiyanto & Wijayaningtyas, 2020), local wisdom (Nugroho & Andarini, 2020), and the implementation of Pancasila values (Asri et al., 2021) on individuals in Indonesian society. However, social capital and firm performance are still believed to have a positive and significant direct relationship (Dewantoro & Ellitan, 2021; Rahmawati et al., 2021; Menike, 2020).

### ***Conclusions***

This research, which was conducted by taking the object of research on SMEs in Indonesia, shows the results that social capital affects the company's performance positively and significantly regardless of the category of whether the SMEs are included in the creative industry or not and also without considering the business life cycle. Thus, regardless of the type of business and regardless of the position of the business life cycle, social capital is proven to improve company performance. The type of business and business life cycle cannot be seen as part of SMEs in Indonesia, but may be the impact of the existence of social capital itself. This is because social capital has become a very close part of Indonesian society and has become

the values applied in the SMEs body in Indonesia which is full of the spirit of gotong royong, togetherness, and the essence of Pancasila values. Therefore, regardless of the type of industry and whether the SME is still in the growth stage or at the maturity level, social capital is a very important in improving the firm performance.

### ***Implications***

With these results, the implications of this research are, first, social capital theory is proven to improve firm performance. This is because the resources and social values applied by the owners or managers of SMEs in Indonesia are proven to be able to foster things that can encourage increased performance, such as new business ideas and business growth while maintaining good relations with stakeholders. That way, SMEs in Indonesia need to maintain the strength of social capital through their customers and suppliers so that performance can improve even though they are in a generally unfavourable economic situation, such as during the COVID-19 pandemic or economic recession. Second, in addition, the government through the Ministry of Tourism and Creative Industries needs to encourage Indonesian SMEs to be able to increase industrial creativity through ease of capital, knowledge in business development, and ease of obtaining business permits in order to support firm performance improvement.

### ***Limitations and Suggestions for Future Research***

This current study only looks at the demographic aspects of SMEs in Indonesia in the context of the type and age of the business to be able to capture the variables of business type and level of business cycles that are in the developing and already in established stages. This study has not seen from other demographic aspects such as gender and education level of the owners or managers of Indonesian SMEs, whether they can be moderating variables of the relationship between social capital and company performance. This is because these variables are personal, while in this study the demographic variables are seen from the side of the business, not from the owner or manager.

Gender and education level of the owner may be able to influence the relationship between social capital and company performance because often the effect of who owns the SMEs will be able to strengthen the social capital of the business, so the stronger the social capital, the higher the firm performance. Another future research suggestion as a development of the current study is the use of more complex research methodologies, such as by adding interviews with SMEs' owners, both with structured, semi-structured and unstructured models, to get a richer data and perspective on social capital has been used in the business. Social capital is used by SMEs to be able to maintain the good performance of the business and even to improve it. This can enrich the results of the research and its discussion, considering that the current research only uses a quantitative methodology through questionnaires to see the relationship between social capital and company performance.

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