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Rajapakshe, PSK and Gamage, SKN and Prasanna, RPIR
and Jayasundara, JMSB and Ekanayake, EMS and
Upulwehera, JMHM and Wijerathna, WAID and
Abeyrathne, GAKNJ

Faculty of Social Sciences and Humanities, Rajarata University of
Sri Lanka

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Social Capital, Performance of SMEs, and COVID-19 Pandemic

PSK Rajapakshe, SKN Gamage*, RPIR Prasanna, JMSB Jayasundara, EMS Ekanayake,
JMHM Upulwehera, WAID Wijerathna, GAKNJ Abeyrathne

*Faculty of Social Sciences and Humanities, Rajarata University of Sri Lanka,
Mihintale, 50300
Sri Lanka*

*Corresponding Author
email: naraddagamage@gmail.com

Abstract

The aim of this working paper is to explore the relationship between social capital and the performance of SMEs and articulate the ways of using the social capital as an instrument to address the performance of the SMEs in context of Covid-19 pandemic. Further, this review identifies the unexplored areas related to concepts – social capital, SME performance, and Covid-19 pandemic which will pave the way for further research in area focused. . The review and discussion on existing state of knowledge disclosed the key areas which create link between social capital and SME performance. First, the investigation of the impact of externalities on SMEs performance, especially the impact of COVID-19 pandemic, and how the social capital could assists to minimize the effect were divulged. Then, the way of allocating social capital to intensify the success of SMEs in the internationalization process was revealed. Accordingly, with the growing significance of the banking institutions during the pandemic period, investigating the banking relationship as an external social capital with the SMEs performance was recognized as one of the critical areas in the pandemic situation. Lastly, during the era of treating customers like the kings of the market, interaction among innovation, marketing capabilities, and social capital to facilitate the competitive performance of SMEs have been substantially addressed. Findings suggested that investigating the dynamic environmental changes of SMEs and social capital influence are vital to stimulate the sustainable competitive advantage of SME sector in the intensified economic competition.

Keywords: *Internationalization, Innovations, SMEs, Social capital, Sustainable competitive advantage*

1. Introduction

Broadly, the main benefit of the interaction between the networks of people and businesses is recognized as social capital. As the importance of the external relationships of the business environment is intensified by the unification of the world, social capital becomes a recurrent theme in the field of research, especially in the context of SME performance. Further, social capital is identified as the factor that facilitates entrepreneurs to make tangible and intangible advantages through social networks and connections with the external environment (Dai et al., 2015; Kurupuge et al., 2017). Social capital usually takes two forms namely, the internal and external social capital. Both of these are equally important in the performance of organizations (Akintimehin et al., 2019). Bridging and bonding social capital also stands upon the meanings of external and internal social capital (Gamage et al., 2016; 2020(b)), and both categories are identical to each other. Social networking, the base of social capital, is the frequent measure entrepreneurs take to access information efficiently and effectively. Thus the information is used to build up the competitive advantage through product innovation and the identification of new market opportunities. Rieckmann et al. (2018) examined the significance of the availability of social capital in out of boundary trading. They emphasized that the nations could achieve supportive resources to their business processes by taking advantage of social networks they have made and maintained. The two factors, trustworthiness and the cooperative working environment, are concerned as critical in business operations, and social capital fuels it. Hence, better interpersonal relationships significantly impact on achieving the ultimate objectives of family oriented SMEs' businesses (Marjański et al., 2019). A mechanism that coordinates and integrates the mutual relationships between the societal units is considered social capital (Putra et al., 2020), and value, and knowledge sharing are significant pillars of social capital.

Furthermore, social capital is the foundation brick of the dynamic improving capabilities that ultimately result in innovations (Xin et al., 2020). With the timely importance of the social capital in business performance, most of the researchers have focused their efforts to investigate the social capital and SMEs performance throughout the last decade (Akhavan & Hosseini, 2016; Akintimehin et al., 2019; Berisha & Pula, 2015; Gamage et al, 2020b; Prasanna, et al., 2020; Hoq et al., 2017; Mahmood et al., 2012; Marjański et al., 2019; Munyawarara & Govender, 2020; Nishantha & Kawamura, 2011; Priyanath & Lakshika, 2020; Putra et al., 2020; Rodrigues, Suzana & Child, 2020; Xin et al., 2020).

It is well evident that social capital is a driving force of the acquisition of a strong customer base domestically as well as internationally. Since the performance of SMEs is critical in achieving sustainable economic growth targets, social capital can be employed to enhance the performance of SMEs? Further, companies have planned to enhance social capital on a private basis without remaining inactive until the regulatory agencies patronage. The primary reason for this initiative is the availability of a wide range of advantages (Cooke & Wills, 1999). Therefore, analyzing the effect of social capital on SMEs performance is a substantial measure in the decision-making units of the policymakers. A preliminary study mainly aimed to give a historical background to SMEs' social capital and performance to identify the areas where there are research gaps and vacuums in scientific knowledge.

In the current scenario, the dynamic business environment is encountered with unexpected and unprecedented threats than prior periods. As a specific mechanism to lower the negative effects of those threats, many firms use social capital as a strategic tool. So, there is a vacuum in scientific knowledge concerning SMEs performance and social capital, although their roles are significant and go hand in hand. Further, today's globalized economies are running in a technological era, and firms are adapting to the technology on a timely basis are the strong market survivals. As social capital is considered a formidable force in technological adoption and innovation capabilities, it is essential to have a prudent literature repository to facilitate information-sensitive interested parties.

As noted above, the social capital is a critical instrument for SME performance in the globalized economy. Similarly, the SME sector is considered as the backbone of economic development in today's globalized economy as its contribution to the economic growth is substantial. Thus, the SMEs are vital in acquiring sustainable economic development in every country due to its contribution in facilitating production processes, employment generation, continually improving innovations, and poverty alleviation (Gamage et al., 2020a; Ekanayake et al, 2020; Jayasundara et al, 2019). Accordingly, flexibility and the formation of healthier competition, and providing support to large firms are the main features of SMEs compared to large-scale enterprises. Thus, SME sector is gaining much interest among academics and policymakers over the world in the recent past due to its significant impact on economic prosperity of both developed and developing countries (Berisha & Pula, 2015; Mahmood et al., 2012; Agyapong et al., 2017; Al-Herwi, 2019). In academic literature, there is no commonly accepted definition for SMEs and definitions are specified in terms of sectors, regions, and countries due to the heterogeneity in business fields and economies at those levels. In economic aspects, the performance of the SMEs is assessed using indicators such as profitability, production or business growth, employment growth, etc. Given this backdrop, the aims of this working paper are to identify critical areas of the social capital which affect the SME performance and to identify the potential ways in in addressing the challenges of SMEs in the Covid-19 pandemic situation.

2. The Economic Mechanism of Social Capital

According to Priyanath & Lakshika(2020), social capital significantly impacts its transaction costs and enhances livelihoods. Entrepreneurs in rural areas have highly relied upon informal credit and other funding sources than the formal lending facilities and social capital is recognized as the main underlying reason for that. It is highly efficient and fund flows are effective in these sectors. Hence, the expansions of the entrepreneurial and smallholder farming businesses are facilitated through social capital (Lin et al., 2017; Munywarara & Govender, 2020).

Moreover, to fulfill resource requirements, networks built on social capital play a vital role in the SME sector. The costs associated with the business processes also can be lowered by having accurate information flow facilitated through the social capital. Then it ensures the positive impact of social capital on the performance of SMEs (Hoq et al., 2017). Further, Gamage et al.

(2020c) suggested that SMEs are crucial role players in economic growth. Hence, the social capital facilitates economic growth by enhancing SMEs' performance (Marjański et al., 2019). Banks are considered the largest lending institutions in any economy, and they substantially contribute to the GDP as a service sector. In fact, credits to the SMEs are significantly impacted on ensuring the growing? Concerning of those banking institutions. According to Shihadeh et al. (2019) the mutual relationship between the banks and SMEs as an external social capital enriches the banking services. Akhavan & Hosseini, 2016 stated that the knowledge sharing is a vital factor affecting innovations and innovation capability. Similarly, resource sharing with the members is significant in achieving a higher production level (Nishantha & Kawamura, 2011). Further, Akhavan & Hosseini, 2016 emphasized that social connections of the enterprises directly lead to innovations and innovation capabilities, and they are critical in acquiring substantial advantages in any economy.

Moreover, social capital is considered an influencing factor of SMEs' performance and acquisition of their business goals (Hoq et al., 2017). Bridging external parties through innovations is a feature of the social capital (Cooke & Wills, 1999), enhancing the nation's advancement relative to the economies. It is evident that community-based organizations (CBOs) usually focus on highly reliable suppliers, and buyers and those close social networks make the firms profitable by reducing transaction costs (Priyanath & Lakshika, 2020). In addition, poverty eradication is recognized as facilitated through social capital. At the same time, the proliferation of new employment opportunities in rural areas (Munyawarara & Govender, 2020) intensifies the well-being of human beings.

3. Social Capital and SMEs performance

3.1 Social Capital, Innovation, and Marketing Capabilities

Networking and collaborating are essential tools used to develop the social capital and innovations in SMEs, and they are significantly impact on the performance of the business processes. Thus, the SMEs could enhance their performance while the exploitation of knowledge and novelties in the business sector is also influenced by social capital (Cooke & Wills, 1999). Novelties in business strategies improve the consumer acceptance and the uniqueness of the businesses (Putra et al., 2020; Bandara et al., 2020). Therefore, that makes a strong customer base while enhancing the success of particular SMEs.

Advanced economies in the world usually equitably allocate their resources to the particular sectors accordingly to the significance possessed in the economy. In contrast, developing economies do not have favorable macro-economic policy environment to allocate resources in fair and equitable manner particularly in such pandemic situation... Further, to enhance the competitive advantage, the usage of social capital prudently is a must in emerging economies as it is positively related to the performance of SMEs. At the same time, it intensifies the innovations (Agyapong et al., 2017). Similarly, Gamage et al. (2020c) suggested a real need to examine the areas related to SMEs in the context of emerging economies.

Akintimehin et al. (2019) emphasized that internal and external social capital are vital in determining organizational success since the significant impact of those two categories on

financial and non-financial performance. Indeed, social capital has been an essential part of SMEs' functioning (Gamage et al., 2020b). It is evident that SMEs with a higher level of social capital can acquire significant mutual benefits and a sustainable competitive advantage (Marjański et al., 2019). That confirms the social networks are the primary technique used to have effective marketing. SMEs in the agricultural sector can enhance production through continuance innovations to reduce the costs and wastes associated with the production. Yeşil & Doğan (2019) explored those innovations are significantly correlated with the social capital sustained by the particular organization. As a cohesion of social networking, social capital provides substantial assistance in acquiring raw materials, customer knowledge, and facilitating competitor analyses. Further, those relationships allow SMEs to enhance cost-effective innovations via applying cost effective methodologies (Putra et al., 2020).

3.2 Social Capital and Internationalization Success

When considering the small firms, the trusteeship they maintain is a crucial factor in the social capital. Additionally, social capital adds an advantage to SMEs in domestic and international markets (Rodrigues & Child, 2020). Competing with well-established international firms is a challenge vested upon SMEs. Therefore, strong networks maintained as social capital by the SMEs act as a buffer to confront the competition of giant domestic and international firms. At the same time, it directly help for risk mitigation and risk management in SMEs sector (Prasanna et al., 2019; Rieckmann et al., 2018).

The tourism industry possesses a significant portion in the trading and networking out of physical boundaries with the unification of the world. Social capital enhances the importance of MSMEs (Micro, Small and Medium Enterprises) at the international level by allowing them to be the center of tourism and economic development (Putra et al., 2020). SMEs usually face more difficulties when entering the international market than the domestic market. On the other hand, competition and risks are high in the global market. Social capital acts as a buffer to SMEs to mitigate those risks and compete sustainably (Rodrigues et al., 2020).

Internationalization is considered a recurrent theme by researchers recently. Although the social capital in the internationalization process does not attract substantial attention, its effect is significant. As revealed by Kontinen & Ojala (2011), social capital is the fundamental intangible resource to the foreign market. Therefore, forming enough and mutually beneficial social relationships facilitates the international success of the business processes as it is the foundation of building global business networks. Similarly, cultural differences of social capital are apparent, and acquiring necessary benefits through those clarities will enhance the internationalization success of the organization (Rieckmann et al., 2018). Withal, social media is used as a basic technique of making social networks in this globalized era.

It is evident that SMEs are role players in export and import industries in every economy. The utilization of social capital in international trade will enhance the financial performance of SMEs. Hence, the balanced trade-off between the formal and informal social networks is substantial in the firms' performance in the competitive environment. Socio-cultural networks

in both dimensions, including formal and informal, must be strengthened to improve performance internationally (Dar, 2020).

3.3 Social Capital, SMEs and COVID-19 Pandemic

The unanticipated change in the external environment which disrupts the whole global economy is the novel Coronavirus-2019/ COVID-19 pandemic. With the emergence of the first patient in Hubei, China, in the latter part of 2019, the pandemic is continuing, consigning a massive number of lives of human beings worldwide. On 11 March 2020 World Health Organization/WHO declared the COVID-19 pandemic as a global pandemic. After that, public health awareness increased, and the regulatory authorities have taken various health-related measures.. Silently, COVID-19 cases are reporting day-by-day with an increasing rate around the globe.. Economists suggested that the COVID-19 pandemic was the most enormous catastrophe of the decade. Further, they predicted that the pandemic impact is higher than the global financial crisis in 2007 and 2008 on the global economy. Although this is a health crisis, its impact has been disrupted whole economic activities without remaining a single entity or a single person being unaffected. On 27 January 2020, the first COVID case was reported in Sri Lanka, but the maiden local case was reported on 11 March 2020. Real pandemic impact starts on that day in Sri Lanka (Gunawardana, 2020), and the closing of schools and CSE (Colombo Stock Exchange) and the imposing curfews were initiated.

The impact of the pandemic reduced the demand for production and lowers the financial stability of the firms. Continuous unfavorable fluctuations in demand decreased the revenue and creditworthiness of SMEs rapidly (Organization for Economic Cooperation and Development, 2020). Further, restrictions imposed and the promoted healthy behavior significantly reduced the virus spreading in the initial stages. Now it is severe as the varying level of virus genres emerged (Gunawardana, 2020). Thus, the productivity and the controlling measures of virus spreading have an inverse relationship. As the resilience levels of the SMEs and the large firms are different, SMEs are more vulnerable to macroeconomic threats than the larger firms. Further, international business partnerships and supply chain were severely damaged by the pandemic. For example, countries with higher COVID cases and deaths are usually ignored by trading partners to lower the spreading of various virus genres and ensure the general public's safety. Accordingly, bankruptcy rates, working capital shortfalls, and supply chain disruptions become higher and frequent in the SME sector during the COVID-19 pandemic globally (Organization for Economic Cooperation and Development, 2020).

During the pandemic period, the government has taken a wide range of relief measures to minimize the impacts on the pandemic upon the Sri Lankan economy. Mainly, lenders and borrowers were facilitated through the fiscal and financial concessions unless the non-performing loan ratios will be rocketed. Further, active credits, non-performing credits, investment loans, promoting refinance schemes, lowering the criteria considering in granting credits, and offering relief packages to employees who lost their livelihoods are used to reduce the magnitude of the pandemic impact (Gunawardana, 2020). In the current scenario, several researchers have focused their efforts on identifying the social capital and impact of the

COVID-19 pandemic. Wu (2021) showed the political trust and social networks were the vital factors contributing to lower the spreading of the virus in China. As the pandemic impact is massive, it challenges newcomers' survival and might be collapsed immediately. As a remedy, Guenther et al. (2021) explore the importance of the solid supportive hand to SMEs by providing appropriate financial reliefs aligning with the market changes.

Moreover, all of these phenomena are recognized as interrelated and interconnected. Hence, it is evident that social capital drives SMEs' performance, it is vital in economic growth. Even though the pandemic is an unexpected critical externality in the business environment, the well-established enterprises are continually growing while the remainings failed during the hardships aroused due to the pandemic impact (Guenther et al., 2021). The higher social capital exists, so handling a health crisis like the COVID-19 pandemic has been more accessible, and compliance with the health measures, improving collective actions while promoting public acceptance is intensified by the social capital during the health crisis (Wu, 2021). Thus, resource mobilization is also facilitated through social networks. Guenther et al. (2021) examined that the pandemic impact differs according to the type and the size of the business. For example, large firms and SMEs' influence is not identical, while self-employed and incorporated enterprises also have been affected by the pandemic in differing degrees. In contrast, social distancing and other restrictions applied on the day-to-day activities of the SMEs made an adverse impact on the sales (Putra et al., 2020), and the continuity of the firms has been threatened.

The government-imposed health-related restrictions affected adversely on the performance of the SMEs. Remote working, travel restrictions, and lockdown directly impacted the employees' engagement in their work. The married women and mothers were the employee category who faced many difficulties (Guenther et al., 2021), and remote working lower the hardships on the employees and the employers. During the lockdown and curfew periods, inactive businesses were permanently closed, while active companies also faced many difficulties (Fairlie, 2020), and there were uncertainties in determining the opening days. Generally, in the world context, the number of COVID deaths and new cases reporting is increasing at an alarming rate. Makridis & Wu (2020) explored and offered a robust finding as the social capital makes it easier to lower the spreading of various virus genres across geographical areas. Liquid deficiency influences SMEs' day-to-day operations, and imposed restrictions disrupt the continuous productions in businesses while highly damaging the earnings of daily wagers. Additionally, the financial strength of the SMEs is highly vulnerable to the pandemic impact since their resilience is lower than the well-established companies (Organization for Economic Cooperation and Development, 2020). In addition, pressures made by the pandemic on SMEs lower their performance significantly, and innovative entrepreneurs with a proper reading of market opportunities and threats possess a strategic position (Putra et al., 2020).

Furthermore, it is recognized that entrepreneurial activities are vital in the economy to overcome the adverse impact made by the pandemic (Wu, 2021) and social capital is the main contributor to enhancing entrepreneurial activities (Munyawarara & Govender, 2020). In addition, technological advancement is a real need to adapt to the new normal since the whole

process has been changed unexpectedly due to the pandemic. Digitalization will be the utmost trending methodology in the business processes in the new normal (Guenther et al., 2021) and the entrepreneurs can have a substantial market share since the technology allows them to build up and maintain easily mutually benefitted social networks. Similarly, Putra et al., (2020) explored social capital as a significant tool used to mitigate the adverse impact on business processes during the pandemic period.

4. Conclusion

This empirical review provides a historical background to the social capital and SMEs performance. According to the prior literature, social capital is a fundamental driving factor in the performance of SMEs in recent periods. With that higher importance, most researchers are focusing their efforts on investigating social capital and the performance of SMEs from different perspectives. In achieving international success, social capital is critical and dynamic changes in the environment, including marketing and innovation capabilities, make the SME sector competitive in the hyper-global competition. On the other hand, banking institutions were considered a significant part of the causes of the global financial crisis. However, in this health crisis, those institutions are considering acting as a part of the solution. Further, there is a strong relationship between bank lending and SMEs also. SMEs could enhance the business activities and their production technologies with the financial association provided by the banks. On the other hand, bankers' non-performing loan ratios can be lowered by granting loans to SMEs (Shihadeh et al., 2019).

Further research on banking and SMEs would be prudent. In an opposite view, the GDP of Sri Lanka is dominated by the service sector and, the agricultural sector has the lowest proportion, although it is a developing nation. Thus, networks build through different countries to access the resources needed to enhance the production of SMEs based on the agricultural sector are much worthier. Hence associating the interested parties by providing scientific knowledge based on the social capital and SMEs in the agricultural sector is much worthier. Acquiring the international market is the main objective of SMEs, and a balanced trade-off existing between formal and informal sectors enhances the competitiveness and resilience in front of the global competition (Dar, 2020). Hence, the formal and informal social networks, SMEs performance, and commercial services are still remain as significant researchable areas. After that, unanticipated changes in the external environment make unnecessary pressures on SMEs and (Wu, 2021) explored the social capital acts as a cushion to lower the impact as same, entrepreneurs with better social capital management and innovations could withstand during the pandemic (Putra et al., 2020). Hence analyzing the social capital and the SMEs' performance in the pandemic period and pandemic impact on SMEs is essential to overcome the downturns in the economies all over the world.

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