

A Multiple Case Study of the Effect of Social Capital on Transaction Costs of Small Enterprises in Sri Lanka

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Abstract

Market mechanism particularly in developing countries provides asymmetrical information which leads to create opportunism and bounded rationality that are the root causes to generate Transaction Cost (TC). Therefore, Small Enterprises (SEs) face serious difficulty in governing TC that discriminates particularly against SEs. Instead, SEs develop informal and personal relationships, inter-personal trust and norms (i.e. social capital) with external actors expecting information which facilitates SEs to minimize TC through the mitigation of opportunism and bounded rationality. Therefore, the paper attempts to study how does social capital facilitate to mitigate TC particularly in SEs in Sri Lanka? Case study method was mainly applied to collect data from six SEs purposively selected from Ratnapura District in Sri Lanka. Data was analysed employing directed approach to content analysis.

Results of multiple case study show that SEs have ability to access low cost, reliable and quick information and information about exchange partners together with their reliabilities using their Social Capital (SC). Such information facilitates SEs to improve their rationality in decision making process. SEs usually get support from network members to assess information which leads to improve the rationality in decision making on transactions. Accordingly, SC on one hand facilitate SEs to access and assess information that affect the mitigation of bounded rationality and on the other hand provide information about exchange partners that helps SEs to mitigate opportunism. Thus, SC affects the decrease of TC of SEs through the improvement of access and assess information which lead to mitigate bounded rationality and opportunism.

Key Words: Small Enterprises, Social Capital, Transaction Cost, Information

1. Introduction

Adam Smith believed that the price mechanism in a perfectly competitive market is the powerful mechanism to allocate resources efficiently [1] and assumed that rational consumers/producers with perfect knowledge are exist [2]; [3]. But in the real world, market mechanism is not perfect due to the existence of market failure and various government involvements [3]; [4]. Therefore, consumers/producers fail to make full rational decisions, because imperfect market provides incomplete, imperfect or asymmetrical information which means that all parties to the transaction no longer possess the same levels of information [2]; [5]; [6]. Due to the asymmetrical information, business firms need to incur cost to search the lowest prices to purchase and the highest prices to sale, the costs for negotiating, the costs of accurately specifying of a transaction in a long-term contract and the cost for monitoring the transaction agreements [7]; [8]. Those costs for searching information and processing them are called as Transaction Cost (TC) [7]; [9]; [10]; [11]. Transaction cost is the costs of using the market mechanism or the cost of participating in a market [12]. Transaction costs are simply the costs of carrying out

any exchange [13]; [14]. Williamson in 1985 [8] regards transaction cost as a transfer of a good or a service between technologically separable interfaces.

According to the Transaction Cost Economics (TCE), TC can be mediated by either an internal firm hierarchy or an external market [10]; [11]. TC are based on agency costs associated with controlling, monitoring and coordinating agents' activities within a firm's hierarchy [11]. TC are incurred due to opportunism in the market and limitations of decision makers in solving complex problems and processing information [11]. In Less Developed Countries (LDCs), market mechanism is not well developed and market support institutions are absent [15]; [16]. Therefore, market mechanism discriminates against SEs in favour of large enterprises in relation to both the factor market and the product market [15]; [16]. Market failure discriminates against SMEs in favour of large firms [16]; [17]. The formal financial sector tends to discriminate against small firms compared with larger firms [15]. Since the failure rates of small firms are much higher than the large firms, particularly for new firms, lenders discriminate against small firms providing credits for established and reputed large firms. On the other hand, labour market distortions have a negative impact on small firms. In formal sector, the wage is well above due to several factors including minimum wages, social security etc. But, small firms tend to operate in a more labour-intensive manner than large firms and small firms fails to employ skill labours which higher the cost. Considering the product market, small firm fails to compete with large firms due to the problems of marketing information, management and business experiences, technology, product quality and reputation [18].

TC is also another reason that leads discriminate against SEs [19]; [20]; [21]. In LDCs, it is often difficult and costly to obtain accurate information for SEs [19]. Therefore, SEs face two problems. One is the problem of having not enough or not accurate and reliable information which helps to make rational decision. SEs fail to make full rational decisions due to lack of information, lack of educational level of entrepreneur, lack of entrepreneur's knowledge to access information, lack of capacity to gather and handle the information and lack of resources to obtain necessary information [5]; [6]; [22]. As a result, SEs suffer higher TC than the large enterprises [21]. The second problem arise due to lack of information and lack of capacity to evaluate information is the risk of opportunistic behaviour of exchange partners [19]. Opportunism is defined as self-seeking behaviour with guile. Guile involves dishonesty in transaction [10]. It may include hidden information and hidden action [23]. There is a high possibility that SEs suffer hazard from opportunistic behaviour of exchange partners [19]. If SEs use legal contract to safeguard their transaction from opportunism, TC will increase. Therefore, higher TC is regarded as one of the major reasons for higher the mortality rate of SEs [16]. According to the TCE, business firms aim at attaining the lowest TC [8]. SEs that have ability to govern TC well are predicted to survive and prosper in the business field [19]. If SEs have sufficient and reliable information and ability to process and evaluate information, their decision making power may be improved [24]. So SEs use informal and personal relationships in order to obtain necessary information [25]. These relationships do not have formal and written agreement but these relationships based on social network, interpersonal trust, and norms [25]. According to the social network theory, basic purposes of network relationships is passing information from one to another [26]; [27]; [28]; [29]; [30]; [31]; [32]. Network dense and complexity help SEs to gather information, ideas, advice, support, etc. [25]; [26]. Network ties allow SEs to become a source of information about a partner's capabilities and reliability [33]; [34]. Thus, business firms obtain necessary information through their social capital and obtain necessary support from social capital to evaluate information that facilitate to lower down the TC through the mitigation of bounded rationality and opportunism. However, scholars have not been given adequate attention to study how social capital affect the decrease of TC particularly in SEs in LDCs? Therefore, this study attempts to fill this gap addressing the research question; how does social capital facilitate to mitigate bounded rationality and opportunism which lead to minimize TC of SEs?

2. Theoretical Background and Research Model

Two theories: Transaction Cost Economics and Social Capital Theory have been reviewed to study the effect of social capital on the improvement of the capacity to access and assess information to mitigate bounded rationality and opportunism which affect the minimization of TC of SEs.

2.1 Transaction Cost Economics

As discussed in the introduction above, major reason for arising TC is information asymmetry [9]; [10]; [14]; [35]; [36] which affects business firms in two ways: bounded rationality and opportunism [37]. TCE recognizes that many business exchanges are characterized by incomplete, imperfect or asymmetrical information which lead to increase TC [2]. Business firms face three constraints: a) limited and unreliable information is available, b) human mind has only limited capacity to evaluate and process the information, and c) only a limited amount of time is available to make a decision. Bounded rationality explains that these constraints limit (bound) to make rational decisions [37]; [38]. Although people may intend to make more rational decisions, asymmetrical information has blocked to do so. This issue is serious particularly in SEs in LDCs. They fail not only to obtain reliable information [19] but also to make more rational decisions due to the lack of knowledge and capacity to evaluate information [5]; [6]; [22]. This means that if small enterprises have ability to access reliable and low cost information and to improve their knowledge and capacity to evaluate information, they can mitigate bounded rationality. Therefore, the study employs the improvement of knowledge and capacity to access and assess information as the indicator to mitigate bounded rationality of SEs.

Asymmetrical information leads to encourage exchange partners to behave opportunistically. Opportunism refers that the exchange partners will seek to exploit a situation to their own advantage [37]; [38]. Opportunism includes guile in pursuit of one's own interests [39]. Asymmetrical informational leads to opportunistic behaviour in two ways; adverse selection (ex-ante opportunism) and moral hazard (ex-post opportunism). Ex-ante opportunism where information is hidden prior to a transaction is call adverse selection which is the phenomenon of misdirecting other organizations based on an organization's private information that is not shared with other organizations in the transactions. It refers to incomplete or distorted disclosure of information, especially calculated efforts to mislead, distorts, disguise, or otherwise confuse transacting parties [40]. Moral hazard is post-contractual opportunism (ex-post opportunism) in the presence of unobservable asymmetric information. This is ex-post opportunism which occurs after a transaction because of the hidden actions of individuals or firms. These parties may have the incentive to act opportunistically to increase their economic welfare because their actions are not directly observable by other parties [2]. TC is increased with the increase of opportunism because the business firm tends to safeguard transaction from opportunism using complex legal contract [2]; [40]. This means that a business firm can avoid opportunism if they have reliable information and capacity to evaluate information.

2.2 Social Capital Theory

Putnam in 1995 [41] defines social capital as the features of organization such as networks, norms, and trust that improve the efficiency of society. Social capital theory suggests that it is a long-lived asset into which other resources can be invested with the expectation of a future flow of benefits such as superior access to information and resources [27]; [31]; [42]. Direct benefit of social capital is access to information: for the focal actor, social capital facilitates access to broader sources of information and improves information's quality, relevance, and timeliness [43]. Uzzi in 1997 [31] found that social embeddedness allows firms to exchange information and resources. Burt in 1997 [44] shows how social capital enables brokering activities that bring information from actors to the focal actor; to the extent that this brokering activity relies on a reciprocal outflow of information,

the entire network will benefit from the dissemination of information. Therefore, SEs have a possibility to access necessary information and support via social capital. Nahapiet and Ghoshal in 1998 [45] identified three dimensions of social capital; structural, relational and cognitive.

The structural form of social capital refers to the overall pattern of connections between individuals [44]; [46]. Structural embeddedness concerns the properties of the social system and of the network of relations as a whole [45]. Network relationships are an important attribute of structural dimension of social capital and generally define as a specific set of relations amongst various groups or actors [26]; [27]; [28]; [47]. Major purposes of network relationships are communication information and sharing resources [28]; [44]. Interactions between the network members by physical or electronic means such as meetings, teamwork, emails or online discussion forums facilitate the access to knowledge. As a result, the overall knowledge creation increases. Important aspects of this dimension are ties between the members of network; network structure based on density and complexity [45]. The current study employs density and complexity as the indicators of structural dimension of social capital.

The relational form of social capital refers to the kinds of personal relationships that people have developed with each other through a history of interactions [48]; [49]. Relational dimension of social capital consists of assets which are created through, and can be benefited from, by relationships. These relationships are the source of fulfilment of social needs such as sociability, approval and prestige [45] and lead to the development of trust and identification with one another [50]. It also describes the degree of trust ensuing from social interaction [51]. Along with the network of relationships, trust and norms are important sources of social capital [43]. Thus the key aspects of this dimension are trust, norms, obligations and expectations and identification [45]. The study uses inter-personal trust as a key dimension to represent relational form of social capital.

The cognitive dimension of social capital is embedded in the properties such as common language or vision that support a common understanding of shared goals and norms of action in a social setting [52]. Cognitive social capital is the outcome of frequent interactions while sharing the same practices, which lead the individuals to learn skills, knowledge and common conventions. This dimension includes attributes such as shared language, shared narrative, common perspectives and communal congruence, or generally agreed upon meanings [45]; [46]; [49]. Meaningful communication is an essential component of networking and requires the sharing of some context between parties to the exchange. This sharing may come about through the existence of shared language and vocabulary, i.e., the means through which people exchange information. Shared language facilitates businesses' access to others in the network and helps build relationships ([45]; [46]; [49]). The current study uses shared vision as indicators of cognitive dimension of social capital.

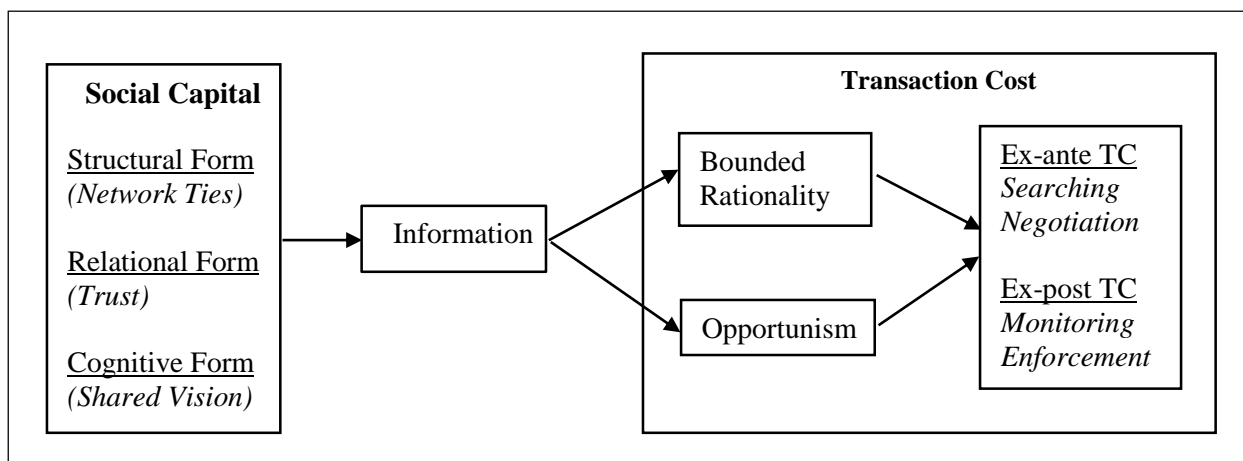
2.3 Conceptual Research Model

The study develops an integrative approach based on the synthesis of social capital theory and TCE to study the research question. As explained above, market mechanism and also public policies in LDCs are not powerful to provide adequate information for SEs. Instead, SEs in LDCs use social capital to obtain necessary information and get support to evaluate such information which facilitate OSEs to make more rational decisions in order to mitigate bounded rationality and opportunism. Figure 1 shows the research model for this study.

Structural form of social capital (network ties) plays an important role in mitigating information asymmetric [53]. The information and assistance gained from network function as a mechanism for reducing information incompleteness [26]; [27]; [28]; [29]. This in turn enables SEs to improve rationality in decision making and to safeguard transaction from ex-ante and ex-post opportunism. Frequent and close interactions between owner of SEs and exchange partners permit them to know one another and to develop good faith relationship between them. Hence, a SEs occupying a central location in a network are likely to be perceived as trustworthy by exchange partners in the network [52]. Therefore, risk of opportunism may be averted and rationality in decision making process may improve, if a SEs have strong network relationships [54]. When SEs and its exchange

partners are satisfied with each other, they will have more confidence and a sensitive expectation that their future dealings with each other will be positive which will minimize the temptation to take advantage of each other (i.e. display opportunistic behaviour) and assist each other providing genuine information to make rational decisions. Thus, opportunistic behaviour of exchange partners becomes decrease and rationality of decision making process will increase if the owner of SEs have strong network relationships. Thus, development of network relationship will not only help to make rational decisions but also to decrease opportunistic behaviour [55]. Therefore, the study predicts that network ties help to access and assess information in order to make more rational decision that leads to mitigate opportunism and bounded rationality which affect to minimize transaction cost of SEs.

Figure 1: Conceptual Research Model



Relational form of social capital (trust) plays an important role in mitigating information asymmetric. Dahlstrom and Nygaard in 1999 [56] justify empirically that opportunistic behaviour consistently increases TC and cooperative interaction reduces opportunism. Achrol and Gundlach in 1999 [57] empirically examine the effects of contract and relational norms safeguard against opportunism and found that social safeguards are useful means of alleviating opportunism. However, Heide and John in 1990 [58] argue that TCE has been justly criticized for its opportunism assumption. They assert that trust and norms challenge this assumption and mitigate opportunistic behaviour. While they acknowledge that opportunism is possible in any economic exchange relationship, they maintain that trust can complement control mechanisms to assure mutually beneficial exchanges [59]. Svensson in 2001 [60] examine the key role of opportunism and find that opportunism is negatively associated with trust. Heide and John (1992) highlighted that relational exchange limits opportunism through the sharing of information and resources. Kale et al. in 2000 [61] indicated that social capital based on mutual trust creates a basis for learning and knowledge transfer across the exchange interface improving rationality. Morgan and Hunt in 1994 [62] suggest that trust exists when a firm has confidence in the exchange partner’s reliability and integrity and in sharing right information. Considering the small enterprises in Sri Lanka, as explain above, informal social relationships are more powerful [25]. Business transactions mostly based on interpersonal trust and norms which are embedded in informal relationships. Thus, relational form of social capital (trust) between SEs and exchange partners become strong both parties discourage to behave opportunistically and share information which lead to minimize transaction cost of SEs. The major attributer of the cognitive dimension of social capital is the shared vision [52]. Shared vision consists of common goals and ambitions of the members of a social network. Common understanding about the ways of interaction leads to more and better opportunities for sharing information without any misunderstanding. Hence the shared vision amongst the network members, leads to share information [52]. Thus, shared vision helps SEs to minimize information asymmetric [23]. On the other hand, a shared vision represents the collective

goals of the members of network. When network members have the same perceptions about their mutual success for an example, they can avoid their possible opportunism and support each other exchanging their ideas and information [52]. With collective goals, network members are motivated to trust one another, as they can expect that they all work for collective goals and will not be hurt by any other member's pursuit of self-interest [63]. Collective goals and values provide the harmony of interest that erases the possibility of opportunistic behaviour [52]. Thus, cognitive form of social capital leads to sharing of information among network members and helps to avert opportunism of exchange partners.

3. Methodology

Qualitative method was mainly applied to collect and analyse data. This research attempts to investigate perception of the Owners of Small Enterprises (OSEs) and their behaviour. The research method involves the purposive selection of six SEs for the case study selected from Ratnapura District in Sri Lanka. Case study helps to clarify the research question to understand the cause and effect between variables [64]. This study defines SEs as employment between 5 and 24 persons engaged that the definition used by the Department of Census and Statistics in Sri Lanka and considers only manufacturing industries. Sample consists of two enterprises from Wood and Wood Products, another two from Non-metallic Mineral Products (cement products), one from Food, Beverages and one from metal product because these categories contribute the majority of small enterprises in the DSD.

Information on the multiple case studies was obtained using a questionnaire containing a combination of open and closed questions. The questionnaire was administered using face-to-face interviews. Data are collected from OSEs because reliability is assured by interviewing the OSEs, considering that they are the most knowledgeable persons who manage the SEs. In order to analyse the data, the study employed qualitative content analysis which is regarded as a flexible method for analysing text data [65]. The study used the directed approach to content analysis because the TCE and social capital theory guides to develop variables to analyse. The study initially determined key variables which affect the existing of TC (i.e. opportunism and bounded rationality) using TCE and social capital theory and then constructed items to measure and analyse the effect of social capital on transaction cost. Directed approach to content analysis provides a systematic structure that allows the richness of socially constructed knowledge [65]; [66]. The dimensions of the conceptual framework provided the codes under which the data were considered and the criteria for analysis were developed from previous literature.

Structural dimension of social capital was measured using network ties of the OSEs. Network relationship of SEs are measured using network density and network complexity. Network density is measured using number of ties that the businessman has and strength of relationship that he/her has maintained with network (social network, business network and supportive network). Network complexity is measured using the pattern of connection of businessmen with his/her network. These items have been developed and adopted by [25]; [47]; [67]. Relational form of social capital is measured using inter-personal trust. The study uses inter-personal trusts because OSEs deal with individual exchange partners, officers and other personals. Inter-personal trusts are measured employing three components reliability, predictability, and fairness which are adapted by [67]; [68]; [69]; [70]. The study adopts the items developed by [51] and [63] to measure the shared vision of SEs. Bounded rationality is measured using two items: capacity to access low cost, reliable and quick information and get support to assess information which improve the capacity to make more rational decision. Opportunism of exchange partners is measured using items developed by [56]; [71]; [72]. Achrol and Gundlach, in 1999 [57] and Vazquez et al., in 2007 [73] measure opportunism using four items: sincerity, truthfulness in dealings, good faith bargaining, and breach of agreement engaged in by the exchange partner.

3.1 Basic Aspect of SEs Participating in Case Studies

Table 1 shows the basic feature of SEs which have been selected as cases to study the research question. Most of the firms started by current owner. All the OSEs are male and married. The age of establishment of SE is more than eight years. All OSEs have more than 10 year business experiences. Half of OSEs have up to tertiary level education and the rest have over secondary level education. The majority of OSEs are over 40 years old except one owner, whose age is 32 years. It is observed that all the firms show satisfactory performances in their businesses considering the growth of employment, sales revenues and profitability.

All the cases have similar characteristics considering exchange partners (buyers and suppliers). All purchase input from selected and limited suppliers while sale their output for the buyer in the open market. Cases 1 and 2 who produce various cement products, they purchase inputs from selected suppliers who have regular close friends. They sale majority of output for the day today customers in the open market while small percentage they offer for the buyers who have previously bonded with produces. Cases 3 and 4 are the producers of wood and wood related producers. They have suppliers in different areas who know the quality and prices of woods purchased by producer while output are purchased by customers in the open market. Case 5 is a producer who produce beakers product. He also have limited suppliers and sales his output for both customers in the open market and buyer who have informal previous agreement. Case 6 is a producer who produce iron work. He purchases input from selected suppliers and produces commodities which are totally based on previous informal agreements with customers. Similarly, Salient feature is that all the cases except case 5 have limited suppliers and customers. But, transaction value of each customers is very high as compared to food producer.

All the SEs produce commodities using simple techniques and equipment. Higher percentage of total productions are sold in the open market while that of necessary inputs are purchased from suppliers who have closely connected with OSEs. They purchase and sales their output without any legal agreements, all transaction based on informal and verbal agreements about prices, quantity, quality, payment procedures and delivery periods etc. Protecting informal and verbal agreements leads to generate good faith relationship between parties creating social capital and in the meantime, OSEs attempt to develop and maintain a strong social capital with social, business and supportive networks. Because they know that social capital has direct and indirect benefits to the businesses providing necessary resources and information.

Table 1: Basic Characteristics of SEs Participating in the Case Studies

Characteristics	Cement Products		Wood Products		Food Products	Iron Works
	<u>Case 1</u>	<u>Case 2</u>	<u>Case 3</u>	<u>Case 4</u>	<u>Case 5</u>	<u>Case 6</u>
Age of OSEs	53 years	56 years	32 years	54 years	44 years	40 years
Educational Level	O/L	Grade 10	A/L	Grade 09	A/L	A/L
Pre-training	No	No	No	No	Yes	Yes
Business experiences	31 years	29 years	12 years	11 years	10 years	16 years
No. of Employment	23	12	15	10	18	07
Firm Establish Year	1983	1985	1994	2002	2004	1998
Firm started by owner	Yes	Yes	No	Yes	Yes	Yes

Source: Prepared based on the interviews with OSEs in January, 2015.

4. Results and Discussion

The paper attempts to analyse how social capital facilitate to mitigate TC particularly in SEs in Sri Lanka? Results of the multiple case study are discussed under three headings; 4.1) Mitigation of bounded rationality, 4.2) Mitigation of opportunism and 4.3) Mitigation of TC.

4.1 Mitigation of Bounded Rationality

OSEs highly believe that they have the ability to access necessary information about new suppliers and buyers, input and product prices and quality, product techniques, business uncertainties (environmental, demand and supply uncertainties) etc. which lead to make better decisions on transaction, using their inter-personal connection. All the OSEs have strong connections with different category of networks mainly business network (friends who involving in the same business or some other businesses, suppliers and some customers), supportive networks (officers of banks, financial institutions, government officers of different department and ministries, politicians, various professionals) and social network including family members, relatives, religion leaders, labourers of the business and different kinds of friends in the civic society. The majority of OSEs frequently interact with their business and supportive network expecting information and advice. Most of them explain that they devote a lot of time a day to interact with the members of network not only to handle business matters but also to engage in personal chats and social events (gatherings, weddings, funerals etc.) which allow to gather important information. They can allocate more time to interact with network members because regular business activities are handled by bonding capital (family members, relations) or chief executive officers under the supervision of OSEs who act as a final decision maker.

Table 2: Possibility to access Information through Social Capital

	Cement Products		Wood Products		Food Products	Iron Works
	<u>Case 1</u>	<u>Case 2</u>	<u>Case 3</u>	<u>Case 4</u>	<u>Case 5</u>	<u>Case 6</u>
Able to access any information needed to make transaction decisions	Strongly agree	Strongly agree	Agree	Strongly agree	Agree	Strongly agreed
Able to find information more quickly	Strongly agree	Strongly Agree	Strongly Agree	Strongly agree	Agree	Agree
Able to find reliable information	Strongly agree	Agree	Agree	Agree	Agree	Agree
Able to find low cost information	Strongly agree	Strongly agree	Agree	Strongly agree	Agree	Strongly agree
Able to find more reliable customers	Agree	Agree	Agree	Agree	Agree	Agree
Able to find more reliable suppliers	Strongly agree	Strongly agree	Agree	Agree	Agree	Agree

Source: Prepared based on the interviews with OSEs in January, 2015.

If OSEs need particular information, they usually consult some suitable network members to get such information. They sometimes meet particular network members or contact over the telephone to get such information. The method of contacting depends upon the importance of information they need. If such members do not have enough knowledge, they sometimes advice the way to get such information, or they may search

their network (bridging) to get the information. OSEs can easily make conclusions when different network members provide the same information. If different information is received, the OSEs search for further information from some other members to confirm as to which information is correct before making transaction decision. All the OSEs accept that they have common goals about the success of other businesses that are doing close friends in the network. The existence of common goal among the network members facilitates the sharing of information. Network members have mutual understand and it affects the decrease of the opportunistic behaviour, business uncertainty and improves the rationality of decision making process.

Interpersonal trust plays an important role in finding information. Trustworthy members of network devote their time and money to provide information they have, on the request of OSEs. Interpersonal trust encourages OSEs to believe in such information. OSEs always pass information among network members who produce similar productions about prices both inputs and outputs when determining prices since similar producers have common vision to determine similar prices for the same products and inputs. Thus, the social capital of OSEs affects the quick, low cost and reliable information. Table 2 shows the possibility to access information through social capital of OSEs. All OSEs agree that they can access any information with low cost, reliable information and find information about reliable buyers and suppliers.

OSEs accept that they have not enough knowledge and experiences to evaluate complex information to make more rational decision regarding transaction. They need to take decisions very carefully because they have limited resources to invest on such transaction. Therefore, they always expect support from network members to evaluate information before making transaction decisions. They mostly consult, discuss and get advice from close friends, professionals, government officers and bank officers to assess information to make decisions. Inter-personal trust between OSEs and network members facilitates to provide good faith support to evaluate information. Trustworthy members spend time and cost to support to assess information and make effective decisions. Close friends of supportive network (lawyers, engineers, architectures, accountants etc.) provide their help OSEs on free of charge to assess information in order to make more rational decision.

Table 3: Effect of Social Capital on the improvement of Capacity of OSEs in Decision Making

	Cement Products		Wood Products		Food Products	Iron Works
	<u>Case 1</u>	<u>Case 2</u>	<u>Case 3</u>	<u>Case 4</u>	<u>Case 5</u>	<u>Case 6</u>
I get advice from network members before making important transaction decisions.	Strongly agree	Strongly agree	Strongly agree	Strongly agree	Strongly agree	Strongly agree
I accept that I don't have enough knowledge to make important transaction decisions assessing information.	Agree	Agree	Agree	Agree	Agree	Strongly Agree
I think that I can take more rational decision with the help of network members.	Agree	Agree	Agree	Agree	Agree	Strongly Agree
Relationships with network members help me to improve the knowledge and capabilities in decision making process.	Strongly agree	Agree	Agree	Agree	Agree	Strongly agree

Source: Prepared based on the interviews with OSEs in January, 2015.

Strong inter-personal trust and relationship encourage both parties to support each other without considering financial losses. OSEs try to search and learn, when gathering network members and having a chat when

meeting them. Network members sometimes share their experiences explain previous stories about handling cunning persons, handling complex matter, facing challenges etc. When gathering network members in different social events, knowledge and experience of OSEs improve due to sharing such experiences. Most of OSEs believe that their decision making power, ability and knowledge improve due to social capital. (See the table 3). Table 3 shows that social capital helps OSEs to assess information which help to improve the capacity of decision making power which leads to mitigate bounded rationality. Lower down of bounded rationality is a necessary requirement when governing transaction cost in economize manner (Hobbs, 1996; Williamson, 1985).

4.2 Mitigation of Opportunism

OSEs believed that almost all the customers are innocent and sincere who do not have sufficient pervious experiences in purchasing commodities (relevant only cement products and wood products). They need only quality product at the lowest possible prices. They do not exaggerate needs to get what they want. Although all the transactions with customers are based on verbal agreement, majority of them have not break these agreements to their own benefits. Most customers provide completely true picture when negotiating and are not willing to behave opportunistically. However, a small number of customers try to behave opportunistically breaking agreements previously agreed. Some customers behave dishonestly about certain things in order to protect their interests. OSEs have experiences and knowledge to observe who behave opportunistically and how to deal with, and treat them. OSEs accept that most suppliers do not behave opportunistically because they are regular suppliers who develop good faith with OSEs. They provide a completely true picture when negotiating. Most suppliers do not exaggerate needs to get what they want. The majority of them have not broken agreements with their own benefits because they expect to make frequent transaction for a long period of time. However, a small number of suppliers try to behave opportunistically breaking agreements.

OSEs always scan and search for information through social capital about the capability, reliability, honesty and opportunistic behaviour of their regular customers and suppliers to make decisions to avoid hazard from opportunism. Meanwhile, OSEs have close relationship with their regular suppliers and customers. In the meantime, they attempt to build up relationship with new exchange partners particularly customers who purchase cement products and wood products, having little a chat with them. If such customers order products paying advanced payment, OSEs attempt to offer products on time. After building up relationship with regular customers, OSEs search information about reliability of the customer using social capital. Then OSEs make a judgment about customer's reliability and supply products that customers need on credit basis. Such customers also try to show their good faith paying credit payments as soon as possible or negotiate with OSEs of payment procedure. OSEs develop close relationship aiming to maintain regular transaction with particular customers and such customers introduce and recommend new faithful customers leading to them mitigate opportunism on the one hand and to increase market share on the other.

Most of the exchange partners are close friends of OSEs and do not expect to behave opportunistically. Any issues related to transaction are solved having negotiation. Regular exchange partners attempt to maintain the trustworthy developed OSEs aiming continuous transaction in future. Most OSEs believed that developing inter-personal trust with business partners and other members of the network highly affects the decrease of opportunism. Therefore, most of OSEs try to develop and maintain strong inter-personal trust with the members of social, business and supportive networks and the internal staff of the business. OSEs always try to show their reliability, predictability, and fairness to network members and exchange partners. Most of them mention that they do not tend to behave or not to do anything that leads to the destruction of inter-personal trust. One OSE specified that;

'Inter-personal trust is a worthier asset than financial benefits. I normally devote financial benefits to develop inter-personal trust because trust is a great investment which helps to safeguard my business

from various obstacles and develop reputation that facilitates to increase the market share of my product in future’.

If an exchange partner behaves opportunistically, the information about the particular person spreads among the network members since the network members have a shared vision. It harms the particular exchange partner. Sometimes network members force such exchange partners not to behave opportunistically in order to safeguard from opportunism.

If OSEs need new suppliers, they search information about suitable and capable suppliers using their social capital and select most suitable suppliers who are capable to work in a more cooperate and reliable manner. If a network member introduces a supplier or a customer, the particular trade partners try to protect agreements and mostly not try to behave opportunistically. OSEs believed that social capital helps to find suitable and reliable exchange partners on the one hand and finding exchange partners with the support of social capital leading to decrease opportunism on the other because exchange partners try to protect the dignity and trust of the member who introduced and recommended him. Thus, social capital helps to mitigate opportunism which leads to the minimization of transaction cost.

4.3 Mitigation of TC

OSEs believe that though the maintenance cost of strong inter-personal relationships with different network members and developing trustworthy relationship is high, benefits of such relationships are more than the cost and time. As explain above, OSEs have ability to search necessary, more reliable, quick and low cost information using their social capital (they do not want more complex information). Sometimes, OSEs get quick information over the telephone which cost is very low. All the OSEs are not made cost on advertising their product because they are not advertising their products. Network members and regular customers introduce and recommend new customers and suppliers to OSEs, it affects to increase the market share without making advertising cost. Furthermore, OSEs don't want to make cost for legal agreement because most of the transactions depend on verbal agreement. Network relationships, inter-personal trust and common goal among network members facilitate to make verbal agreement which need not to spend any cost. Therefore, OSEs are able to minimize negotiation cost which include the costs of deciding the details of transaction, the responsibilities of each partner, assignment of benefits, method of payment, and the schedule over which benefits will be paid. Thus, social capital leads to minimize the cost for searching and negotiation which affect the minimization of ex-ante transaction cost of SEs.

Strong social capital causes to minimize monitoring costs which are the costs the partners make to observe the transaction as it unfolds, and to verify the compliance with the agreed terms. As explain above, network relationships, common vision and inter-personal trust lead to mitigate opportunism. OSEs highly believe that reliable exchange partners do not behave breaking previous agreement. More trusted exchange partners who have close friend and interact with OSEs do not do any mistake in transaction because trusting relationship and close friendship is higher than the transaction. Therefore, OSEs do not spend more time and money to monitoring transaction. If they have any issues in transaction, close relationships and inter-personal trust encourage them to solve such dispute in flexible and friendly manner. Thus, social capital leads to minimize ex-post transaction cost (monitoring and enforcement) of SEs.

5. Conclusions

This paper attempts to analyse how social capital facilitates to access and assess information in order to improve the capacity of OSEs to make more rational decision to mitigate bounded rationality and opportunism which affect the minimization of TC of SEs. Based on the discussion, the following conclusions are made.

First, the study demonstrates that SEs use relational governance to mitigate their TC, developing and maintaining strong network relationship with social, business and supportive network members and developing inter-personal trust with network members because almost all the transactions of SEs are based on informal and verbal agreements. Salient feature is that SEs have a small market share which is limited to a small region. They sell their output for regular buyers and purchase inputs from regular suppliers who have close relationships with OSEs. SEs have capacity to maintain a strong social relationship with manageable number of network members with regular interaction, expecting to obtain information. OSEs believed that developing a strong social capital is a valuable asset and they devote a lot of time and money to maintain it. But, they do not consider such money and time a waste because their social capital generates numerous valuable benefits which are not available in the open market to purchase. One OSE explains;

'Benefits are received even at an unexpected time without spending a single cent. Though I am willing to pay, I can't purchase some important benefits from the market because such benefits are not available to purchase in the market'.

Secondly, the finding indicates that the capacity and ability of OSEs to access and assess information to make more rational decision have been improved due to the use of social capital that lead to mitigate bounded rationality which affects the minimization of transaction cost of SEs. They use their network relationships to obtain various information that are needed to improve the capacity of OSEs to make more efficient transaction decisions. They have sufficient time to search information, and necessary information are obtained quickly (over the phone) with minimum cost. OSEs usually get support from network members to evaluate, get ideas and advice to make transaction decision. Decision making power of OSEs improves due to the information access through social capital and support given by network members to evaluate information.

Thirdly, the capacity and ability of OSEs to access and assess information to make decision to avoid opportunism of exchange partners have been improved due to the use of social capital. The ability of OSEs has improved to search information about the capabilities and reliabilities of regular and new suppliers and customers leading the decision to avoid opportunism, using their network relationships. Interpersonal trust leads to mitigate the opportunism of exchange partners. Common vision of network members to share information also affects the mitigation of opportunism. Thus, OSEs access and assess information to make decision to mitigate opportunism resulting in the minimization of TC of small enterprises.

Fourth, study reveals that social capital leads to minimize ex-ante and ex-post TC of small enterprises. Social capital facilitates OSEs to search necessary, more reliable, quick and low cost information which leads to decrease searching cost. Social capital facilitates to increase the market share without making advertising cost because network members and regular customers introduce and recommend new customers and suppliers to OSEs, it affects the increase of market share. OSEs don't want to make cost for legal agreement because most of the transactions depend on verbal agreement. Thus, social capital leads to minimize the cost for searching and negotiation which affect the minimization of ex-ante TC of small enterprises. Strong social capital causes to minimize monitoring costs which are the costs to observe the transaction agreements. Reliable exchange partners do not behave breaking previous agreement. More trusted exchange partners do not make any mistake in transaction because trusting relationship and close friendship is higher than the transaction. Therefore, OSEs do not spend more time and money to monitoring transaction. If they have any issues in transaction, close relationships and inter-personal trust encourage them to solve such dispute in flexible and friendly manner. Thus, social capital leads to minimize the cost for monitoring and enforcement which affect the minimization of ex-post TC of small enterprises.

The results of this study suggest that OSEs need to know the importance of the development and maintain strong social capital which affects the decrease of TC through the improvement of the capacity to access and assess information. SEs in LDCs can achieve better performance decreasing TC, by maintaining a social capital. Encouraging SEs to develop strong social capital facilitates to develop SEs, and it will be a solution to higher failure rate recorded in SE sector in LDCs.

6. References

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