The Significance of Social Capital in Modern Enterprise Management

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Introduction

This paper reviews the concept of social capital and examines the question of whether this concept is important in contemporary enterprise management from the perspective of enterprise value, risk, and risk management.

Firstly, this paper will provide a brief review of the definition of social capital, the development of the concept, and its functions. Secondly, it will look at the importance of the social capital concept in contemporary enterprise management by: (1) examining the connection between the author's existing research and the social capital concept; (2) examining the relationship between corporate culture, corporate philosophy, and social capital, along with conducting case studies; and; (3) examining social capital as a kind of "soft control" from the perspective of risk management, considering the question of the "righting moment" of an unstable enterprise.

Thirdly, it will look at cases where social capital has served as a stabilizing mechanism in enterprise management and examine the importance of the connection between strategy and social capital from the perspective of risk management.

This paper makes the case for the importance of social capital as intangible capital in contemporary enterprise management; the importance of social capital as a kind of "soft control" from the perspective of risk management; and the importance of linking risk management considerations, social capital and strategy from the perspective of enhancing corporate value.

1. Social Capital: Definition and its Functions

(1) The concept behind the term "social capital" and how the concept developed

The Japanese direct translation of the term social capital, "shakaishihon" refers to the infrastructure that serves as the foundation of a city -- e.g. electricity grids, water mains, and roads -- and therefore it means something different from the term "social capital" as used by

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1 The definitions of social capital in this section largely refer to the information found in the Japanese Wikipedia entry on the subject (December 15, 2009).
Robert Putnam, the academic who led the way in developing this concept. For this reason, in Japanese the term "shakaikankeishihon" or "social-related capital" is frequently used. This is a "soft" concept that views the abundance of human relationships as a kind of capital for society.

In his 1993 book, "Making Democracy Work," the American political scientist Robert Putnam theorized that the different levels of efficacy of local governments in the north and south of Italy were attributable to differences in the accumulation of social capital. This book defines social capital as "features of social organization, such as trust, norms, and networks, that can improve the efficiency of society by facilitating coordinated actions," and this has become the widely understood definition of the term.

In straightforward terms the concept of social capital refers to "a variety of voluntary organizations involved in social problems," and "an abundance of human relationships throughout the whole of society." It could also be called community strength or social solidarity. It would also be fair to say that it refers to "face-to-face relationships," like socializing with friends, belonging to organizations like local sports clubs, joining organizations that discuss public issues, and chatting with neighbors.

(2) How the concept of social capital developed

What follows is a brief review of how the concept of social capital developed.

i) Before Robert Putnam
   - In 1916 L.J. Hanifan emphasized the need for goodwill, fellowship, mutual sympathy and social intercourse in the development of a community and the need for investment to bring this about.
   - In 1961 Jane Jacobs noted, from an urban sociology perspective, the manifestation of social capital in social networks of neighborly relationships in modern cities, and the importance of this.
   - Since 1970 there have emerged social capital concepts focusing on the individual, especially individual human capital like individual connections, personal relationships, and a diverse circle of acquaintances.

ii) Robert Putnam's research: Putnam looked at American social trends and issues through the prism of social capital, igniting social capital research around the globe.

iii) After Robert Putnam: international research (e.g. OECD and World Bank)
   - The OECD (2001) has defined social capital as "networks together with shared norms, values and understandings which facilitate cooperation within or among groups."
   - According to the World Bank, "Social capital refers to the institutions, relationships, and norms that shape the quality and quantity of a society's social interactions. Increasing evidence shows that social cohesion is critical for societies to prosper economically and for development to be sustainable. Social capital is not just the sum of the institutions which underpin a society – it is the glue that holds them together."

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(3) The functions of social capital

From the definitions above it can be understood that this "social capital," which encompasses trust, norms, and networks is a human resource and a kind of intangible capital. Furthermore, because it is intangible, it is necessary to use some sort of indirect yardstick in order to measure it. Looking at the concept of social capital and the phenomena that it covers, the functions served by social capital in a variety of areas, such as social capital and the local community, social capital and social issues, the effects of social capital on macroeconomics, and the relationship between social capital and public policy, have been observed in existing literature.

- Social capital and community safety/security improvement (ordinarily a positive correlation)³
- Social capital and the unemployment rate (negative correlation)⁴
- Social capital and birthrate (positive relationship)⁵
- Social capital and cost of medical care for the elderly (negative correlation)⁶

The findings of this research have a major influence on enterprise management. Ohmori (2004) observed that with respect to the relationship between social capital and business, social capital performs an active function in enterprise management.

i) SC expands business opportunities through the exchange of semi-confidential information (the sharing of knowledge and ideas through information exchange and joint development)⁷.

ii) SC plays an important role in corporate governance. Figuring out how to drive personal relationships within the company, as well as personal relationships between the company and the periphery, in the direction of contributing to increased harmony and productivity is an important management responsibility. The recent scandals in the energy industry in the US and in the food industry in Japan suggest the possibility that modern corporate law alone is insufficient for corporate governance.⁸

iii) SC gives communities individuality, and this may lead to the creation of business opportunities and a local culture.⁹

⁵ Ibid. pp. 17-18.
⁹ Ibid. p.102.
2. The Importance of Social Capital in Enterprise Management

(1) The place held by social capital in the author's existing research
In his research on corporate value and governance, internal control, risk management and, finally, corporate culture, the author has presented a strategic approach to raising corporate value based on intangible capital.\(^{10}\) The author has shown how the trustworthiness and ethical views of top management, the morale and teamwork of those in the field, and corporate philosophy are important elements in the formation of corporate value, and he has dubbed this "organizational capital." These elements are roughly the same as the concepts of "trust, bonds, networks, and norms" that represent the core concepts of social capital, the theme of this paper, and differ only in whether they apply to communities and societies or companies and organizations.

In order to link the human capital within a company or organization to corporate value, a network that is based on trust, bonds and acceptable norms in personal relationships must be formed between the company and its stakeholders, and corporate strategy must exist on this foundation, ultimately lifting the value of the corporation. Personal relationships in which there are problems with trust, bonds, and norms can give rise to an undesirable corporate character and corporate culture. This in turn increases the possibility of corporate scandal or wrongdoing, thereby harming corporate value. Research on social capital shows a pattern in which desirable social capital maximizes organizational capital, which in turn lifts corporate value.

Figure 1 is the author's conceptual model of how corporate value is lifted by emphasizing the link between organizational capital and strategy.\(^{11}\) Figure 1 illustrates mainly the following points:


Figure 1. A strategic approach to enhancing corporate value based on intangible capital risk

Notes: 1. +Risk shows the uncertainty of opportunity, -Risk shows the uncertainty of losses.
2. The major risks assumed by companies are 1) strategic risk, 2) operational risk, 3) financial risk, and 4) disaster risk, in that order.

i) Corporate value is made up of tangible capital and intangible capital. Intangible capital is particularly important and, within this, organizational capital (corporate culture, corporate philosophy, the trustworthiness and ethical views of top management, and the morale and teamwork of those in the field), a concept which is similar to the term social capital herein, is extremely important.

ii) Effectively linking this organizational capital to strategy is critical to enhancing corporate value. With respect to the first point above (i.) it is sufficient to show that that investment related to intangible capital exceeds 77% of the four-industry average. Furthermore, with respect to the particular importance of corporate culture within organizational capital and how linking corporate culture and strategy enhances corporate value, Ueda (2008) shows that when Japan's beef bowl industry faced a crisis, the differences in the responses of Yoshinoya and Sukiya were attributable to their differing corporate philosophies, corporate cultures, and strategies, and this resulted in differences in their business results.

Before delving into this, this paper will discuss to the similarities between corporate culture and the concept of social capital (meaning trust, bonds and norms, or, as the OECD defines it, "networks, together with shared norms, values and understandings which facilitate cooperation within or among groups").

According to Niihara, corporate culture is really the internal, informal code of conduct and values that serve as the foundation for decisions made by those who make up the company. O'Brien (1996) says that to form a corporate culture, a company must build up values, beliefs, attitudes, assumptions, interpretations, customs, habits, practices, knowledge and behaviors that are shared by groups of people. In other words, she says, the culture of a company is like an iceberg. The values, beliefs, assumptions and interpretations are below the surface, and what is visible to the naked eye is the customs, practices, and behaviors, according to O'Brien. She observes that researchers are coming to believe that in environments where competition is fierce, "soft stuff" like corporate culture may have an even stronger influence over business results/earnings than "hard stuff" like organizational structure, systems, and strategy. In fact, O'Brien says that there is research that suggests that in some cases corporate culture actually influences the long-term results of a company.

Seen in this light, corporate culture is an even broader concept than the social capital concept of "networks, together with shared norms, values and understandings," but there is a fair amount of duplication and similarity between the two. In effect, a company's internal, informal code of conduct and values, and, in the author's opinion, the mentality of top management and other executives and its corporate philosophy together are one of the pillars

13 Hiroaki Niihara (2003), Nihon no Yuushuukigyo Kenkyuu (A Study of Japan's Best Companies), Nihon Keizai Shimbun, p.254
that make up its corporate culture, and these elements have a major influence over corporate decision-making. This shows how accumulating and building social capital within a company can have a major influence on corporate behavior.

Next this paper with examine the case of the Japanese beef bowl industry.

(2) Case study of the importance of social capital in an enterprise: How Yoshinoya and Sukiya responded to crisis\(^{15}\)

This incident in Japan's beef bowl industry is an example of how remarkable differences in corporate value can arise thanks to an appropriate and robust corporate culture and strategy.

Up to this point, the beef bowl industry had relied on American beef. However, in December 2003 the Japanese government banned the import of US beef after BSE was discovered in American cattle, and this was a major development that had a severe negative impact on corporate value. That is to say, after this change in the external environment, the profitability (corporate value) of these two companies has diverged sharply due to the differing management responses at Yoshinoya, which had been the industry leader, and Sukiya, its rival.

〈Yoshinoya response〉

In January 2004 the company introduced a new menu with pork bowl and grilled chicken bowl items, but sales were not good. In February 2004 it stopped selling beef bowls made from its inventory of American beef. The company, which stood by American beef, suspended sales of beef bowls until the Japanese government decided to reopen imports of American beef in July 2006.

〈Sukiya response〉

Sukiya suspended sales of beef bowls in February 2004. It resumed sales of beef bowls in September of the same year after switching from American beef, which it could not guarantee was 100% safe, to Australian beef. Even after the government reopened imports of American beef in July 2006, the company said it will continue to use Australian beef in its beef bowls until safety can be assured.

Figure 2 shows the companies' ordinary income from 2003 to 2007, and Figure 3 shows their share prices during the same period.

\(^{15}\) This case study from the Ueda paper (2008) cited in Note 1.
Figure 2. Sukiya and Yoshinoya ordinary income trend
Note: Unite millions of yen; red bars Yoshinoya, yellow bars Sukiya; prepared from data obtained from company websites

Figure 3. Sukiya and Yoshinoya share price charts
Source: Yahoo! Japan Finance (2008)
While both companies faced the same regulatory change (i.e. the US beef import ban), due to their differing management responses, Sukiya succeeded in its strategy of turning adversity into opportunity, and in 2005 it managed to turn the tables on Yoshinoya, the undisputed leader, in terms of both ordinary income and share price.

Since it was established in 1982, Sukiya's vision has been "to become the number one company in the global food industry, while remaining faithful to the central core of our business, which is food safety." This vision was behind the management decision making that allowed it to turn the tables on its rival. The company established a food safety oversight unit with three committees: a PR committee, a Technology committee and a Legal affairs committee and it changed its internal business processes so that it could shift from importing American beef to Australian beef. The backdrop for its decision was the fact that the company put a corporate culture that treats food safety as the highest priority ahead of the cost of changing business processes.

Another factor is the company's medium to long term business strategy, which encompasses the following points: 1) The evolution of the mass merchandising system (a seamless framework for controlling the entire process from menu development to procuring food ingredients, production/processing, distribution, and finally sales); 2) a growth strategy that includes store expansion and M&A activity; 3) the evolution of the brand; and 4) the pursuit of food safety.

It is reasonable to think that Sukiya was able to enhance corporate value as a result of this connection between corporate culture and strategy.

(3) The relationship between resilience and social capital in times of crisis
Companies face a variety of risks. They deal with these risks in two fundamental ways: 1) risk finance, which means the routine accumulation of funding in a planned fashion (e.g. insurance plans, derivatives, and the accumulation of internal reserves); and 2) risk control, which means minimizing the frequency of risk events and the losses to the company in when an event occurs (e.g. various risk mitigation strategies and disaster prevention measures). The former is a strategy to minimize the decline in corporate value by dealing with risk events financially, while the latter seeks to control risk through a variety of measures.

Risk control comprises both "hard control" such as the manuals, rules, and legal compliance, as well as "soft control" such as the bonds, solidarity, networks, and trust among people who confront risk. This "soft control" is the social capital that is theme of this paper, and risk control that emphasis social capital will become important in the future. Figure 4 is a simplified representation of this using earthquake risk as an example.

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A meaningful view of social capital is that it belongs to risk control, and "soft control" in particular. That is to say, "There are a number of conceivable approaches for effectively addressing a variety of risks, but enhancing the "soft" elements of social capital -- trust, norms and networks -- functions as an effective means of risk management." To further expound on this point, the following hypothesis can be put forward in connection with enterprise management.

"If a company has weak social capital, there will be a stronger negative impact on the company when a risk event occurs. The company will also tend to have a weaker resilience for business continuity following a risk event, and the company will tend be more vulnerable to risks," and "If a company has high social capital, the business will be more resilient when a risk event occurs, and building strategies that make it possible to bridge changes in the external environment and internal resources including social capital should make corporate value even more resilient." Figure 5 illustrates this concept.

Figure 5. Issues concerning the relationships between risk, social capital, corporate resilience and corporate value
Ueda has focused on the following research findings concerning risk, social capital, and corporate resilience.

Through interviews with dozens of companies Yossi Sheffi (2005) of the Massachusetts Institute of Technology has found that one thing that companies with a high degree of resilience have in common is a superior supply chain design, and another is organizational culture. Sheffi concludes that two main factors have a major influence on corporate value and resilience in particular. These are a strategically constructed supply chain and an appropriate corporate culture. Sheffi has observed the following four cultural features that make an organization capable of responding flexibly and quickly: 1) Continuous communication among employees with information; 2) delegation of authority; 3) enthusiasm for work (a strong interest in being involved in the company's goals and a sense of responsibility, sometimes also called attachment, attentiveness, or sense of solidarity), and 4) preparedness for disasters, accidents, and events.

Of the four cultural features named by Sheffi, the first continuous communication among employees with information and the third enthusiasm for work (a strong interest in being involved in the company's goals and a sense of responsibility, sometimes also called attachment, attentiveness, or sense of solidarity) would not be possible without fostering the bonds, solidarity, trust, and internal organizational networks that constitute the social capital discussed in this paper. In other words, it could be fair to say that investment in social capital is the wellspring of resilience, and, by extension, restored corporate value.

However, in order to enhance corporate value in an environment that is becoming competitive, as discussed earlier, it is necessary to build strategies that make it possible to bridge changes in the external environment and internal resources including social capital.

3. The Relationship between Strategy and Social Capital as a Stabilizing Mechanism

As we have pointed out a number of times in this paper, enterprise management, and SMEs in particular, are subject to a variety of risks. These are truly varied. Externally they include uncertain demand, pressure from competitors, regulatory compliance, and natural disasters. Internally they include product quality, pricing, channel problems, employee motivation, scandals, wrongdoing, internal control, and financial risk.

The word "risk" comes from the Latin "risicare," which means "to navigate a ship between rocky outcrops." So the navigation of a ship can be used to demonstrate the relationship between enterprise management and risk management (the enterprise equivalents are shown in parentheses).

For a ship (enterprise) to arrive at its destination safely and on time (business goals), the

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18 Ibid. p.259.
question is how, under the leadership of its captain (top management), can the internal resources (tangible capital and intangible capital) be utilized to keep a rocking ship balanced (optimizing business risk and overcoming business uncertainty) amid changes in the external environment such as wind, waves, and typhoons (regulation, competition, supply chain, consumer trends, etc.) and under the influence of the internal factors such as accidents, sailors, and fuel (marketing environment, business environment, internal control environment, etc.) and arrive efficiently at the destination (enhancing corporate value). Figure 6 illustrates this notion.

A company's objective can be boiled down to maximizing corporate value and sharing this with its stakeholders. To accomplish this, it has to have the ability to predict and evaluate the external environment and then adapt flexibly, and then, based on this, it must also have the ability to restructure internal resources and adjust strategy. Ultimately, it requires unswerving management. Figure 6 shows that a company is subject to a variety of lurking risks that are connected with both external and internal factors, and the business resources need to address these risks, especially invisible intangible capital, and corporate culture, corporate philosophy, business ethics, and trust are deeply connected to social capital.

This paper has already introduced Ohmori (2004) view on the function of social capital in enterprise management. From a risk/risk management perspective the author of this paper sees social capital as serving a function similar to a ship's ballast keel, in that it is a mechanism to right an unsteady enterprise.

Figure 6. Social capital as a ballast keel to right the enterprise after it is destabilized by risk
It goes without saying that the concept of social capital is a concept that is focused on the connection between the people who make up the organization, and Cohen and Prusak (2003) assert that this has advantages for the company. "This kind of connection supports collaboration, commitment, ready access to knowledge and talent, and coherent organizational behavior. This description of social capital suggests appropriate organizational investments--namely, giving people space and time to connect, demonstrating trust, effectively communicating aims and beliefs, and offering the equitable opportunities and rewards that invite genuine participation, not mere presence." 19

Cohen and Prusak (2003) examined the functions of social capital in dealing with the issue of the uncertainty of corporate activity, and they present the case of Viant, a US e-business company, as shown in Table 1. 20 However, as emphasized in this paper, it is hard to produce the positive corporate performance that is enhanced corporate value through social capital alone. Above all else, a company must have the ability to predict and evaluate the external environment and then adapt flexibly, and then, based on this, it must also have the ability to restructure internal resources, including social capital, and adjust strategy. Although not mentioned in Cohen and Prusak's (2003) study, in reviewing Viant's subsequent performance the author found that the company was affected by the economic slowdown that was caused by the collapse of the IT bubble, and it was forced to layoff personnel and merge with another company, as shown in Table 1.

The main reasons for the company's deteriorating results were management errors in areas such as addressing strategic risk (namely, the risks associated with rapid growth) and its over-reliance on specific customers.

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20 Ibid. pp.221-228.
<table>
<thead>
<tr>
<th>Company name</th>
<th>Viant Inc.</th>
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<tbody>
<tr>
<td>Industry</td>
<td>e-business design &amp; support (established in 1996)</td>
</tr>
<tr>
<td>Corporate culture/philosophy</td>
<td>Building long-term relationships compatible with the corporate culture</td>
</tr>
<tr>
<td>Actions</td>
<td>Team-based employment interviews and coaching, training centered on corporate culture and compatibility</td>
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</table>
| Relationship to social capital | ・ Focus on relationships among employees, training program that focuses on adapting to the corporate culture and forming bonds  
・ Objective is to create bonds through training by on-site leaders, including managers in each region and country |
| Subsequent developments | ・ Viant lays off 125 employees, or 17% of its workforce, to reduce overhead costs when the economy slowed after the IT bubble collapsed, and closes the Dallas office in order to reduce its dependence on dot-com company clients. The company expects to record a 5-7 million dollar charge in the fourth quarter as severance allowances. About 100 of the employees terminated at various Viant offices were responsible for paid consulting services.  
・ Viant's troubles began when it became clear that third quarter earnings were far below expectations. CEO Bob Gett says that the company's performance has deteriorate because dot-com companies slowed their decision-making as they ran out of cash, and a number of companies have been unable to obtain financing, and this has blunted their sales and marketing efforts. Like other companies in the industry, Viant rapidly expanded its customer base of start-up companies that were flush with venture cash. But when the dot-com bubble burst, many of these clients went bankrupt. Viant itself realized that it had overexpanded.  
・ Viant reconsiders its excessive reliance on clients in the Internet space, and seeks to develop business in other areas. But, Viant was bought by a company called Divine in Sept 2002, and Divine file for bankruptcy in 2003. Neither company exists anymore. |

Table1. Viant investments in social capital and subsequent corporate developments  

The next cases (Table2) are extremely interesting as cases in which companies enjoyed success by connecting "soft control" through social capital to strategy.21 In particular, elements

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such as, "investment in employees and taking care of customers, operating without debt, beautiful offices, and the lack of a need for a statement of core values," show the limit of "hard controls," and in this respect these cases are in agreement with the author's assertions. By connecting the fostering of social capital through management that focuses on "soft control" (emphasis on employees and customers) to strategic risk management, they have been able to steadily enhance corporate value.

<table>
<thead>
<tr>
<th>Company name</th>
<th>Paychex Inc. (11,000 employees)</th>
<th>SAS Institute Inc.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry</td>
<td>Payroll services (established in 1971)</td>
<td>Business analytics software (established in 1976)</td>
</tr>
</tbody>
</table>
| Corporate culture/philosophy | • "Nobody gets special treatment" policy  
  • Creating a culture of mutual respect, emphasizing humility and fairness  
  • Fair treatment                                           | • Creating a workplace where employees are happy to work  
  • Create software that is absolutely necessary for customers  
  • Treat people fairly                                      |
| Actions/strategies     | • Putting job titles on business cards is prohibited  
  • No need to write contracts with customers  
  • If a customer is dissatisfied, he can leave without a penalty  
  • Two-thirds of new customers come from word-of-mouth recommendations  
  • Operates almost entirely debt-free  
  • All employees become shareholders through stock options  
  • 121 hours of training per year (40 courses, of which 23 are certified for college credit) | • Almost all employees have their own office  
  • Offices located on a beautiful, expansive, park-like campus  
  • Onsite doctors and nurses, top-notch daycare facility, walk-in hairdresser  
  • Mainly invests in employees, no need for acquisitions, "buying other companies is really about satisfying the CEO's ego"  
  • Doesn't depend on outside capital  
  • 24% of sales revenue invested in R&D  
  • Unlimited free technical support as long as a customer is using the software |
| Relationship to social capital | • Respecting, trusting and treating people (employees and customers) fairly  
  • Has no formal statement of core values                      | • Treat people fairly  
  • Trust in people                                             |
| Subsequent developments | Increased sales and net profit for 16 straight years up to 2007, market capitalization exceeds 15.0 billion dollars | Since the company was established, it has steadily increased sales revenue (1.9 billion dollars in 2006), and it is now the world's largest privately held software company |

Table 2. Enhancing corporate value by connecting fostering social capital to strategy
Conclusion

The insights gleaned in the course of this investigation are as follows:

1. The concept of social capital is a concept that goes beyond communities and societies, and is something that has ample utility from the perspective of contemporary enterprise management and particularly in the creation of corporate value.

2. In the author's existing research, social capital is treated as a company's intangible capital, and organizational capital in particular, and it holds extremely high level of importance.

3. With respect to the creation of corporate value, it is highly likely that an appropriate corporate culture will give rise to social capital, and there is a close relationship between creating desirable social capital and building a desirable corporate culture.

4. Social capital can serve the function of providing resilience, especially when a company is in crisis. Social capital serves an important function as a "soft control," especially from a risk management perspective.

5. Social capital serves as a ballast keel that provides righting moment to unsteady enterprise. However, in to bring a company back up to a level where corporate value can be enhanced, investment in internal resources, and social capital in particular, as well as strategies and risk management capabilities that it allow it to responsibly flexibly to changes in the external environment are also extremely important. Social capital alone is insufficient to enhance corporate value when there is severe environmental change or when market competition is fierce.
References