

# The Social Capital towards the Performance of Small and Medium Scale Enterprises evidences from Sri Lanka

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**Abstract:** Small and Medium-scale Enterprises (SMEs) are one of the driving forces for economic development by enhancing national production, creating income, employment, and mitigating poverty in any country. Social capital is defined as the total stock of relationships that an individual possesses. In the Sri Lankan context, much attention has not been paid to social capital. The objective of this study is to recognize the interrelation between the social capital concept and the performance of SMEs and how social capital impacts SMEs in Sri Lanka. The study was conceptualized using 03 variables; network ties, trust, and shared vision, and a dependent variable is the performance of small and medium-scale enterprises. A self-administered questionnaire was applied to collect primary data for the present study. Survey data were collected from 384 SME owners through the simple random sampling technique. The trustworthy and shared vision has the highest impact on the performance of SMEs based on the findings of the regression analysis. The findings of the present study will enable scholars and practitioners to gain more insight and understanding of social capital concepts while providing novel insight and useful suggestions to owners of SMEs'.

**Keywords:** Community Social Capital, Performance of SMEs, Network ties, Trust, Shared vision

## I. INTRODUCTION

SMEs play a vital role in the Sri Lankan economy. It is recognized as the backbone of the economy. SMEs account for more than 75 percent of all enterprises and provide 45 percent of employment, accounting for 52 percent of the Gross Domestic Product (GDP). Different countries define SMEs in different ways based on the level of growth, the total number of workers, annual turnover, and the total number of employees. The Sri Lankan government considers SMEs as the backbone of the economy, as they account for more than 75 percent of all enterprises and provide 45 percent of employment, which accounts for 52 percent of the Gross Domestic Product (GDP). SMEs foster broad-based equitable growth and expand opportunities for women and youth to participate in the country's economic development (Ministry of industry and commerce Sri Lanka, 2020). The different definition of SMEs in Sri Lanka represents in table 1.

Table 1: Definition of SMEs in Sri Lanka

Manufacturing Sector			
Criteria	Medium	Small	Micro
Annual Turnover	Rs. Mn. 251 - 750	Rs. Mn. 251 - 750	Less than Rs. Mn. 15
Number of Employees	51-300	11-50	Less than 11
Service Sector			
Criteria	Medium	Small	Micro
Annual Turnover	Rs. Mn. 251 - 750	Rs. Mn. 16 - 250	Less than Rs. Mn.15
Number of Employees	51 - 200	11-50	Less than 11

Source- (National Policy Framework for Small Medium Enterprise Development)

The Social Capital concept is a more significant tool for SMEs. The Social Capital concept has several definitions illustrated by researchers. Previous research studies identified social capital concept generates a strong impact on the performances of SMEs. The aggregate of the real and potential resources contained inside, available through, and generated from an individual's or social unit's network of relationships is referred to as social capital (Nahapiet & Ghoshal, 1998). Adler and Kwon (2002) have defined the goodwill that's arisen by the fabric of social relations that can be mobilized to grease action. Further, Chaminade and Vaang (2007) defined networks and social capital created by network relationships were considered soft infrastructure for resource sharing among small businesses. Both formal and informal networks assist small businesses in forming relationships with actors in their environment to acquire capital, funding, information, and expertise that they may not be able to produce on their own. The core

concept of social capital holds that social networks matter, both for those who participate in them and, in some cases, for standers. The foundation of social capital is trust. People practice reciprocity when they do something for another person without expecting something in return (Machado, 2013).

Many researchers realized how the social capital concept involves SMEs in western and many Asian countries in the

world. Individuals can gain economic gains from social capital through entrepreneurship because it can help to solve two institutional economic problems, such as compensating for asymmetrical knowledge and lowering transaction costs as a result of social and economic activity (Svendsen, 2003). SMEs haven't insufficient assets, mostly financial assets, which limits their ability to be inventive, innovative, and economical; yet, it is believed that they may compensate for this shortfall through the formation of social capital (Wirba, 2017). When considering the Sri Lankan context, there are few studies relating to the social capital concept. Nishantha B. et al. (2011) stated in their studies that developing countries, including Sri Lanka, have lesser consideration for the social capital concept. So, this research study refers to the significance of the social capital concept for SMEs' performance and how to apply this concept to their business functions.

In today's business environment, small and medium businesses encounter several problems in staying competitive in today's business world and conducting day-to-day operations efficiently. Small and medium enterprises have to adapt to the rapidly changing business environment and face business pressures from large businesses and multinational corporations. The government of Sri Lanka is striving to establish, through an SME policy framework, the best possible conditions for SMEs. The government firmly believes that this policy will encourage small businesses to become medium-sized and medium-sized businesses that will become large companies.

The connection between the social capital concept and small and medium enterprises is illustrated by both local and international researchers from their empirical studies. The effect of social capital on the growth of small and medium-sized enterprises and found that the growth of by making contacts, SMEs are greatly affected by their social capital. But in the Sri Lankan context lack of consideration for this concept is noted. Nishantha B. et al. (2011) identify a limited or lesser consideration of the social capital concept by many developing countries such as Sri Lanka. This concept is effectively applied by developed economies' SMEs. Due to less attention to the social capital concept in Sri Lanka, the primary objective of this study is to identify the impact of the community social capital on the performance of SMEs in the western province of Sri Lanka. Furthermore, this study tries to identify the impact of the network ties on the performance of SMEs in the western province of Sri Lanka, identify the impact of the trustworthiness on the performance of SMEs in the western province of Sri Lanka, and identify the impact of the shared vision on the performance of SMEs in the western province of Sri Lanka.

This study examines the impact of community social capital on the performance of small and medium enterprises in Sri Lanka. The term SME is used to denote micro, small and medium enterprises. The Sri Lankan government regards SMEs as the backbone of the economy, as they account for

more than 75 percent of all enterprises and provide 45 percent of employment, which accounts for 52 percent of the Gross Domestic Product (GDP). SMEs foster broad-based equitable growth and expand opportunities for women and youth to participate in the country's economic development. (Ministry of industry and commerce Sri Lanka). Previous research studies identified social capital concept generates a strong impact on the performances of SMEs. The aggregate of the real and potential resources contained inside, available through, and generated from an individual's or social unit's network of relationships is referred to as social capital (Nahapiet & Ghoshal, 1998). Chaminade and Vaang (2007) defined networks and social capital created by network relationships were considered soft infrastructure for resource sharing among small businesses. Both formal and informal networks assist small businesses in forming relationships with actors in their environment to acquire capital, funding, information, and expertise that they may not be able to produce on their own. The core concept of social capital holds that social networks matter, both for those who participate in them and, in some cases, for standers. (Nishantha, Yoshio & Amura, 2011) those developing countries, including Sri Lanka, have lesser consideration for this concept. So, this research study refers to the significance of the social capital concept for SMEs' performance and how to apply this concept to their business functions. According to this background, the purpose of this research is to answer the question, "to what extent does the community social capital impact the performance of small and medium-scale enterprises in the western province of Sri Lanka"?

## II. LITERATURE REVIEW

### *Social Capital*

Since social capital is a contemporary concept, it has produced numerous sorts of definitions, evaluated in various study stages, and created many key conceptualizations which took advantage of the theoretical and applied literature. Social capital consists of the aggregation of resources that are embedded within the network of relationships between organizations and individuals (Inkpen & Tsang, 2005). The notion of social capital is based on a concept of social networks or social ties that can be characterized by established norms of behavior and trust that allow individuals to act together to achieve common objectives (Flora, 1998) effectively. Social capital through effective bonding and the connection of external participants has a positive impact on the use of resources and establishing faith in organizations (Adler & Kwon, 2002).

In this sense, social capital is defined as the relationship between the entrepreneur and others. Such relations are possible competitive advantages if they provide ways to find opportunities or to get resources or if they facilitate the use of other resources (Anat & Ken, 2002). According to Anklam (2002), social capital covers the "context pool of relationships, interpersonal trust and standards that allow specific behaviors and individual-individual contacts and provide circumstances

for organizational development and sharing of information." Adler and Kwon, (2002) explain that social capital affects the company's efficiency, which increases profitability and growth, which is characterized by improved corporate communication, efficient collective actions, enhanced stock management, increased access to resources, and reduced transaction costs. Social capital refers to resources that can be invested in an organization for future benefits, such as quick access to knowledge, resources, and new market opportunities (Burt, 2000). Furthermore, he refers that social capital functions as an information outflow and the network are valuable for accessing information for the enterprise. The information can be obtained by the company via the network.

Nahapiet and Ghoshal (1998) state that social capital is useful for exchanging information and access in the appropriate places when it is right. If the company has a high amount of social capital, you can obtain information that is highly effective and accurate. The efficiency and Effectiveness of company activities can be increased through social capital. The social interaction structure helps to create the adopted picture of the common language between people. Acquah (2002) stated that social capital is into categories of internal and external social capital. Internal is within the organization, structures, and social network relationships among individual members. External social capital includes all other structures and network relationships outside the organization, including both formal and informal network relationships. Nahapiet and Ghoshal (1998) identified three dimensions of social capital: analytical purposes, structural, relational, and cognitive. This structural dimension underlines the level of connection and closure among members of the social network, and the relational dimension emphasizes the strength of such social relations, and the key elements of this are confidence and confidence. The cognitive dimension highlights the common values, norms, and beliefs existing within the social network. Additionally, social capital is a source of work readiness for undergraduates and influences a venture's performance (Amarathunga & Wijethunga, 2021).

#### *Social Capital Theory*

Weak ties theory (Granovetter, 1973), structural hole theory (Burt, 1992), and social resource theory (Lin et al., 1981) are among the primary components of social capital theory. A weak tie is the polar opposite of a strong connection, which refers to a bond formed through social connections in social networks with low interaction frequency and intimacy (Shen, 2020). It is an important part of the social structure because it may find the shortest path and increase the rate at which information is passed between groups.

According to social capital theory, networks facilitate the development and maintenance of relationships, motivate network players to engage in beneficial activities, and create possibilities for network actors to individual cumulative capital (Bourdieu 1986). According to Nahapiet and Ghoshal (1998), social capital is contained in cognitive capital, structural capital, and relational capital. Cognitive capital is

developed from the sources of shared representations, shared values, goals, and shared interpretations (Nahapiet & Ghoshal, 1998). The combined resource of a social network's features and patterns is referred to as structural capital. Further, Nahapiet and Ghoshal (1998) revealed that relational capital is a network resource that is developed and shared through close encounters with one another, and each party recognizes and approves the contribution of the other.

#### *Performances of Small and Medium-scale Enterprises*

Garage (2003) states that different countries are defined by different means of defining SMEs using factors such as the number of employed people, amount of capital invested, sales volume, or nature of the company; not only do different countries apply diverse definitions of the concept of SMEs but they are also defined differently within countries, regions, and institutions. Ministry of industry and commerce Sri Lanka has defined that the category of SMEs consists of companies with a workforce of fewer than 300 employees and annual sales of less than Rs. 750.0 MN.

Venkatraman and Ramanujam, (1986) define financial performance as "the accounting-based measurements which quantify profitability of the company by financial ratios such as return on equity (ROE), return on assets (ROA) and return on sales (ROS). Richards, et al. (2008) state that financial measurement should be focused on owners and managers. Indicators of financial performance are identified as profit, revenue, ROI, ROE, growth, sales, and profitability. Hart (1992) states that sales growth and market share were more significant metrics to measure financial performance, which also plays a major role in the business performance of companies.

Clark (1989) emphasized that, in general, financial statements become a weakness for SMEs as small and medium-sized enterprises have no financial statements to measure business performance. Wu and Zhao, (2008) explain that the adoption of such measures still has covered every dimension expected from non-financial performance indicators (NFPI) of business performance, such as efficiency, convenience, innovation, flexibility, and education which also play an important role in firm performance. The evolving perception of business performance in a more complicated path also requires non-financial performance in dimensions to be extremely important to improve business performance through processes (Neely, 1994).

#### *Social Capital & Performances of SMEs*

Social capital contributes to the benefit of financial resources and boosts the efficiency of organizational operations. This can identify social capital as economic assets (Celestini, Gavronski, & Kaynak, 2013). (Okten & Osili, 2004) evaluated the effects of social capital on small and medium-sized enterprises' growth and concluded that SMEs' growth is impacted by their social capital through the network. Social capital helps to harness the environment's resources and opens

the path for new markets. (Chow & Chan, 2008) identified if the firm has a strong social capital level, it can gain high levels of information and efficiency. Enterprises can be increased through social capital in terms of efficiency & Effectiveness. The social interaction structure enables the adopted view of interpersonal trust between people in a common language of the organization. Social capital is the resources that form a relationship pattern, a value of ties between people, and a shared understanding among people.

Nishantha, Yoshio, and Amura (2011) stated in their study that small entrepreneurs may benefit mutually from their network type and boost their growth rather than act independently in the current competitive market by building and sustaining network-type interactions between comparable sorts of firms. (Acquaah, 2002) asserted that social capital's impact on company operations and performance was complicated, and research indicated that social capital was not always useful to company operations and performance improvement.

Abeyrathne (2020) stated that the majority of research that investigates the link between social capital and SME success uses quantitative methods. There is a scarcity of scholars who are specifically interested in the impact of social capital on the success of SMEs. Many additional variables have influenced the performance of SMEs. Previous research has looked at the characteristics that function as a buffer between social capital and SME success. Nonetheless, research identifying the direct influence of social capital on the success of SMEs is limited—and this might be a future path for researchers. Moreover, they emphasized that both developing and developed nations have concentrated on research areas, social capital, and SMEs. However, the majority of studies have been conducted in developed nations rather than developing nations. In developing countries, social capital and SMEs were focused solely on Bangladesh, Brazil, China, Ghana, Thailand, and Malaysia. The highest number of research studies focuses on developed countries, indicating a lack of research studies focused on developing countries.

Nahapiet and Ghoshal, (1998) identified three dimensions of social capital, which are structural, relational, and cognitive dimensions. According to those dimensions, network ties, shared vision, and trustworthiness were identified as the major determinants of social capital. Saha and Banerjee, (2015) demonstrate a positive relationship between social capital generated through formal and informal networks and firm performance while also establishing the superiority of formal networks in the form of membership associations over informal networks in terms of generating effective social capital and providing a platform for cooperation and mutual support among member firms.

#### *Network Ties*

The term networks describe a collection of 'actors' (people, departments, or businesses) and their strategic links (family, community, finance, business alliances) with each other

(Johnsen & Johnsen, 1999). Network connections are viewed as crucial vehicles for information sharing and transfer in the context of SMEs (Uzzi, 1997). Adler and Kwon (2002) contrast that ties are a vital element of social capital because network links provide opportunities for transactions of social capital. Ties in industry/trade networks and business associations provide information, ideas, problem-solving abilities, benefits of resource sharing, access to new markets, skill development, and legal and advocacy services to member firms (Bennett & Ramsden, 2007).

#### *Trustworthy*

Trust is essential to the development of relationships and is regarded as a catalyst before connections grow, and the result of successful transactions between persons or companies is increasingly established (Kandemir, Yaprak & Cavusgil, 2006). Trust is expected by Two or more entities (persons and organizations) to be honest, cooperative, and predictable based on common standards (Fukuyama, 1995). Trust is particularly useful as a governing structure that makes exchanges secure and minimum (Dyer & Chu, 2003). McEvily, Perrone, and Zaheer, (2003) asserted that it supports knowledge sharing by enhancing knowledge disclosure to others and allowing others to have access to their knowledge. Neace (1999) states that additional advantages may also be such as increasing sales and higher return on investment.

#### *Shared Vision*

The shared vision is considered to be people with the same behavioral values and expectations (Thorelli, 1986). Inkpen and Tsang (2005) refer to it as shared goals. The results of a shared vision developed among members of organizations include integrated strategy, better synchronization of operations, and more timely and useful sharing of knowledge among their network partners. Members of successful networks keep a shared view of what the participants should do and what they should do (Wollebaek & Selle, 2002).

### III. RESEARCH METHODS

The current study used an explanatory research strategy with a primary emphasis on evaluating hypotheses developed based on empirical research findings. The data is only collected once, quantified, and statistically analyzed in the current study, which is cross-sectional.

The target study population considers SMEs in the entire western province. According to the Department of Census and Statistics, (2021) recognized population of SMEs in the western province is 308524. The Western province has the largest number of SMEs than other provinces in Sri Lanka. According to Krejcie and Morgan's table (Krejcie & Morgan, 1970), the sample size is 384. However, 400 questionnaires were issued to boost the generalizability of the findings and to account for the faulty and incomplete questionnaires returned by certain respondents. Even though 400 questionnaires were distributed, only 384 completed questionnaires were received. Accordingly, the actual sample

size of the present study is 384. The simple random sampling technique was used as a sampling method, where each population element has an equal probability of being selected for the population. The primary method of data collection in this research study was a questionnaire survey. The questionnaire includes pertinent questions that were found to be helpful for the study. The purpose of the survey is to gather important information on how the idea of community social capital affects the performance of SMEs.

Four hypotheses were tested to measure the nature of the relationship between work readiness and five components of graduate employability capital; H1 - There is a relationship between social capital and the performance of SMEs, H2 - There is a relationship between network ties and the performance of SMEs, H3 - There is a relationship between trust and performance of SMEs and H4 - There is a relationship between shared vision and performance of SMEs.

IV. FINDINGS AND DISCUSSION

The level of association between social capital and the level of performance of SMEs was measured using correlation analysis. The findings of the correlation analysis of the study are summarized in Table 2.

Table 2. Summary of the Correlation Analysis

Variables	Correlation coefficient (r)	Sig. Value (p)
Social Capital & Performance of SMEs	0.683	0.000
Network ties & Performance of SMEs	0.626	0.000
Trust & Performance of SMEs	0.692	0.000
Shared Vision & Performance of SMEs	0.715	0.001

(Source: Findings of the Correlation Analysis, 2021)

*Results of Alternative Hypothesis 1 (H<sub>1</sub> 1): There is a relationship between social capital and the performance of SMEs.*

According to the results of the correlation analysis presented in Table 2, the test is significant, (r= 0.683, p < 0.05). Accordingly, hypothesis 1 is accepted and it was revealed that there is a positive association between social capital and the performance of SMEs in Sri Lanka.

*Results of Alternative Hypothesis 2 (H<sub>1</sub> 2): There is a relationship between network ties and the performance of SMEs.*

Based on the results of the correlation analysis presented in Table 2, the test is significant, (r= 0.626, p < 0.05). Accordingly, hypothesis 2 is accepted and it was revealed that there is a relationship between network ties and the performance of SMEs in Sri Lanka.

*Results of Alternative Hypothesis 3 (H<sub>1</sub> 3): There is a relationship between trust and the performance of SMEs*

As per the results of the correlation analysis presented in Table 2, the test is significant, (r= 0.692, p < 0.05). Accordingly, hypothesis 3 is accepted and it was revealed that there is a positive association between trust and the performance of SMEs in Sri Lanka.

*Results of Alternative Hypothesis 4 (H<sub>1</sub> 4): There is a relationship between shared vision and the performance of SMEs.*

According to the results of the correlation analysis presented in Table 2, the test is significant, (r= 0.715, p < 0.05). Accordingly, hypothesis 4 is accepted and it was revealed that there is a positive association between social capital and the shared vision of SMEs in Sri Lanka.

Further, multiple regression analysis was used to determine the impact of social capital variables on the dependent variables of the performance of SMEs. The results of multiple regression analysis are shown in Table 03.

Model	R	R Square	Adjusted R Square	Std. The error in the Estimate	Durbin-Watson
1	.781	.609	.606	.419	2.189

(Source:Survey data, 2021)

R explains how independent variables, Network Ties, Trust, and Shared Vision, are jointly correlated with the dependent variable; the performance of small and medium-scale enterprises. R-value is close to 0.781, which means that there is a strong association between the independent variables of the social capital concept and the dependent variable of the performance of SMEs. The proportion of the dependent variable, which is explained by the derived model, is indicated by the R square value. The R square value of this study is 0.609. This says that 60.9% of the performance of SMEs has been explained by the model. This is approximately a moderate level.

This study provides an idea of how social capital affects the performance of SMEs. Nishantha. et al. (2011) stated in their study that small entrepreneurs might benefit mutually from their network type and boost their growth rather than act independently in the current competitive market by building and sustaining network-type interactions between comparable sorts of firms. It is also clear that the concept of social capital influences both financial (monthly income, monthly profit, and monthly expenditure) and non-financial factors (innovation, educational opportunities, providing convenience to stakeholders, ability to face rapidly changing environment, efficiency). Moreover, Nishantha et al. (2011) stated that there is limited or lesser consideration of the social capital concept in developing countries such as Sri Lanka.

## V. CONCLUSION & RECOMMENDATION

The purpose of this research was to offer a broader picture of the extent of the influence of the social capital concept on the performance of SMEs in Sri Lanka. The study concluded that there is a positive relationship between the concept of social capital and the performance of SMEs. Where network ties, trust, and shared vision affect the financial and non-financial performance of small and medium enterprises. The study has implications for both entrepreneurs and managers of small and medium-sized businesses (SMEs). They should aim to maximize the benefits of social capital by combining all three factors, such as network ties, trust, and shared vision, to achieve the best performances. They must maintain a balanced attitude with all of the social players in their environment. Sharing of resources includes the exchange of information and expertise among members.

Further, the study revealed that small and medium-sized business owners intend to change strategic decision-making to improve performance by establishing a shared vision between networks and people within the network. SME owners should have a good understanding of the company's networks in particular and have a policy on how to deal with the company's networks. At the same time, the organization must work with them in such a way that the company's networks have confidence in the company. New technologies, new ideas, and new knowledge flow into the organization. Different policies and activities need to be organized to build trust between networks, thereby improving the performance of the organization. The network offers services and referrals to help you access the export market, as well as assistance for innovation, market expansion, legal and consulting services, and other company development services as needed. Forms that include a formal network, trust, and a shared vision aid in the development of innovative talents among members. Companies, expertise, research facilities, and the exchange of information that impact their performance.

## VI. FUTURE RESEARCH DIRECTIONS

The present study focused on the association between social capital and the level of performance of SMEs in Sri Lanka. The scope of the study can be further expanded to measure similar relationships related to large-scale organizations and multinational organizations and comparisons can be made among the different contexts. Further, the demographic factors, psychological factors, and socio-economic factors belonging to owners might be mediated and moderated by the association between social capital and the level of performance. Accordingly, future researchers are suggested to assess the mediation and moderation effects of the demographic factors, psychological factors, and socio-economic factors of the owners. Additionally, due to the cross-sectional nature of this investigation, just one single point was used to determine the level of connection. Therefore, it is proposed to undertake longitudinal studies, collecting data repeatedly with the necessary interventions. Moreover, it is critical to perform qualitative studies to

identify effective strategies for strengthening social capital among entrepreneurs in light of the present Covid-19 issue, new normal conditions, and the current economic downturn in Sri Lanka.

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