STRATEGIC ADVANTAGE OF RELATIONAL CAPITAL IN SMALL AND MEDIUM-SIZE ENTERPRISES

*R. Preetha, Assistant Professor, Department of Commerce and Management, Amrita School of Arts and Sciences, Kochi, Kerala, India
**Dr. Clement Sudhakar, Professor, Department of Management Studies, Karunya University, Coimbatore, Tamil Nadu, India.

Abstract: Relational capital offers a prospective source of justifiable competitive advantage and is believed to be the source from which economic growth may sprout. The advent of technology has fuelled rapid globalization which enables even small and medium scale companies to compete globally with much bigger firms and achieve success. Also it is believed that small and medium sized enterprises (SME’s) across the world try to be in a network mode, collaborating and developing relationships, which results in an era of innovation. Hence this paper is an attempt to study the influence of relational capital on a firm performance namely customer capital, supplier capital and network (employees) capital.

Keywords: Relational capital, Small and Medium Scale Enterprises, customer capital, supplier capital and network capital.

I. Theoretical Background

In 1991, Barney, in his seminal study “Firm Resources and Competitive Advantage”, expanded Werner Felt’s 1984 model with concepts from organizational economics and strategic management literature to demonstrate that firms can gain and maintain a competitive advantage. Barney coined the phrase “Resource-based view (RBV) of the firm” to describe this new model. Barney argued that a firm’s sustained competitive advantage derives from resources and capabilities that are rare and valuable, imperfectly imitable, and not substitutable. This view supports our argument that in a knowledge based economy, the competitive edge of a firm is determined by its ability to leverage its human capital and intangible assets. This has a significant impact on its profitability and value creation efficiency. This includes value of relational capital which also fit in the theory of ‘stakeholder view’ (Donaldson and Preston, 1995,) which maintains that stakeholder relationships include all forms of relationships of the company with its stakeholders, e.g. employees, customers, suppliers, and residents of the community.

Today’s business environment is characterized by hyper completion and accelerated pace of changes when compared with past era. The advent of technology has fuelled rapid globalization which enables even small and medium companies to compete globally with much bigger firms and achieve success. The larger firm should learn how to be agile from these smaller firms (Brock and Evans 1989; Fiegenbaum and Karnani 1991; Jarillo 1989; Power and Reid 2005). These small and medium firms are filled full with creativity and their ability to innovate play a major role in their value creating efficiency in a dynamic environment. The field of entrepreneurship has attracted scholars from various domain of social science over the last couple of decades as it deals with identification, evaluation and exploitation of occasions that exists in the external environment (Gundry and Kickul 2007; Hitt et al. 2001; Venkatraman 1997; Zahra and Hess 2001).

Miles et al. (2006) has propounded the idea that small and medium sized firms across the world will try to be in a network mode, collaborating and developing relationships, which results in an era of innovation. They were also of the view such networks and collaborations will be mainly initiated by these small and firms, because of the reason that they do not possess the resource to involve in continuous innovation, and they may view their network as an alternative option in achieving their business goals. Though resources help a firm to have an competitive advantage, the relational view model put forward by Dyer and Singh, (1998) emphasis that the competitive advantage of a firm is gained out of not only its resources but also out of its relational aspects with other stakeholders in its environment. The term relational capital is defined “as the set of all relationships established between firms, institutions and people that stem from a strong sense of belonging and a highly developed capacity of cooperation typically of culturally similar people and institutions” (Capello and Faggian 2005). The concept of relational capital has gained scholarly attention in the recent literature. Fitzpatrick (2009) views relational capital as the set of business relationships.
The relational capital gives added advantage to the firms as they are helpful in obtaining information from external environment. These information are useful to small and medium enterprises in their decision making process and exploiting new business opportunities (Granovetter 1978). The studies till late 90’s past has given more prominence to objective and tangible factor and intangible factors has been considered to be as distant feature contributing to business (Costabile 2001, Edvinsson 1997 and Zambon 2004). Relational Capital comprises of both formal and informal relationships, i.e. temporary and permanent in nature and can be detrimental to a firm’s success (Westlund, 2003; Hormiga et al., 2010). The whole idea of relational capital is based on the concept that firms are not isolated in environment but they interact in their environment, and are dependent on the networks that are created as a result of their interaction (Hormiga et al., 2010). This implies that value is generated from relationship with both the internal and external factors, i.e. stake holders.

Costabile (2001) views relationship capital as the sum total of stock of trust, fidelity and loyalty that is possessed by a firm. Further corporate firms should put in efforts to improve the above areas to gain competitive advantage over period (Putnam, 1995; Pirovano and Gilodi 2003; Granovetter, 1973). Authors Thompson and Heron (2006) have suggested that the quality of relationship significantly influences the performance of research intensive firms. It can be inferred that the relational capacity refers to a firm’s ability to establish suitable relationship with its internal and external actors through a reciprocal network, and through active information sharing Elaydi and McLaughlin (2012). The advantages that arise out of relational capital are manifold in nature. A firm focused on improving its relational capital benefits in two aspects: cost reduction and increased market value Kijek and Kijek, (2007).

To elaborate this further, it is observed that Knowledge flow happens through relationship network created among employees, suppliers which will facilitate process innovation and thereby cost reduction. The relationship network between employees and suppliers also help in identifying the needs of customers and ensuring a better customer satisfaction. A higher quality product and satisfied customer will result in repeat purchasing behavior and higher sales turnover.

II. Scope of the study

The Indian Small and Medium enterprises sector plays a pivotal role in Indian economy in last few decades. They not provide large employment opportunities at a relatively cheaper cost but also help in the development of industrial establishment in rural areas too. Many of these SME’s are auxiliary players to bigger industries and contribute on a large scale to the social and economic advancement of the nation. These small and medium comprise of 36 million industrial units in number and employ around 80 million people either directly or indirectly. It is estimated that they contribute over 7 % to India’s GDP and adds about 45% to the gross manufacturing output and 40 % of the products exported from the country. These facts highlight that this sector has a major role to play in the all-inclusive ambitious growth of the nation. An enquiry into their relationship management practices will add value to the existing body of literature.

In Indian context not many studies has been conducted on the role of relational capital in SME’s performance. Based on the existing literature it can be observed that relational capital has a significant impact on the growth and performance of SMEs. Our study will help in testing the same on Indian environmental conditions. The emergence of technology has put the concept of relational capital a huge risk. Many initiatives by today’s so-called smart firms are on replacing relational capital advantages with technological gadgets and services. Our study will help in examining the importance of relational capital and their role in this era, as they are key strategic assets of small and medium firms.

This paper is an attempt to examine the impact of relational capital on Indian SMEs performance i.e., a study of influence of three components of relational capital on a firm performance namely customer capital, supplier capital and network (employees) capital(Kaufmann and Schneider 2004; Boedker et al. 2005; Marr and Roos 2005; Watson and Stanworth 2006). These three components are well defined and was quoted by relational capital, intellectual capital and knowledge researchers in their work. In short the objective of the study is as follows

a) To study the impact of customer capital on the business performance of small and medium enterprises.
b) To determine the impact of supplier capital on the business performance of small and medium enterprises.
c) To study the impact of network capital on the business performance of small and medium enterprises
d) To investigate the impact of relational capital components on the business performance of small and medium enterprises
The literature on entrepreneurship highlight that SMEs are highly successful in building and maintaining relationships and are able to innovate using the strength of their collaborators (Miles et al. 2006). It has to be understood that the negotiations between collaborators are easily facilitated when the employees of participating firms have a higher degree of trust on each other. The studies conducted by Welter and Kautonen (2005) reinforce our argument that relational capital enhances firm performance. Hence, the first hypothesis of the study is interpreted as follows:

**Hypothesis 1:**
Relational Capital has an impact on the performance of small and medium enterprises in India.

Welbourne et al. (2008) states that there exists a higher degree of relational capital in small and medium enterprises firms and it may even multiply over a period of time. Ahuja et al. (2000) discuss about the strategic advantage of networks of firm, which are engaged in a collaboration. Networks and collaboration helps firms to develop technology and incorporate them in to their day to day operations. The relationship and collaborations can be between various stakeholders of the business. The collaboration can be between with supplier firms and principal firms, same way it can be between principal firm and its customer or client firms. This advantage is termed as “collaborative advantage” of small and medium enterprises by Huxham (1996). Hence the second set of hypothesis is interpreted as follows

**Hypothesis 2a:**
Network capital has an impact on the performance of small and medium enterprises in India.

**Hypothesis 2b:**
Customer capital has an impact on the performance of small and medium enterprises in India.

**Hypothesis 2c:**
Supplier Capital has an impact on performance of small and medium enterprises in India

### III. Future studies and expected outcome

The research is designed with the intention to highlight the role of relational capital on performance of small and medium enterprises. For the purpose of study, the researchers aim to conduct a survey for collecting the data from the respondents of Small and medium scale enterprises. Also the researchers would like to target participants of Management Development Programmes aiming at improving skills of executives of small and medium enterprises. These Management Development Programmes attract higher level of executives and help us in having access to a group that is extremely difficult to approach. A questionnaire is already developed based on literature review of previous work carried out in this area (Welbourne and Wright 2002). This study will help in drawing conclusion that relational capital is a strategic asset for small and medium enterprises and paves way for developing improved measures for assessing their role in future.

### References

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