

## SOCIAL CAPITAL AND ITS INFLUENCE ON THE FINANCING AND PROFITABILITY OF SMALL-SCALE ENTERPRISES (ISRAEL EXPERIENCE)

**Introduction.** Understanding the impact of social capital on the entrepreneur-ship process is an area of considerable interest among scientists. A broad range of studies are devoted to this problem (Adler and Kwon, 2002; Coleman 1988; Fukuyama, 1995; Griffith and Harvey, 2004; Kostova and Roth, 2003; Leana and Van Buren, 1999; Paldam and Svendsen, 2000). The social capital of a firm can be regarded as a resource that reflects the character of the firm's social relations and influences business capital and businesses performance (Hunt, 2000; Kostova and Roth, 2003). The tighter the links to communities are, the stronger the effect of the social capital (Honig 1997; Walker et al. 1997).

The purpose of this study is to investigate how social capital affects the financial funding and profitability of small businesses.

**Theoretical framework.** Social capital is defined in the literature as an asset that is engendered via social relations and can be employed to facilitate action and enlarge one's profit (Griffith and Harvey, 2004). Social capital enables individuals and firms to cooperate with one another to achieve objectives (Coleman, 1988). Thus, a firm's social capital can be explained in terms of business cooperation.

Griffith and Harvey (2004) defined two groups of social capital: capital at the individual and firm levels. Social capital at the individual level is presented as the social capital of the firm's manager. Firm level social capital represents relationships in the business network that include customers, business partners and governmental agencies. Business networks are a set of interconnected organizations or a set of connected relationships (Peng and Luo, 2000). Birley (1985) used a loose classification of entrepreneurial networks that comprises banks, accountants, local governments, business contacts, family and personal friends. Developing business networks provide a base of positive word-of-mouth resulting in enhanced business profitability (Reichheld and Teal, 1996).

Entrepreneurs require resources such as information, capital, skills, and labor to start business activities. They can complement their resources by accessing their contacts. Business social networks, however, do not constitute the resources themselves but rather represent the ability of the entrepreneurs to mobilize

these resources on demand (Portes, 1995). The classic resources in economic theory are capital and labor. Capital accessibility is the entrepreneur's perceptions concerned with networking to gain capital funds (Adam, 2003).

More resources help to achieve higher performance (Tesfom, 2006). Perreault et al. (2003) pointed to the existence of a link between business performance and social capital in specific forms. According to Griffith and Harvey (2004), utilizing the firm's social capital can provide performance gains. This allows businesses to not only be more profitable in the short run, but also in the long run (O'Brien and Jones, 1995). One's social network is viewed as a crucial factor for business success (Pearce, 2005; Redding, 1991).

On the other hand, reliance on social support networks in a restricted community can be associated with lower profits and higher failure rates (Bates, 1994). Studies conducted in Israel on immigrant entrepreneurs found that they rely only to a minor extent upon business networking, but the social capital immigrants acquire through business ownership improves the odds that their businesses will survive (Lerner and Khavul, 2003).

In this study a firm's social capital is regarded as business networks that include private businesses, governmental agencies, business associations and self-employed entrepreneurs. Correspondingly, I delineated four groups of business cooperation: cooperation with private businesses from the same sector, cooperation with private businesses from other sectors, cooperation with governmental institutes, and cooperation with others (business associations, donors, business advisors and self-employed entrepreneurs etc.). The study focuses on the impact of social capital in terms of business cooperation on financing small businesses' business growth.

**Method. Data collection** — data for the study were collected in Israel in 2005—2006. The target research population consisted of entrepreneurs who owned operating businesses at the time of the survey. Based on a combination of convenience and snowball samples, 496 business owners from all regions of Israel and all business spheres were surveyed. All the businesses under investigation were small businesses according to the definition of the Israel Small and Medium Enterprises Authority (2006).

Table 1

## Characteristics of entrepreneurs and their businesses

Characteristics	Cooperate	Do not cooperate	Test	Sig.
<b>Characteristics of entrepreneurs</b>				
Gender:	100%	100%	$\chi^2 = 8,832$	0,003
1. Male	70,2	57,0		
2. Female	29,8	43,0		
Age	38,6	40,5	$t = -1,953$	0,050
Education:	100%	100%	$\chi^2 = 10,755$	0,013
1. Up to and including a matriculation certificate	16,3	25,0		
2. Vocational studies	25,9	31,8		
3. Undergraduate degree	33,1	25,4		
4. Graduate or doctoral degree	24,7	17,8		
Former entrepreneurial experience	55,1%	41,2%	$\chi^2 = 8,996$	0,003
Former managerial experience	57,4%	46,0%	$\chi^2 = 6,170$	0,013
Years of work experience before becoming entrepreneur	12,7	15,1	$t = -2,477$	0,014
<b>Characteristics of businesses</b>				
Type of business	100%	100%	$\chi^2 = 20,507$	0,000
Production	10,8	6,6		
Trade	30,6	43,0		
Personal services	36,2	41,2		
Professional services	22,4	9,2		
Duration of business activity, years	5,9	5,6		NS
Number of employed workers	4,5	3,5		NS

*Measures.* Dependent variables are scope of investment, share of debt in business capital and businesses profitability. Scope of start-up capital was categorized on a scale of 1 to 4: “1” = up to 5,000 NIS; “2” = 5,001—25,000 NIS; “3” = 25,001—100,000 NIS; “4” = more than 100,001 NIS, with \$1 = 4,0 NIS. Share of debt in business capital is continuous variables measured in percentage. Businesses profitability was categorized on a scale of 1 to 3: “1” = income does not cover expenses; “2” = income covers expenses; “3” = income exceeds expenses.

Independent variables are dichotomy variables (“0” = does cooperate, “1” = does not cooperate): cooperation with private business from the same sector, cooperation with private business from other sectors, cooperation with governmental institutes, cooperation with others (cooperation with business associations, business advisors, self-employed entrepreneurs etc.); and a dummy variable for business type (trade, professional services whereas personal services is a reference category).

*Sample characteristics.* The study revealed significant differences in characteristics between entrepreneurs who cooperate and those who do not (table 1).

Entrepreneurs who do cooperate are younger, more educated, have more entrepreneurial and managerial

experience. Men are more likely to cooperate than women. Entrepreneurs who are engaged in professional services and production are more likely to cooperate than entrepreneurs engaged in trade and personal services. The study did not find differences between the businesses as to business type and duration of business activity and number of employed workers.

**Results.** In order to investigate how social capital affects the financial funding and profitability of small businesses, I conducted a regression analysis. The dependent variables were the scope of investment, share of debt in business capital and profitability of business.

The range of independent variables covers cooperation of businesses with other businesses and organizations and business type. Because only 6,6—10,8% of entrepreneurs engaged in production, I examined only three types of businesses: trade, professional services and personal services, with the last as a reference category. Table 2 presents the results of the regression model.

The analysis indicates that cooperation significantly influences the funds of businesses (all the regressions are significant at the level 0,05). 37,3% of the variance of the scope of investment, 34,5% of the share of debt in business capital and 45,8% of the profitability are explained by the business cooperation.

Regression results for financial funds and profitability of businesses

Independent variables	Scope of investment, $R^2=0,373^{**}$ (0,025)		Share of debt in business capital, $R^2=0,345^*$ (0,047)		Profitability of business, $R^2=0,458^{***}$ (0,003)	
	Beta	t-statistics	Beta	t-statistics	Beta	t-statistics
Cooperation with private businesses from the same sector	0,349 (0,058)	1,974*	0,283 (0,1528)	1,455	0,198 (0,228)	1,230
Cooperation with private businesses from other sectors	0,119 (0,458)	0,752	0,485 (0,014)	2,648**	0,126 (0,395)	0,864
Cooperation with governmental institutes	0,294 (0,125)	0,119	0,126 (0,549)	0,607	-0,518 (0,005)	-3,048***
Cooperation with others (business associations, business advisors and self-employed entrepreneurs etc.)	-0,092 (0,568)	-0,577	-0,358 (0,053)	-2,028*	-0,163 (0,273)	-1,116
Dummy 1 (trade)	0,416 (0,025)	2,369***	-0,088 (0,672)	-0,428	0,007 (0,965)	0,045
Dummy 2 (professional services)	-0,043 (0,815)	-0,236	-0,117 (0,598)	-0,534	0,331 (0,060)	1,951*
(Constant)		0,019		-0,931		2,007

Notes: \*\*\* Sig.<0,005; \*\* Sig.<0,05; \* Sig. <0,10.

The scope of investment in businesses that cooperate with other businesses from the same sector is larger than that of those that do not. Cooperation with private businesses from other sectors and cooperation with business associations, donors, self-employed business advisors etc. significantly influence the share of debt in business capital. Cooperation with governmental institutes significantly increases the profitability of business.

The study found that business type also significantly affects financial funds and business profitability: businesses engaged in trade need more investments and businesses engaged in professional services are more profitable than others.

**Conclusions.** The study revealed that business social capital in terms of business cooperation significantly influences financial funding and profitability of businesses. The scope of investment in businesses that cooperate with other businesses from the same sector is larger than that of those that do not. One possible explanation is that large businesses with large-scale investments need more cooperation, and therefore, their managers are more likely to utilize businesses ties.

Factors influencing the share of debt in business capital are cooperation with private businesses from other sectors (such as suppliers, clients, financial and credit organizations), and cooperation with business associations, donors, business advisors, and self-employed entrepreneurs. Close cooperation with all these organizations broadens access to loans and trade

credit and, therefore, facilitates businesses' mobilizing of capital.

Nevertheless, only cooperation with governmental institutes contributes to business profitability. This can be explained by the fact that many governmental institutes in Israel support entrepreneurs. Entrepreneurs can receive all types of governmental support: training and advice, financial support, and support for creating and maintaining business ties. Designated loans on favorable terms and other kinds of support are significant factors in a business' profitability and viability.

In sum, the study revealed that social capital of business in terms of cooperation with private businesses, business associations, business advisors and self-employed entrepreneurs facilitates mobilization of capital. Nevertheless, only cooperation with governmental institutes contributes to business profitability.

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- Кушнірович Н. О. Соціальний капітал та його вплив на фінансування та прибутковість підприємств малого бізнесу (досвід Ізраїлю)**  
Досліджено вплив соціального капіталу на фінансування та прибутковість підприємств малого бізнесу. Дані для дослідження було зібрано в 2005—2006 рр. в Ізраїлі методом анкетування. Вибірка респондентів побудована на основі комбінації методів Convenient Sample і Snowball Sample і містить відповіді 496 власників підприємств малого бізнесу.  
*Ключові слова:* соціальний капітал, фінансування, прибутковість, підприємства малого бізнесу.
- Кушнірович Н. А. Социальный капитал и его влияние на финансирование и прибыльность предприятий малого бизнеса (опыт Израиля)**  
Исследовано влияние социального капитала на финансирование и прибыльность предприятий малого бизнеса. Данные для исследования были собраны в 2005—2006 гг. в Израиле методом анкетирования. Выборка респондентов построена на основе комбинации методов Convenient Sample и Snowball Sample и содержит ответы 496 владельцев предприятий малого бизнеса.  
*Ключевые слова:* социальный капитал, финансирование, прибыльность, предприятия малого бизнеса.
- Kushnirovich N. A. Social capital and its influence on the financing and profitability of small-scale enterprises (Israel experience)**  
This study investigates how social capital affects the financial funding and profitability of small businesses. Data were collected in Israel in 2005—2006. Combining convenient and snowball samples, 496 entrepreneurs who have operating businesses were surveyed via a questionnaire.  
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