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Research paper



Incorporating Social Networks in Business Relationships of Retail SMEs for Better Business Performance

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Abstract

The presence of hypermarkets with modern retail format has impacted the performance of retail small medium-enterprises (SMEs) in Malaysia. The challenges of remaining competitive and the ability to sustain the business have pushed many retail SMEs to cease operations within a short period after commencement. Despite these challenges, retail SMEs can still attain competitive advantage through the strategies of strengthening and maintaining business relationships with their social networks. This study postulates that fostering social networks, specifically on the notion of homophily or similarities among social network members, is able to lure valuable resources needed by retail SMEs in achieving superior business performance. Unfortunately, only few studies have focused on social networks from within the Asian context and many tend to overlook the importance of social networks specifically in retailing. This study also suggests the relationship between value and status similarities of retail SMEs and their ability to coordinate efforts in horizontal relationships. Therefore, this study extends the discussion on the role of social networks towards better business performance of retail SMEs in Malaysia by conceptualizing a framework indicating the importance of value and status homophily on coordination of activities leading to business performance of retail SMEs.

Keywords: *social networks, retail SMEs, coordination, business performance*

1. Introduction

For many nations in the world, the retail industry has often been considered as the backbone of the economy and in Malaysia it is one of the biggest contributors to the income of the country and offers massive employment to the population. The retail industry has gone through massive evolution since the peak of modern retailing in the 1980s in Malaysia. It was in the 1980s up till the 1990s that global retailers from Japan (Kimisawa, Hankyu Jaya to name a few), from the Netherlands (Makro) and from France (Carrefour) thrived and brought modern and large format retailing into Malaysia. This was the beginning of the competitive decade where large retailers dominate the retail scene and the small ones that are mostly retail SMEs found the competitive pressure to be too overwhelming. Although it was often emphasized that retail sizes need not necessarily denote customer attraction, small retailers are still of the opinion that the large retailers are controlling the retail scene.

The competitive retail industry and significant market changes are among the factors that are attributing directly or indirectly to the performance of retail SMEs. It is implied that the tight competition since the entrance of big retailers and modern retail format have affected the business performance of retail SMEs. Past studies have shown that the success of giant retailers often come at the expense of local merchants[1], as many small retailers find that they cannot compete with these large stores.

Large stores frequently offer lower prices for their merchandise than small, local retailers. As a consequence, many small retailers have only two choices, whether to adapt quickly or go out of business. Many studies discussed the impact of the growth of chain stores or hypermarkets on small retailers and many have reported the negative impact that such large stores have on the small retailers2 3. The most profound impact on small retailers is not only economic but also on related issues like unemployment as well as related sociological impact4. The losses incurred by small retail stores due to the establishment of giant stores like large supermarkets and hypermarkets may lead to social instability and studies have indicated that a community's retail sales volume tend to see increment when a large format retailer enters the local market place, while the retailing activities in surrounding communities decrease5. The giant retailers act as magnets that increase competitiveness while drawing away consumers from the community from patronizing small local stores. Realizing the importance of making sure that these retail SMEs survive and remain competitive in the business, many supporting programs had been launched by the Malaysian government such as the Small Retailers Transformation Program (TUKAR) with RM30 million worth of funding6. The aim of the program is to strengthen rural and urban cooperative wholesale and retail sectors with an additional funding of RM300K for new start-ups of cooperatives7. The current 2017 budget has allocations to fund the retailers in support of their continuity. Unfortunately, retail SMEs are still struggling and some are forced to shut down after venturing into the business for just a few years.

Not many SMEs are able to survive for at least five years and many are reported to close their unprofitable ventures within three

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years after operating8. Essentially, the success of SMEs is still low and the failure rate of small businesses in the first five years is more than 50 percent 9. Only 10 percent of start-ups survived beyond the 10 years of venture10. For retail SMEs, much like any other SMEs, the competitive pressure within the first five years is also a concerned as they struggle to survive amidst the growth of the much larger and well established supermarkets or hypermarkets. Among the challenges faced by SMEs, particularly in Asia are: improving productivity and product / service quality, increasing entrepreneurial activity, encouraging innovation and technological upgrades among local firms, improving utilization of government incentives, developing human capital and encouraging smart partnerships11. These challenges affect the sustainability of such businesses and therefore there is a need to find strategic initiatives in ensuring long-term viability. Various strategies have been highlighted and discussed by past scholars to facilitate retail SMEs in many countries especially in building and strengthening the business relationships. It was reported by many researchers that SMEs can innovate and achieve efficient growth of their businesses only through creating and maintaining a network of partners12 13. Networks are essential especially to SMEs with limited resources as they are dependent on firms with such resources14 15 and it has been reported that the main success of SMEs is the ability to coordinate the work with limited resources16. This is the essentials of networking which has been deemed to have positive impact on growth and is the source of benefits. Essentially, business network is shown to be one of the most influential initiatives that are able to help the business and exchange partners to share valuable resources from the formal bonding. However, many studies has still overlooked the importance of social relations from a social network perspective even though it has the capability of luring the business to obtain more valuable resources and in retaining the business through long-term commitment. Business owners make use of social relations and social contacts as medium to obtain access to information, customers, and suppliers and to the sources of finance41. Social network is different from established business network in that social relation is the basis of the relationship. Business networking on the other hand, is a formalized and structured relationship between network members where profitable business performance is usually the ultimate aim. In Malaysia, previous studies on SMEs emphasize more on studying the entrepreneur's demographic features, entrepreneur's business profile and motivation, problems faced by entrepreneurs, government assistance program for entrepreneurs, and entrepreneurial process to start a business17 18 19 but only a few researchers have discussed on the importance of the entrepreneurs' social networks20 21. Little study has been done to look at the relationships between social networks and performance of small retail businesses or retail SMEs in Malaysia. Even though many scholars discussed the importance of building networks and contacts in order to be successful in business 22 23 24, research into networks related to business success has been given little attention25 26 27 and the concept of networks is still ambiguous and contradictory when it comes to the analysis of small enterprises and their networks. Thus, this study is proposed based on two main objectives. The first objective is to investigate the effects

of social networks towards the business performance of retail SMEs in Malaysia. This study is proposing that understanding the relevance of social networks in influencing performance of retail SMEs is important as the social network contain specific characteristics in which the retail SMEs can take advantage of as these are not present in large interfirm relationships. The second objective is to investigate specifically the effect of status and values homophily or similarities between retail SMEs on coordination and ultimately on business performance of retail SMEs. This is deemed important as not many studies have focused on the idea of connectedness and coordination towards achieving long-term business success.

2. Literature Review

The concept of networking has recently become more prominent in explaining the development of business[28] and establishment of the business formation among entrepreneurs[29]. The application of the network concept (and the subsequent social network approach) to the relationships between business organizations originates in the mid-1980s. The main elements of network are actors, links, flows and mechanisms[30]. The network is basically made up of actors and represented graphically as the nodes of a web which can be referred to different types of entities to be analysed such as human beings, places, computers, organizations or any areas based on interest of the firms. The links also known as the ties are the arches and represent the relationships between the individuals/nodes which are connected. The ties may describe different forms, directions, lengths and intensities. In line with this, the flows indicate the exchanges that occur between the actors which are also known as individuals within the network. They may have different content of nature and transaction such as the flows of information, advice, monetary, goods (raw materials, components, and equipment), power, friendship and many more. Lastly, the mechanism of the network can be referred to the modes and rules of connection employed by the actors within the networks. On a similar note, networking is related to the business relationship that is associated with more than one network[31] and it is reflected based on three components consisting of the performer, the activity, and the source in each network[32]. Networking is not a sudden commitment but it occurs with the mutually-agreed commitment between members within the networks. Networking exists when network members compromise in investing specific time, energy and efforts to foster the business relationship. However, different from other formal networks in business, social networks would exist informally but it is very important in obtaining valuable resources to run the business. Social networks consist of informal networks (family, relatives, friends, acquaintances) and formal business networks such as customers, distributors, suppliers, competitors, government[33]. The core understanding of social network is based on Jacob Levy Moreno's study (also known as Moreno) who was the force behind the development of sociometry studies in the late 1970s, which believed that individuals in any society are involved in extending their social relationships with each other through a kinship ties[34]. Social networks theory was developed by Bourdiew[32], expatiated by Coleman[34] and refined by Portes[35]. The use of social network analysis in entrepreneurship started in the 1980s[22]. Unlike other types of network, social network provides emotional support for the owner of the business whereas the connection in social networks is commonly influenced by emotional relationship between friends[36 37], family[38], consultants and other

entrepreneurs[34]. The ties between many friends in the network are basically close, strong and dense[39 40] since the duration of friendships are long term and also create multidimensional roles in the relationship[41.] At the same time, the relationships of new friends are also casually developed, formed and will grow stronger because of many factors like sharing common interests, even though it begins as business acquaintances. Similar with old friends, new friendships also have multidimensional relations[42]. Other studies reported that spouse/life partner, parents, friends and relatives support are more important than support from business collaborators, acquaintances, former employers and former co-workers which influence the success of new ventures [43.] Creating good networks give benefits to a business in many ways since an effective and efficient networks are able to contribute and enhance the

information exchange such as in business planning, product line development, marketing activities and merchandise display; which is important for business success[44]. On the other hand, networking is also believed to be created and will shape social ties and trust between members. Uzzi[45] supported that ties will bond most networking relationships and are similar and common in attaining overall goals and it has been found that small business owners gain advantage from a support network consisting of a wide variety of individuals ranging from relatives to business associates[46]. These support networks basically provide opportunities in many areas that facilitate advertising decisions; strategies in business promotion and devise means of attracting customers; shared knowledge pertaining to customer problems; analyse trends; business location considerations, and negotiation tactics related to lease agreements and product selection. Past studies also added the advantages of social networks as the business owners are able to obtain resources such as information, access to finance, access to skills, and gain knowledge and advice[43 47.] Network relationship is also essential to obtain information, advice or ideas[48 49], to get access to the outsourcing of research and development (R&D), to establish joint R&D ventures; and to create marketing or manufacturing relationships[50]. Networking is also helpful in resources-gathering, cost-sharing in terms of R&D, training and marketing activities. SMEs everywhere are now seeking local networks and support systems to help break through the challenges of globalisation[58]. The social network perspective is fundamentally the basis to the study of network relationships and network effects which provide the foundation for describing and characterizing a firm's set of formal networks of relationships and organizational actions[21 51 52]. Social networks are critical for SMEs performance as Stam et. al.[53] pointed out clearly the importance of networks in enabling the capabilities of entrepreneurs to identify opportunities, obtain resources below the market price and to secure legitimacy from external stakeholders as well as provide emotional support[54]. The competency of business owner is essential to ensure social network is smoothly-organized and well-coordinated. Social network competence in terms of business performance is the way of analysing the capabilities of a group of entrepreneurs in building social relationship through social interrelation. This capability included the ability of business entrepreneurs to establish social relationship with employee, social closeness with customer, funding organisations, social closeness with the authority such as government and professional bodies[58]. SMEs networking[55] also mean having connection between SMEs to influence horizontal coordination of efforts and create business strategic choices[56]. SMEs need to strengthen their networking to have better performance and assist them to choose the best strategies for business. SMEs performance is sometimes referred to as the activities involving how well or poor an SME is performing in terms of financial and non-financial activities[57]. Financial activities are the indicators for objective measurement; non-financial activities are the indicators for subjective measurement. Activities such as return on investment, return on equity, return on capital, employee retention and market share are all used to assess the SMEs performance. However, some other SMEs performance also can be measured subjectively in helping SMEs to have a better customer loyalty, better products quality, quality technology and a better development of product comparatively[58]. Business owners also can deal with risks in ensuring business continuity through networking[59]. It is widely recognized that networks and business relationships can have considerable impact on firms' ability to sustain and improve their competitive advantages[60]. Moreover, there are studies reporting that SMEs performance also can be measured through customer relations[61 62] and customer loyalty[63]. Even though customer retention and customer loyalty are subjective indicators in measuring business performance, they are both important in making sure the business is sustainable as more loyal customers will maximize profits to the business. These loyal customers are able to act like a company's brand ambassador and they tend to use word mouth-to-mouth to persuade closest friends and other people to use the same brand like them. Subsequently, previous scholars have reported many factors that also contributed to the profitability of SMEs such as entrepreneurial style, emotional intelligence, innovation capability, social capital and networking activities that can all impact the performance of SMEs[58]. In understanding social networks, one main characteristic of such network is that of homophily. This refers to the principle that a contact between similar people occurs at a higher rate than among dissimilar people. Homophily can be divided into two types; status homophily and value homophily[64], where status homophily describes the similarity of individuals based on socio-demographic characteristics such as ethnicity, gender, or age, and acquired characteristics like religion, intelligence, education, occupation, or behaviour patterns. Ethnicity play the biggest part in structuring the networks in other ethnically diverse societies through marriage bonding, work relations and schoolmate friendship. Racial homophily occurs in friendship networks in early grades and racial/ethnic minorities commonly get more heterogenous advice and support networks than their majority counterparts[68]. In regard to gender, homophily of networks is different from race or ethnicity. Race and ethnic homophily are dominated by important features such as education, income, residence and others. This study believed the similarity of features shared by members in social networks is helpful in obtaining valuable resources for the business purposes. In terms of gender differences of homophily, boys tend to engage with larger groups and heterogeneous cliques. Girls on the other hand, tend to move toward very different social circles, smaller groups and homogenous cliques. Different for adult; men tend to engage with more gender homophilous networks than women, especially in establishments where they are a strong majority[68]. Age homophilous among close friendship can be stronger than any dimensions as this ties are commonly formed in childhood. Therefore, the ties became close, intimate and longer lived[68]. Some of the ties formed are more personal and involve larger number of exchanges like marriage bonding, friendship and confiding relationships. Religious homophily in all societies with religious diversity also play an important role even though it is not typically strong as race and ethnicity. Different from nonparents, parents usually show greater religious homophily in their network ties.

Generally, religion is inherited from family origin and it develops through religious institution and education system in the society. Meanwhile, social class often determines the social status of one person in the society. Social class can be seen from neighborhood residence; education and school settings; occupation and voluntary association activity. Social class included education status and occupation prestige is important as religion and gender as a person tend to connect and be intimate within a homophily social class[68]. Thus, this study believes members who have the same level of education and similar background of occupation is easily connected. They usually have greater tendency to extend social cooperation and have confident of each other. On the other hand, value homophily describes the similarity of individuals based on values, attitudes and beliefs which defines the wide variety of internal states presumed in shaping individuals' orientation toward future behavior. Value homophily or influence also comes from the misperception of friends' beliefs and attitudes. People tend to assume that their friends are like them, when in fact areas of disagreement simply are not discussed. Homophily is more straightforward for individuals, where the tendency to build connection, friendship or association with others is higher if these individuals have similar attributes[65]. Homophily can be considered as a strong mechanism of connections as it has the capability of potentially altering where individuals expect self-similar alters tend to accept them[66 67] and to hold beliefs that affirm their own views[67]. Homophily leads to the intimacy of relationships among members involved as it is capable of reducing member's conflicts, misunderstanding and also in controlling costs that exist within the connections[63 64]. So if individuals are more likely to build

social ties with the same acquaintances, the tendency to maintain the ties is stronger than to maintain the relationship with heterophilous. The heterophilous relationships are more fragile and likely to break apart as the heterophilous relationship will have difference in opinions and beliefs which may lead to conflict, frustration and stress[62]. This study believes that retail SMEs who share similar attributes and characteristics with their social network members are more likely to gain valuable resources through organized coordination and therefore attain better business performance.

As such, the following framework is conceptualized:

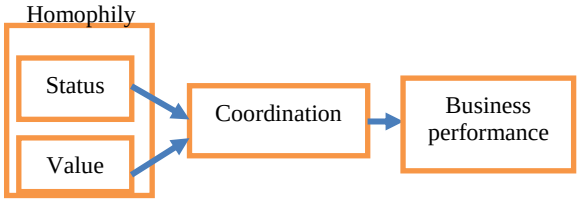


Fig. 1. Conceptual framework of homophily in social networks and business performance of retail SMEs in Malaysia.

Figure 2 conceptualizes the effect of homophily in social networks influencing business performance of retail SMEs in Malaysia. Based on the conceptual framework, this study is postulating that:

H1: Status homophily in social networks has positive relationship with coordination of efforts influencing business performance of retail SMEs.

H2: Value homophily in social network has positive relationship with coordination of efforts influencing business performance of retail SMEs.

Homophily relates to individuals who have one or more similar social attributes like sharing common social class where the greater these individuals share same common attributes they have greater tendency to establish a connection[68]. Status homophily assumes that retail SMEs that share common characteristics like the type of retail format, the ethnicity of retail owners, the size and the length of business in operation are more likely to share similarities which lead them to coordinate their efforts in the distribution channels. Such coordination therefore will influence their business performance. Alternatively, value homophily which refers to the sharing of values, attitudes and behaviours among the retail SMEs are also postulated to lead to coordination of efforts and therefore enhances their business performance. Retail owners also would not neglect the importance of the digitalization era to ensure that coordination would go smoothly and the business performs well. The new era of research emphasized on the role of networking which digitally mediated relationships of assortativity, homophily, and network building. These relationships are created and maintained via instant messaging, blogs, online-community membership, or email, unlike the traditional relationships such as face-to-face contact, which can potentially mask visible characteristics of potential contacts[69].

3. Conclusion

This study provides a review of the social network theory given that social interaction is likely to enhance network capabilities like coordination. Coordination occurs when channel members are brought together to advance the goals of the distribution network. It is coordination that is likely to influence the business performance of retail SMEs in Malaysia as they need to work together in order to combat the aggressive advancement of the large retail competitors. There is more voice in unity and the retail SMEs must put together their efforts if they are keen to see a fairer competitive environment. It is hoped that this study will be able to gather more literature pertaining to the involvement of the retail SMEs in the distribution channels in limiting the advancement of larger and more dominant retail players in the industry. Undoubtedly, maintaining the relationships among retail SMEs in the distribution channels through social networks is needed to ensure the survival and sustainability of retail SMEs in facing challenging competition from giant retailers. Indeed, contributing to the understanding of how to sustain retail SMEs would contribute to the economic and social stability of the industry in Malaysia.

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