

## **“Thought Paper”: The Role of Social Capital in Frontier Capital Markets**

### **#1: “How do we define Social Capital?”**

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**“[Social Capital is] the web of social relationships that influence individual behavior and thereby affects economic growth”, Karen Pennar: *Business Week*, Dec. 15, 1997**

This paper is one of a series of “thought papers” published by the Network Science Center at West Point. As our research teams conduct their analyses, certain findings and insights arise that may not be directly related to the research question at hand but, we believe, are important to both the academic and policy communities. This particular series of “thought papers” will address insights concerning social capital and its role economic development issues.

The Network Science Center at West Point has been involved in ongoing research exploring the network topologies of Capital Markets in Frontier Capital Markets. Frontier Markets are essentially a subset of Emerging Markets with lower market capitalization and liquidity. This term was coined in 1992 by the International Finance Corporation. Our team’s research has involved extensive data collection efforts including numerous interviews with financial leaders and innovators in these emerging economies.

During the course of this data collection and the subsequent analysis, the research team has identified additional topics that we believe are ripe for analysis. We believe that addressing these research topics is vital to understanding and devising potential innovations in economic development.

Throughout the course of our interviews with key actors and organizations within our networks of interest, it became apparent to the research team that the key individuals' social networks were amazingly powerful and influential. The team was aware of the concept of social capital and thought that it would be important to explore this concept in more depth and to further determine how to incorporate this concept more fully into our network analysis.

### **Social Capital Defined**

The term 'social capital' on the most general level refers to the access to resources by virtue of social relations. Once we delve into the many facets of the term we encounter difficulties to find a clear definition of what is meant by 'social' and in as much we could talk about 'capital' in this framework. 'Social' then refers either to individuals (Van Der Gaag & Snijders 2004:2), groups, organizations or all of these social elements and their respective networks (Adler & Kwon 2002:20). Some experts – amongst them Bourdieu, Portes and Inglehart - even focus their definition on the ties between social entities or their underlying motivation and rules. Yet others define 'social capital' as a mix of human relations and the culture that shapes them or entirely focus on the resources an agent may obtain (ibid.).

Although the basic definition of 'social' does not carry an evaluation of the nature of the social relation, throughout most of the 'social capital' body of work the assets obtained through social relations are seen as positive events and include next to actual also potential or perceived benefits (Adler & Kwon 2002:20). The work on social capital can be divided into two strands of understandings of 'benefit': one strand emphasizes individual goal attainment (references include Baker, Bourdieu, Burt, Coleman, Pennar, and Portes), while the other underlines collective action and the pursuance of common interests (Brehm & Rahn, Fukuyama, and Putnam) (Adler & Kwon 2002:20, Bebbington 2009:165, Van Der Gaag & Snijders 2004:2). The benefits of social capital that serve an agent's personal interest include information, the facilitation of action, general support, opportunities (mostly economic) and the pursuance of economic goals, as well as the acquisition of economically valuable skills

and traits (Adler & Kwon 2002:20). Besides benefits that further economic interest, social capital may also improve the individual's social standing as it offers not only influence, control, and power, but also encourages solidarity (Adler & Kwon 2002:29f).

Only few authors point to negative aspects of social capital. On the micro-level, strong relationships can restrict information flow and stifle development and innovation. This has especially tragic effects on institutions and organizations in the marketplace. The process of establishing and maintaining relationships is an investment of time and social exclusivity that may not be cost efficient. Research concerning the information benefits of social capital reveals that strong relationships in and between social networks are not only less efficient, but also more costly to establish and maintain than weaker relationships (Adler & Kwon 2002:30f). The closure<sup>1</sup> of a given social network furthermore renders the individual member less powerful as his information can be substituted for by other members. On the other hand, a "gatekeeper" in the position of bridging structural holes may function as censor for incoming and outgoing information. Another risk of closures in networks lies in the increase of group solidarity that often tends to limit or exclude outside contacts and information flow. This potentially restricts access to benefits for outsiders as well as diversity to the group membership (Adler & Kwon 2002:22, 30f). In an organizational environment, such a configuration may lead to the disintegration of the organization as a whole. Internal ties in a given sub-group that grow too strong and exclusive may be responsible. Several studies extend this hypothesis onto the macro-level and show how societal sub-groups may become disruptive to the broader society (see Brass, Butterfield & Skaggs (1998), Foley & Edwards (1996:39), De Souza Briggs (1998)). Paradoxically, group membership may also restrict access to social capital-resources, e.g. establishing norms of sharing rather than accumulating profits or preventing girls from attending school (Grootaert et. al. 2004:4). Additionally, on the level of society Bourdieu as well as Fukuyama point out that social capital inherently aids in the persistence of social inequalities (Adler & Kwon 2002:22, 30f). This is due in part to the tendency of social capital to reproduce itself

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<sup>1</sup> The closure of the network structure refers to the extent to which social contacts of the focal actor themselves are socially connected (other than focal actor-contact).

(especially in respect to social contacts). Another reason may lie in the absence of institutionalized control and accountability measures that prevent features of nepotism, insider-trading and other forms of favoritism (Grootaert et. al. 2004:4).

Some authors define resources in terms of the means by which they are provided such as means and processes which promote communal development, which may include trust, tolerance, informal values and norms (of reciprocity) (Adler & Kwon 2002:20, 22). Others emphasize elements of social interaction like an individual's expectations for action (by others), the individual's ability to cooperate or the individual's efforts of establishing, maintaining and mobilizing a social network (Adler & Kwon 2002:22). If benefits are not supplied through more or less institutionalized social rules underlying social interaction, it is the individual who voluntarily provides them, perhaps motivated by self interest in that the provision of assets now may engender support later (Adler & Kwon 2002:21). All authors, however, agree on the importance to understand the multidimensionality of social capital (Grootaert et. al. 2004:3); the diversity of social connections (private and professional), the multitude of assets each relationship can offer (pertaining to the roles of everyone involved), and the motivations that render the social connection to turn out resources.

The term 'social capital' entails such a plethora of definitions, concepts, and subcategories that it would overwhelm the scope of this paper should we even attempt a comprehensive definition of a term that De Souza attributed "a circus-tent quality" to (1998:178). . In our work, we focus on 'social capital' as means to further economical development. On the micro-level, social capital is most relevant in form of social leverage and social support (De Souza Briggs 1998:178). The former implies access and thus possibly a gain in power and influence. For example, information about job openings and the submission of recommendations or evaluations for an open position by a social contact can give an individual a distinct advantage. In contrast, social support helps to maintain the status quo by providing emotional and material assistance for everyday problems (ibid.). Like Van Der Gaag and Snijders (2004:4f.), we encounter

the challenge to quantify aspects of social capital that are meaningful for our focus on economical development.

### **The Way Ahead**

Sociologists and economists are in general agreement that social capital needs to be taken into consideration when attempting to understand the networks involved in economics especially when analyzing economic development. As network analysts and mathematicians, our team is focused on measurement and quantification. Is it possible to measure a concept like Social Capital? This challenge will be the focus of the team's next Social Capital "thought paper."

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