The relationship between social capital and the director's duty to promote the success of the company

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Abstract

Purpose – The purpose of this paper is to explore the relationship between social capital and the directors' duty to promote the success of the company and to foster business relationships, which is a comparatively under-researched issue.

Design/methodology/approach – The approach taken focuses on the concept of social capital, its various forms and influence on business performance. Ultimately, the paper explores ways in which directors' duties as stated in s.172 (1) of the Companies Act 2006 may affect the building and maintenance of forms of social capital.

Findings – It seems that it is likely that by complying with s.172 (1) directors will build forms of social capital, which in turn will enhance the business performance of companies in aspects such as innovative activity, transaction costs, and productivity. Consequently, the building of social capital is likely to promote the success of the company.

Originality/value – It can be stated that s.172 (1) CA 2006, is a potentially paradigmatic move in the way in which company directors undertake their business and view their company's stakeholders (Dignam and Lowry). Davies appears to agree with this view commenting upon the "ideological significance" of the introduction of s.172. It certainly seems that the inclusion of a duty to consider the importance of fostering business relationships implicitly promotes the pursuit of social capital.

Keywords Social capital, Directors' duties, Business relationships, Business success, Directors, Customer relationship management

Paper type Conceptual paper

Introduction

The last decade has witnessed a growth of research into the concept of social capital, which can be defined as a "system of interpersonal networks" (Dasgupta, 2000). In relation to private limited companies, links can be made to the duty contained in s.172 (1) of the Companies Act 2006 (CA), which requires a director to "act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole." This is because social capital can have a positive impact on business activities and can thus contribute to the success of the company. Although the interests of shareholders are prioritised, directors are obliged to take into account wider factors including: "the need to foster the company's relationships with suppliers, customers and others' which is essential to the creation of social capital" (s.172 (1)(c)).

S.172 (1) is a reformulation of the common law duty to act bona fide in the interests of the company, but the insertion of a list of factors that the director must have regard to, including the importance of fostering business relationships, reflects the greater

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awareness of the need for business to adopt a more holistic, stakeholder view of their operations and relationships (Kershaw, 2009; Dignam and Lowry, 2010). Indeed, Dignam and Lowry (2010) consider the directors' duties contained in s.172 (1) to be a "reminder" to directors of their obligation to nurture good relationships with the company's stakeholders. The paper will begin by defining the concept of social capital and explaining the different forms that it takes. The impact of social capital will then be discussed, with express reference to the duty of directors contained in s.172. The paper will conclude by considering the role that s.172 plays in the creation of social capital and vice versa.

Social capital

There are a growing number of definitions for the phenomena that constitute what is described as social capital. For example, Ostrom and Ahn (2003) consider social capital as "an attribute of individuals and of their relationships that enhance their ability to solve collective problems". Coleman (1988) agrees stating that social capital exists in the "relations among persons". Other authors such as Conway and Steward (2009) also believe social capital to be located in relationships. The notion of location of social capital is employed by Conway and Steward (2009) to reveal their view that social capital is not owned by any individual or group. This, they say, is due to the fact that if an individual were to withdraw from a relationship, the social capital is likely to cease to exist.

However, Huggins and Johnston (2010) argue that social capital is held by an individual. This interpretation of social capital may create a dilemma in terms of its questioning of whether social capital is an individual and/or a group construct. Huggins and Johnson question whether individuals seek social capital for personal gain or for an organisational-based motive. It should be recognised that personal gain is acceptable for a sole trader or single member company. This conundrum may have implications for s.172 CA 2006. Namely, directors' duties focus upon promoting the success of the company, also as stated in s.175 to another duty is to avoid conflicts of interest, these may or may not differ with the director's notion of personal gain. At the heart of the debate is how the role played by directors creates an environment whereby personal and/or organisationally-motivated social capital may be built. However, there are likely to be opportunities for tension to occur between the building of social capital for individual and organisational gain.

Dasgupta (2000) views social capital as a "system of interpersonal networks" and to be a macro-scale phenomenon affecting the whole economy. Small-scale network involvement output he considers being human capital rather than social capital. Indeed, Dasgupta (2005) defines social capital as being "interpersonal networks, nothing more". He develops this statement by referring to a prerequisite for social capital as being the maintenance of trust which members of an interpersonal network have in each other. The maintenance is achieved by the "mutual enforcement of agreements". Developing the notion of agreement, Fountain (1998) considers efficient and effective networks to have the capability to resolve conflict. Further, Dasgupta (2005) believes the quality of an interpersonal network to be dependent upon the use to which it is put. Others, like Fukuyama (2003) define social capital as "an instantiated informal norm that promotes cooperation". Social capital is described by Coleman (1988) as not being a unitary entity, rather a number of different entities. Dasgupta (2000) also refers to the variety of forms of social capital. Woolcock and Narayan (2000) and Beugelsdijk and Van Schaik (2005a) allude to the multidimensional nature of social capital. Coleman (1988) states that, although social capital may arguably be rather disparate in its construction, there are two common elements, namely, social structures, and individuals and organisations undertaking actions. Social capital may be distinguished from other forms of capital in that the more it is used the more it increases (Putnam *et al.*, 1993). Similarly, Woolcock and Narayan (2000) are of the opinion that the fabric of social capital changes over time. Putnam *et al.* (1993) consider that social capital may increase via a "virtuous circle" of activity and diminish as a consequence of a "vicious circle" of activity. Fountain (1998) supports the concept of social capital increasing in a virtuous circle; she refers to the "self-reinforcing cyclic nature of social relationships". In particular, do elements of social capital such as trust, social norms and networks increase with the presence of a virtuous circle of activity? (Putnam *et al.*, 1993). Virtuous circles, if they contribute as suggested to the formation of social capital are likely to be an outcome if directors actively foster relationships with suppliers, customers and other stakeholders.

Kaasa (2009) describes company level social capital as being focused upon Putnam *et al.*'s (1993) view of social capital (trust, norms, and networks). At company level, this means the trust, norms, and networks are associated with an individual employee (Kaasa, 2009). Further, Putnam *et al.* (1993) link social capital to social organisations in that they may both be constituted of trust, norms and networks. Dasgupta (2000) critiques the work of Putnam *et al.* (1993) when he states that in his opinion Putnam *et al.* (1993) although identifying components of social capital, fail to articulate how they would be "amalgamated" to form social capital. Bjornskov (2006) also questions Putnam *et al.*'s (1993) definition of social capital, considering it to be vague. Its vagueness, continues Bjornskov (2006), stems from the amelioration of a wide variety of societal entities into a single concept. It should also be noted that Putnam *et al.*'s (1993) work has been criticised as an oversimplification of the environment in which social capital exists (Beugelsdijk and van Shaik, 2005a, b).

Other factors which influence social capital include cultural differences (Coleman, 1988). Coleman considers cultural differences to impact on the likelihood that benefit or aid will be lent and requested and the subsequent knock-on effect to the closure of social networks (closure of social networks may be interpreted as completing/joining up loose ends of a network).

Bonding and bridging social capital

Woodhouse (2006) refers to two different forms of social capital; namely, bonding and bridging social capital. Bonding social capital may be described as a situation where the relationships existing between a group of individuals (or within a community) enable them to "get by" maintaining their existence and status quo (Woodhouse, 2006; Putnam, 2000). Similarly, Putnam (2000) defines bonding social capital as being an outcome of the connections built between individuals in the same group. Bridging social capital also refers to relationships between individuals in a group or community. However, in this case relationships extend outside the group (or community) and, as a result, gain access to skills and resources currently not available within the group (or community). A result social capital may also have implications for s.172 (1)(d) which identifies a need for directors to be mindful of the impact of their actions on the community.

The newly-found skills and resources take the group forward – beyond merely getting by (Woodhouse, 2006). There may be parallels to be drawn between notions of bridging social capital and the work of Huggins (2010). Huggins' definition of network capital as being a "calculative and strategic" network enabling exchange of knowledge may ultimately perform a similar function to bridging social capital. This may be the case in that building and maintaining bridging social capital may necessitate a structured and strategic approach. Further, the exchange of knowledge may be an outcome of bridging social capital. Huggins also writes of network capital involving companies accessing rather than acquiring knowledge. Huggins builds on an expectation that competitive advantage may accrue from network capital. If the fostering of business relationship can, as suggested by Huggins be actively created then s.172 could contribute to the creation of a framework of activity where different forms of social capital may result. Indeed, such activity may lead to the achievement competitive advantage as a result of calculatively building network capital.

Putnam (2000) considers bridging social capital to be achieved via connections built between different often diverse social groups. The distinction between bonding and bridging social capital has been simplified by Putnam (2004). His interpretation focuses upon how alike people are in terms of social class, ethnicity, gender and age. Bonding social capital, state Putnam (2004), is typically a social network in which individuals are alike, whilst, bridging social capital is more likely to constitute a social network in which individuals are dissimilar.

Further, Putnam (2004) states that bridging social capital is more likely to produce positive outcomes. This is because bridging social capital may be less likely to produce destructive outcomes such as criminal activity. In reality, many individuals are exposed to, and participate in, both bonding and bridging social capital (Putnam, 2004). There is a danger that bonding social capital, if characterised by strong ties, as described by Granovetter (1992), may inhibit an organisation or an individual's ability to create relationships with individuals and/or organisations external to the auspices of bonding social capital. For instance, in the early stages of its life cycle, a company may be dependent upon family, friends and a trusted local network for its supplies and market. However, to develop and grow a company is likely to need to work with different suppliers and others in the market. There is an opportunity for conflict for directors, do they remain loyal to friends and family or do they act in the best interests of the business and look to build bridging social capital which may create relationships with different customers, suppliers and other stakeholders. The strength of existing ties associated with bonding social capital may limit a company's desire and capability to build bridging social capital. This is also considered by Dodgson *et al.* (2008), who consider relationships which may be regarded as too strong can inhibit current and possibly future business activity. Clearly this has potential for directors to be compromised given the contents of s.172, s.175 and s.176 CA 2006. Directors may therefore approach business relationships and the concept of social capital differently.

Thus, bonding social capital, although usually a desirable resource may need to be actively managed to prevent it inhibiting individual and company development. If bonding social capital is not actively managed and becomes too dominant a force it may suffocate a company and permanently limit its potential for development. Bridging social capital may be described as being the means by which locally-based networks can "transcend" the locally-based focus of their existence (Woolcock and Narayan, 2000).

Cognitive and structural forms of social capital

Kaasa (2009) identifies two other forms of social capital: cognitive and structural. Similarly, Tsai and Ghoshal (1998) consider their view of social capital: social ties, trust, and value systems to correspond to a structural, relational and cognitive description of social capital. The structural facet of social capital has its roots in social interaction, whilst, the relational aspect of social capital may be said to be located in the social interactions in the form of trust and trustworthiness (Tsai and Ghoshal, 1998). Finally, the cognitive aspect of social capital is sourced in a shared understanding of desired modes of behaviour and outcomes (Tsai and Ghoshal, 1998). Further, Kaasa (2009) refers to cognitive social capital as being constituted from norms and trust, and structural social capital as encompassing formal and informal networks. Clearly, Kaasa (2009) is referring to the work of Putnam *et al.* (1993) by re-categorising the constituent elements of social capital. Landry *et al.* (2002) also refer to cognitive and structural social capital. Concurring with Kaasa (2009), Landry *et al.* (2002) consider structural social capital to be networks, relational and participation assets. The Landry *et al.* (2002) definition of cognitive social capital provides a fuller description, including norms, attitudes, beliefs and values impacting upon the interdependence facet of social capital. In many social capital-based research studies the main form of cognitive social capital explored is trust (Landry *et al.*, 2002; Woodhouse, 2006).

Social capital and the achievement of desirable business activity

Social capital is considered to have positive relationships with business activity such as innovation, transaction costs, and productivity. A possible fundamental linkage between social capital and innovation is a statement made by Putnam *et al.* (1993). The statement "trust lubricates cooperation" clearly identifies the importance of trust as an enabler of cooperation. Beugelsdijk and Van Schaik (2005a) believe that higher levels of trust usually lead to higher levels of cooperation. A possible link is made by Rutten and Boekema (2007) and Shan *et al.* (1994) who support the view that cooperation and collaboration are essential to the process of innovation. Further, they consider social capital to play a vital role in the efficiency and effectiveness of cooperation and collaboration. Likewise, trust is considered by Fountain (1998) to be a prerequisite for effective collaboration. Social capital, state Rutten and Boekema (2007), is a prerequisite for an efficient and effective process of innovation. In support, Tsai and Ghoshal's (1998) research reveals a significant positive link between a company's social capital and its capability to innovate and likely direct or indirect impact upon the promotion of the success of the company. Landry *et al.* (2002) also consider social capital to be an influential factor in the decision to innovate or not and subsequently the radical nature of the innovation. Indeed, social capital may be considered to be a crucial element in an organisation's bid to become more innovative (OECD/Eurostat, 2005). Consequently, it may well be the case that trust via cooperation is also of importance to innovation. Indeed, Landry *et al.* (2002) describe social capital as being an "essential ingredient to understand innovation".

Further, as stated by Putnam *et al.* (1993) and Beugelsdijk and Van Schaik (2005a), "cooperation breeds trust". If this statement is true then cooperation and trust mutually supporting and fostering one another may create a particularly fecund virtuous circle; a virtuous circle which may increasingly produce higher levels of trust and cooperation. Rutten (2003) agrees with this proposition, stating that companies are more likely to cooperate with each other if they are in a high-trust relationship. The rationale for such a statement is the expectation by companies of the benefits of working together. It has been stated that increased levels of trust, as a consequence of increased levels of cooperation, may lead to lower levels of risk aversion and an increased likelihood of more radical forms of innovation taking place (Akcomak and ter Weel, 2008; Kaasa, 2009). Sweeney (2001) demonstrates clarity of thought in his work linking the social capital outcome of trust as focal to innovative activity. It is mutually held trust which acts as an enabler for innovation to take place (Sweeney, 2001).

On the other hand, Knack and Keefer (1997) and Landry *et al.* (2002) believe that innovation is less likely to happen where comparatively low trust exists. Their rationale for this view is that low trust between an organisation's stakeholders may divert attention away from more productive use of resources. They maintain that societies with comparatively higher levels of trust are more likely to engage in innovative activities. Conversely, comparatively low levels of trust may be expected to lead to higher transaction costs. Higher transaction costs are likely to increase the cost of doing business with another individual or organisation. As a result, time and resource are diverted away from innovative activities towards lower value-add policing of interactions with stakeholders. Woodhouse (2006) states that increasing levels of trust are likely to reduce economic transaction costs. Indeed the creation of trust between stakeholders if likely to further work towards promoting the success of the company. Beugelsdijk and Van Schaik (2005a) also refer to trust as having the capability to reduce transaction costs. Typically, Beugelsdijk and Van Schaik (2005a) suggest that trust may reduce the need to closely monitor business activities. It is also likely that comparatively low levels of trust may reduce levels of innovative activity. Likewise, Knack and Keefer (1997) believe the presence of trust diminishes the need to monitor and check the progress of a contractor. Similarly, Cooke *et al.* (2005) refer to the presence of trust reducing contractual complication and the need for enforcement of contracts; thus enabling companies to allocate time and resources to value-add activities such as innovation. Woolcock and Narayan's (2000) network view (as illustrated in 1.0) may reduce transaction costs and, via collectivity outcomes, contribute to increasing levels of knowledge sharing and innovation.

To facilitate information and knowledge sharing, Sweeney (2001) advocates the development of networks. Although Sweeney (2001) does not mention the term bridging social capital, he recognises the need to create and develop it. This is evident in Sweeney's (2001) identification of the need to have external relationships which facilitate the sharing of knowledge and information (possibly some tacit information) from a multitude of sources/networks (both internal and external to the company, community or region). To further investigate social capital as a factor affecting innovation, research undertaken by Cooke *et al.* (2005) reveals that innovative companies typically make use of non-local networks. Such companies are more likely to collaborate, and are also more likely to have comparatively high trust relationships, with other stakeholders. The need to have external relationships arguably fulfils directors' duties in s.172 of promoting the success of the company.

Bridging social capital is developed in a very similar manner by "plugging" into external agencies and/or networks. Another potential supporter of the network view is Kaasa (2009). Her research reveals that formal and informal networks have a positive impact on innovative activity. Similarly, Miles and Green (2008) stress the importance of formal networks such as professional associations and informal groups for the generation of ideas. Another supporter is Ahuja (2000), who believes innovative activity may be promoted by a company developing an increased number of direct ties in its network. The number of direct ties a company has in its network is linked to benefits such as "knowledge sharing, complementarity, and scale" (Ahuja, 2000). Directors fostering business relationships are likely to increase opportunities for such benefits to accrue. The direct ties alluded to by Ahuja (2000) enable companies who collaborate to access a larger resource pool than if they had acted independently, Tsai and Ghoshal (1998) also share this view. Complementarity facilitates the achievement of synergistic outcomes resultant of intra- and inter-company skill amelioration.

The direct ties related benefit of scale are similar to those of knowledge sharing, namely, that companies in a direct ties network are able to access a larger pool of resources *per se* (Ahuja, 2000). The research of Landry *et al.* (2002) reveals that structural social capital in the form of networks and other forms of relational assets has a positive relationship with innovation. In other words, as the quantity and quality of structural social capital increases, so does the likelihood of innovative activity.

It may be stated that to support and/or promote innovation, networks need to be open, efficient and effective in information/knowledge exchange (Fountain, 1998). Fountain (1998) refers to productive networks as a "mesh" of "flexible peer-to-peer" relationships. This, she states, is a source of social capital. The peer-to-peer meshed network described by Fountain (1998) may be an enabler of innovation. This may be the case if individuals and/or organisations become more adaptable as an outcome of the network. Fountain refers to a meshed network as having the capability to enhance individual and/or organisational awareness and understanding of the business environment. The greater awareness and understanding may result in increased capability to identify opportunities or threats, identify and implement solutions, and as a result increase levels of innovation and promote the success of the company.

Nevertheless, Fountain (1998) expresses a note of caution, stating that the information sharing resulting from networks is not as valuable as the social capital produced. To elaborate upon this statement, social capital rather than information capital is more likely to produce useful, innovation-focused outcomes. This is the case, states Fountain (1998), because of the "screening of information" for authenticity, validity and potential impact undertaken by network members. The most efficient and effective form of network to achieve such screening is a collaborative one (Fountain, 1998). Fountain (1998) also alludes to the trust built up in meshed peer-to-peer networks. This trust, she states, is likely to add value to the information exchanged and encourage collective learning to take place.

It is evident that Fountain (1998) expresses support for the formation of horizontal networks as opposed to vertical networks; horizontal networks seemingly being more supportive of the formation of social capital and consequential innovation outcomes. A possible reason why horizontal networks may be more likely to assist the formation of social capital is to be found in the work of Hall (2002). Hall (2002) holds the view that social capital formation requires individuals to regularly interact in a context of "relative equality". Arguably, a state of relative equality is more likely to exist in a horizontal as opposed to a vertical network. The notion of relative equality may be of particular interest to directors' duties of building and maintaining relationships.

Fountain (1998) supports the view that proximity matters in social capital construction, with the key social capital abutment to innovation being the lowering of transaction costs (Landry *et al.*, 2002). Transaction costs such as "search and information costs, bargaining and decision costs, and policing and enforcement costs" are reduced (Landry *et al.*, 2002). This is likely to be the case because of the expected increase in levels of trust, leading to a diminishing role for security checks when undertaking a project. As a consequence, it is expected that lead and launch times are decreased, further promoting the success of the company.

To further strengthen the linkage/relationship between social capital and innovation, it has been stated that social capital may improve the productivity of both physical and human capital (Woodhouse, 2006). In addition, social capital may have an impact upon the willingness and capability of an individual or a group to take a risk. Woodhouse (2006) considers social capital to impact upon risk acceptance or risk adversity. Also, higher levels of trust are expected to lower risk aversion (Kaasa, 2009). For example, higher levels of trust are associated with higher levels of investment in R&D (Akcomak and ter Weel, 2008). Further, Woodhouse (2006) states that social capital may be considered to be a form of insurance against risk. As a result promote likelihood of the directors acting in the interest of the company's stakeholders. The degree of willingness to take risks is generally accepted to be a factor affecting levels of innovative activity (Akcomak and ter Weel, 2008; Mulgan *et al.*, 2007; Young Foundation/NESTA, 2007). Therefore, via the extent of risk acceptance or risk aversion, social capital may be linked to innovation. It has been stated that societal levels of risk adversity are a factor affecting innovation (Kaasa, 2009). Kaasa (2009) supports the view that social capital influences the level of innovation. In her research Kaasa (2009) has identified a positive relationship between innovation (represented by the number of patent applications made) and aspects of social capital such as general trust, institutional trust and civic participation. However, it should be noted that Kaasa (2009) focused upon patent data as a means of measuring innovation. It may not be surprising that civic participation and institutional trust are considered to be the facets of social capital which have the strongest positive relationship with innovation. Not surprising because patentable innovation may be said to be heavily dependent upon the strength of a country's legal system – in particular, a country's legislature and enforcement capability, as applied to and in relation to intellectual property. However, the Landry *et al.* (2002) study finds that trust does not have a significant statistical relationship with innovative activity. It should be noted that the Landry *et al.* (2002) study was undertaken with a sample of manufacturing companies from the region of Monteregie in Canada. Trust may arguably be less important as an issue affecting innovative activity in Canadian manufacturing companies.

Cooke *et al.* (2005) write of the dangers of making assumptions of a linear causality nature. They urge caution when making linkages between the presence and strength of social capital and company performance (innovation being among Cooke *et al.*'s (2005) performance indicators). Cooke *et al.* (2005) consider that rather than exploring linear causal relationships, it is more apt to explore associations between social capital and variables of innovation activity.

Coleman (1988) considers social capital to be in line with other forms of capital by being productive. Sweeney (2001) also describes social capital as a productive resource. He considers the product of social capital to be of value, this value being dependent upon "social organisation". Social organisation that produces value has the following attributes: trustworthiness, reciprocity, and norms predicated to encourage individuals to behave in a manner supporting a collective *raison d'etre*. Of particular note in the context of cooperation is the concept of "generalised reciprocity", as referred to by Putnam *et al.* (1993), which may be described as a "continuing relationship of exchange". However, the exchange may initially in terms of benefit be rather one-sided. Nevertheless, the party providing the benefit has an expectation that the benefit recipient will, in the future reciprocate the benefit (Putnam *et al.*, 1993). The expectation is considered by both parties to be mutual. Coleman (1988) also exposes and explores trustworthiness and expectation of reciprocation of benefit given by a trustee.

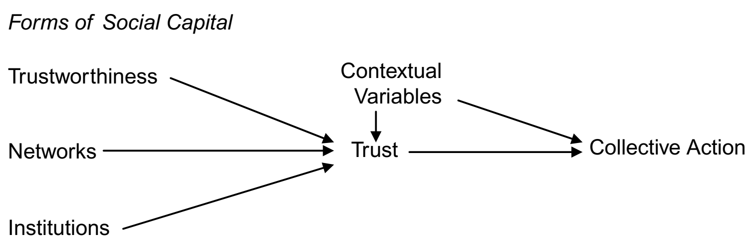
To further investigate the notion of exchange Cooke *et al.* (2005) distinguish between traded and untraded interdependencies. They consider untraded interdependencies to be a form of "gift relationship" where a favour or useful resource is exchanged without the receipt of financial compensation. Conversely, traded interdependencies involve the exchange of a useful resource and exchange of financial resources. Of interest in terms of social capital is the volume and quality of untraded interdependencies; in particular, the concept of giving and receiving favours. Favour giving and receiving are typically considered by companies as going "beyond normal practice" (Cooke *et al.*, 2005). The notion of giving and receiving favours has potential to compromise s.175 and s.176, the duty not to receive benefits from third parties. Putnam *et al.* (1993) describe a situation where generalised reciprocity is more likely to flourish where "dense networks of social exchange" exist. Putnam *et al.* (1993) continue stating, the exchange is more likely to occur when trust is expected to be "requited not exploited". Coleman (1988) also writes about the relevance of reciprocal expectation of benefit and she refers to the expectation of future benefit from the person providing the work or favour to be in the form of a "credit slip". It may also be possible to consider social capital as an enterprise's stock of "social trust values and norms" (OECD/Eurostat, 2005). Therefore, the mutual expectation aspect of generalised reciprocity may be considered an essential ingredient to improve the level of social capital. Norms such as reciprocity, states Fountain (1998), are considered to be a prerequisite of efficient and effective relationships. In continuance of Coleman's (1988) banking analogy, Fountain (1998) refers to the "favour bank". The favour bank concept enables individuals to accrue favours to be cashed in at a later date. That is, work is done, or support is given on the basis or expectation of reciprocated work or support in the future. In corroboration, Fountain (1998) considers the formation of social capital to rely upon individuals and groups to believe in the value of long-term relationships.

The perception of long-term reward acts as a form of compensation for the actual or potential short-term resource sacrifice made by the individual or group. Further, the level of reciprocity existing between companies and between individuals may be considered to be a factor affecting the diffusion of information and knowledge (Kaasa, 2009). The concept of reciprocity may provide a linkage to innovation. For example, Landry *et al.* (2002) stress the interdependent nature of stakeholders in the innovation process. Following on from this, there is to be an implication for innovation, given that innovation is typically reliant upon the appropriate diffusion of information and knowledge. A question may be posed as to whether or not the notion of shared expectation exists. In the case of directors' duties the commonly shared expectation of trust being "requited not exploited" may be considered a prerequisite for a state of general reciprocity to exist. Another link between social capital and innovation is the diffusion of innovation. The diffusion of innovation is considered to be more efficient and effective where strong association exists between individuals (Woodhouse, 2006).

Putnam *et al.* (1993) also identify networks of civic engagement as "an essential form of social capital". They consider networks of civic engagement to increase the likelihood of cooperation for the following reasons: reducing the likelihood of opportunism; increase the likelihood of reciprocity; enhance the effectiveness of the information flow (enabling information relating to trustworthiness to be communicated); provide a means of supporting an ongoing culture of expectation of collaboration leading to success (which may in turn lead to more collaboration and hopefully more success). The aforementioned benefits of networks of civic engagement may be considered to further strengthen the case for the awareness, creation and fostering of virtuous circles of activity. S.172 (1)(d) if adhered to by directors may increase the likelihood that the company would be supportive of its community. To explore the effectiveness of networks of civic engagement, the work of Putnam *et al.* (1993) may be further applied to the case of directors' duties, in particular, the extent to which horizontal and vertical networks exist. If directors have horizontal networks – making it more likely that trust and cooperation will exist (Putnam *et al.*, 1993). The differing structures and cultures of promoted by directors in different organisations may be expected to influence the existence and extent of social capital present. Similarly, Knack and Keefer (1997) consider trust and civic cooperation to be more important to the levels of social capital.

As shown in Figure 1, Ostrom and Ahn (2003) identify trust as the key linkage between social capital and collective action.

They believe trust to be an outcome of social capital. Others such as Fukuyama (2003), Dasgupta (2000), Hall (2002) and Woodhouse (2006) support the view that trust is an outcome not a form of social capital. Dasgupta (2009) confirms his belief that the only way to create trust is via social capital. For the purpose of this paper, collective action will include such phenomena as cooperation, collaboration and generalised reciprocity. Trust is defined by Ostrom and Ahn (2003) as the "subjective probability" recognised by an individual that another individual will undertake a particular course of action. Gambetta (1988) also defines trust as having a level of "subjective probability" that an individual will undertake a predicted course of action. Likewise, Beugelsdijk and Van Schaik (2005b) consider trust to be an individual's "expected dependability". Similarly, Dasgupta (2000) defines trust as being an individual expectation of the likely actions of others; the trust issue identified by Dasgupta (2000) being that the individual has to make a decision about his/her choice of action before knowing what the action of others will be. Thus, Dasgupta (2000) appears to concur with the notion of subjective probability as a fundamental tenet of trust. Similarly, Kaasa (2009) refers to confidence in others' actions as a factor of trust. Further, Ostrom and Ahn (2003) consider trust to contribute to mutual (trustor and trustee)



Source: Ostrom and Ahn (2003)

Figure 1.
Social capital, trust and collective action

beneficial outcomes. Trust may be a means by which companies may protect themselves against opportunistic behaviour. For instance, Cooke *et al.* (2005) explore the extent to which companies' formal and informal relationships affect their exposure to social capital and thus their capability to guard against opportunistic behaviour. In their exploration of social capital they investigate the contribution of mutually held trust, swapping favours, and credibility, reliability and reputational judgements to a company's capability to protect itself against opportunistic behaviour. Clearly, directors need to take care here or risk falling foul of s.172, s.175 and s.176.

Trust is a seemingly omnipresent facet of social capital. Woodhouse alludes to trust being disaggregated into two sub-categories, thick and thin trust. Thin trust refers to the trust existing in the general environment. Thick trust is conserved with an individual's more immediate environment such as work and family life. Trust may be considered to be a prerequisite for the successful building, maintaining and developing relationships – both intra- and inter-organisation (OECD/Eurostat, 2005). Indeed, Putnam *et al.* (1993) consider trust to be an "essential component of social capital". Trust as described by Beugelsdijk and Van Schaik (2005a) is the expectation of another individual's reliability of understanding, equality, commitment and predictability of actions. At more of a micro level, trust may be regarded as the property of an individual or as a facet of interpersonal relationships (the individual may be interpreted as an individual or a company) (Beugelsdijk and Van Schaik, 2005a). In terms of interpersonal relationships and the perception of others, trust, states Dasgupta (2000), is based upon reputation.

It may be stated that higher levels of societal trust increase the likelihood of the existence of a meritocracy. In other words, the recruitment and selection of human capital is more likely to focus upon an individual's education and skills and places less emphasis on who the individual knows (Kaasa, 2009). Fountain (1998) holds the view that to enable a more omnipresent form of generalised trust to exist there needs to be an element of "transivity of trust" present. Transivity of trust is described by Fountain (1998) as "A trusts C because B trusts C and A trusts B".

In relation to Figure 1 Ostrom and Ahn (2003) highlight the need for clarity when defining trustworthiness. They view trustworthiness as having its roots in an individual's "intrinsic motivation" to cooperate (or not) with another individual. The intrinsic motivation they maintain exists even in the absence of the other forms of social capital – networks and institutions. Therefore, if the insight provided by Ostrom and Ahn (2003) is accurate any research undertaken from a social capital perspective should be mindful of the individual, personalised foci of trustworthiness. In other words, although there are other factors affecting social capital in a given context, it is likely an individual may be influenced by the other forms of social capital. It remains that individuals, with their personal life legacy/baggage and understandings, have an innate intrinsic motivation to cooperate or not. A further potential complication is that an individual is expected to have a personalised continuum of trustworthiness (Ostrom and Ahn, 2003). This means that an individual may exhibit differing degrees of trustworthiness with different trustees.

Networks may provide an opportunity to share with others, perceptions of an individual's trustworthiness. As previously stated, Putnam *et al.* (1993) identify two forms of network – horizontal and vertical. Horizontal networks are considered to be the most effective in the construction of social capital. It should be noted that, Knack and Keefer's (1997) work partly contradicts the research of Putnam *et al.* (1993). Knack and

Keefer's (1997) research refutes the positive relationship between horizontal networks and trust identified by Putnam *et al.* (1993). The two entities, according to Knack and Keefer (1997), are unrelated. To further the possible relationship between social capital and innovation, Rutten and Boekema (2007) support the view that horizontal networks may boost levels of innovative activity. They refer to the "Stimulus Cluster Scheme" in The Netherlands. As described by Rutten and Boekema (2007) the "Stimulus Cluster Scheme" was designed and implemented to encourage SMEs in the Eindhoven area to cooperate with each other to increase levels of innovative activity. Levels of innovative activity increased, with the most significant contributory factor being the increased level of cooperation between SMEs. The events in Eindhoven conclude Rutten and Boekema (2007) are evidence that horizontal networks can increase levels of innovative activity and consequently promote the success of the company.

Beugelsdijk and Van Schaik (2005a) discuss the network issue of whether weak or strong ties are most effective as an abutment to economic development. The debate, according to Beugelsdijk and Van Schaik (2005a), has supporters on both sides of the argument. For instance, Coleman (1990) considers a strong (closed) network to offer the most effective means of stimulating cooperation. On the other hand, Burt (1992) supports the view that weak ties are more likely to improve economic development via greater access to information. Although recognising both points of view Beugelsdijk and Van Schaik (2005a) state that open and closed networks both offer opportunities for embeddedness and, as a consequence increased access to information. Indeed, Rutten and Boekema (2007) believe social capital has a fundamental role to play in both innovation and economic development. They consider that, whatever levels of economic and technological skills a company or region has, it will not fulfil its potential unless there is sufficient quantity and quality of network skills available. A lack of social capital may leave companies "isolated" (Rutten and Boekema, 2007). Consequently, in this situation directors may not be fulfilling their duty in s.172.

Institutions referred to in Figure 1 are considered to be formal and informal rules for society. Ostrom and Ahn (2003) consider formal and informal rules of society to be a form of social capital. Rules may be formal, set out in legislation such as CA 2006; informal rules may have their origin in formal rules and/or evolved from societal expectations of individual and group behaviour. Institutions may create an environment whereby trustworthiness is more or less likely to be present. For example, legally enforceable sanctions may be applied if an individual reneges or defaults on a transaction with a person who has trusted them. Dasgupta (2000) supports this view. He writes at length about the importance of the application of punitive measures to a defaulting trustee. Kaasa (2009) provides an additional categorisation of institutional trust. According to Kaasa (2009) institutional trust is the trust an individual has in government, government agencies, the news media and banks. Similarly, Kaasa (2009) states "the institutional trust of firms is based upon the institutional trust of individuals". Further, trust in a nation's legal system and intellectual property rights is expected to affect levels of innovative activity. This is primarily due to the increased levels of confidence individuals and companies have that R&D expenditure will result in a worthwhile financial return: in other words, reducing the opportunity for others to illegally copy your innovation. In support of this statement, Akcomak and ter Weel (2008) consider trust to have a positive effect on the volume of patent applications. On the other hand, Ostrom and Ahn (2003) stress the importance of institutions not stifling the opportunity for individuals to create an environment enabling voluntary cooperation and the solving of collective problems.

Akcomak and ter Weel (2008) refer to social capital as performing an important function in reducing "information frictions in investment decisions, which makes the financing of risky projects more transparent". The notion of "information frictions in investment decisions" is likely to be a factor affecting investment decisions made by directors in the interest of the company's members. The varying level of social capital exhibited, for example, in the form of trust, may impact on investment decisions. It may be stated that trust that may or may not exist in the three continuum projects is likely to influence their performance. For example, work undertaken by Knack and Keefer (1997) highlights the importance of trust to innovative activity and returns to human capital investment. Hence, the level of trust between a director and his/her stakeholders is likely to affect the performance of his/her business.

It is important to note, as stated by Akcomak and ter Weel (2008) that social capital originates as a result of individual-to-individual social interaction. Taking this observation further, social capital may be said to be facilitated by "spontaneous co-operation" (Putnam *et al.*, 1993). Further, Akcomak and ter Weel (2008) consider education to be positively related to social capital citing the "denser networks" created by higher levels of education which act as fertile ground for social capital to grow. Akcomak and ter Weel (2008) provide evidence of positive relationships between levels of education, social capital, and the successful implementation of government support programmes. There may also be negative economic outcomes resulting from social capital (Ostrom and Ahn, 2003). Further, Dasgupta (2000) expresses a note of caution when he refers to social capital as yielding positive or negative productivity. Woolcock and Narayan (2000) concur with this view, recognising that social capital may have positive and/or negative outcomes. For instance, family business dynasties and gangs may form social capital but may increase levels of corruption (Akcomak and ter Weel, 2008). Fountain (1998) also identifies social capital as having possible negative outcomes such as the promotion of illegal activities.

The value of trust is apparent when Dasgupta (2009, p. 1) emphatically states that the "deep requirement for economic progress is the development of trust among people". Trust can be said to be a prerequisite for the economic and social fitness of a country (Knack and Keefer, 1997). Indeed, they continue stressing the importance of trust to successful aggregate performance. Ultimately, Dasgupta (2009) believes that the trust created by social capital should lead to an increase in a country's economic wealth. At an operational level Fukuyama (2003) is of the opinion that trust may reduce economic transaction costs; primarily, the costs incurred during the process and outcome of trading/exchanging commodities and/or services. In comparison to the work of Ostrom and Ahn (2003), Woolcock and Narayan's (2000) definition of social capital is less explicit in its reference to trustworthiness and reciprocity. However, Woolcock and Narayan (2000) view trustworthiness and reciprocity as being developed iteratively.

Conclusion

A generic and arguably all-encompassing definition of social capital is that of Cooke *et al.* (2005), who define social capital as the "application or exercise of social norms of reciprocity, trust and exchange for political or economic purposes". This definition is one of the few which considers the purpose behind actions or feelings typically associated with social capital. In other words, it provides an opportunity to reveal the motivation or desired outcomes driving those who engage in social capital related activities. Here too are potential links with directors' duties in that relationship building with customers, suppliers and other stakeholders may lead to the building of social capital. Others, such as Woodhouse (2006), consider social capital to be a resource. The resource of social capital is an accumulation of many interactions between different people (Woodhouse, 2006). The seemingly multitudinous available definitions of social capital may enable the concept to be employed in a comparatively wide range of contexts and uses. Given the broad range of definitions for social capital a single, universally acceptable definition is unlikely to be produced. This does not negate the application of the concept; however, clarity is required when considering which facet of social capital is to be applied in a particular context.

Social capital may be said to lack the physical presence of more traditional forms of capital. Unlike physical forms of capital, social capital is highly unlikely to be bought or sold. The intangibility of social capital has created an aura of vagueness which may in turn cause scholars to question its validity. Coleman (1988), Landry *et al.* (2002), and Woodhouse (2006) highlight the intangible nature of social capital. Dasgupta (2000) also refers to the comparable intangible qualities of social capital. Indeed, of the three forms of capital: physical, human, and social, it is social capital which is considered to be the least tangible (Coleman, 1988). There has been and is currently much debate on the subject of social capital measurement. Physical and human forms of capital can be valued and measured. The social capital of an organisation that may be expressed in the form of goodwill can be given a value by an accountant. Indeed, there seem to be a multitude of ways of measuring social capital.

In business terms social capital formulation is considered to be beneficial, Rutten and Boekema (2007) advise companies to "invest in relationships". Others, such as Sweeney (2001), identify a variety of social capital factors which may improve the likelihood of economic development and innovative activity occurring. For example, among Sweeney's (2001) factors are the need for "social cohesion based on a shared value system". In a similar vein, Sweeney (2001) supports the need for a culture where "mutual trust, reciprocity and commitment to collective welfare" are recurrent themes. In essence, Sweeney (2001) is advocating an environment where social capital is fostered, believing social capital construction to have a positive relationship with innovation and economic development.

It can be stated that CA 2006 s.172 (1)(c) "the need to foster the company's business relationships with suppliers, customers and others" if followed and actioned by directors is likely to positively contribute to the formulation of social capital in its various guises. The business opportunity to create social capital and as a consequence contribute to increasing levels of innovative activity, lowering transaction costs and improving productivity rates may not be fulfilled, due to the tension and conflict which may result (Fountain, 1998; Putnam *et al.*, 1993; Shan *et al.*, 1994, Beugelsdijk and Van Schaik, 2005a; Rutten and Boekema, 2007). Such tension and conflict can occur as an outcome of a director's uncertainty of who or what to prioritise when building relationships – does a director prioritise the fostering of business success or prioritise his/her personal gain. It is worth noting that the aforementioned choice prioritisation may not be mutually exclusive.

Typically attempts are made by business to measure engagement with various facets of its influence and activity. In terms of quantifying and/or quantifying the extent and value of an organisation's social capital there are likely to be difficulties in measuring accurately such activity (Coleman, 1988; Landry *et al.*, 2002; Woodhouse, 2006). As a result it may be problematic for a director to truly identify the extent of social capital which may be formed as a result of adherence to s 172 CA 2006. Nevertheless, the extant literature strongly suggests that the fostering of relationships with suppliers, customers and other stakeholders is likely to result in the creation of social capital. As stated above the presence social capital is likely to positively impact upon customers, suppliers and other stakeholders, and also upon key business activities such as innovation, productivity and the lowering of transaction costs.

It can be stated that adherence by directors to the duty of fostering business relationships with suppliers, customers and other stakeholders may lead to the creation or growth in various forms of social capital. Consequently, business organisations may improve levels of innovative activity, productivity, and lowering of transaction costs as a result of increasing the presence of different forms of social capital. However, it is worthwhile noting that any relationship building undertaken by directors should comply with s.172, s.175, and s.176.

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