

COMBATING MARGINALIZATION AND POVERTY  
THROUGH INDUSTRIAL DEVELOPMENT

◀ **COMPID** ▶



## **Social capital for industrial development: operationalizing the concept**



UNITED NATIONS  
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## Social capital for industrial development: operationalizing the concept

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## Contents

Explanatory notes	iv
Overview	1
I. Social capital in economic development literature	3
A. Social capital approaches in economic literature	3
B. Economic effects related to social capital	14
C. Power asymmetries in social capital	15
D. Bonding and bridging social capital	20
E. Conclusions for the operationalization of social capital	24
II. Review of recent industrialization literature with social capital dimensions	25
A. Microlevel: interfirm relationships	25
B. Mesolevel studies and connections to social capital	27
C. Macrolevel: generalized trust, business systems, State-economy relations and cyclical factors	39
D. Conclusions for the operationalization of social capital	41
III. Conceptualization of social capital: causality, definition and indicators	43
A. Positioning social capital within industrial development	43
B. Definition of social capital	46
C. Methods of data collection	47
D. Conclusions	51
IV. Field studies on the footwear subsector in Ethiopia and Viet Nam	53
A. Footwear industry in Ethiopia and Viet Nam	53
B. Microlevel data from firm surveys	58
C. Mesolevel indicators	71
D. Contextual factors: macro level indicators of social capital	75
E. Conclusions on case studies	81
V. Conclusions and recommendations	85
A. Operationalizing social capital for industrial development	86
B. Recommendations for the United Nations Industrial Development Organization	97
Annexes	
I. Questionnaire for shoe producers in Addis Ababa	105
II. From survey questions to composite	115

## **Explanatory notes**

References to dollars (\$) are to United States dollars, unless otherwise stated.

Countries are referred to by the names that were in official use at the time the relevant data were collected.

In accordance with the World Bank definition of low-income countries (economies with a gross national income per capita of \$767 or less (2003)), the following 61 countries are listed as low-income countries: Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Cameroon, Central African Republic, Chad, Comoros, Congo, Democratic People's Republic of Korea, Democratic Republic of the Congo, Côte d'Ivoire, Equatorial Guinea, Eritrea, Ethiopia, Gambia, Ghana, Guinea, Guinea-Bissau, Haiti, India, Kenya, Kyrgyzstan, Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mongolia, Mozambique, Myanmar, Nepal, Nicaragua, Niger, Nigeria, Pakistan, Papua New Guinea, Republic of Moldova, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, Sudan, Tajikistan, and United Republic of Tanzania. The number of countries included in this list is subject to revision depending on the changing economic status of the countries concerned.

The term "newly industrializing country" is used to describe developing economies, be they countries, provinces or areas, where there has been particularly rapid industrial growth. It does not imply any political division within the ranks of developing countries and is not officially endorsed by UNIDO.

The following abbreviations and acronyms appear in this report:

COMPID	Combating Marginalization and Poverty through Industrial Development
GDP	gross domestic product
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organization

## OVERVIEW

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The present report on *Social capital for industrial development: operationalizing the concept* is part of the broader Combating Marginalization and Poverty through Industrial Development (COMPID), research programme of the United Nations Industrial Development Organization (UNIDO), designed to enhance the competitiveness of industrial producers in marginalized countries.<sup>1</sup> The *Industrial Development Report 2002/2003* posits that, especially in the least developed countries, building industrial competitiveness: "... can involve heavy costs and great risks and uncertainties" (UNIDO [131], p. 9). The main reason for conducting research on operationalizing social capital is that there are grounds for believing that social capital could potentially mitigate some of the risks and uncertainties that exist in low-income and marginalized countries, and thus help to increase their level of competitiveness.

While social capital can be addressed from many different angles, the focus here is on its relation to industrial development and economic growth. Accordingly, the report attempts to provide answers to the following questions:

(a) Is social capital relevant for economic development, in general, and for industrial development in marginalized countries, in particular?

(b) If so, how can the concept of social capital be operationalized, and how can the relationship between social capital and industrial development be characterized?

(c) Is it possible to increase levels of social capital in industrial sectors through policies? If so, which forms of social capital can usefully be promoted?

The present enthusiasm concerning the metaphor of social capital opens up opportunities to focus more squarely on the intangible, social and cultural aspects of development, which are important, yet do not receive due attention, to the extent that they are often still treated as an afterthought. Within the context of industrialization in marginalized countries,<sup>2</sup> it is useful to distinguish between the following three main sets of issues while unpacking the container concept of social capital:

(a) Microlevel issues built around trust, or a lack thereof, cooperation through intra- and inter-firm relationships, how they enable, or inhibit, firms to access and participate effectively in value chains, by lowering transaction costs, and to develop more quality-driven competitiveness;

(b) Mesolevel issues that function around the depth of interfirm networks and institutional thickness of clusters, and the extent to which this enables, or inhibits, groups of firms to engage in inclusive collective action, develop supportive localized policy networks, and generate learning spin-offs, including collective learning;

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<sup>1</sup>The COMPID Research Programme entails five research projects, which, in addition to the present report on Social capital for industrial development: operationalizing the concept, are as follows: Supporting industrial development: overcoming market failures and providing public goods; Industrialization and poverty alleviation: pro-poor industrialization strategies revisited; Productivity enhancement and equitable development: the challenge for SME development; and Technological development in low-income countries: policy options for sustainable growth.

<sup>2</sup>The explicit focus of the COMPID Research Programme.

(c) Macrolevel issues that concern boundary conditions for industrial development as set by the relative efficacy and reliability of institutions; relations between the State, civil society and the private sector; the level of social integration and cohesion versus exclusion and inequalities; the extent of generalized trust; and shared values and norms in society.

By exploring and connecting these three sets of issues, an attempt is made to explain the container concept of social capital. Pragmatically, the report focuses on those aspects of social capital that could be, in one way or another, usefully promoted by UNIDO. As such, the focus here is on mesolevel issues, and a few selected aspects at the microlevel and macrolevel that can perceptibly be influenced by UNIDO.

The report starts with a literature review that draws on two broad, yet largely unconnected, bodies of literature. First, chapter I deals with the booming and mainly economic literature on social capital as the newly discovered possible missing ingredient in development. This literature, spearheaded by the World Bank, is seen by mainstream economists as an attempt to reintegrate the social and economic dimensions of development. They focus on either macro or micro issues, often putting forward ambitious claims on causal relations between, for example, social capital and levels of economic development on the basis of proxies, often generated by secondary material collected for other purposes. Heterodox approaches in economics challenge these studies and suggest other ways to acknowledge the social aspect in an economy. In contrast to the economic mainstream, chapter II reviews a second body of literature that hinges on painstakingly collected primary data on clusters and value chains in developing countries. While this literature by and large does not use the label of social capital, it addresses the socio-economic issues identified above, especially at the mesolevel and microlevel. Both bodies of literature are seen to provide useful inputs to the operationalization of social capital, specific to industrial development in marginalized countries.

Chapter III merges the main conclusions from both bodies of literature, positions social capital within the industrial development discourse, develops a definition of social capital and identifies indicators to measure social capital. Chapter IV provides main findings on two pilot field studies, using the methodology developed in chapter III, in analysing the leather footwear industry in Ethiopia and Viet Nam. Finally, chapter V synthesizes the main conclusions from both the literature review and the pilot case studies, and presents an action plan on how to strengthen UNIDO activities through mainstreaming attention for specific forms of social capital.





## **I. SOCIAL CAPITAL IN ECONOMIC DEVELOPMENT LITERATURE**

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From the vast amount of literature on the social in economic literature on development, and on industrialization in particular, only a part of it relates to social capital. Besides, not all the research that has been carried out over the past decade on the social dimensions in economic and industrial development employs language on social capital. Nevertheless, these two strands have developed quite independently of each other. For the purpose of this report, that is, for operationalizing social capital within the context of industrialization in marginalized and low-income countries, it is relevant to discuss both bodies of literature. The review thus addresses questions on the nature of social capital, including constitutive elements, relevant variables, their place in economic theory and the relationships between social capital and economic variables, such as empirical work involving measurement, data collection and testing of causal relationships, mediated by social structures.

To begin with, social capital is regarded very broadly as the economic effect on social relations in a society, sector, market or organization. These social relations are not necessarily positive, neither are their economic effects. Social structures inevitably incorporate power asymmetries that lead to processes of inclusion and exclusion, on the basis of certain discriminating criteria, to relationships of authority and control, as well as to inequalities between people that could range from implicit differential treatment to sheer oppression of one group by another. As a consequence, it must be realized that social capital can have a perverse character, involving societal costs, such as undemocratic tendencies, and economic costs, such as market failures due to rent-seeking or the formation of cartels.

### **A. SOCIAL CAPITAL APPROACHES IN ECONOMIC LITERATURE**

Social capital has been a contested notion among economists since its inception in economic literature in the mid-1990s. Its origins are in sociology, with authors such as Pierre Bourdieu, James Coleman and Robert Putnam (for brief overviews of the development of the concept, see James Farr [45], John Field [46] and Nigel Swain [123]). It is not a theory like the concept of human capital, nor is it a clearly distinguishable field of study. John Field has summarized its “theory” as the recognition that “relationships matter” (Field [46], p. 1). Rather than a theory, social capital is a loose concept that has been embraced as the “missing link” in economic analysis. Given the variety of views among economists on social capital, various definitions of social capital exist. Most definitions are entirely functionalistic, assuming a direct positive relationship between the “social” in the economy, on the one hand, and economic variables, such as income or growth in gross domestic product (GDP),<sup>3</sup> on the other.

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<sup>3</sup>For example, the World Bank defines social capital in its research project on social capital and poverty as “the institutions, the relationships, the attitudes and values that govern interactions among people and contribute to economic and social development” (World Bank [135], p. 1). On the World Bank web site, there is a more recent definition, which is equally functionalistic: “social capital refers to the norms and networks that enable collective action” (<http://www1.worldbank.org/prem/poverty/scapital/home.htm>).

Literature on social capital tends to fall in two categories: (a) an integrationist approach, trying to integrate social capital into mainstream economic theory and conventional empirical analysis; and (b) an alternative approach that is critical about the concept and demonstrates several flaws in the empirical research on social capital, yet acknowledges that there is some value added in the underlying idea of social capital (van Staveren [122]) and in understanding that social relations matter in economic development.

### 1. Integrationist approach

Literature discussing the concept of social capital—its history, definition, sources, functions and relationship to other economic concepts—often suggests that social capital be viewed as the missing link in economic analysis. While until recently it was a neglected variable, its inclusion could add to the state-of-the-art economic explanation and prediction. Bearing this in mind, social capital does not represent an alternative analytical concept for economic analysis, but is instead embedded in existing economic frameworks. Since a major part of economics adheres to a methodology based on methodological individualism, translated in microeconomics into the assumptions of rational choice and utility maximization, the integrationist approach to social capital also understands social capital in an individualistic way, namely, as a property or characteristic of individuals. In such a framework, the social capital effects on communities, organizations and countries are deduced from rational choices made by individuals.

Investment in social capital is subsequently explained in either of two ways: functional or instrumental. The functional explanation of social capital is in terms of its macro effects: social capital is generated because it has beneficial consequences for the economy. The instrumental explanation of social capital focuses on the microlevel, and holds that individuals will invest in social capital as long as it increases their individual utility at the margin. The integrationist literature on social capital often employs both methodological viewpoints, even though they partly contradict each other.<sup>4</sup> Both functionalism and instrumentalism do not have an ontological basis, that is, they do not describe, understand or explain the social origins of social capital, but focus exclusively on its individual or aggregate economic effects.

Generally speaking, there are three different ways in which social capital is integrated in the economic mainstream: as a preference in utility functions; as an individual (or firm) resource; and as an instrument to address imperfect information and risks. Keeping in mind that this report is not exhaustive, the next subsections briefly discuss how each of these ways of conceptualizing social capital in mainstream economics can be found in the literature.

#### *Social capital as a preference*

Social capital was introduced as a preference in utility functions by Becker [11], and also in a less sophisticated manner by Glaeser, Laibson and Sacerdote [58]. Social capital is perceived as a preference for certain social values, including recognition and prestige. Individuals are assumed to choose the type and level of social capital that maximizes their expected utility.

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<sup>4</sup>For example, even if social capital is beneficial at the macrolevel, why would individuals invest in it if their individual benefits are low, as in the case of free rider problems or asymmetric information?

Others have also understood social capital as an individual characteristic, for example, van der Gaag and Snijders ([55], p. 206), who regard it as an individual resource, in the following formula:

$$SC = \sum_j s_j$$

where  $j$  refers to resource items and  $s_j$  is a measure for the availability of this resource item to an individual. In a utility function, social capital is expressed as an individual's social network (Becker [11], p. 5):

$$U_t = ut(x_t, y_t, z_t, P_t, S_t)$$

where  $U$  = utility,  $x$  and  $y$  are goods bought in the market,  $z$  are goods produced in the household, and  $P$  and  $S$  are, respectively, stocks of personal and social capital, all at time  $t$ .  $P$  and  $S$  are endogenous preferences, whereas  $x$ ,  $y$  and  $z$  represent exogenous preferences as is common in neoclassical economics. The endogeneity of social capital in Becker's dynamic utility function implies that individuals choose the social network from time  $t-n$  until time  $t$  that will maximize their utility at time  $t$ , where  $n$  may be seen as the age of the individual. Hence, expected utility is maximized through the "right" social network, relying on the rational choice approach (Swain [123], p. 191).

This integration of social capital in utility functions appears as an elegant recognition of the individual as well as the social dimensions of the concept: individuals employ social capital to maximize their individual utility, but, at the same time, their stock of social capital changes as a consequence of interaction with others. However, this conceptualization also instrumentalizes social relationships which, if applied to real life, would carry the risk of damaging these relationships, which in the end may not lead to positive utility effects (van Staveren [120]).

In a survey in France, Degenne, Lebeaux and Lemel [31] found that social networks of households did not appear to improve the well-being of poor households, and that they were not meant to do this. In other words, the support networks around households that they studied were important in themselves, as social relationships, and were not instruments for improving the well-being of households: "Although personal networks are clearly invaluable to everyone and people mobilize them frequently, their asset value does not necessarily explain why they were constituted and their support potential may not be the main reason for keeping them up. Support is a very tangible thing but network support may only be one form of sociability among many others, *not a return on investment in relations*. Relations actually arise from interaction in the course of the daily living, be it with family, neighbours, co-workers or friends" (Degenne, Lebeaux and Lemel [31], p. 72—emphasis in original).

#### *Social capital as an individual resource*

The conceptualization of social capital as an individual resource often runs parallel to the analysis of other resources, like human or financial resources. This understanding of social capital is closely linked to the former one, as an individual preference, for example, in the work by Bourdieu and Wacquant [17]: "Social Capital is the sum of resources, actual or virtual, that

accrue to an individual or a group by virtue of possessing a durable network of more or less institutionalised relationships of mutual acquaintance and recognition.”

Most development literature engaging with social capital regards it as a resource. This resource may be owned by individuals, firms, organizations and sometimes even by entire countries. Fukuyama [54] regards social capital as a resource at national and organizational levels: some countries have it, while others do not, and some multinational corporations have it, while others do not. But the analytical link to economic theory in the work of Fukuyama is weak. His approach differs from that of the rational choice approach of Becker: “That modern economies arise out of the interactions of rational, utility-maximizing individuals in markets is incontestable. But rational utility maximization is not enough to give a full or satisfying account of why successful economies prosper or unsuccessful ones stagnate and decline” (Fukuyama [54], p. 351). However, Fukuyama does not provide an alternative to Becker’s formulation, apart from arguing that people often act for non-utilitarian ends in group-oriented ways (ibid., p. 21).

A major body of research that attempts to integrate social capital into economics as a resource can be found in the World Bank social capital initiative, which defines social capital as “the institutions, the relationships, the attitudes and values that govern interactions among people and contribute to economic and social development” (World Bank [136], p. 1). The initiative has resulted in various studies and publications, partly available on a very informative web site.<sup>5</sup> The project has also resulted in a volume on the concept of social capital (Dasgupta and Serageldin [30]). This book attempts to integrate social capital into the body of mainstream economics, mainly as a resource, but also acknowledges some institutional aspects of social capital.

In particular, Serageldin and Grootaert [117] have come forward with suggestions for such integration, in particular for measuring social capital as an aggregate resource, preferably reflected in a single index. The policy advice emanating from such an integrative perspective is that social capital needs to be strengthened through the support of civil society and government at the local level, rather than through (central) State support. In line with this conception of social capital as a resource, Paldam and Tinggaard Svendsen [101] suggest that social capital should be regarded as a production factor of its own, resulting in the following production function (slightly adapted from Paldam and Tinggaard Svendsen [101], p. 237):

$$Y = f(K, T, L, H, SC)$$

where  $Y$  is production,  $K$  stands for capital,  $T$  for technology,  $L$  for labour and  $H$  for human capital, while  $SC$  is social capital as the additional production factor.

It is precisely this view of social capital as an independent resource, as a non-State responsibility but residing with individuals, firms and organizations, which has led to a critique of the World Bank social capital initiative (Fine [48] and [49]; Fox [52]; Fox and Gershman [53]; Harriss [65]; and Harriss and de Renzio [66]). The danger of this policy stance is, as Harriss and de Renzio [66] have observed, that by reducing the role of the State, decentralization could

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<sup>5</sup><http://www.worldbank.org/poverty/scapital/index.htm>.

become less effective. The tendency of World Bank policy recommendations to assume that social capital can serve as a substitute for the role of the State, or at least as a precondition for a well-functioning State, must be treated with caution. This is, as Harriss ([65], p. 8) has put it, as if to expect "... the most disadvantaged people to pull themselves up by their own bootstraps, in a way which is remarkably convenient for those who wish to implement large-scale public expenditure cuts."

Jonathan Fox [52] has elaborated this argument by drawing on World Bank project experiences in rural Mexico. He concluded that World Bank funding of social sector investments in rural areas does not support the poorest and weakest segments of the population, nor helps these groups to organize themselves in order to access poverty reduction programmes. "The World Bank therefore appears to be contributing, on balance, to the dismantling of social capital, especially among the many independent community-based economic organizations on the front lines of grassroots development. In short, most of the World Bank's Mexico funding continues to ignore social capital's potential contribution to the fight against poverty" (Fox [52], p. 971).

In a more substantial paper, comparing World Bank projects in Mexico and the Philippines, Fox and Gershman [53] have found that only three out of 10 projects had a pro-poor impact and potentially social capital-building effects. They ascribed the failure of most projects to a lack of attention and understanding by World Bank project managers of community-based organizations. For example, in rural finance projects, private commercial banks were chosen as partners rather than community-based financial organizations. Fine ([48], p. 12) has concluded rather cynically about the social capital approach of the World Bank that "(...) social capital allows the World Bank to broaden its agenda while retaining continuity with most of its practices and prejudices which include benign neglect of macro-relations of power, preference for favoured non-governmental organizations and grassroots movements, and decentralized initiatives." Critiques of the view that civil society and the State would be substitutes have led to the development of a synergy approach. In this approach, the discussions focus around the question of what types of synergies between civil society and the State would be needed to enable effective and stable socio-economic development, and what kind of synergies are associated with the consolidation of democratic institutions (see, for example, Evans [43]).

The latest volume emerging from the World Bank social capital initiative, by Grootaert and van Bastelaer [62], although coming only three years after the first volume on the subject referred to above (Dasgupta and Serageldin [30]), clearly incorporates some of the critiques of the earlier work, to the extent that it is more modest on the results and policy implications of social capital. This is further reflected in a redefinition of the concept towards understanding social capital as "the institutions and networks of relationships between people, and the associated norms and values" (Grootaert and van Bastelaer [62], p. i). Besides, social capital is now broken down in scope (three levels of analysis: micro, meso and macro), forms (structural and cognitive) and impact on development (reduction of transaction costs and increase in collective action).

In the first part of the book, a chapter by Collier [24] with a microeconomic perspective, stands out. He distinguishes three types of externalities of social capital: through the initiation

of social capital; through efforts not mediated by the market; and through unintended consequences. The link between social capital and economic benefits is through trust, Collier states, which leads to collective action. In this sense, social capital can be a substitute for both the market and the State, as it provides social sanctions against opportunism, helps to manage a common pool of resources and the provision of public goods, and leads to economies of scale in non-market activities. But Collier also warns against too much optimism placed on the impact of social capital on poverty reduction. He acknowledges that social stratification and reputation lead to exclusion of the poor, while norms and rules may or may not protect the poor.

A deep insight, in the empirical contribution by Fafchamps and Minten [44] on the benefits of social capital for agricultural traders, reveals a reduction in transaction costs among traders through trust in interaction, access to credit, information on prices and economies of scale in quality control. In their conclusion, they suggest that social capital may be a viable and cost-effective substitute for laws and legal systems for small businesses. In the concluding chapter of the volume, Grootaert and van Bastelaer admit the limited success of earlier attempts, including that of the World Bank social capital initiative, to define and conceptualize social capital. Nevertheless, they note an emerging framework for analysis, in which they see the World Bank taking a pragmatic position, focusing on the measurement of social capital.

Comparing the two volumes, the later one certainly indicates progress in analytical depth of the World Bank social capital initiative. But at the same time new confusions are created, for example, through the introduction of the dual concepts of civil social capital and government social capital. Together they fall under such a broad category of social capital that almost any institution, formal or informal, and any form of collective action, in civil society as well as by the State, are captured by it. Hence, the distinction between the State and civil society as two different forms of governance becomes blurred. Moreover, empirical research suggests that State-related social capital, measured as trust in State institutions, is not necessarily positively related with other social capital measures, such as associational membership and effectiveness (Dani [28]).

#### *Social capital as reducing imperfect information and risk*

Finally, social capital is not only integrated into economics as a preference and a resource, but also as a variable that addresses the risks attached to imperfect information. One strand of this literature relies on game theory, allowing social dimensions into bargaining games and analysing the effects they have on game outcomes, partly through the risk-reducing effects of social capital (see, for example, Dasgupta [29], Hargreaves Heap [64], Moore [91], Paldam [100] and Torsvik [129]). Another strand of the literature on risk and imperfect information approaches social capital from a transaction costs point of view (see, for example, Grabowski [59] and Szreter [124]). Here, social capital is represented by a productivity scale factor, proportional to the number of transactions. Assuming the number of transactions is, in turn, proportional to production, this would give the following inclusion of social capital into the production function (Paldam and Tinggaard Svendsen [100], p. 237):

$$Y = cSC f(K, T, L, H)$$

where  $c$  is a constant and  $SC$  is the scaling factor for social sources of productivity.

Both types of research on social capital as a mechanism to address the risks following from imperfect information view trust as the major variable of social capital. Trust in this literature (Dasgupta [29], p. 330) is defined instrumentally as rational expectations of the behaviour of others. Paldam and Tinggaard Svendsen [101] label this as “rational trust”, which seems close to what, in the literature on rationality, is referred to as procedural rationality: long-term interaction with others, in which present benefits of opportunism are forgone for the sake of greater future benefits from cooperation (Hargreaves Heap [64]). Hence, trust is regarded as an instrumental value in the maximization of utility by an individual.

Surprisingly, a well-known economist specializing in transaction costs, Williamson, disagrees with this interpretation of trust. According to Williamson [135], the instrumental view of trust confuses credibility, which derives from calculable risk, with the ethical value of trust. Risks can be calculated with the help of a probability distribution, whereas trust is relied upon in the absence of such distribution. In circumstances of fundamental uncertainty, Williamson is cautious about reliance on the distinction by Keynes between risk and uncertainty. Recognizing the social, personal and contingent dimensions of trust, he comes to the conclusion that instrumental conceptualizations of trust are erroneous, since calculativeness could actually destroy trust between two parties rather than represent it.<sup>6</sup> He concludes that “calculativeness will devalue the relation” (Williamson [135], p. 484) since it “may well be destructive of atmosphere and lead to a net loss of satisfaction between the parties” (ibid., p. 481).

The same critique of the understanding of trust can be addressed to the integration by Becker of social capital as a preference in utility functions, which assumes a purely instrumental approach to social relationships. Consequently, it might be better to replace the term trust with credibility, in the integrationist perspective of social capital. The integrationist approach to social capital has certainly generated insightful results, particularly in microeconomics. But the extent to which these attempts at the conceptualization of social capital in economics will do justice to not only the capital but also the social aspect of the concept is yet to be seen.

## **2. Alternative approach**

The alternative approach to social capital rejects methodological individualism as a purely instrumental or functional view of social capital, which regards it only as a means rather than an end in itself, expressing solidarity, social cohesion, patronage, domination, prestige, reputation, trust, sociability and organization<sup>7</sup> (see also the critique of Fine [49]). In the words of Edwards and Foley ([38], p. 677), social capital points “analytical attention to the embeddedness of cultural factors—such as identities and aspirations—in the meso level social structures such as neighbourhood, church, family, school, and voluntary associations. These are relational contexts in which understanding of how the world works, orientations toward it, and how to engage it are embedded, produced and reproduced in a continuous process of construction, negotiation, and appropriation.”

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<sup>6</sup>In philosophy, non-instrumental definitions of trust can be found, for example, the one formulated by Baier ([6], p. 30): “To trust is to make oneself or let oneself be more vulnerable than one might have been to harm from others—to give them an opportunity to harm one, in the confidence that they will not take it, because they have no good reason to.”

<sup>7</sup>With thanks to Erhard Berner for his comments on a draft version of the present report at an Institute of Social Studies workshop held in July 2003. He has pointed out this range of social relations that are core issues in sociology and seem to be more adequate labels for describing “the social” in the economy than the capital metaphor.

The alternative approach recognizes that social capital may not only have benefits but also costs, and that its effect partly depends on the power asymmetries that are present in the context in which social capital is studied (Baron, Field and Schuller [8]; Dolfsma and Dannreuther [33]; Field [46]; Fine [49]; Molyneux [89]; and Taylor and Leonard [126]). For example, membership of a group, such as the mafia, is not necessarily a good thing. Groups may also enforce norms, for example, on a gender basis that limit the capabilities of people belonging to other groups, or powerful groups may offer benefits only to those who are on the inside. Hence, the alternative approach to social capital does not study social capital in a social vacuum but acknowledges power asymmetries leading to exclusion, control and inequality, which influence the economic effects of social relations.

### *Metaphor*

Most critiques of social capital start with a critical discussion of the name of the concept and the metaphorical implications of the word “capital”. Some economists do not see any value added in using the concept. They hold the view that neoclassical economics does not need it. Arrow [2] argues that it is not capital at all, and since it does not extend in time, it does not involve a deliberate sacrifice in the present for future benefits, and it is inalienable. Solow [119] queries, in the same World Bank volume, what is social capital a stock of. “Any stock of capital is an accumulation of past flows of investment, with past flows of depreciation netted out. What are those past investments in social capital? Can an accountant measure them and cumulate them in principle? ... If I told you that the rate of return on social capital had fallen from 10 percent a year to 6 percent a year since 1975, would that convey any clear picture to you?” (Solow [119], p. 7).<sup>8</sup>

Other critics see the notion of social capital being absorbed in the neoclassical paradigm in a way that still does not acknowledge the social in the economic sense (see, for example, Elster [40]; and Fine [48] and [49]). Fine [49] and Harriss [65] do not see much value added in the concept either, since they find it moulded into the straightjacket of methodological individualism, ignoring issues of power, conflict and class. “Rather, the reintroduction of the social has the troubling dual aspect both of rhetorically smoothing the acceptance of broadening the scope of justifiable intervention from the economic to the social in order to ensure policies are successful. Social, and covert political, engineering is to complement economic engineering, with social capital producing a client-friendly rhetoric” (Fine [49], p. 20).

Fine prefers instead to study social, political and cultural dimensions of economic processes from the perspective of political economy, which rejects methodological individualism, utility maximization, and the concern with market imperfections. In a similar critical vein, other terms have been suggested for social capital, such as social cohesion, or simply trust, in order to move away from the capital metaphor.<sup>9</sup> But this is too simple a change of one term for another. As sociological literature suggests, social relations are characterized by a wide variety of expressions, which cannot easily be grouped under a single label (see also the listing of sociological terms above).

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<sup>8</sup>Both Arrow [2] and Solow [119] seem to have problems with the instrumentalism ascribed to social capital in the integrationist approach, an unexpected critique from neoclassical economists adhering to the idea of individual utility maximization.

<sup>9</sup>The capital metaphor is clearly problematic, which can be clarified with an example about friendship. For physical capital, the more a machine is used, the less valuable it becomes; it depreciates, while friendship only strengthens when friends meet, share, talk and do whatever sustains their friendship. To the contrary, when a friendship is no longer “used”, that is, when friends have less and less contact, the value of it depreciates, but not when it is in use.



### *Measurement*

For a more holistic understanding of social capital, there is much critique of the empirical research conducted on social capital and, in particular, of the exercises aimed at the measurement of trust, group membership and civic norms. A major flaw in the empirical literature is the cyclical explanation of social capital: the success of a group is attributed to its social capital, but social capital is measured by group success (Durlauf [36]). The foundational empirical research by Putnam has generated strong methodological critique of the use of data, the neglect of Italian politics, confusion of social capital as a cause or effect in relation to other phenomena, and the relationship of social capital to the State and GDP growth (Fine [49] and Tarrow [125]). For example, measurement of group membership fails to distinguish between types, purposes and structures of groups, as well as power relations within and between groups.

Hoeber Rudolph ([71], p. 1766) therefore suggests distinguishing between types of associations by posing questions such as: “Are associations political or non-political and if political are they deliberative or interest oriented? Are they hierarchical or egalitarian? Are they voluntary or ‘natural’ (ascribed)?” She found no unambiguous relationship between associational membership, on the one hand, and trust or cooperation, on the other, and therefore cautions researchers against using associational membership as an indicator for social capital. “If we are to use the concept of civil society at all, and populate it with social capital-generating associational life, we must be able to specify what type of associations are likely to generate habits of mutual trust and collaboration. Not all associations are likely to do so, and we need criteria of distinction” (Hoeber Rudolph [70], p. 81). Furthermore, as Dani [28] has suggested, associations may reflect distrust in government and political institutions—associations may be a response to this distrust rather than a reflection of general trust, beyond the boundaries of associations.

Another problem detected in the empirical research on group membership is that measuring social capital by aggregating individual group membership ignores the fallacy of aggregation in a social context. The social value of groups resides in the group effects, and cannot be regarded as a linear relationship with individual membership. More critical empirical research indicates that some variables may be contradictory, like trust and group membership, or strongly relate to contextual variables, such as trust and inequality, which seem to be negatively correlated, suggesting that inequality and hierarchy should also be taken into account when measuring social capital. Douglas Caulkins [20] has argued from his study in Norway, for example, that organizational density does not necessarily lead to more generalized trust in a society. Unfortunately, the measurement of social capital in much of the literature ignores differences in trust and trustworthiness between groups of people, inequalities within and between groups, and inequalities expressed through dominant social norms.

When measuring social capital not on the basis of group membership but on trust, similar qualifications need to be made. Edwards and Foley [38] as well as Baron, Field and Schuller [8] have noted that trust is often affected by power relations, where inequalities have a negative impact on trust. This insight runs contrary to what proponents of the integrationist approach to social capital, like Fukuyama [54] and Dasgupta [29], assume about trust as being independent from hierarchical relations and social and economic inequalities. Trust is often measured with a general trust question in surveys, such as the world values studies, but this is not an unambiguous question.

The norms and values measured in such surveys do not necessarily reflect social capital or beneficial economic impacts of social relationships. Others prefer to measure outcomes of trust, such as the number of relationships in a personal network, assuming that this number is strongly and positively related to an underlying mechanism referred to as trust (for example, in van der Gaag and Snijders [55]). Trust may be more appropriately regarded as an outcome of social capital rather than a determinant of it (Field [46], pp. 65 and 125). What is clear, however, is that trust “(...) is one of those rare assets, like loyalty and goodwill, which have a value but no price” (Cooke and Morgan [26], p. 30).

In the alternative approach, relevant indicators for measuring social capital are groups, networks, concrete forms of trust and particular social norms and values, but not measured in a linear way as in much of the mainstream empirical literature. Social capital is understood as contextual, which requires an effort of measurement that is not so much aimed at developing a single index or a set of unambiguous, quantifiable indicators, as is promised by the social capital tool provided by the World Bank, but which acknowledges the heterogeneity of the concept. The World Bank advises policy makers to use the tool of their integrated questionnaire for the measurement of social capital (the *SC-IQ*), measuring at the household level group membership, trust, collective action, communication, social differences and subjective well-being. Swain [123], for his part, suggests the use of ordinal scales for the measurement of social capital in relation to context-specific qualitative variables, which allows for a context-specific interpretation of social capital.

Recent studies that compare the relative importance of social variables and individual characteristics suggest that personal abilities probably play a relevant role too—either next to social capital variables, or in relationship with these variables (Dekker [32] and Krishna [80]). What is important in the measurement of social capital is to develop an understanding of how groups, networks, trust and norms and values are defined, expressed and experienced. In chapter IV, on the field work undertaken for this report, a combination of quantitative and qualitative methods of measurement has been used to better understand the complexities of the indicators of social capital.

#### *Social relations, power and spin-off effects*

Although critical of the metaphor and measurement of social capital, there is a mass of alternative literature on social capital that employs the concept to critique mainstream economics, in an effort to find alternatives for methodologically individualist assumptions on rationality, utility maximization, or calculative risk for explaining social relations in a country. These publications understand social capital very broadly, as representing values, norms, social relationships, shared meanings and institutions, but also allowing for contestation and contingency through the acknowledgement of inequalities, inclusion/exclusion, path dependency and uncertainty. Social capital is often regarded as a constraint and as enabling economic action, as a benefit as well as a cost, depending on the context. The more holistic understanding of social capital (Edwards and Foley [38]) does not fit so well with methodological individualism and instrumental views focusing exclusively on (beneficial) effects of social relations while ignoring their social dimensions.

In the alternative literature, scholars acknowledge the ontology of social capital as being basically social, not individual. This ontology is sought at the interpersonal level rather than at the individual level, or in the aggregation of individuals in groups. Edwards and Foley support this methodological shift, but point out that a focus on the individual or groups overlooks the meanings of interrelationships within groups and across groups, like in networks. An alternative methodology that has an ontological character is that of intentionality. Such a methodology tries to explain phenomena from the intentions of people that are embedded in their beliefs. These beliefs can relate to society, social values and relationships, like friendship, cooperation, honesty, responsibility and trust.

Hence, an intentional explanation of social capital recognizes that people have values that are shared and contested, but are nevertheless present in communities of people, and that they want to contribute to these values. So, even when people group together to further their interests, for example, in a business association, this social relationship between the members of the association will only emerge and hold when the members of the group share, at least to a minimum extent, some beliefs. They need to trust each other in order to reduce freeriding; they need to share some basic social norms to facilitate group interaction; and they need to develop some loyalty, even to the extent of excluding others, to prevent the group from collapsing before the goals have been attained.<sup>10</sup> This need for sharing common beliefs is even stronger in a context of much uncertainty and a weak legal framework.

The distinguishing feature of social capital in the alternative approach is that it is not thought to stem from individual utility as such. If friendships, for example, would come about in this way, it is very unlikely that they would last as long as they do in the real social world, according to Elster [41]. The basis of social capital, hence, is social cohesion in groups and communities, social relations in societies and network relationships between individuals and groups, which express underlying shared—and contested—values, as well as power differences, and which may have positive as well as negative social and economic effects. In other words, social capital research cannot escape the social reality in which it is embedded, as both enabling and constraining (Field [46]).

While intentionality is acknowledged in this report as the underlying factor for social relations (referring to the Aristotelian view that human beings are social and political animals and not purely individualistic), it is not enough to explain social capital, especially since a clearer understanding is still necessary as to why such intentional social relations have economic effects. Here, attention is drawn to the complement of intentional behaviour: unintentional consequences of behaviour. As has been argued by van Staveren [121], intentional behaviour will often have unintended consequences for an economy.

Such effects are not unfamiliar to economists: they are labelled external effects or externalities, or as spillover effects or spin-offs. In other words, intentional social relations may generate spin-offs for the country, depending on the kinds of beliefs that underlie particular social relations. For example, trustworthy behaviour between people may enable market transactions—

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<sup>10</sup>This, however, may lead to perverse social capital as expressed in collusion, leading to entry barriers, cartels, dominant mergers and other inefficiencies.

with people other than those with whom one is associated in social life. Negative economic effects could also arise from social relations, for example, when disrespect for a certain group in society, such as immigrants, leads to segmentation of labour markets, causing job segregation and wage discrimination for immigrants.

Such an understanding of social capital, as the combination of intentional social behaviour and unintended consequences for economic behaviour enables a researcher to acknowledge the role of power asymmetries in social relations and their impact on economic variables. Obviously, such a conceptualization of social capital in economics is not at all simple, since it requires an analytical framework that is different from the one generally used, drawing on various heterodox traditions in economics, rather than the mainstream. As a guide on this path of social capital research, Baron, Field and Schuller [8] have distilled some road signs from the contributions to their volume. The five characteristics for alternative social capital research, as summarized below (see Baron, Field and Schuller [8], p. 35), suggest the following:

- Shifting the focus of analysis from the behaviour of individual agents to patterns of relations between agents, social units and institutions;
- Linking the micro-, meso- and macrolevel of analysis;
- Allowing for multidisciplinary and interdisciplinarity;
- Reinserting issues of value into the heart of social scientific discourse;
- Acknowledging heuristic quality.

The rest of the chapter follows this alternative path in social capital research, emphasizing:

- The distinction between social relations and economic effects;
- The location of social capital at the interpersonal level rather than at the individual level;
- The mediation of the “social” and the “economic” through social structures that are characterized by power asymmetries.

## **B. ECONOMIC EFFECTS RELATED TO SOCIAL CAPITAL**

A variety of economic effects dealt with in the literature is assumed to be related to social capital (Baron, Field and Schuller [8]; Collier [24]; Dasgupta and Serageldin [30]; Flap [50]; and Grootaert and van Bastelaer [62]). Some of the effects are mentioned more often than others, and seem to draw on a wider common understanding. These effects have been broadly grouped into three types of economic impact relating to: reducing transaction costs; enabling and reinforcing of collective action; and creating learning spin-offs.

### **1. Reducing transaction costs**

Here, the underlying mechanism of social relations is the moral value of trust. Trust replaces contracts (in particular, in cases where these are incomplete or very costly) and monitoring (in particular, in uncertain environments), which saves time and money. Trustworthy behaviour

also helps to build a reputation, which is likely to generate even more trust, further reducing transaction costs. Trustworthiness, in turn, helps to reduce the likelihood of freeriding in public goods as well as rent-seeking and moral hazards. Accordingly, trust can be understood as “the confidence that parties will work for mutual gain and refrain from opportunistic behaviour” (Cooke and Morgan [26], p. 30). It reduces transaction costs because it enables parties to economize on time and effort, which generates the efficiency of being able to rely on the word of a partner.

## **2. Enabling and reinforcing collective action**

In this case, the underlying mechanism of social relations is solidarity and/or organization. Cooperation between individuals and organizations creates economies of scale, and helps to provide and manage semi-public goods (outside the State) or enforces the supply of public goods by the State. In a context of uncertainty, trust reduces the risks of cooperation and discloses possibilities for action, which would have been unattractive otherwise (Cooke and Morgan [26], pp. 30-31). Such trust-confirming cooperation can also enhance the bargaining power in the market, leading to increased access to, or better negotiation terms in, capital markets, technology and market access.

## **3. Creating learning spin-offs**

Here, the underlying mechanisms of social relations are social cohesion and sociability. By working together, workers learn from each other on the job. This process is stimulated in a setting of teamwork, where new team members learn on the job under the guidance of workers who are more experienced. A mobile workforce, in particular when it is a specialized workforce possessing special skills, helps to transmit human capital through learning from one company to another—a feature of human capital deepening that is also drawn upon in the new growth theory. Another form of learning spin-offs is through collective learning by jointly acquiring or quickly transmitting new technology, for example, through business networks (Porter [106]). In both ways—by increasing the average level of human capital and transmitting new technology—social cohesion and sociability stimulate earnings and thereby enhance total factor productivity. The transmission of information is also helped by trust, which helps to overcome transaction costs in the transmission process, as participants in high-trust relationships tend to have a greater capacity for learning because they are party to extensive and richer information flows (Cooke and Morgan [26], p. 31).

The three above-mentioned forms through which social capital is expressed in an economy are all presented in positive terms, that is, as economic benefits. But this is only part of the often too rosy social capital story. Social capital has a dark side too.

## **C. POWER ASYMMETRIES IN SOCIAL CAPITAL**

As pointed out in the review of the alternative literature, social capital does not automatically lead to positive effects. It emerges from underlying social relations, which are very often characterized by power asymmetries. When these asymmetries are strong, social capital is likely to

have less economic benefits. Or, social capital may benefit only a small group in an economy, but at the cost of economic efficiency for the country as a whole.

As Norbert Elias and J. Scotson [39] have already indicated, power runs through all social structures and can be expressed in a wide variety of ways, some more explicit, others more implicit. Power asymmetries lead to the control of some over others, as well as to processes of inclusion and exclusion of people or groups of people on the basis of certain discriminating criteria attributed to them. Finally, power asymmetries lead to inequalities between groups or within groups, ranging from implicit differential treatment to sheer oppression or exploitation.

As has become clear from the review of alternative literature, social capital is not immune from the workings of power. The expression of social relations, through norms, rules and habits, as well as the structure of networks and groups, exhibits power relations and often influences and is influenced by inequality, control and exclusion. The relationship between social relations, through power asymmetry, and social capital is complex. Fox ([51], p. 95) already recognized the inherent contradictions between power and social capital by pointing out that in situations of extreme power inequality, trust transforms into accepting a lack of choice rather than as an expression of the social capital of a society: “‘We’ve got to trust them’ means in fact: ‘we don’t trust them but feel constrained to submit to their discretion’. This simply describes, of course, a power relationship.”

The literature on the relationship between social capital and power suggests that the relationship is often negative, that is, social capital is less effective in situations of inequality, control and exclusion (Baron, Field and Schuller [8]; Dolfsma and Dannreuther [33]; Edwards and Foley [38]; Field [46]; Fine [49]; Harriss [65]; Molyneux [89]; and Taylor and Leonard [126]). This is, however, not always obvious. Sometimes beneficiary effects of social relations are caused by power asymmetries, not by trust (Hardy, Phillips and Lawrence [63]). “Despite calls to the contrary (for example, Granovetter [61]), a functionalist emphasis persists in the literature on interorganizational relations ... Such a perspective tends to focus on surface dynamics and to ignore the fact that power can be hidden behind a facade of ‘trust’ and a rhetoric of ‘collaboration’ and can be used to promote vested interests through the manipulation and capitulation of weaker parties” (Hardy, Phillips and Lawrence [63], p. 65). This should warn social capital researchers not to confuse social capital, or its effects, with other social phenomena, such as power and structures. Contrary to the workings of control mechanisms, “... trust arises as a result of a communicative process through which meaning is shared” (ibid., p. 65). But, to make matters even more complicated, trust and contract are not necessarily trade-offs. In a trusting environment, trust may stimulate contracting between strangers (Bennett and Robson [12]).

Taylor and Leonard [126] have concluded, from the case studies that they brought together in their book, that the idea of social relations as inherently positive for economic development, generating economic growth through local embeddedness of firms, is a far too rosy picture. Their case studies indeed illustrate how power, as well as certain institutions, forms of governance and the role of time and uncertainty affect the economic impact of social relations.

“What the case studies demonstrate is that in concrete situations, inter- and intra-firm relationships involve, in almost every instance, the exercise of unequal power to exclude, exploit and control network relationships (Taylor and Leonard [126], p. 291).<sup>11</sup>

Predictability (or credibility, as defined by Williamson) may arise from trust, but also from power; for example, when a firm has only one input supplier available, there is lack of choice. “It is, however, important to differentiate between trust-based interactions and power-based interactions since there is a substantive difference between co-operation achieved through power differentials that render some partners unable to engage in opportunistic behaviour, and a willingness to voluntarily sacrifice the benefits of opportunistic behaviour in order to co-operate with a trusted partner. While the first kind of co-operation may produce predictable behaviour, it will not produce the kinds of advantages that have been associated with trusting relationships” (ibid., p. 67). This is an important distinction, in terms of whether predictability (or credibility) is also more likely to lead to a deepening of the relationship (through process-based trust), or merely to the absence of manifest opportunistic behaviour (in the case of power). Accordingly, in chapter III, an effort is made to reveal the relative importance of trust and power in the relationships in the small and medium enterprises sector.

Field ([46], p. 74) has listed four ways in which social capital and inequality may be related, as follows:

- Access to different types of networks is unequally distributed;
- Social capital in networks can be used to disadvantage others;
- Social capital in groups can benefit members, but reproduce inequality or generate unintended consequences for others;
- Social capital can have a levelling-down effect on the aspirations of people, providing disincentives for individuals in a group to save and invest.

Some specific expressions of power asymmetries are briefly discussed, in particular, power asymmetries between civil society and the State, and power asymmetries underlying social inequalities and exclusion, as expressed in social indicators in the Millennium Development Goals. But first the role of power asymmetries in the relationship between social relations and social capital is explained.

### **1. Social relations—power—social capital**

Looking closely at the three forms in which social capital is expressed in a country, as introduced above, the way in which power asymmetries impact upon each of these expressions of social capital may be observed. For such an understanding, it is necessary to distinguish the three major power asymmetries in social relations:

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<sup>11</sup>In their book, a case study on the unequal relationship between transnational corporations and local businesses in Fiji and a study on distrust between Israeli and Arab entrepreneurs in Israel show how social relations lead to the power to exclude. A case study on the publishing industry as well as a study on female homeworkers shows the power to exploit, while the power to control business relationships is illustrated in a case of the impact of the leather industry supply chain on tanneries in Argentina and a study on garment production in Fiji (Taylor and Leonard [127]).

- Control (by force or social norms);
- Exclusion versus inclusion;
- Inequality.

In the case of transaction costs, the elite may succeed in tax evasion and evading democratic procedures by bribing government officials. This certainly reduces their own costs and hence provides benefits, albeit at a cost to the economy at large. In the case of collective action, processes of exclusion could lead to market segmentation, setting up entry barriers for certain groups in, for example, the credit or labour market. Alternatively, collective action could result in market power in the case of cartels. Again, these benefit a small group at the cost of others, such as the unemployed or consumers. Finally, in the case of learning spin-offs, it is quite likely that these will occur much less, or not at all, in a work environment with high inequality. In such an environment, the opportunities and social incentives to learn from other entrepreneurs or workers are limited. Besides, collective learning in a sector will be constrained by high inequality, as not all firms will be allowed access to the collective learning process.

In a country, such asymmetric relations tend to have perverse impacts, such as market segmentation, entry barriers, rent-seeking, cartels, monopolistic tendencies, negative externalities, freeriding and moral hazards. In other words, they lead to negative or perverse forms of social capital, through negative impacts on the efficient allocation of resources.

## **2. Social capital and power asymmetry with the State**

A wide variety of relationships are possible between the State and social capital. At the one extreme, social capital can be fully controlled by the State, for example, in the case of State- or political party-controlled organizations, such as the communist mass-organizations in countries like China and Viet Nam. An example of State-controlled social capital in industrialization would be business associations set up by the State, linked to the ruling party or even controlled by the same party. At the other extreme, social capital can develop outside and independently of the State, as is, for example, the case in neighbourhood groups in the United States or in environmental pressure groups in many Western countries.

In the latter case, social capital may pressure the State to act in a certain way through policies, institutions, regulations and taxes and subsidies. An example would be a local cluster of industrial activity that demands roads and streetlights, threatening the local government to relocate to another town if the State does not provide such public services. Alternatively, social capital and the State are complementary, acting on their own competencies. An example of independent social capital that functions as a substitute for State roles would be business associations that maintain local roads, provide security services for the area in which they are located, or provide business development services of better quality than those which the Government is able or willing to provide.<sup>12</sup>

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<sup>12</sup>Bennett and Robson [12] have argued that business advice by the public sector is often less effective than by the private sector.



Hence, the relationship between social capital and the State may either be indistinguishable (when social capital is fully State-controlled), mutually supportive (complementary), or tense (trying to influence each other). When the focus is on trust, as an indicator of social capital, the role of the State and generalized trust may mutually reinforce each other, as argued by Rothstein—either in a positive way or in a negative way. “In a society where it is ‘common knowledge’ that the impartiality of government officials can be corrupted, most people who have the necessary resources to do so will try to take advantage of this possibility. (...) The causal mechanism I want to specify here is that ‘generalized trust’ runs from trust in the universalism of government institutions to trust in ‘most people’. It makes no sense to trust ‘most people’ if they are generally known to bribe, threaten or in other ways corrupt the impartiality of government institutions in order to extract special favours” (Rothstein [111], p. 134).

When government institutions are not perceived as trustworthy, the likelihood of finding high levels of generalized trust is poor, although the ineffective functioning of the Government for the common good may very well be counterbalanced by some small-scale groups exhibiting bonding social capital and filling the gaps of some government services for the members of the group through collective action. But it would be more likely in those circumstances to find groups of well-linked people reaping gains from corruption and tapping public resources, rather than making up for the lack of public services with their own resources.

### **3. Millennium Development Goals: reducing exclusion and inequality**

The Millennium Development Goals involve a targeted reduction of gaps in social and economic development and hence in the underlying processes of inequalities and the exclusion of weaker groups in society. The inequalities and exclusion that drive these goals are expressed in the following three forms:

- Geographic inequality: developing countries score much lower on the social indicators than developed countries;
- Ethnicity and culture, in so far as they reduce access to and maintain control over economic resources by groups within a society;
- Gender inequalities and exclusion of women from male-dominated areas of economic activity, leading to gendered market segmentation and other gender-based distortions in markets.

Thus, the gaps in social and economic development that are to be addressed by the Millennium Development Goals reflect international as well as intranational power asymmetries. As a consequence, it is likely that these asymmetries reduce the potential benefits of social capital within and between countries. Meeting the Millennium Development Goals is expected to reduce the negative economic effects of power asymmetries as sketched above, for example, by reducing segmentation in input markets, reducing market power of global buyers, and limiting opportunities for rent-seeking and moral hazards for firms as well as State agencies. The Millennium Development Goals, therefore, have an important indirect potential impact on the dynamic efficiency of industrial sectors in marginalized countries and the competitiveness of such sectors. But before delving into literature that studies such relationships, it is necessary to introduce the two major types of social capital, as they emerge from the literature, namely bonding and bridging social capital.

## **D. BONDING AND BRIDGING SOCIAL CAPITAL**

Literature on social capital reveals a very important distinction between two types of social capital, namely bonding and bridging social capital. The distinction between these types of social capital reflects the power asymmetries, as discussed earlier. Bonding social capital implies differentiations between groups of people through processes of inclusion and exclusion, whereas bridging social capital refers to generalized social relationships beyond groups, such as families, ethnic groups, class, or otherwise structured groups.

### **1. Bonding social capital**

Bonding social capital emerges from strong social ties, which are based on a common identity, for example, on the basis of family and kinship, gender, ethnicity, religion, but also organizational culture. The social cohesion in a group generates intragroup social capital. This type of social capital, which develops at the microlevel of local communities, is sometimes referred to as ascribed group membership, since membership is attached to a certain social or cultural characteristic of an individual. As a consequence, bonding social capital generates a particular type of trust that is ascribed to the members of the group: "I trust you because you are a member of my clan." Through norms that groups establish for their functioning, they have the opportunity to control trust to a certain extent, for example, by punishing those who take advantage of the trust ascribed to them.

Groups with bonding social capital are based on kinship, religion, ethnicity, class/caste, gender or geography, and hence their relationship with the market is often also differentiated along these lines. Ascribed groups are relatively closed (because of ascribed membership) and hence the result may be segmented markets with entry barriers for non-group members, which is inefficient in terms of resource allocation. On the other hand, such groups tend to generate high levels of trust, cooperation and organization, facilitating intragroup exchange, collective action and learning. As Massimo Repetti [109] has remarked for various African countries, production is often based on close (family) ties, including patterns of subordination and paternalism, as well as practices of sharing resources and redistribution of profits. Particularly in a context of high political uncertainty, macroeconomic instability and a constraining institutional framework, it is the existence of bonding social capital that helps to overcome part of the huge inefficiencies in the economy.

### **2. Bridging social capital**

Bridging social capital emerges from weak social ties across society in which individual and organizational behaviour is embedded (Granovetter [61]), but which are nevertheless held together through the sharing of some common values. Weak ties exist among people who are heterogeneous, having different identifications, and belonging to different groups. Hence, weak ties do not occur at the intragroup level, as in the case of bonding social capital, but at the intergroup level, in other words, at the mesolevel and macrolevel in a country. Such relationships often occur both horizontally, creating networks between loosely connected individuals and organizations, as well as vertically, between hierarchical or temporary links as, for example, in a value chain.

It is important to note that the word “weak” should not be interpreted negatively here, since, paradoxically, the weakness in the ties is the strength of bridging social capital: social relationships are voluntary, continuously leaving open the option of breaking up or changing one relation for another, without social sanctions. These are much more open social relations compared with those of bonding social capital, and are sometimes referred to as earned relationships, relying on earned trust among loosely connected people rather than on ascribed trust among a homogeneous and strongly related group.

Bridging social capital generates what is labelled generalized trust, which is based on the belief that everyone shares a minimum set of common values and therefore has a minimum level of trustworthiness to act upon these values. Generalized trust is not blind trust, a belief in the unquestioned goodness of everyone in which trustworthiness is considered to be beyond doubt; it includes checks and balances on the trustworthiness of others, in particular through the assessment of the reputation of a person over time, and rewarding trustful behaviour through reciprocity of trust. In other words, generalized trust must be earned.

The difference in the process of assessing one’s trust is that, in the case of bonding social capital, trustworthiness is only assessed later, which in the case of betrayal leads to groups sanctions, whereas in the case of bridging social capital, trust is monitored at every stage, step by step, in which each step includes a check on trustworthiness. Bridging social capital enables the emergence of economic transactions between strangers and helps to reduce the inevitable transaction costs arising from incomplete contracts and uncertainty.

In the case of bridging social capital, social relations and market exchange are intertwined through crosscutting loose ties among actors, expressing generalized social norms and heterogeneous social relationships. Such a form of bridging social capital enables the growth and dynamics of markets by flexibly connecting different markets and permitting an efficient allocation of resources, which is only possible in a relatively stable setting and a conducive policy environment.

The two categories of social capital are, however, not mutually exclusive. An economy needs both types of social capital. It requires a minimum level of bonding social capital for bridging social capital to emerge. Social capital is deeply embedded in close social relationships and can only emerge in localized face-to-face human relationships, which modern developments, like the Internet and mobile phones, can only partially replace. Bonding social capital generates externalities for the behaviour of individual agents from group practices, creating and reproducing certain social capabilities, for example, strong social norms, which include mutual help, trustworthiness, sociability, solidarity, loyalty and responsibility, as well as knowledge-sharing. Bridging social capital builds on these social capabilities. This distinction has been characterized by Putnam [107] as bonding social capital enabling “getting by” and bridging social capital as supporting “getting ahead”.

### **3. Transformation of bonding into bridging social capital**

The transformation of bonding into bridging social capital is crucial, since it promotes strong dynamic efficiency. The relationship between the two, however, is not straightforward: the two

levels of social capital are partly trade-offs and partly support each other. Weak social ties tend to have the highest economic benefits, hence, bridging social capital can be more beneficial than bonding social capital, although without bonding social capital there is no fertile ground for bridging social capital to develop. Bridging social capital requires that economic actors are familiar with the strong ties of bonding social capital, which provide them with the necessary social capabilities, particularly interpersonal capabilities of trust, sociability, organization, responsibility and loyalty, to connect to other people. Experiences of trust and trustworthiness in groups enable people to extend these values to others outside their group.

Too much bonding social capital can cause constraints, if it is not complimented by bridging social capital. If people deal only with members of their own group, they run the risk of getting “locked” into a very limited economic realm that is not very innovative, nor efficient in terms of resource allocation. Too much bonding social capital can also exclude others from social capital generation; others who have either no groups to share social capital, or who are members of less influential groups with limited access to resources.

Too much bonding social capital can also reduce the generation of bridging social capital, while too much reliance on generalized trust and the trustworthiness of strangers, without being able to force social sanctions upon those who take advantage, as can be done in a group with strong ties, may lead to blind trust which has economic risks and subsequent costs. As Douglas Caulkins [20] has found in his research in Norway on bonding and bridging ties, the bonding ties of group membership do not necessarily enable the generation of bridging ties across groups. In other words, he found no support for the hypothesis that “the greater the organisational density, the greater the social capital and generalised trust” (Caulkins [20], p. 178).

Bonding social capital could lead to the formation of cartels between firms, and could allow male entrepreneurs to enjoy more advantages than their female counterparts; for example, males are allowed easier access to and control over credit.<sup>13</sup> It connects entrepreneurs to government officials, thereby encouraging rent-seeking practices, such as nepotism and corruption. In other words, power asymmetries are often beneficial for those who are in high positions, but can create a net welfare loss. Hence, bonding social capital can sometimes be labelled perverse social capital: it benefits a minority but creates costs for the excluded.

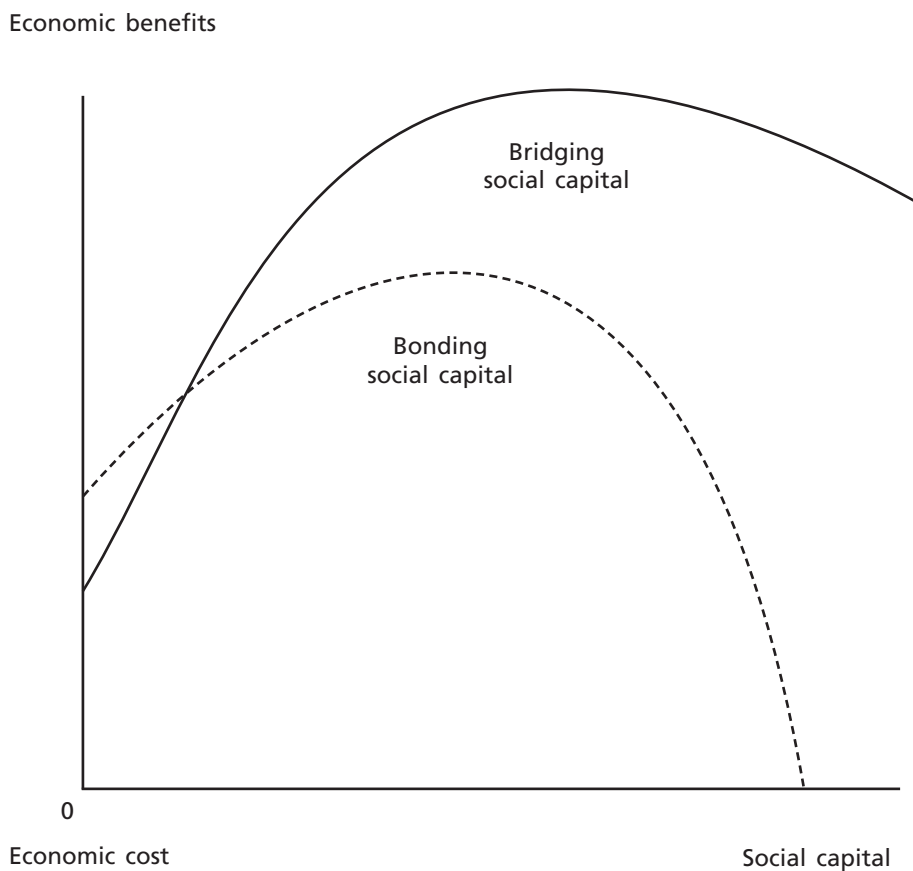
It is important to note that in the literature the notion of linking social capital, which implies a connection to powerful and important people and/or organizations, can sometimes be detected. The idea of linking social capital is that there are more benefits to be derived from knowing the mayor than from knowing the garbage collector, or from being a member of the association of businesswomen than of a women’s literacy class. This view, however, displays a linear and optimistic view of the relationship between social capital and power. Critical studies on the interaction between social capital, inequality and exclusion show that this relationship is very complex (van Staveren [122]). Although the notion of linking social capital is ignored in this report, the relationships between social capital and power asymmetries are analysed in more detail.

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<sup>13</sup>See, for example, research on social capital and gender inequality for female entrepreneurs in credit through group-lending (Linda Mayoux [90]; Katherine Rankin [108]; and Maxine Molyneux [89]).

Figure I below reveals the possible relationship between bonding and bridging social capital, on the one hand, and economic benefits, on the other.

FIGURE I.  
RELATIONSHIP BETWEEN SOCIAL CAPITAL AND AN ECONOMY



What is it that determines the transformation of bonding into bridging social capital? Literature is rather silent on this issue, since it tends to focus on either of these forms of social capital, but much less on the relationship and dynamics between the two. Again, it is the issue of power asymmetries that seems to play a major role here, as it tends to constrain the shift from bonding social capital to bridging social capital. It seems that the transformation from bonding to bridging social capital should reduce the importance of an ascribed common identity (group orientation) and increase the importance of a common goal (network orientation) and widely shared values (society orientation). This transformation takes place at the mesolevel. At this level, people do not group together because of a common identity, as they may have very different identities, but they group around common goals, goals that are shared between individuals, groups and organizations, either horizontally in networks, or vertically in a hierarchy, or along the value chain of a product.

## **E. CONCLUSIONS FOR THE OPERATIONALIZATION OF SOCIAL CAPITAL**

From the literature thus far reviewed on the operationalization of social capital, it can be concluded that social capital impacts both positively and negatively on productivity enhancement and economic growth. Since social capital is difficult to measure, it can best be approached through a combination of quantitative and qualitative research methods. On the positive side, social capital reduces transaction costs, enables and reinforces collective action and generates learning spin-offs. Social capital resides not in individuals but in relationships. Ownership therefore cannot be defined through property rights or physical embodiment, as is the case with financial or human capital, but by the density of social relations. It embodies two forms: bonding and bridging.

Both forms of social capital are necessary, but they are most effective in the “right” mix, enabling a transformation from bonding to bridging social capital. Transformation of social capital from bonding to bridging depends on reducing the role of a common identity and increasing the role of common goals and shared social values. On the negative side, social capital is constrained by power asymmetries: control, exclusion and inequality, and power asymmetries lead to low social capital or even adverse social capital, generating inefficiencies, as expressed in market segmentation, entry barriers, rent-seeking, cartels, monopolistic tendencies, negative externalities, freeriding and moral hazards.

In light of the above conclusions, and as mentioned at the beginning of the chapter, social capital is broadly defined as the economic effect of social relations.



## **II. REVIEW OF RECENT INDUSTRIALIZATION LITERATURE WITH SOCIAL CAPITAL DIMENSIONS**

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This chapter attempts to extract the main propositions from the vast amount of literature that has emerged in recent years on interfirm relationships, clusters, value chains, business associations and business systems. While this literature by and large does not use the label of social capital, it focuses great attention on issues of trust, networking and the importance of high-density social relationships as a complement to economic relationships. Therefore, the aim here is to filter the main propositions contained in this literature, which could be of relevance for an industrialization-specific operationalizing of the container concept of social capital.

### **A. MICROLEVEL: INTERFIRM RELATIONSHIPS**

The most basic point for operationalization at the microlevel, as also discussed in chapter I, is to understand that social capital is not a characteristic of individual firms or entrepreneurs, but consists of sets of relationships among entrepreneurs and of entrepreneurs with other stakeholders. Focusing on the issue of trust, the aim is to explore the relevance of a variety of trust typologies used in the literature. The discussion is restricted to situations where B has the option to choose whether he will cooperate with, or behave opportunistically towards, A. As A must choose a course of action in anticipation of the choice B will make, A is forced to take a risk. Although business people do not usually take risks easily, they are sometimes forced to take chances. Therefore, A gathers as much information as possible about B, based on the likelihood that B will choose to cooperate. Based on this information, A places trust in B, to a certain degree and for specific issues.

Different types of information are required to assess the risk as perceived by A. Following Humphrey and Schmitz [73], Knorringa [77] and [137], a distinction can be made between ascribed and earned trust. Ascribed trust is tied to the characteristics, such as family background or ethnicity, as was explained earlier in relation to bonding social capital. Within this category, a distinction can be made between direct ascribed trust when A and B share a common characteristic, or indirect ascribed trust when B, for example, belongs to a community that A perceives to be generally trustworthy. Earned trust is based on the previous experience of A in dealing with B, in short, his business reputation. Besides, within this category one can distinguish between the personal or direct experience of A in dealing with B on previous occasions, and the indirect earned trust that A can place in B because of the reputation of B in the business community. As already mentioned, this second type of trust is an expression of bridging social capital.

Much of the literature on trust assumes that after an initial trial-and-error period, trust relations are primarily built on extending earned trust, while ascribed trust can help the relationship to develop faster. A key proposition emerging from Knorringa ([78] and [79]) is that, at the same time, ascribed distrust can actually block cooperation from even starting. In situations of entrenched antagonistic relationships between main groups of actors in a particular sector, ascribed distrust can prevent earned trust from emerging at all. In such situations, it is necessary at least partly to overcome social barriers before economic dynamism can develop.

A key proposition from Schmitz [115] is that the emphasis necessarily changes from ascribed to earned trust when relationships become more attuned to the logic of the new competition, based on the recognition that entrepreneurial firms need to continuously improve and combine competition with selective cooperation in more demand-driven markets (Best [13]). In other words, actors cannot effectively rely on only ascribed trust relationships when confronted with more volatile and demanding supply chain relationships in global value chains. This does not necessarily mean that earned trust totally replaces ascribed trust, but that ascribed trust alone does not suffice any more when aiming to enhance competitiveness under globalization.

Moore [92] recently contributed to the trust literature by putting forward how both ascribed and earned trust are basically assessments that A makes about the character of B. He proposes that apart from such a character assessment, actors also make—implicitly perhaps—an assessment of the incentives for cooperative behaviour. Drawing on game theory, these incentives can be seen as covering the following range of alternatives:

- (a) Relative presence or absence of institutional sanctions on cheating (Can A take B effectively to court?);
- (b) Reputational jeopardy (How afraid is B of having his reputation damaged?);
- (c) Direct retaliation (To what extent does B expect that A can and will directly retaliate, for example, by burning down B's factory or kidnapping B's child?);
- (d) Future non-cooperation and interdependence (How damaging could it be to B, if A refuses to include B in future activities?).

In essence, the incentive assessment is an attempt by A to "... put himself in B's position and to work out what incentives he faces to be trustworthy, or not. The institutional context plays a major role here" (Moore [92], p. 84). In short, Moore argues that trustworthiness depends both on the disposition of a person and on circumstances. For an operationalization of trust, as part of identifying policy variables, the incentive assessment may actually be just as important as the character assessment.

Finally, in the management literature on trust, a three-stage dynamic scheme shows how trust tends to develop at the interfirm level, that is, from bonding towards bridging social capital (see, for example, Butler and Gill [19]; Child and Möllering [21], p. 3; Lane [82]; and Nooteboom [98], p. 90). These are:



- (a) Control in the absence of trust—contracts and controls (pre-trust, or credibility);
- (b) Assessment of trustworthiness and developing tolerance levels of trust—intensive communication and courtship leading to knowledge-based trust, building reputations, showing competence, leading to goodwill trust;
- (c) Widening of tolerance levels on the basis of social bonding, leading to recognition and support of common goals, generating mesolevel trust.

At the firm level, the four different types of entrepreneurs include: self-employed or “blue collar”; self-made indigenous entrepreneurs or “white collar”; political entrepreneurs, who develop their business at least partly through being close to or part of the political decision-making process; and new competition entrepreneurs, who specialize in developing relationships with other value chain actors, especially outside transnational corporations or global buyers. These four types of entrepreneurs are viewed to be oriented towards distinct mixes of bonding and bridging social capital.

For example, while most self-employed entrepreneurs serving local markets will depend on bonding social capital, new competition entrepreneurs will focus first and foremost on developing and drawing on bridging social capital. Finally, the ownership structure of firms becomes an important element at the microlevel, co-determining, for example, relationships with the State in the case of State-owned enterprises, but also joint ventures with foreign companies (that selectively brings in a constrained type of bridging social capital), or wholly foreign-owned affiliations. Since this report focuses on the sectoral level and not on the performance of individual firms, the level of intrafirm relationships is not elaborated on here.

## **B. MESOLEVEL STUDIES AND CONNECTIONS TO SOCIAL CAPITAL**

At the mesolevel, the literature on sectoral and geographical clustering of firms and on issues relating to informal and formal types of (business) association, to regional innovation systems and to linkages and upgrading processes within value chains have been drawn upon. Clustering is a common feature in many developing countries, perhaps especially in rather traditional and partly artisan-based industries dominated by small and medium enterprises. Opportunities for predominantly bonding social capital formation are expected to be higher among firms that are already geographically and sectorally concentrated. The literature on business associations is also of particular relevance, as this literature, even though only superficially connected to cluster literature, deals with the rationale for collective action, a key element in the social capital framework.

While cluster literature predominantly focuses on producer-producer relations and horizontal forms of collective action, it is the value chain perspective that initiates vertical relationships and provides the link to bridging social capital with outside actors further down or up the value chain. The aim is to draw upon some of the main trends in the literature on clustering, business associations, regional innovation systems and value chains, and to further specify and elaborate on a social capital framework within the institutional context of marginalized countries dominated by small and medium enterprises. Finally, reference is made to attempts to consciously create cooperation in clusters or value chains.

## 1. Industrial clusters

Many cluster studies assign major importance to the intangible aspects of what appears to make clusters special and successful. Clusters can embody social capital when the geographical proximity of firms is matched by some level of density of social relations among firms, through a variety of business relationships (Schmitz [115] and Taylor and Leonard [126]). Nadvi [96] puts forward that social networks, such as the one in Sialkot, Pakistan, influence production relations, and that these interactions may not only change over time, but meeting higher standards requires greater local cooperation, especially for bridging social capital.

Various labels have been suggested for social capital embodying clusters, such as “structural embeddedness” (Taylor and Leonard [126]) or “institutional thickness” (Amin and Thrift [1]). Social capital in clusters of small and medium enterprises is expressed, according to Amin and Thrift, through:

- A high number as well as a variety of organizations across the market, State, and civil society, all of which relate to a particular cluster of small and medium enterprises;
- A high level of interaction within the cluster of small and medium enterprises;
- Mutual awareness of a common enterprise for the cluster of small and medium enterprises.

Such cluster social capital tends to support local economic growth and linkages to export markets because it features persistence over time (long-term, not ad hoc, relationships) as well as flexibility (open-ended relationships with mutual learning) and inclusiveness. The collective efficiency or economic effects of cluster social capital are reflected in the strong presence of (Schmitz [115], p. 466):

- Division of labour and specialization among small producers;
- Variety of suppliers of raw materials;
- Range of new and second-hand machinery and suppliers of spare parts;
- Agents who provide connections to national and international markets;
- Specialized services (technical and financial);
- A pool of workers with sector-specific skills;
- Joint action (informal or formal, ad hoc or long-term strategic business associations).

The first five aspects are often seen as “passive” external economies through which firms can benefit simply by being located in the cluster. To fully achieve collective efficiency, firms also need to actively engage in (selective) joint action.

“In summary, the argument is that clustering facilitates the mobilization of financial and human resources, that it breaks down investment into small risky steps, that the enterprise of one creates a foothold for the other, that ladders are constructed which enable small enterprises to climb up and grow. It is a process in which enterprises create for each other—often

unwillingly, sometimes intentionally—possibilities for accumulating capital and skill” (Schmitz [115], p. 478-479). This understanding of cluster social capital reflects well the methodology of intentional and unintentional consequences that were introduced earlier in the alternative literature review.

In relation to technological development and skills upgrading, according to Boschma, Lambooy and Schutjens [16], cluster social capital can potentially propel cluster-based innovation through:

- Trust-based supplier relationships that reduce risks of opportunistic behaviour by exchange partners (reduction of transaction costs);
- Cooperation between small firms that makes up for the lack of economic scale, of resources to tap export markets and of bargaining power vis-à-vis banks, and that helps in the joint purchase of inputs and joint bidding on large projects (collective action);
- Clusters that embody social capital and offer the flexibility needed for innovation, compared to hierarchy (lock-in) or the market (contracts which cannot possibly regulate everything) (bridging social capital);
- Transmission and exchange of knowledge and information, leading to learning and innovation (learning spin-offs).

In clusters with a strong institutional thickness, incremental innovation can occur, for example, through:

- Local user-producer interaction;
- Incremental innovations on the shop floor;
- Local learning spin-offs (through team work, labour market dynamics, job rotation);
- Cooperation with local organizations;
- Demanding local clients.

Finally, learning in a cluster is most effective in a mix of formal learning through human capital investment, and informal learning through tacit knowledge (Asheim and Isaksen [3], p. 171):

- Intuitive skills acquired through learning by doing;
- Routines, norms of behaviour, beliefs in organizations, networks and communities;
- “Know who”: personal ties.

The second and third points above clearly rely on the presence of social capital. However, it must be stressed here that most industrial clusters in developing countries appear to possess only small amounts of such forms of cluster social capital.<sup>14</sup> Nevertheless, it is important to try and identify steps to strengthen the transition from bonding to bridging social capital in order to propel the process in clusters towards more innovation and learning opportunities.

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<sup>14</sup>This also appears to be true for many industrial clusters in Europe, contrary to the rather romantic and idealized picture of such industrial clusters in the first wave of cluster studies from the Third Italy.

At the same time, a cluster with tight social relationships always poses a risk of lock-in effects. As mentioned earlier, too little bridging social capital because of too much bonding social capital can be inefficient. An example of such a lock-in effect is demonstrated by Sofer and Schnell [118] in a comparative study between Jewish and Arab entrepreneurs in Israel. It points out that Arab entrepreneurs rely too much on bonding social capital and too little on bridging social capital. Innovation is limited when learning is constrained within (a segment of) a cluster of small and medium enterprises. That is why clusters need bridging social capital that not only spreads within a cluster, but also forms a bridge between the cluster and organizations outside the cluster, such as national research and development centres, universities, national governments and perhaps even international contacts. As Cooke and Wills [25] have argued, it is important for success in the innovation of small and medium enterprises to link to external innovation networks.

## **2. Business associations**

The next body of literature relevant to operationalizing the social capital framework revolves around the rationale and role of business associations.<sup>15</sup> It is important to stress at the outset that while most of the existing literature focuses on formalized business associations, the more generic lessons drawn from this literature also bears relevance to more informal types of association among firms. While donors might be tempted to equate social capital formation with supporting formal business associations, especially sectoral associations, the aim here is to provide a more nuanced discussion of the rationale for selected firms to work together.

Business associations are defined here as voluntary membership organizations that provide certain goods and services to their members,<sup>16</sup> which can be a key social capital asset. Business associations are known to provide four different types of goods:

- Solidarity goods, for example, those that offer a place/event where members can meet socially;
- Collective action goods, namely those that represent the collective interest of members vis-à-vis others, such as governments, clients and suppliers and other third parties (such as universities);
- Club goods and services that are only available to members;
- Authoritative goods or self regulation through which members establish and enforce certain norms and standards for individual behaviour, and through which business conflicts between members can be mediated and resolved.

The type of goods produced by a business association influences the social capital it contributes to its members. Solidarity goods are principally aimed at connecting members. Hence they would have a positive impact on networking. While this would also apply to collective action

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<sup>15</sup>This subsection is based on a paper written by Albert H.J. Helmsing [68] for the present UNIDO report.

<sup>16</sup>There are countries where corporatist institutional arrangements have made membership of business associations obligatory. From a social capital perspective, voluntary membership would seem to be essential, given the extra dynamic efficiency benefits of bridging social capital over bonding social capital.

goods, these require actions from members. The least networking potential may be generated through the production of individual goods, such as business development services. Both solidarity goods and authoritative goods are trust-enhancing. Business development services may enable members to “prepare for interactions that may produce trust”. Similarly, successful collective action goods promote process trust.

Solidarity goods may prepare members for collective action. If a business association produces business development services and authoritative goods, these may reduce transaction costs. Even solidarity goods may reduce the will of members to engage in post-contractual opportunism towards other members, and as a result reduce freeriding problems and moral hazards. As far as learning is concerned, solidarity goods contribute to tacit learning (interacting with role models); business development services clearly have a learning spin-off, while collective action contributes to learning by doing, and authoritative goods contribute to learning by interacting, or collective learning.

A general point in the literature on business associations is that industrialists have a greater incentive to engage in associational activity than traders (Lucas [86]). This is well explained by the fact that industrialists often have more sunk costs and need longer recuperation periods to recover their investments. Traders, on the other hand, have more mobile investments.<sup>17</sup> The economic structure influences the level at which associational activity is organized and whether associations assume functional or territorial forms. Research on this issue is limited to developed countries (see Coleman and Jacek [23]; Schmitter and Lanza [114]; and van Waarden [133]), and its findings include the following:

- If an industry is economically concentrated on a small number of large firms, it is less likely that associations are organized at subnational levels;
- When sectors have large numbers of small firms and when markets are dispersed spatially, associations tend to be organized locally or regionally, the reason being that associations need to maintain contact with their members to provide services;
- If an economic activity is concentrated on one single region, it tends to give rise to associational activity at that level;
- Countries with large internal markets (and federal structures) have a greater proportion of subnational business associations than smaller countries, which are more dependent on their international sector;
- The manner in which collective wage bargaining is conducted influences the level at which business associations are organized;
- Tradable sectors are more likely to engage in associative activity than survival/subsistence activities.

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<sup>17</sup>Perhaps more important is the sunk investment issue. Compare shop owners with mobile traders. The former have important investment in their shops and are members of the local chamber of commerce. Street traders and itinerant traders have less sunk costs and are also less organized.

It has been argued that business associations can contribute to reducing transaction costs (Fafchamps and Minten [44]), but that may only apply in situations where there is “complex contracting” (Mumvuma [95]), in a context of uncertainty. Simple contracting involves low transaction costs, and hence there is less scope for business associations to assist in lowering them further. Besides, vertically integrated firms are less likely to need business associations, as against the more interdependent firms. Vertical integration as it were insulates a firm from the external environment. As Meyer-Stamer [88] argued, vertical integration may actually be sustained as a response to a turbulent economic environment. Globalization, within the context of changing State structures, could simultaneously give rise to both internationalization and localization of business association activities.

To avoid static reasoning, it is important to recognize that economic structures are dynamic and business associations may either reinforce or try to overcome the limits of historical patterns. For example, in a specialized regional economy, established dominant interests may try to defend their export industry at all costs, using business associations as instruments. In that case, the business association contributes to enhancing lock-in. At the same time, entrepreneurs may have access to other exclusive networks and alliances to advance their interests. Thus the presence of business associations cannot be assumed automatically as indicative of the existence of trust and inclusive policies. Entrepreneurs may straddle different mechanisms simultaneously to gain access to the State. Even though business executives trust their own associations far more than government, this does not prevent them from freeriding on their own associations.

Also, the issue of power should not be ignored. Business associations, like any other group, are not immune to the workings of power. Associations may include some and exclude others; they may treat some members more equally than others, or they may be organized in a hierarchical way, enabling control by powerful members over weaker parties.

Business associations may be organized differently, according to what Schmitter and Lanzalaco [114] refer to as “logics of association”. The most important and well-known ones are: the “logic of membership” and the “logic of influence”. The first concerns the role of business associations for providing solidarity services and creating/confirming the identity of its members. Such business associations are generally not sector-specific, but general multisectoral associations. The logic of membership in a way contributes to both bonding social capital as much as it generates bridging social capital, in the sense that it allows members to connect/network across sectors of activities and form new ventures.

The second logic is the logic of influence. Here it would be the characteristics of the policy-making structures that could be influenced to shape the organization of the business association. Conventionally, the logic of influence tends to focus more on State and government policy. However, business associations may also exert influence over labour unions, buyers, clients and other third parties. Business associations organized with this logic typically produce public goods that benefit both members and non-members. One could hypothesize that new competition would foment industry-level associations across the value chain.

Schmitter and Lanzalaco distinguished two additional forms of logic. First, the “logic of implementation” is particularly relevant for the production of individual and “club-good” services to members, such as research and development. These are services which individual firms are unable to provide themselves, and for which no market equivalent exists (they cannot be bought). The rationale here is production considerations, such as economies of scale and technical competence. Globalization, new competition and the growing complexity of a country have all stimulated the demand for business development services and the growth of such services supplied by business associations to their members. Services delivery is financed either through membership fees or (increasingly) through cost recovery.

The second additional logic identified by Schmitter and Lanzalaco is the “logic of goal formation”. This logic expresses the potential tension between business associations representing unified interests and the diversity of its members. The more diverse the (potential) membership, the more difficult it will be to pursue collective interests. The logic of goals formulation also has a vertical dimension. If State structures are highly centralized, business associations have to operate nationally to exert their influence. Finally, it stands to reason that these four forms of logic do not exist independently, but that all four influence the organization of a business association.

A business association can promote trust if it is organized according to the logic of membership or of goal formation. A business association would be more effective in collective action when the logic of influence is its guiding principle. The logic of implementation is the one that seeks to organize the association in such a way that it produces its services in the most efficient way, reducing transaction costs for its members. Finally, learning spin-offs may be influenced by, for example, the logic of implementation that may generate information asymmetries between staff of the business association and the members. Similarly, the logic of influence may distance the leadership from its members and cause information asymmetries.

The last dimension of associations to consider is the degree of association. A low degree of association would refer to informal arrangements, with low frequency and effort, and would be of limited importance to the performance of the member enterprises. A high degree of association would imply a greater degree of contract specification between members. A high degree of association often also implies formalization, entry and exit barriers and procedures. Higher degrees of association are likely to be restricted to smaller groups, reducing networking potential, in terms of size, but with much higher quality.

### **3. Regional innovation systems**

A regional innovation system concerns a network of public and private institutions at the sub-national or regional level, whose activities and interactions initiate, modify and diffuse new technologies (European Union [42]). Broadly two approaches to regional innovation systems can be distinguished, originating from evolutionary theories of economic and technological change or from regional science theory (Doloreux and Parto [34]). The first approach is basically top down, and derives from new growth theories of the 1980s that stress the importance of technological change for economic growth (Dosi [35]). Within this approach, national

innovation systems were to generate a coherent scientific research cum technological development and innovation drive to promote economic growth.

Even though national innovation systems were important for moving the relevant research frontiers in advanced countries, translation into technological innovation by firms was less than expected. The regional innovation system can be seen as a response to this lack of diffusion. Regional innovation systems offer more decentralized delivery of technological services to firms, and are expected to be closer and more responsive to the needs of these firms. At the same time, the regional level is still expected to possess an adequate scale for efficient and effective delivery of such intermediary services.

The second approach starts from below and revolves around a range of theories on clusters, production systems and industrial districts. In essence, to acquire new competencies for sustained competitiveness, small and medium enterprises need at least partly to rely on external public and private sources. Through joint, collective and public action, resources and institutions may be built (or rebuilt) and renewed (Maskell and Malmberg [87]). In addition, these theories have emphasized the importance of exchange of tacit knowledge, which requires spatial and social-cultural proximity between firms.

Typical activities in a regional innovation system include facilitating interaction between firms and research and technology centres, creation of technology centres and brokering services, reducing barriers to technological acquisition and development costs and human resource development and training. These measures are directed at small and medium enterprises that, unlike large corporations and specialist firms, are unable to individually find their way in the knowledge economy.

Regional innovation strategies have become an important strategic coordination instrument, using innovation audits to identify demands at the firm level, and, on the basis of inventories of the local knowledge base, to identify gaps and propose actions at the regional level to reduce systemic failure and trigger a process of networking and partnership formation. Recent studies on regional innovation systems (for example, Doloreux and Parto [34] and UNIDO [131]) distinguish between different types of regional innovation systems, the relative importance of public and private players, and different governance models.

#### *Regional innovation systems and social capital*

Social capital is considered to be a basic precondition for regional innovation systems to function. This is either formulated loosely in terms of social and cultural proximity alongside spatial proximity, or more elaborately as “shared value systems, norms and institutions that enhance trust and reciprocity and more or less institutionalised forms of social interaction such as networks and other forms of social organisation” (Landabaso, Mouton and Miedzinski [81], p. 1). Social capital is seen as a key ingredient to enhance and accelerate exchange and creation of knowledge and innovation. In addition, it can reduce transaction costs involved in innovation processes. Shared value systems, norms and institutions can amplify the range of actors and resources on which firms can draw to augment their competencies and seek and extend cooperation for mutual benefit (Asheim and Coenen [4]).



Experiences with regional innovation systems in Europe demonstrated that these help to build social capital (Landabaso, Mouton and Miedzinski [81]). The community innovation survey of 2000 found that the three most frequently undertaken actions under these strategies are directed at: creation of clusters and business networks; innovation projects with universities and technology centres; and interregional networking. In other words, all actions were directed at fostering social capital at the regional level. According to the authors, weak regional partnerships between public and private actors were the principal cause of lack of success with the regional innovation strategies. The main reasons for these weak regional partnerships were as follows:

- (a) Regional governments sometimes felt threatened by bottom-up processes, which opened up innovation policy to a wide array of actors;
- (b) Regional governments felt insecure about translating demands of local small and medium enterprises into new European Regional Development Fund programmes;
- (c) Research and technology institutions sometimes resisted a more demand-led orientation of their programmes;
- (d) A weak “take-up” by firms and a lack of available regional “champion” firms;
- (e) Regional innovation strategy initiatives were sometimes too much driven by external consultants, leading to a supply-driven approach that was less sensitive to the practical needs of the firms. This, in turn, reduced responses at the firm level (Landabaso, Mouton and Miedzinski [81]).

When considering the implementation difficulties of regional innovation systems in Europe, it seems reasonable to expect that it would be even more difficult to implement a regional innovation system in marginalized countries. Furthermore, small and medium enterprises in marginalized countries seem to be even more “technology-following”, with a considerable time lag. Especially in more marginalized countries, future action needs to focus on “innovative imitation” (Grandinetti [60]) instead of on endogenous technological innovation. By implication, the vertical nexus (like relationships with outside buyers) would be more important than the horizontal interaction promoted through regional innovation strategies. In other words, cleverly tapping global sources of knowledge (that can be imitated) may be more important than constructing independent local knowledge centres.

#### **4. Value chain analysis**

Value chain analysis focuses on the vertical linkages of small and medium enterprises, both upstream and downstream. The value chain perspective draws attention to the sequence of activities stemming from product conception to the final consumer, stressing the importance of activities other than production itself, notably design, logistics and marketing. Moreover, control of a value chain does not require owning the manufacturing operation, nor direct management of all activities (Cowling and Sugden [27]). According to Jarillo [76], in most recent successful examples of industrial organization, the leading actors in value chains focused only on a few strategic activities. In value chains that produce and sell labour-intensive consumer goods, such as footwear, the leading actors are large retailers, (ex-)manufacturers of established

brand names and import wholesalers. In such buyer-driven chains, these lead firms "... act as strategic brokers in linking overseas factories with evolving product niches in the main consumer markets..." (Gereffi [56]).

Relationships between producers and lead firms are usually characterized by a complex mix of market, hierarchy and trust. Although theoretically one could set a breaking point where leading actors switch from arms-length contracts with independent suppliers to wholly-owned subsidiaries, the business world is aware of many intermediate forms that can fill the continuum between perfect market and pure hierarchy. Relationships often display characteristics of uneven networks within which leading actors manage relationships that are both obligatory and asymmetrical (Pfeffer and Salancik [103]; Sako [112]). In such vertical interfirm relationships, eliciting selective cooperation has proven to be an efficient strategy for small and medium enterprises, both in theory (Axelrod [5] and Ring and van der Ven [110]), and in the Italian and Japanese success stories of new competition (Best [13] and Sako [112]).

A general, but often, implicit proposition from this literature is that more quality-driven or high-road production entails also higher levels of (especially earned) trust. In contrast, old competition and much of the import-industrialization were based on ascribed trust. Lane [82] argues that under intensified, quality-driven competition, trust has become more necessary, but also more problematic. Her proposition is that trust is at present an even more important precondition for success than before, while at the same time intensified competition makes trust more difficult to develop and more risky to invest in.

A quality-driven or high-road environment may well offer more opportunities for organizational learning which, in turn, increases the likelihood of upgrading. Upgrading in value chain literature is usually broken down into:

- Process upgrading (doing things better);
- Product upgrading (producing better goods);
- Functional upgrading (engaging in additional and higher value-added activities) (Humphrey and Schmitz [72]).

A key issue in the present literature is the extent to which asymmetrical relationships with buyers provide small and medium enterprises with opportunities for learning and upgrading. Recent studies (among others, Gereffi [57] and Schmitz and Knorringer [116]) argue that (global) buyers often play a significant role in process and product upgrading, especially for their more favoured suppliers. From the social capital angle, it could be argued that bridging social capital developed through these vertical linkages is essential for creating such learning spin-offs for small and medium enterprises. The controversial issue is whether firms are also able to achieve functional upgrading, and to determine the role buyers play in furthering, neglecting or obstructing functional upgrading by their suppliers.

While the Gereffi study on garments recognizes that there are many obstacles to functional upgrading, he emphasizes the dynamic learning curves that producers in value chains are

exposed to: moving from mere assembly to monitoring the entire production process, to design and sale of their own branded merchandise. In contrast, Schmitz and Knorringer [116] found that, in the footwear industry, global buyers tended to see attempts at functional upgrading as encroaching on their core competencies and actively discouraged such attempts.

The power asymmetries that firms from marginalized countries face in trying to gain access to global value chains have two sources, according to Hobday [69]. First, they are by definition almost dislocated from the mainstream international markets that they wish to supply, and, secondly, they are dislocated from the main international sources of technology and research and development (Hobday [69], p. 1193). These dislocations appear to create the need to enter global value chains under quasi-hierarchical conditions, in other words, conditions of uneven control.

Bini [14] developed two propositions in his study on upgrading in the leather tanning industry in Ethiopia. One relates to gaining access to global value chains. It states that a critical mass of producers needs a minimum threshold of capabilities before international buyers can be persuaded to invest in long-term relationships. The second deals with upgrading the skills of more mature participants in global value chains. What is critical here is that, as Humphrey and Schmitz put it, local collective action is needed to fill in the capability gaps that are left by the vertical relationships with buyers. This refers to those capabilities that outside buyers would not be willing to invest in, but that could help a cluster of firms to overcome a lock-in situation.

The most recent literature aims to connect value chain analysis with cluster studies, focusing on the interaction of local governance through, for example, business associations and global governance through value chain linkages (Humphrey and Schmitz [72]). A key question is whether there is necessarily a trade-off between developing stronger local connections and relying more strongly on global connections. The case studies in Ethiopia and Viet Nam might shed some light on this question.

The new literature is also closely connected to issues centring around collective learning (Lazarcic and Lorenz [84] and Lesser [85]) and endogenously generated forms of governance (Meyer-Stamer [88] and Helmsing [68]). Locational externalities and collective learning could lead to a self-organizing process in small and medium enterprises. In turn, these could lead to new, locally embedded institutions and, hence, to local forms of governance.

From a dynamic perspective, this emergence of institutions and governance can be thought of in terms of co-evolution, that is, the cluster of small and medium enterprises generates certain institutions, but changes in these institutions could affect the structure of the cluster itself. Thus, a cluster of small and medium enterprises could generate efficiency gains, or “active collective efficiency”, which could lead to specialization within the cluster, governance, based on formal and/or informal business networks, and collective action towards local government, demanding certain public goods considered necessary for the cluster performance. Social capital is thus likely to play a key role when focusing on such active collective efficiency in a cluster.

## 5. Intentionally created cooperation

Almost all case studies on cooperation, either horizontally in clusters or vertically in value chains, deal with situations where some forms of cooperation and trust already exist. This means that they examine the past, in particular how cooperation has led to upgrading and learning, and try to derive lessons of a general nature from these experiences. Unfortunately, these lessons do not seem to be particularly appropriate to situations characterized by distrust and antagonism.

There is a small, yet important, part of literature on purposively creating cooperation in hostile environments (Barnes and Morris [7]; Morris [93]; and Morris, Bessant and Barnes [94]). This approach focuses on how purposive action by intermediaries or local champions can promote cooperation and trust-building within a particular sector and/or value chain.<sup>18</sup> Based on five case studies in South Africa, Morris [93] draws the following set of general policy lessons for those interested in supporting attempts to create and deepen cooperation:

- An external crisis, when it also includes new market opportunities, helps firms to overcome their natural tendency to go it alone in hostile environments;
- Developing trust is a fundamental element and can be established through “concrete activities demonstrating the clear benefits of cooperation” (Morris [93], p. 8);
- Neutral external intermediaries, well aware of the industry, are often a necessary but not sufficient condition;
- Internal change agents, “willing and able to play a catalytic function propagating cooperation, are essential” (ibid., p. 9);
- Lead firms need to sanction and legitimize the creation of cooperation, but should preferably not dominate the process;
- Inherited mindsets need to be broken, to open up avenues for new ways of thinking, taking into account old and new problems confronting the industry;
- A critical mass of production firms with a potential for horizontal cooperation is required;
- Especially at the initial stages, a facilitating government is very important, and early successful attempts to collectively lobby the Government can accelerate the process;
- Developing cooperation and trust is necessarily a slow process, for which no blueprints exist, which usually needs to proceed “... at the pace of the slowest” (ibid., p. 8), because it is crucial to keep a critical and diverse mass of firms on board;
- Constructing cooperation is a step-by-step process, based on practically oriented activities that provide visible benefits, to enhance information flows and knowledge-sharing. Firms need to be locked into the process either through financial obligations and/or membership fees, and encouraged to develop a sense of joint ownership of the collectivity. The process requires periodic quantifiable assessments of real benefits to sustain the process.

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<sup>18</sup>As discussed in the next section, this approach follows Moore [91] in claiming that islands of effective market cooperation can be created and sustained in hostile environments, contrary to the argument by Platteau [104].

Many of the elements mentioned above are also reflected in the brokers' programme as executed by the UNIDO small and medium enterprises cluster and network development programme. A more systematic understanding of the role of social capital in the creation of cooperation, however, may help to make such a programme even more effective.

### **C. MACROLEVEL: GENERALIZED TRUST, BUSINESS SYSTEMS, STATE-ECONOMY RELATIONS AND CYCLICAL FACTORS**

Many sectoral studies pay lip service to the importance of the macrolevel but do not systematically explore the extent to which macro issues, which set the playing field, impact upon or constrain developments at the mesolevel and microlevel. To put it broadly, economic relationships take place within the "generalized moral order" of a particular society at a particular point in time (Platteau [104]). This environment determines the prevailing conceptualization of what constitutes opportunistic behaviour, and the morally acceptable strategies to protect one from opportunists. This moral order is reflected in the somewhat less esoteric institutional setting, the formal or informal, but generally known, "rules of the game" (North [99]). Humphrey and Schmitz [73] use the label of minimal trust to indicate a threshold of trust that enables markets to develop effectively.

While Platteau basically maintains that such a generalized moral order can only change very slowly, and in markets of low-trust societies it will therefore function poorly, Moore [91] is more optimistic and puts forward that islands of effective market cooperation can be constructed and may even positively influence the overall order. In the context of the present report, this is a crucial issue. Given that the focus is on marginalized countries, it would probably be necessary at least partially to believe in going against the odds of being able to create selective cooperation (as a part of social capital) in hostile environments.<sup>19</sup>

Useful approaches at this macrolevel that also connect rather directly to the present project are the business systems approach (Jakobsen and Torp [75] and Whitley [134]) and the approach by Goran Hyden [74] to connect different perspectives on civil society to manifestations of social capital. The common element in these approaches is the focus on how diverse political decision-making processes impact upon the specific external business environment, namely, footwear producers in Ethiopia and Viet Nam. Key issues in these approaches are patterns of ownership, predictability of the broader environment, efficacy of the legal system, transparency of the political system, and more specific issues like the question whether land can be privately owned, or how are taxes levied, or the accessibility of the banking system for business credit.

A related concern is the extent to which business associations and chambers of commerce are public or private in their orientation. Pedersen and McCormick ([102], p. 122) argue that a key problem in many African business systems is that they are fragmented and volatile, which makes developing bridging social capital extremely difficult, especially between small and large firms. Entrepreneurs are caught in risky environments, where they can be confronted with

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<sup>19</sup>See for example the work by Morris, as discussed above, where cooperation is created in a non-conducive environment.

problems beyond their control. They often need to base their business relationships on personal relationships because "... monopolistic or illicit tendering practices and the inability of the legal system to secure enforcement of contracts is a major problem" (ibid., p. 121).

Finally, they are exposed to increasingly pervasive rent-seeking and corruption, especially among groups of businesses with political protection, and growing instability because of increasingly predatory States. As a result, small entrepreneurs are boxed into what Mumvuma [95] calls simple contracting. He finds that "... transactions and associational activities as a consequence are often polarized along religious, racial, gender, ideology etc. lines." (Mumvuma [95], p. 256).

An even broader but important issue is how State-economy relationships impact upon opportunities for creating social capital in a specific subsector. According to Evans [43], the social capital that is most crucial for industrial transformation is "... formed in the networks that are neither public nor private but fill the gap between the two spheres, in a constellation that avoids excessive corruption and rent seeking and exclusion..." (Evans [43] p. 1122). His key proposition applicable to this report is that the key constraining factor for marginalized countries is not a lack of prior endowments of social capital at the microlevel, but rather one of scaling up microlevel social capital: "... to generate solidarity ties and collective action on a scale that is politically and economically efficacious" (ibid., p. 1123). Evans [43] convincingly argues that there are no a priori reasons to assume significant differences of stocks of social capital at the microlevel. In his view, what distinguishes environments where social capital does or does not develop is the problem of scaling up microlevel social capital to the mesolevel and (in his view especially) the macrolevel.<sup>20</sup>

Evans identifies as the missing ingredient a "... competent, engaged set of public institutions that enact upscaling of social capital ..." (Evans [43], p. 1125). However, he recognizes that "... clientilistic capture is the natural consequence of close public-private ties involving elites" (ibid., p. 1129) and that "... highly inegalitarian social structures presided over by fragile, fragmented government apparatuses are the general rule" (ibid.). He therefore suggests not waiting for such public institutions to emerge, but working against the odds in attempting to create synergistic relationships between groups of local entrepreneurs and reformists in the public sector, and that such examples exist even in very hostile environments. But the scaling-up idea seems to ignore what in the alternative social capital literature was referred to as the weak relationship between bonding and bridging social capital: these are two different types of social capital in which the second does not necessarily follow from expanding the first.

Finally, a study by Bazan and Schmitz [9] makes clear that the propensity of entrepreneurs to cooperate varies over time. Their longitudinal study of a shoe community in Southern Brazil shows how initially social relationships facilitate cooperation between entrepreneurs, but that during a period of rapid growth entrepreneurs become more focused on going it alone. However, when this period of fast growth ends, increased cooperation (based more on earned as compared to ascribed trust) is again necessary to effectively respond to growing global

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<sup>20</sup>A similar point was made in a study on African business system as described by Pedersen and McCormick [102], where one of the main problems is upscaling of informal family or clan-based networks to a broader business-oriented collective action.

competition. The relationship between social capital and economic growth therefore may well not be unidirectional. Social capital, in terms of sufficient ascribed or earned trust among a critical mass of entrepreneurs, may be crucial to get an initial growth process started and accomplish entry into global value chains. Besides, social capital, primarily relying on earned trust, is needed for collective action, and learning spin-offs may be crucial to enhance upgrading opportunities for more advanced clusters in global value chains.

#### **D. CONCLUSIONS FOR THE OPERATIONALIZATION OF SOCIAL CAPITAL**

Keeping in mind the broadly defined definition of social capital as the economic effect of social relations, the main conclusions arising from the review of industrialization literature with social capital dimensions are as follows. To start with, high levels of ascribed distrust can prevent earned trust from emerging at all. While ascribed trust relates to bonding social capital, earned trust relates to bridging social capital. Clusters may especially embody bonding social capital, characterized by high-density relationships among a variety of organizations within a cluster as well as the mutual awareness of a common goal. More generally, cluster-based development of small and medium enterprises is more likely to depend on bonding social capital, whereas value-chain development of small and medium enterprises depends on building bridging social capital.

To engage successfully in new competition and more demanding international value chains requires a transition from bonding to bridging social capital. At the same time, intensified competition makes trust more difficult to develop and more risky to invest in. Power asymmetries in global value chains, particularly in buyer-driven value chains, may still enable process and product upgrading for small and medium enterprises, but are unlikely to allow functional upgrading. Business associations and regional innovation systems can reinforce the economic effects of social relations—depending on their functions and social structure, but they also risk “locking” into only bonding social capital. Finally, while building up social capital is a slow process, particularly when the macroeconomic, social and political context is not supportive, building up social capital is sometimes shown to be possible even in an insecure and volatile environment with a lack of sanctions on opportunistic behaviour.







### **III. CONCEPTUALIZATION OF SOCIAL CAPITAL: CAUSALITY, DEFINITION AND INDICATORS**

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This chapter draws the main implications from the literature review and develops a methodology for operationalizing the concept of social capital. This methodology has been tested in two small case studies, as reported in chapter IV. Without undervaluing the findings from these modest initial case studies, the methodology itself is arguably at least as important, as it might be used as a guide for follow-up studies. During and after the execution of the case studies, new insights into the methodology have been incorporated and a consolidated version thereof is presented below.

From the literature review it became clear that three main issues needed to be tackled, in order to adequately respond to the main objective of this COMPID research project, namely, “to determine how social capital can be made an operational concept for technical assistance in the field of industrial development.” The first challenge was to pin down the role of social capital in the (industrial) development process. For example, is social capital a key pillar of development, a root cause of development without which development is highly unlikely? Or is social capital more usefully seen as a factor that influences the effectiveness of key factors of production? Or is it merely a nice spin-off from economic growth?

This first issue of the role of social capital in the (industrial) development process is dealt with in section A below. After positioning social capital within the broader industrial development discourse, section B proposes a more elaborate working definition of social capital that can be used in the context of policy development, programme formulation and technical assistance. Finally, and most importantly for future research, indicators at the micro-, meso- and macrolevels of analysis have been developed for measuring social capital.

#### **A. POSITIONING SOCIAL CAPITAL WITHIN INDUSTRIAL DEVELOPMENT**

The literature reviews in chapters I and II above have discussed various aspects of social capital and its theoretical and empirical dimensions, including the issue of the role of social capital in the industrial development process. This subsection will consolidate the insights on the positioning of social capital within the industrial development process. The analysis proceeds in two steps covering, first, social relations as the foundation of social capital and, secondly, the economic effects of social relations.

##### **1. Social relations**

The first step is the level and type of social relationships that form the foundation of social capital. Social capital always requires underlying social relations, whether it generates intended

or unintended economic effects. In other words, social capital builds upon social relations, both in the case of intended economic effects, as in collective action among suppliers to access global value chains or to lobby local government for physical infrastructure, and in the case of unintended economic effects as in trust, which reduces uncertainties in market relationships between suppliers and buyers or investors and producers.

How do these social relations come about and are they always a good basis for social capital? Social relations emerge in any community, group and society and involve linking structures and the concept of agency, thereby making the behaviour of individuals a mix of following and responding to structures, on the one hand, and expressing individual motivations and goals, on the other. Social relations are complex social phenomena that cannot be summarized here. But what is clear is that social capital varies with the strength of social relations (close ties or weak ties) and the type of relations (the role of power)—as well as with the motivation and goals of relationships and their extent of formalization in groups, organizations and institutions. The literature review suggests that social capital is more likely to emerge when based upon the following social relations:

- Intrinsic valuation over time of at least some social relationships (relatedness as an end in itself rather than (only) as instrumental for personal benefit);
- Relative importance of weak ties over strong ties (with generalized trust being relatively important compared to ascribed trust);
- Relatively minor role of power (inclusive rather than exclusive relationships, low levels of inequality and limited exercise of control by some over others);
- Shared social values, reflected in common goals (in the case of intentional economic effects) or in shared norms and routines (in the case of unintended economic effects).

## 2. Economic effects

The second step in the positioning of social capital leads from social relations to economic effects. These may be positive, in the case of efficiency gains, or negative, in the case of efficiency losses (with gains limited to a small group). The efficiency losses result from perverse social capital, and may be summarized as rent-seeking (for example, through corruption), freeriding (for example, in a business association), moral hazard (for example, through abusing family relationships in the use of labour or credit), and collusion (for example, through entry barriers for certain suppliers). The positive economic effects in terms of efficiency gains may be summarized as follows: reduction of transaction costs; enabling and reinforcing collective action; and generating learning spin-offs.

Whereas, in the mainstream approach, social capital is generally regarded as an additional production factor or a general productivity scale factor, the alternative approach understands the causal relationship of social capital as attached to the regular production factors. This would lead to the following conception of social capital in the production function:

$$Y = f(\alpha K, \beta T, \gamma L, \varepsilon H)$$

where  $K$  stands for capital,  $T$  for technology,  $L$  for labour and  $H$  for human capital, and where  $\alpha$ ,  $\beta$ ,  $\gamma$  and  $\varepsilon$  are productivity scale factors for each of the production factors, representing the efficiency impact of social capital.

Positive signs for the parameters would indicate efficiency gains, while negative signs would signal efficiency losses. Hence, this conceptualization of social capital cannot be measured separately in a regression function of economic growth with indicators, such as group membership, trust or social values. That is because social capital will not have an independent effect on the allocation of resources in an economy, but will enable or inhibit the allocation of each production factor, as well as influence their productivity.

For example, credit supply to groups rather than individuals has shown to increase the efficient allocation of capital in poor rural regions in the world, generating production among landless peasants and women without productive alternatives. New economic growth theory has argued that learning spin-offs among workers, through learning by doing, on-the-job training and intrasectoral mobility of workers, has helped to increase labour productivity, even resulting in increasing returns for human capital investment.

The relationship between social relations and economic effects, cannot usefully be simplified to a single indicator, or even a set of indicators, which would be expected to have an independent effect upon gross domestic product (GDP) growth (or another economic variable).<sup>21</sup> Rather, social capital should be understood as a complementary variable, attached to economic variables that reflect outcomes of allocation processes and productivity within these processes. This feature of social capital is sometimes referred to as a “lubricant” (Field [46], p. 63), or “social cement” (Repetti [109]) in economic interactions, influencing the efficiency of these interactions and hence, economic outcomes.

This operationalization makes it much more difficult to measure social capital. For example, when measuring credit as a production factor, the social capital effect is already included in the measurement of the capital. Social capital has enabled the allocation of credit through social relations (for example, by generating trust in formerly discriminated groups of entrepreneurs), or has influenced the productivity of the capital (for example, through economies of scale among producers when they collectively establish a test unit).

This invisibility of the causality of social capital, in combination with the difficulties in measuring social capital (and distinguishing its constituting elements from its effects), points to the need for a methodology different from that usually employed in establishing causal relationships in economics. One such alternative methodology can be found in critical realism, which argues for a combination of quantitative and qualitative methods, and draws attention to invisible causal mechanisms, such as, motivations, values, institutions and power (Lawson [83]). Research building on realism is scarce in economics, however, and even more so for research on social capital, as the literature review of social capital has indicated.

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<sup>21</sup>This is, however, assumed in some statistical analyses of social capital (see, for example, the quantitative relationships proposed by van der Gaag and Snijders [55], or Paldam and Tinggaard [101]).

It is too early to assess the causality of social capital in detail, if only because there is still a possibility that an unknown third factor may help to explain both social capital and economic performance. The causality issue needs to be treated in more detail, as there are still many unanswered questions. But the direction in which to look for answers seems to be to investigate, at various levels of analysis, how social relations influence economic outcomes and vice versa. This can only be assessed through a combination of quantitative and qualitative methods of empirical research. This is precisely the methodological choice that has been taken for the present report, as will be explained below, after introducing the definition of social capital.

## **B. DEFINITION OF SOCIAL CAPITAL**

Building on the very general definitions provided earlier, it is possible to extend and focus the definition of social capital for the purpose of this report. Social capital, hence, refers to a wide variety of economic effects of social relations. These can be intended, but require a basic level of shared values to build upon, or they can be unintended, following from intrinsically valued social relations. Two types of social capital can be distinguished: bonding social capital with ascribed trust based on close ties of family, ethnicity, gender, class, culture, or region; and bridging social capital with generalized trust based on partial and ex-post monitoring of trustworthiness among relative strangers. Whereas bonding social capital is expressed through group membership, bridging social capital plays out through weak ties based on shared social values and goals.

Both forms of social capital assume the existence of social relations based on shared values—without such a basis, social capital will not emerge, as it resides in social relations, not in individuals. Also, both forms of social capital are constrained, at the same time, by the workings of power, through inequality, exclusion and control.<sup>22</sup> With sufficient strength in social relations and limitation of power, social relations are likely to result in three types of economic benefits: reduction of transaction costs; collective action; and learning spin-offs. But, with more influence of power differences, these benefits may easily turn into gains for a small group, at the cost of others, and sometimes even at the cost of inefficiencies for the economy as a whole.

Social capital therefore can be defined as the set of social relations that enables entrepreneurs to gain, maintain or expand access to economic resources, which are used by entrepreneurs to reinforce the productivity of these economic resources. For (groups of) producers this would refer to ways in which social relations—with, for example, buyers, suppliers, other producers, workers, facilitators and officials from business associations, civil society organizations and government—enable them to gain, maintain or expand access to markets, new designs, raw materials, credit, licenses, testing facilities etc. The economic effect of social capital is that it reduces transaction costs, it enables and reinforces collective action, and it generates learning spin-offs.

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<sup>22</sup>According to Field ([46], p. 82): "... there is considerable evidence that both the overall level and the more specific nature of people's social capital can play an important role in determining whether they can access resources. Yet this insight into the influence of social capital on inequality is not a widely discussed one, and it has rarely so far penetrated the discourse of policy-makers."

### C. METHODS OF DATA COLLECTION

A key lesson from the literature review, further reinforced by the findings presented in the next chapter, is that for an operationalization of social capital useful to UNIDO, a variety of data needs to be collected at the micro-, meso- and macrolevel. Connecting findings from these various levels of analysis, or, in other words, seeing the industrial system at work, seems to be a good way to improve the understanding of social capital.

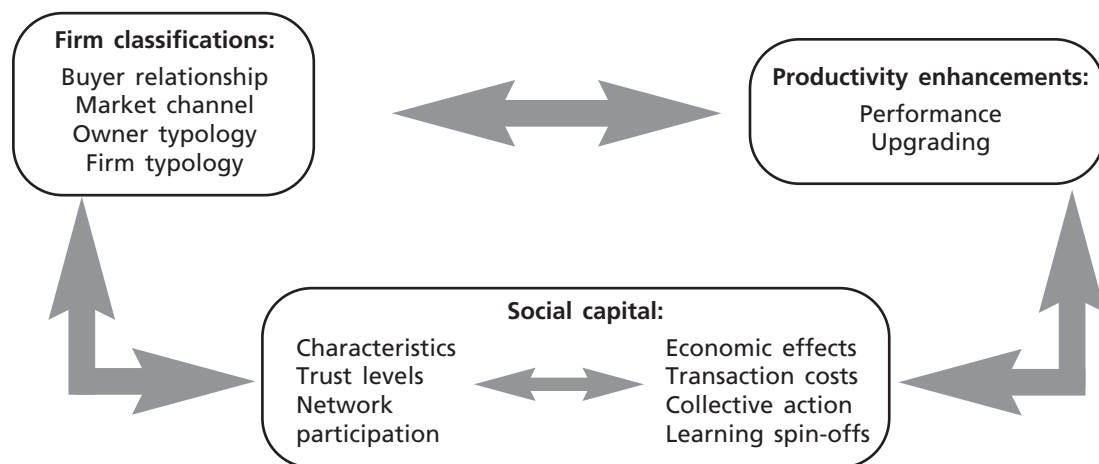
A useful point of departure for sectoral data collection is to develop subsector maps through a subsector approach. The subsector approach (Boomgard and others [15]) is a strong analytical device for rapidly gaining an initial understanding of an industrial activity and its linkages. It looks at basic economic parameters, such as type of products produced, price, quantity and the number of firms, producers and traders in a particular market channel or value chain. A subsector map shows who bargains with whom in particular market channels, and it helps to visualize the relative importance of various market channels in terms of production and employment.

#### 1. Microlevel data collection

Microlevel data has been collected primarily through a survey, executed by local researchers, drawn from a stratified sample of firms in distinct market channels based on an initial subsector mapping. In the survey questionnaire, the aim was to include power asymmetries to measure social capital. Some variables are discrete variables, whereas others reflect people's beliefs and attitudes, preferably measured on an ordinal scale, or indicating probabilities, as has been advised by various social capital researchers (Durlauf [36], Nooteboom [98] and Sako [113]).<sup>23</sup> The complete questionnaire can be found in annex I. The questionnaire is constructed around four key sets of variables, and coded answers in the closed questionnaire were used to develop a number of composite variables (for an overview of how composite variables are derived from survey questions, see annex II). The key composite variables from the firm survey are reflected in figure II.

FIGURE II.

#### KEY COMPOSITE VARIABLES FROM FIRM SURVEY



<sup>23</sup>An example of such a question in a survey would be: "Do you think you can rely on the cooperation of others in the cluster to set up a joint quality control unit?" Choose from (a) no; (b) less than 25 per cent chance; (c) less than 50 per cent chance; (d) less than 75 per cent chance; (e) yes, this is very likely.

### *Firm classifications*

Firm classifications are based on the following:

- (a) Buyer relationship: arm's length, network, quasi-hierarchy;
- (b) Market channel: domestic or export; high end, main market, low-end price range of products; shoes for men, women or children; leather content; fashion content;
- (c) Owner typology: subsistence, self-employed specialized, indigenous entrepreneurs, political entrepreneurs and new competition entrepreneurs;
- (d) Firm typology: formal/informal sector; home-based, informal workshop, small and medium and large enterprises.

### *Social capital characteristics*

Social capital characteristics reflect the following:

- (a) Trust levels: levels of generalized, earned and ascribed trust, plus credibility:
  - (i) Perception of risks of trusting behaviour, importance of fear of being the "sucker";
  - (ii) Incentive assessment:
    - Relative presence or absence of institutional sanctions on cheating;
    - Reputational jeopardy: how afraid is B to have his or her reputation damaged;
    - Direct retaliation: to what extent does B expect that A can and will directly retaliate, for example, by burning down his or her factory or kidnapping his or her son;
    - Future non-cooperation and interdependence: how damaging will it be to B if A refuses to include B in future activities.
- (b) Network participation: local embeddedness versus isolation, range of business partners, external linkages;
- (c) Associational membership: number of organizations, reasons for membership.

### *Economic effects of social capital*

The economic effects of social capital relate to the following:

- (a) Transaction costs: what is the relative amount of money and time spent on:
  - (i) Finding alternative suppliers or buyers;
  - (ii) Monitoring compliance of transaction partners;
  - (iii) Achieving access to production factors;
- (b) Collective action:
  - (i) Cooperation with other producers on: exchange of information; sharing machines and tools; joint purchasing of inputs; joint marketing; joint product development;
  - (ii) Lobbying the State;

- (c) Learning spin-offs:
  - (i) Relative number of improvements with a significant input from cluster or value chain actors;
  - (ii) Joint initiatives, such as developing testing facilities or quality control facilities;
  - (iii) Feedback from buyers into the production process.

### *Productivity enhancement*

Productivity enhancement involves the following:

- (a) Performance indicators: trends in output in number of pairs, average price of products, average quality of products and number of workers;
- (b) Trends in product, process and functional upgrading.

As an addition to the basic survey, the senior researcher carried out more in-depth interviews with entrepreneurs and other stakeholders, to acquire a more qualitative overview of distinct types of relationships across the various market channels (similar to the methodology followed in Knorringa [79]).

## **2. Mesolevel data collection**

At the mesolevel of analysis, the field studies focused on issues around interfirm networks, attempts at collective action, and the existence or emergence of localized policy networks. Data on these issues was collected through semi-structured interviews with local key respondents involved in the subsector, but not necessarily producers of footwear (like traders in leather or finished products, machinery suppliers, pattern makers and other persons with a solid understanding of at least part of the subsector). The “spiders in the local web”, actors with multi-memberships and a key presence in the sector, were identified and interviewed. Additionally, a special effort was made to identify and interview individuals who are or might become local catalysts in attempts at collective action. In both Ethiopia and Viet Nam, a “mesocard” workshop with local stakeholders was organized to allow the key issues to be discussed interactively.

A mesocard exercise is designed to provide an opportunity for a group of people to systematically discuss a specific topic.<sup>24</sup> Important features are, first, that all participants get an equal and initially anonymous opportunity to put forward key issues (by putting key words on cards that will be shuffled and then put up against a wall). Secondly, it provides a structure to eliminate duplicates, cluster similar cards, and zoom in on the core issues. After some practice sessions in other environments, it was agreed that this could be a useful tool for obtaining significant mesolevel information from a group of footwear producers within a very short period of time. Actually getting a group of busy entrepreneurs together in one place for one or two hours turned out to be the most difficult part of this exercise. In both Ethiopia and Viet Nam, it involved tremendous preparation, discussions with association representatives and perseverance from local UNIDO staff to organize the workshops.

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<sup>24</sup>With many thanks to Jorg Meyer-Stamer for suggesting this approach, introducing it and helping to tailor it to the specific needs of this project. More details can be found at [www.mesopartner.com](http://www.mesopartner.com) and [www.metaplan.com](http://www.metaplan.com).

The following items provided a checklist for the open interviews with representatives of groups, networks, associations and other key respondents:

- Types of goods provided by groups: solidaristic, collective action goods; club goods and services; authoritative goods or goods involving self-regulation;
- Logics of grouping: logic of membership, influence, implementation and goal formation;
- Types of owners involved: self-employed, self-made indigenous entrepreneurs, political entrepreneurs and new competition entrepreneurs;
- Degree of associability: What does one put in, as an entrepreneur, and what does one get out of it?
- Awareness of common goals: To what extent does a shared vision or strategy exist for the footwear sector within and between groups? Do they adequately identify and implement responses to external changes? Do groups of entrepreneurs jointly invest ahead of demand based on a shared vision? How united or fragmented are the various associations? To what extent do they complement or compete with each other?
- Trust at interorganizational level, through an exploration of: frequency and openness of interorganizational communication; extent of open-endedness of relationships; extent of balance between autonomy and dependence; extent of narrowness and restriction to networks;
- Power asymmetry: degree of inequality between cluster segments; barriers to entry (exclusion) between groupings and cluster segments; upward and downward mobility in roles (entrepreneur, worker and agent);
- Perception of the importance of social capital: What is the perception of the presence or lack of existing social capital? What has been done or could be done to generate social capital? How can opportunistic behaviour be made costly? Which sanctions really hurt?
- What are, if any, the problems of “scaling up” levels of social capital from the microlevel or small-group level to the mesolevel and macrolevel? Which groups are able to span the public-private divide? Are these networks “developmental” or instruments of “corruption or rent-seeking”?
- Look for potential social capital catalysts among entrepreneurs, but also among service providers: public agencies, public-private partnerships, donor agencies and business associations. Identify actors with multiple memberships, especially those who bridge various groupings.

### **3. Macrolevel data collection**

Macrolevel information has been collected through secondary sources in combination with interviewing resource persons whose publications on the historical, political, social, cultural or economic development of Ethiopia or Viet Nam indicated a connection with social capital issues.

Secondary data has been collected to establish the levels of economic and industrial development, sectoral standards and cyclical factors, the institutional setting and State-private sector-civil



society relations. Secondary data, to the extent possible, has been double-checked while conducting interviews with key respondents. Part of a macrolevel assessment of social capital should also take into account macrolevel inequalities in the economy and exclusions from economic processes, given the negative relationship between social capital and power asymmetries. Accordingly, an overview is provided of the achievements and distributions of human development indicators of the country involved in the case study.

Under the heading of institutional setting, information has been collected on the efficacy of the legal system, the tax system, land ownership, accessibility of the banking system and import and export regulations and tariffs. This is complemented with an analysis of State-private sector-civil society relationships, with a focus on how these general features condition the scene for actors in a particular sector, in the case studies of the footwear industry. Finally, data from the UNIDO statistical office on levels of country and sectoral competitiveness can be used.

#### **D. CONCLUSIONS**

Chapter III has provided a framework for operationalizing social capital. It positioned social capital within the broader industrial development process as a factor that influences the efficiency and effectiveness of key production factors. Such an operationalization makes the measurement of social capital much more complex. The container concept of social capital has been unpacked by developing indicators at the micro-, meso- and macrolevel of analysis, and the argument has been that connecting the findings on these indicators at various levels of analysis can improve the understanding of social capital. Chapter IV provides findings on two initial case studies on the footwear industry in Ethiopia and Viet Nam, which have been used as test cases in the operationalization of social capital.





## **IV. FIELD STUDIES ON THE FOOTWEAR SUBSECTOR IN ETHIOPIA AND VIET NAM**

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Here the findings from the two initial case studies are presented to experiment with the operationalization of social capital. Section A explains the choice of countries and sector for the field studies. This is followed by a brief and selective overview of some key features of the global footwear industry and of the footwear subsectors in Ethiopia and Viet Nam, to provide the necessary context. The next three sections explore the three main sets of issues that were identified in chapter III to unpack the container concept of social capital.

Section B focuses on microlevel issues around (lack of) trust and cooperation in interfirm relationships, and how that enables firms to access and participate effectively in market relations, or inhibits them from doing so. The main source of data for this section is a survey carried out among, in total, 106 footwear producers in Ethiopia and Viet Nam. Section C deals with mesolevel issues around the depth of interfirm networks and institutional thickness, and the extent to which this enables groups of firms to engage in inclusive collective action, to develop supportive localized policy networks and to generate learning spin-offs, or inhibits them from doing so. The main sources of data for this chapter are workshops organized both in Ethiopia and Viet Nam with footwear entrepreneurs, and interviews with key respondents like association representatives in both countries.

Section D tackles the macrolevel issues around boundary conditions for industrial development as set by the relative efficacy and reliability of institutions, State- civil society-private sector relations, level of social integration and cohesion versus exclusion and inequalities, extent of generalized trust and shared values and norms in society. The principal sources of data for this chapter are background documents prepared by senior local researchers and a variety of recent policy and research documents on Ethiopia and Viet Nam. Finally, section E provides the main findings from the case studies, including an integrated analysis of Ethiopia and Viet Nam.

### **A. FOOTWEAR INDUSTRY IN ETHIOPIA AND VIET NAM**

This section explains similarities and differences between the countries selected for the case studies, and focuses in particular on introducing the main features of their footwear industry. It aims to serve especially readers who are relatively unfamiliar with the footwear subsector. Ethiopia and Viet Nam have a similar size of population and a very low average income. Both countries are emerging from an extensive period of central planning towards a more market-based model of development. In this process, both face the challenges of nurturing new (macro, meso and micro) mechanisms to promote industrial development.

The footwear industry is an appropriate sector for these case studies, as it has played and still plays an important role in the industrialization strategy of both countries. Also, more generally, the footwear industry is seen as a labour-intensive sector that requires relatively modest investments and unsophisticated skills. Therefore, the footwear industry is one of the sectors that particularly interest industrial policy makers focusing on more marginalized countries.

Notwithstanding the general similarities between Ethiopia and Viet Nam mentioned above, the development trajectories of the footwear industry in Ethiopia and Viet Nam are very different. In short, the Ethiopian footwear industry has not been able to significantly export its products, while it faces increasingly strong competition in its domestic market, especially from Chinese imports. By contrast, Viet Nam has in recent years become one of the main global exporters of footwear. A multitude of factors explains this difference.

In the present report, the focus is on those aspects that can be related to social capital and a lack thereof at the macro-, meso- and microlevel of analysis. To be able to position these more detailed findings in later chapters, the rest of this chapter provides a brief look at the position of Ethiopia and Viet Nam within the changing structure of the global footwear industry.

### **1. Structure of the global footwear industry**

A main trend in the global footwear industry is the increased concentration in both distribution and production of footwear. A relatively small number of global buyers purchases and distributes an increasingly large share of global footwear production, especially in the cheaper market segments. These global buyers, located in the United States and Europe, are the spiders in the web of the main buyer-driven global value chains. In other words, international trade in footwear is not about anonymous markets with an infinite number of buyers and suppliers, but it is managed trade where access to global markets often runs through these spiders in the web.

A key to global access lies in convincing these spiders, and in practice their (local) intermediaries, of the ability and reliability of particular manufacturers. As the main spiders have increasingly concentrated on branding, marketing and designing, the functions of logistics, quality control and production management have increasingly shifted to second-tier countries and areas, like Taiwan Province of China and the Republic of Korea, whose labour costs are nowadays too high for mass production of cheaper varieties of footwear. These entrepreneurs from Taiwan Province of China, the Republic of Korea and a number of other countries and areas, which have often developed relations of trust with the main spiders over several decades, are now managing and controlling production especially in China, but also in some other countries in the region like Viet Nam.<sup>25</sup>

Next to these main global value chains exists a multitude of smaller and more specialized value chains between producers in a variety of countries and wholesalers and retailers from around the world. Countries, like Ethiopia, that simply do not have the critical mass in terms of production

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<sup>25</sup>This process is often referred to as triangle manufacturing (Gereffi [57], p. 114, and Schmitz and Knorringa [116], p. 193).

capacity to supply the main global players, and are also not on their "radar screen", need to find access to global markets through these smaller national (or international) intermediaries.

The other side of the coin is that finding export opportunities is increasingly important for the footwear industry in developing countries, because in many countries the domestic market is flooded with imported footwear, especially from China. The next two sections will introduce the subsector maps for the Ethiopian and Vietnamese footwear industry.

## **2. Ethiopian footwear industry<sup>26</sup>**

The Government of Ethiopia recently published its Ethiopian industrial development strategy, in which the leather industry is identified as one of the key growth sectors. Based on the observation that Ethiopia possesses one of the largest livestock in Africa, the leather tanning and leather products subsectors are to produce and sell more and higher value added products in the international market. Ethiopia has a tradition of producing and exporting high-quality semi-processed leather, which is finished and made into final products in, among others, Italy and the United Kingdom of Great Britain and Northern Ireland.

Next to four large public sector tanneries and two public sector footwear factories, each with 600 to 700 workers, some main private groups exist.<sup>27</sup> Within these private groups, tanning is usually seen as the core activity, while, for example, the footwear factory is merely a spin-off activity. Even though these footwear factories are relatively large by Ethiopian standards (50-75 workers) and have plans to export, at present they by and large sell only in the domestic market, and mainly distribute through their own retail shops. They supply the top end of the domestic market, if the very small amount of high-quality global-brand imported footwear is disregarded.

A group of around 30 registered small-scale factories also serves the more expensive market segments in Ethiopia, and some of them export (or have plans to export) relatively small quantities to mainly other African countries. Most of these registered factories have so far suffered less from Asian imports that were originally mostly destined for the cheaper market segments in Ethiopia. However, this is rapidly changing as the quality of imports is increasing, putting pressure on the competitiveness of the registered small-scale factories.

The main impact of the cheap Asian imports so far has been on the extensive informal sector. Informal sector producers used to be competitive in the cheaper domestic market segments, producing both very basic footwear and inferior imitations of fashionable products with an international or domestic brand name. The cheap Asian imports have all but taken over that last market segment, which leaves the informal producers with supplying the most basic traditional types of footwear and trying desperately to compete with the cheap imports.

In Ethiopia, most leather (footwear) workers and entrepreneurs share an ethnic and regional identity, that of the Guraghes from the Southern Nations, Nationalities and People's Region,

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<sup>26</sup>See subsector map of Ethiopian footwear in figure III for more details.

<sup>27</sup>At the time of the field study, October 2003, a total of 19 tanneries were in operation.

especially around the town of Wolkiso. Most of these workers are poor and seasonally move between producing footwear (or petty trading) in Addis Ababa and farm work (or petty trading) in their native area. A widespread apprenticeship system exists that reproduces and reinforces this ethnic concentration especially in informal footwear production. Also, quite a few of the larger footwear enterprise owners, and owners of tanneries, share a Guraghe background. Some of the more successful family businesses in the leather sector currently were founded one or two generations ago by small traders of raw hides and skins who came from Wolkiso to Addis Ababa.

In short, while informal sector producers and the smaller factories are facing an acute crisis and more and more producers appear to be withdrawing from the market, the larger formal sector producers still have a reasonable grip on the more expensive domestic market segments. The challenge for the larger formal sector producers is to become successful exporters, which they have not yet been able to achieve. This is due to a variety of reasons. One that is always mentioned by Ethiopian producers is that they suffer from the effect of stigmatization as a country prone to natural disaster and famine.

A common response among international buyers is: “Do you really expect me to believe you can systematically supply quality shoes from a country as poor and famine-prone as Ethiopia?” Some internal reasons are the lack of a critical mass of sizeable export-oriented producers in Ethiopia and a lack of sustained quality in management and production. Finally, another reason for not having achieved significant entry into international value chains is that footwear is merely a side activity for the main private companies that could take the lead in a more concerted and sustained effort at making Ethiopian footwear more competitive. While for Ethiopia the challenge is to achieve entry, the Vietnamese footwear industry has achieved entry, but faces the challenge of functional upgrading.

### **3. Vietnamese footwear industry<sup>28</sup>**

In Viet Nam both the formal and the informal sector (at least in the major urban areas) have been booming since the mid-1990s. The loosening-up of central planning regulations has led to a progressive blossoming of the economy, initially led by booming consumer spending, and followed up by foreign investment and rapid export growth. This general pattern can also be seen in the footwear industry. Before the opening-up of the economy, exports consisted mainly of uppers to the former socialist States of Eastern Europe. In recent years, the Government of Viet Nam has encouraged the formation of joint ventures with foreign partners.

In the footwear industry, around 80 per cent of exports originates from around 80 foreign direct investment or joint venture companies in which the foreign partner (often intermediaries from Taiwan Province of China or the Republic of Korea) takes care of the key value-chain-related activities like supply of machines and material and organizing orders. The Vietnamese partner is responsible for providing labour and maintaining factory facilities and, critically, manages approvals from and relationships with Government agencies. Initially, the creation of joint ventures was a strategy adopted by the Government to renovate State-owned enterprises. However, over time more Vietnamese partners in the joint ventures are private companies.

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<sup>28</sup>See subsector map of Vietnamese footwear in figure IV for more details.

Most, if not all, inputs in the export-oriented factories are imported through the Asian intermediaries. Especially in the South, around Ho Chi Minh City, there are numerous large-size processing plants with 5,000-6,000 workers each.<sup>29</sup> In contrast, one major factory in Viet Nam employs more workers than the total employment in the whole Ethiopian footwear industry (which is slightly less than 5,000 workers when the roughly 2,500 persons employed in the informal sector are included).

Next to the foreign direct investment and joint venture companies that focus exclusively on exports, the formal footwear sector consists of another 75 large-scale State-owned enterprises, employing around 130,000 workers, and around 60 large-scale private factories, employing around 65,000 workers, who produce for both domestic and export markets. Smaller private firms, of less than 200 workers, and a significant group of informal workshops and home-based producers altogether generate an additional employment of around 70,000 workers. While some of these smaller firms are active in higher-quality niche export markets, most of them produce cheaper varieties of footwear that compete with Chinese imports.

The booming Vietnamese footwear industry is nevertheless not a straightforward success story. First of all, quite a number of State-owned enterprises are struggling to become competitive, and some of them will be closed down or equitized. Secondly, the less dynamic segment of the informal sector, producing cheap and not very fashionable footwear, is squeezed out of the market by Chinese imports and by newly established larger and more mechanized domestic producers. Finally, for a more sustainable development of the Vietnamese footwear industry, its export processors need to develop additional skills in order to be able to become direct exporters, as elaborated upon below.

#### **4. Conclusions**

From a policy perspective this leads to at least two separate but possibly connected issues to address for Ethiopia. The first is how to enable formal producers to become successful in export markets, or, in other words, achieve entry into international value chains. The second is to find ways to support informal producers in either upgrading within the footwear subsector (for example, through creating learning linkages with formal producers), and/or assisting in generating alternative income sources for groups of Guraghe, who used to depend significantly on footwear, to ease the "sharing of poverty".

For Viet Nam, the main policy issue appears to be to find ways in which to support the larger factories in functional upgrading in global value chains. In other words, the focus is on how to move from processing for intermediaries to direct exports, for which the Vietnamese footwear industry would need to develop skills beyond the production process, like designing and marketing. Interestingly, some of the smaller firms in Viet Nam seem to be already successful in directly exporting higher value added leather shoes. Therefore, managers from some of the very large but hierarchic and more rigid processing plants could learn from the experiences of some of the smaller owner-managers more attuned to the new competition.

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<sup>29</sup>The largest joint venture company in the sample survey employed 5,675 persons at the time of the survey, and stated that it employs around 5,850 workers in peak periods.

For Viet Nam, a separate focus on the marginalized in the informal sector seems less opportune as compared to the situation in Ethiopia. First, it concerns a relatively smaller group of people in relation to the total size of the industry, and, secondly, alternative forms of income-generating activities are more widely available in the vibrant urban centres of Viet Nam. Also for Ethiopia, the focus will be mainly on the first challenge of exploring how a proper emphasis on social capital can contribute to developing policy proposals that enable Ethiopian footwear producers to become successful exporters. Section C addresses these sectoral policy issues in more detail with a stronger focus on the mesolevel dimension of social capital. The next section first presents microlevel findings from a sample survey carried among footwear producers in Ethiopia and Viet Nam.

## **B. MICROLEVEL DATA FROM FIRM SURVEYS**

After preparing the footwear subsector maps for Ethiopia and Viet Nam (figures III and IV), a stratified random sample was drawn for each country. Obviously, especially for the informal segments of the sector, the overall firm population is necessarily based on estimated guesses by a number of local key respondents. In both Ethiopia and Viet Nam, a fair amount of time was spent on acquiring a solid grip of the numbers of market channels and firms in each subsector. As can be seen from figures III and IV, the coverage is much higher in Ethiopia, where 5 out of 10 of the larger factories were covered, 10 out of 30 of the smaller factories, and around 10 per cent of the informal sector with 37 interviews. In the much larger Vietnamese footwear sector, the size of the sample implies a much more modest coverage, but the stratification by market channel at least attempts to cover sectoral heterogeneity. Interviews, using a questionnaire with closed questions, were carried out by the local counterparts in October 2003 in Ethiopia and in November 2003 in Viet Nam.<sup>30</sup>

This section reports findings from two small sample surveys of formal and informal footwear firms (52 interviews in Ethiopia, 54 in Viet Nam). The data presentation is structured around the four key sets of variables also discussed in chapter III:

- Firm classifications (buyer relationship, market channel, owner typology, and firm typology);
- Social capital characteristics (trust levels, network participation, associational membership);
- Economic effects of social capital (transaction costs, collective action, learning spin offs);
- Productivity enhancement indicators (performance, upgrading).

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<sup>30</sup>Peter Knorringa, the Institute of Social Studies senior researcher, carried out the five interviews with larger factories in Ethiopia, and participated in some of the other interviews in Ethiopia and Viet Nam, but focused more on the open interviews with key respondents.



FIGURE III.

MAP OF THE ETHIOPIA FOOTWEAR SUBSECTOR

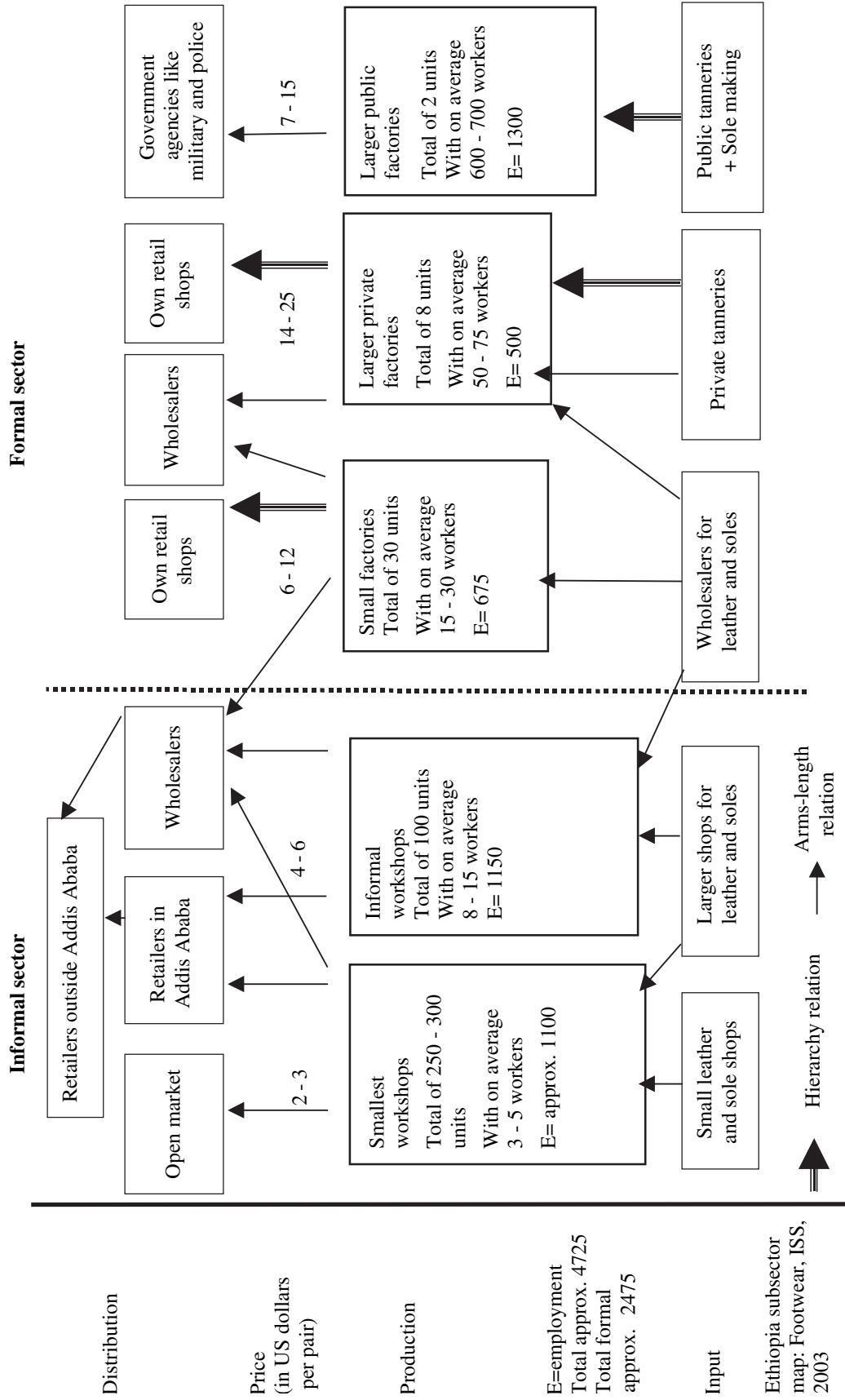
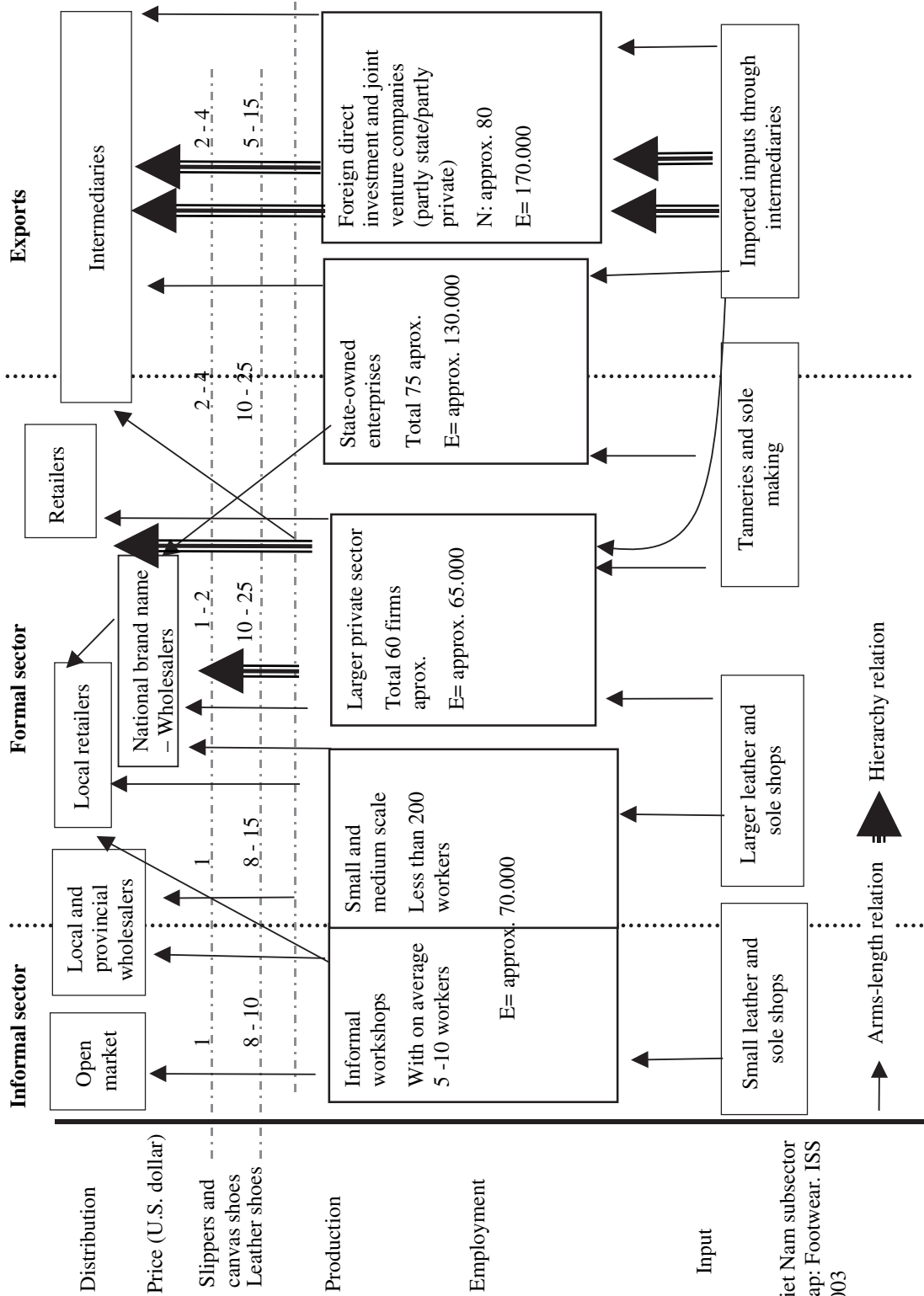


FIGURE IV.  
MAP OF THE VIET NAM FOOTWEAR SUBSECTOR



An underlying reason for the data analysis has been to investigate to what extent the data on the intervening variables of social capital contribute to a better understanding of the relationship between key firm characteristics and levels of productivity enhancement. After all, this would be one way to operationalize the importance of social capital. Before discussing levels of association between the various key variables, the data set is introduced by presenting the main characteristics of footwear firms in Ethiopia and Viet Nam.

### 1. Firm classifications: What do the firms look like?

Table 1 shows a cross-tabulation of firm typology and owner typology, distinguishing between Ethiopia and Viet Nam. The informal sector consists of the home-based units, with usually five or fewer family workers, and informal workshops that are larger, typically 10 to 15 workers, and not located in the home. The formal sector consists of registered small and medium enterprises with up to 200 workers, and large-scale firms with more than 200 workers. The owner typology distinguishes between subsistence entrepreneurs, where production is limited to peak periods, and self-employed specialized entrepreneurs, who by and large produce throughout the year. For formal sector entrepreneurs, a distinction is made between indigenous entrepreneurs and political entrepreneurs, where political entrepreneurs are those who indicated that dealing with public sector agencies is an important part of their work, and that they see good political contacts as an important factor for success.

The main findings from table 1 are, first, that while most home-based units and even most informal workshops in Ethiopia are run on a subsistence basis, almost all home-based units and all informal workshops in Viet Nam have enough orders to run throughout the year. The really bad situation for the subsistence producers in Ethiopia is further underlined by the observation that for all the Ethiopian producers who produce only in peak periods, shoe production is nevertheless their main source of income. Secondly, large-scale firms in Viet Nam are the only category of firms predominantly run by political entrepreneurs.

TABLE 1.  
TYPES OF OWNERS AND TYPES OF FOOTWEAR PRODUCERS IN ETHIOPIA AND VIET NAM

Country		Firm typology				Total
		Home-based	Informal workshop	SMEs	Large scale	
ETHIOPIA (Owner typology)	Subsistence	25	7	—	—	32
	Self-employed specialized	2	3	—	—	5
	Indigenous entrepreneurs	—	—	7	1	8
	Political entrepreneurs	—	—	4	1	5
	<b>Total</b>	<b>27</b>	<b>10</b>	<b>11</b>	<b>2</b>	<b>50</b>
VIET NAM (Owner typology)	Subsistence	1	—	—	—	1
	Self-employed specialized	20	10	—	—	30
	Indigenous entrepreneurs	—	2	5	5	12
	Political entrepreneurs	—	—	—	11	11
	<b>Total</b>	<b>21</b>	<b>12</b>	<b>5</b>	<b>16</b>	<b>54</b>

The additional data on education and job experience of entrepreneurs in the survey shows that very few informal sector owners have formal sector job experience. Also from other discussions, it became clear that high barriers to entry exist between the formal and informal sector. In Ethiopia, recruitment in formal factories appears to work through family, kinship, village and tribal networks of those artisans and non-artisans who are already inside the formal sector. By contrast, in Viet Nam, recruitment works through labour contractors who bring in young women from peri-urban areas. In the survey, and also in other discussions, relatively few examples were found of people who worked in the formal sector for a number of years, after which they started their own (initially informal) workshop. More generally, the linkages between footwear producers in the formal and informal sector were found to be very weak.

In the initial classification of entrepreneurs based on the literature review, it was thought that many “new competition” entrepreneurs would be found, but, in the total sample, there were only eight entrepreneurs who indicated that ISO 9000 and other international quality standards are very important for developing their business. All eight entrepreneurs represent large-scale Vietnamese exporters, which means that none of the owners of small and medium enterprises in Viet Nam, nor any formal sector entrepreneur in Ethiopia, sees adhering to international quality standards as very important. This devastating observation is nuanced by the observation that four out of five Vietnamese small and medium enterprises, three out of 11 Ethiopian small and medium enterprises, and both large-scale firms in Ethiopia indicated that adhering to international quality standards will become important in the next few years.

Two other firm characteristics that were compiled from the survey responses are the type of relationship that entrepreneurs have with their main buyer, and the main type of market channel used. In the classification of main market channel, a differentiation is made between the low, main and high end of the domestic market, and a separate category for exports as the main market channel for firms that exported at least 50 per cent of their production in the previous year. With such a classification, none of the Ethiopian firms qualifies as exporter.<sup>31</sup>

The various market segments were identified in line with the price levels in Ethiopia and Viet Nam as mentioned in the subsector maps. Even though exports are treated as a separate category because of its significance in additional exposure, exporters do not by and large produce higher-quality, higher-price products as compared to those sold in the high-end domestic market. Out of the 14 Vietnamese exporters, four sell their export products at a price below \$5, seven sell between \$5 and \$10, and only three sell at the high-end (by domestic standards) of more than \$15 per pair.

The buyer relationship is a frequently discussed issue in the recent value chain literature. Here again, a differentiation is between arm's length, network and quasi-hierarchy, on the basis of several questions concerning the regularity of orders from specific buyers and the percentage of products bought by the main buyer in the last year (more than 50 per cent is considered an indication of a quasi-hierarchical relationship). This was checked with regard to the extent of technical assistance and designs provided by main buyers.

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<sup>31</sup>The main Ethiopian firms are trying to become exporters, as discussed in the next chapter.

TABLE 2.  
MARKET CHANNEL AND BUYER RELATION FOR FOOTWEAR PRODUCERS IN ETHIOPIA AND VIET NAM

COUNTRY			Buyer relation			Total	
			Arms length	Network	Quasi hierarchy		
ETHIOPIA	Domestic low end	Count	7	4	8	19	
		Percentage within buyer relation	25	80	42.1	36.5	
	Domestic main market	Count	20	0	6	26	
		Percentage within buyer relation	71.4	—	31.6	50	
	Domestic high end	Count	1	1	5	7	
		Percentage within buyer relation	3.6	20	26.3	13.5	
	<b>Total</b>	<b>Count</b>	<b>28</b>	<b>5</b>	<b>19</b>	<b>52</b>	
		<b>Percentage within buyer relation</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	
	VIET NAM	Domestic low end	Count	1	1	—	2
			Percentage within buyer relation	7.1	11.1	—	5.0
Domestic main market		Count	9	4	3	16	
		Percentage within buyer relation	64.3	44.4	17.6	40	
Domestic high end		Count	2	2	1	5	
		Percentage within buyer relation	14.3	22.2	5.9	12.5	
Export		Count	2	2	13	17	
		Percentage within buyer relation	14.3	22.2	76.5	42.5	
<b>Total</b>		<b>Count</b>	<b>14</b>	<b>9</b>	<b>17</b>	<b>40</b>	
		<b>Percentage within buyer relation</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	

The main findings from table 2 are, first, that arm's-length relations with buyers are dominant in the domestic market channels, while quasi-hierarchical relationships are dominant in the export channel. Secondly, network relations appear to be the least common type of relationship with buyers, but occur more frequently in Viet Nam (23 per cent) as compared to Ethiopia (10 per cent). Thirdly, 71 per cent of Ethiopian producers supplying the high end of the domestic market are characterized as being in quasi-hierarchical relationships. However, as discussed in the previous chapter, most of these high-end producers are part of the main private groups in the Ethiopian leather and footwear sector that sell through their own retail shops. Thus, even though the formal ownership relations may differ, most of these producers are probably part of a full-fledged hierarchy more than a quasi-hierarchy.

## 2. Relationships between key variables

The following subsections will present, step by step, some main findings on levels of association between the key variables.<sup>32</sup>

### *Which types of firms perform better?*

Table 3 on the total sample shows how all the firm classifications are statistically significantly associated with the productivity enhancement indicators. However, this overall picture hides significant differences between Ethiopia and Viet Nam. While the relationship between firm

<sup>32</sup>Using Kendall's correlation coefficient, see annex II for details, and the introduction to chapter IV, section B, for an overview of key variables.

TABLE 3.  
INDICATORS OF SOCIAL CAPITAL, PERFORMANCE AND UPGRADING PER COUNTRY  
(PERCENTAGE OF FIRMS)

<b>Social capital characteristics</b>						
<b>Trust composite</b>		<b>Composite indicator on extent of trust in other actors</b>				
		<i>Very small</i>	<i>Small</i>	<i>In between</i>	<i>Great</i>	<i>Very great</i>
Ethiopia		11	53	9	27	— n 45
Viet Nam		—	11	13	63	13 n 54
<b>WVS</b>		<b>World Values Study question on “Generally speaking”</b>				
		<i>Most people can be trusted</i>		<i>You can’t be too careful</i>		
Ethiopia		16		84		n 50
Viet Nam		41		59		n 53
<b>Bonding</b>		<b>Easier to establish trust with persons from same background?</b>				
		<i>Yes</i>		<i>No</i>		
Ethiopia		55		45		n 49
Viet Nam		16		84		n 51
<b>Bridging</b>		<b>Easier to establish trust after doing satisfactory business?</b>				
		<i>Very much</i>	<i>Agree</i>	<i>Indifferent</i>	<i>Disagree</i>	<i>Strongly disagree</i>
Ethiopia		31	45	14	6	4 n 51
Viet Nam		2	57	39	2	0 n 54
<b>Network participation</b>		<b>Composite indicator for extent of active network participation</b>				
		<i>Very inactive</i>	<i>Inactive</i>	<i>In between</i>	<i>Active</i>	<i>Very active</i>
Ethiopia		—	16	20	53	12 n 51
Vietnam		10	26	9	39	17 n 54
<b>Social capital economic effects</b>						
<b>Transaction costs</b>		<b>Composite indicator for extent of facing transaction costs</b>				
		<i>Very high</i>	<i>High</i>	<i>In between</i>	<i>Low</i>	<i>Very low</i>
Ethiopia		4	44	11	38	2 n 45
Viet Nam		—	23	6	64	8 n 52
<b>Collective action</b>		<b>Composite indicator for extent of cooperation with other producers</b>				
		<i>Very low</i>	<i>Low</i>	<i>In between</i>	<i>High</i>	<i>Very high</i>
Ethiopia		87	11	2	0	0 n 52
Viet Nam		70	26	4	0	0 n 54
<b>Learning spin offs</b>		<b>Composite indicator for extent of learning spin offs</b>				
		<i>Very low</i>	<i>Low</i>	<i>In between</i>	<i>High</i>	<i>Very high</i>
Ethiopia		8	43	39	10	— n 51
Viet Nam		41	37	2	19	2 n 54
<b>Productivity enhancement</b>						
<b>Performance</b>		<b>Composite indicator on performance since 2000</b>				
			<i>Poor</i>	<i>Average</i>	<i>Strong</i>	
Ethiopia			65	29	6	n 48
Viet Nam			13	43	44	n 54
<b>Upgrading</b>		<b>Composite indicator on extent of upgrading since 2000</b>				
			<i>Poor</i>	<i>Average</i>	<i>Strong</i>	
Ethiopia			40	23	37	n 48
Viet Nam			39	17	44	n 54

classifications and productivity enhancement indicators is overall statistically significant for Viet Nam (table 4), table 5 on Ethiopia shows a different picture. By and large, there is no statistically significant relationship between firm classifications and productivity enhancement in the Ethiopia sample. A main underlying reason is that only 6 per cent of all Ethiopian producers perform well (44 per cent for Viet Nam), while 65 per cent perform poorly (13 per cent for Viet Nam), which means that statistically significant levels of association are very unlikely to occur.

As can be seen from table 5, the exceptions are the association between, on the one hand, market channel and firm typology and, on the other hand, levels of performance, where also in Ethiopia the formal producers in small and medium enterprises that supply more high-end market channels perform relatively better.

*Which owners are more trustworthy and more active networkers?*

The social capital characteristics examined comprise five variables, namely, a trust composite indicator,<sup>33</sup> a variable called WVS, proxies for bonding and bridging social capital and an indicator that captures the extent of network participation. The WVS variable is based on responses to the one question on trust included in the world values survey, which is often used in comparative empirical social capital studies.<sup>34</sup> Respondents found this by far the most difficult question to answer in the questionnaire, because it stresses a general attitude towards other persons. Respondents frequently stated that this depends on the type of other person. To capture possible variation in levels of trust according to the type of counterpart, a trust composite indicator was included.<sup>35</sup> A proxy for bonding social capital was constructed from answers to the question on whether or not it matters, if a person is a relative or comes from the native area in order to establish trust in a business relationship. The proxy for bridging social capital was based on answers to the question on whether it becomes easier to trust a person, who was initially a stranger, after doing satisfactory business for some time. Finally, a composite indicator was developed on the extent of participation in local footwear networks.<sup>36</sup>

Tables 5 and 6 show that entrepreneurs in Viet Nam more often think that “generally speaking, most people can be trusted”, while Ethiopian entrepreneurs rely more readily on both bonding and bridging social capital. The correlation between on the one hand, the WVS variable and the trust composite indicator, and on the other hand, the various types of firm classifications is weak for both the Viet Nam and the Ethiopia sample.<sup>37</sup>

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<sup>33</sup>Respondents were asked to what extent they trusted shoe producers from their own ethnic background, shoe producers from another ethnic background, suppliers of inputs, buyers, government officials and, finally, strangers.

<sup>34</sup>The formulation of the question is: Generally speaking, would you say that most people can be trusted, or that you can't be too careful in your dealings with people? It provides two possible answers: (a) Most people can be trusted; (b) You can't be too careful.

<sup>35</sup>Respondents were asked to what extent they trusted shoe producers from their own ethnic background, shoe producers from another ethnic background, suppliers of inputs, buyers, government officials and, finally, strangers.

<sup>36</sup>In the chapter on methodology, associational membership is included as a characteristic of social capital. However, too few firms in the sample answered the questions on associational membership. No informal units were members, and, as elaborated upon in the next section, in Ethiopia the footwear association had just been announced and did not yet have a track record nor an established membership. Therefore, it is not included as a variable in the survey, but will be discussed in section C.

<sup>37</sup>Surprisingly, for the total sample, the relationship is statistically significant for the trust composite indicator with the type of market channel and owner typology (table 3).

TABLE 4.  
TOTAL SAMPLE KENDAL CORRELATION COEFFICIENTS

	Firm classifications			Social capital characteristics					Social capital economic effects			
	Buyer relation	Market channel	Owner typology	Firm typology	Trust composite	WVS	Bonding	Bridging	Network participation	Transact costs	Collective action	Learning spin offs
<b>Social capital characteristics</b>												
Trust composite	0.097	0.242**	0.271**	0.16								
WVS	-0.107	-0.152	-0.117	-0.08								
Bonding	0.188	0.175*	0.074	-0.027								
Bridging	-0.039	0.164*	0.168	0.186*								
Network participation	0.314**	0.211*	0.215**	0.383**								
<b>Social capital economic effects</b>												
Transaction costs	-0.216*	-0.006	0.087	-0.07	0.156	-0.172	0.174	-0.041	-0.204**			
Collective action	0.405**	0.334**	0.332**	0.455**	0.161	-0.183	0.014	0.117	0.362**			
Learning spin offs	0.336**	0.118	0.073	0.348**	-0.011	0.06	-0.207*	0.110	0.421**			
<b>Productivity enhancement</b>												
Performance	0.227*	0.515**	0.427**	0.357**	0.398**	-0.136	0.164	0.147	0.143	0.118	0.391**	0.078
Upgrading	0.308**	0.264**	0.229**	0.395**	0.056	-0.017	-0.107	0.154	0.337**	-0.374**	0.411**	0.485**

Notes: WVS—World Value Study.

\* = 5% level of significance

\*\* = 1% level of significance



TABLE 5.  
KENDAL CORRELATION COEFFICIENTS FOR VIET NAM

	Firm classifications			Social capital characteristics					Social capital economic effects			
	Buyer relation	Market channel	Owner typology	Firm typology	Trust composite	WVS	Bonding	Bridging	Network participation	Transact costs	Collective action	Learning spin offs
<b>Social capital characteristics</b>												
Trust composite	-0.101	0.016	0.024	0.079								
WVS	-0.226	-0.065	0.065	-0.087								
Bonding	-0.400**	-0.155	-0.403**	-0.366**								
Bridging	-0.025	0.199	0.132	0.234*								
Network participation	0.462**	0.462**	0.583**	0.615**								
<b>Social capital economic effects</b>												
Transaction costs	-0.365**	-0.591**	-0.537**	-0.472**	0.02	-0.231	0.151	-0.192	-0.346**			
Collective action	0.592**	0.388**	0.556**	0.555**	0.152	-0.066	-0.351*	0.092	0.483**			
Learning spin offs	0.492**	0.594**	0.669**	0.753**	0.239*	-0.060	-0.317**	0.280*	0.571**			
<b>Productivity enhancement</b>												
Performance	0.434**	0.389**	0.434**	0.439**	0.254*	0.076	-0.305*	0.110	0.420**	-0.374**	0.521**	0.600**
Upgrading	0.451**	0.562**	0.646**	0.636**	0.143	0.031	-0.266*	0.262*	0.546**	-0.516**	0.550**	0.673**

Notes: WVS—World Value Study.

\* = 5% level of significance

\*\* = 1% level of significance

TABLE 6.  
KENDAL CORRELATION COEFFICIENTS FOR ETHIOPIA

	Firm classifications			Social capital characteristics					Social capital economic effects			
	Buyer relation	Market channel	Owner typology	Firm typology	Trust composite	WVS	Bonding	Bridging	Network participation	Transact costs	Collective action	Learning spin offs
<b>Social capital characteristics</b>												
Trust composite	0.037	0.025	0.177	0.082								
WVS	0.084	0.021	-0.099	0.051								
Bonding	0.433**	0.042	-0.006	0.055								
Bridging	-0.114	-0.054	0.033	0.105								
Network participation	0.19	0.117	0.113	0.101								
<b>Social capital economic effects</b>												
Transaction costs	-0.153	0.209	0.277*	0.294*	-0.032	0.044	0.011	-0.07	0.05			
Collective action	0.193	0.204	0.122	0.248	0.04	-0.286	0.172	0.046	0.223*			
Learning spin offs	0.279*	-0.047	-0.075	0.003	0.157	0.086	0.084	0.17	0.179			
<b>Productivity enhancement</b>												
Performance	0.068	0.381**	0.199	0.270*	0.101	-0.072	0.077	-0.109	0.005	0.305*	0.196	-0.044
Upgrading	0.181	0.022	-0.057	0.087	-0.016	-0.070	-0.025	0.076	0.052	-0.245	0.205	0.366**

Notes: WVS—World Value Study.

\* = 5% level of significance

\*\* = 1% level of significance

The proxy for bonding social capital reveals a clear difference between Ethiopia and Viet Nam. For Ethiopia, the only social capital characteristic that is statistically significantly related to any firm classification is the level of bonding social capital with the type of buyer relationship. More specifically, firms with arm's-length buyer relations more often rely on bonding social capital (table 6). The reverse is true for Viet Nam, where especially larger firms, run by political entrepreneurs, with quasi-hierarchical buyer relations, rely on bonding social capital (table 5).

A majority of entrepreneurs in both Ethiopia (76 per cent) and Viet Nam (59 per cent) relies on bridging social capital (table 6), but this is not more true for some categories of firms, buyer relations, market channels or entrepreneurs than for others.

The social capital characteristic that has the highest levels of association with the firm classifications, and one which also discriminates most clearly between Ethiopia and Viet Nam, is the extent of network participation. Network participation is statistically significantly associated with all firm classifications in the Viet Nam sample, and with none of the firm classifications in the Ethiopia sample. Therefore, in Viet Nam, relatively larger firms, operating in more attractive market channels, with tighter buyer relations and run by better-educated and more politically oriented entrepreneurs, are also more active network participants (table 5). In Ethiopia, this relationship is not that straightforward (table 6), but, there is no significant overall difference in the extent of network participation between Ethiopia and Viet Nam.

In short, while Vietnamese entrepreneurs more often trust other actors than Ethiopian entrepreneurs, tendencies among entrepreneurs to trust other actors are generally not strongly associated with the firm classifications. It is a different story for the composite variable of network participation. While a majority of both Ethiopian and Vietnamese entrepreneurs actively participate in networks, for Viet Nam this is, and for Ethiopia this is not, more associated with some groups of firms or entrepreneurs than others. The next step is to see whether significant levels of association can be found between the characteristics of social capital and the economic effects of social capital in the survey.

*Do more active networkers have lower transaction costs and cooperate and learn more effectively?*

An attempt was made to measure the economic effects of social capital through composite variables on, first, transaction costs derived from survey questions on, for example, amounts of time spent on finding new suppliers or acquiring credit. Secondly, composite variables were developed on the extent of collective action, derived from survey questions on exchanging information, sharing machines and lobbying with other producers to stop Chinese imports. Thirdly, a composite indicator was developed for learning spin-offs, derived from survey questions on benefiting from inputs of other producers, buyers or support organizations. Table 6 shows that levels of collective action are generally very low, and in Ethiopia even somewhat lower. Learning spin-offs are more often low in Viet Nam, while more Ethiopian firms face high transaction costs.<sup>38</sup>

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<sup>38</sup>The transaction costs indicator predominantly shows a negative sign, pointing to the fact that, contrary to the initial assumption based on the literature review, higher transaction costs appear to be an investment in realizing better opportunities, instead of an indicator that reaps the benefits of social capital.

For the total sample (table 3), and for Ethiopia and Viet Nam separately, only very weak levels of association are found between tendencies to trust and the indicators for transaction costs, collective and learning spin offs. However, statistically significant relations are found between all economic effects of social capital and network participation for the overall sample. Also, for Viet Nam, these three relations are statistically significant (table 4), while, for Ethiopia, only a significant relation exists between levels of collective action and network participation (table 5). The final step in presenting some main findings from the survey is to see whether statistically significant relations can be found between the economic effects of social capital and levels of productivity enhancement.

*Do firms that enjoy more economic benefits from social capital also perform better and upgrade more?*

Entrepreneurs who actively invest in networking, spend more time on finding the right transaction partners, more often share with other producers and more often learn from others do indeed perform better and upgrade more often in Viet Nam, but not in Ethiopia. All these economic effects of social capital are also statistically significantly associated with the firm classifications for Viet Nam but, by and large, not for Ethiopia.

### **3. Conclusions**

Variables that aim to measure characteristics of social capital, that is, tendencies of trusting behaviour among entrepreneurs, have generally not been found to be statistically significantly linked to either the firm classifications or productivity enhancement indicators. It can be concluded that the indicators that aim to measure the economic effects of social capital, that is, that measure what entrepreneurs actually do (in terms of investing in networks, or trying to selectively share and cooperate) provide a more useful operationalization of social capital.

The general expectation at the microlevel has been that higher levels of social capital would be intertwined with more productivity enhancement by relatively larger and more formal firms that supply more attractive market channels and have tighter relationships with their buyers. This connection is found in the case of Viet Nam, but not for Ethiopia. It seems clear that in Ethiopia a multitude of other issues and factors, which it was not possible to get a grip on through this microlevel sample survey, play an important role. Some issues are obvious: for example, the overall sectoral crisis is reflected in the observation that only 6 per cent of sampled firms in Ethiopia perform well. This strongly limits the spread in the productivity enhancement indicator of performance.

The typologies of firms and entrepreneurs reflect a dual industrial structure. As the scope and rationale of cooperation and networking appears to differ between the formal and informal sector, this could be an interfering factor in establishing levels of association. Other main explanatory issues relate to the overall structure of the global and national footwear industry and the political economy of Ethiopia. These are dealt with in the following sections of this chapter, starting with a discussion on the mesolevel indicators.

## C. MESOLEVEL INDICATORS

This section reports the findings from workshops held in Ethiopia and Viet Nam with groups of footwear producers, and findings from other discussions with key respondents. The present chapter focuses on the extent to which social capital formation is enabled or inhibited at the mesolevel of analysis. Information about the mesolevel was collected through discussions with sectoral and association representatives, UNIDO experts and local researchers, and through a mesocard workshop. The key questions used in the mesocard workshops are based on preliminary discussions with key respondents and discussions with the senior local researchers in both Ethiopia and Viet Nam, and reflect the different challenges facing footwear producers in the two countries.

### 1. Mesocard exercise in Ethiopia

In Ethiopia, the mesocard exercise eventually took place during the two-week field visit to Ethiopia of the senior Institute of Social Studies researchers.<sup>39</sup> Ten footwear entrepreneurs joined the meeting, held in the office of the Ethiopian Tanners Association, among them the chair and secretary of the newly established Ethiopian Footwear Association. As reported in section A above, a key challenge for the Ethiopian footwear industry is to achieve entry into international value chains.

Following up on this idea, the first key question in the workshop was: “What needs to be done to successfully export?” Each participant received three cards to put forward three key issues to be addressed in order to rise to the challenge of entry. The first round results strongly prioritized supply-side issues, such as access to capital, instead of demand-side issues, for example, access to market information.<sup>40</sup>

After removing duplicates and clustering the cards along the lines of supply- and demand-side issues, the senior researcher of the Institute of Social Studies was asked to comment and emphasized the importance of demand-side issues. This led to an interesting discussion that made clear that most of the entrepreneurs were not much concerned about demand-side challenges. They basically felt that, once they would be able to solve their supply-based problems, their products would be competitive in the market and could be sold successfully. However, a few entrepreneurs did emphasize the possible key role of demand-side issues, and a heated debate in Amharic followed.

In the second round, all entrepreneurs got three tick marks to indicate the three main issues to be addressed by ticking three of the 14 different cards from the first round.<sup>41</sup> In this second round, demand-side issues were prioritized with most ticks going to “Access to market information”, which got only one vote in the first round. The other three most frequently mentioned issues in the second round were “quality product”, “timely delivery” and “competitive price”.

<sup>39</sup>Peter Knorringa was joined in this meeting by Anne Line Mikkelsen from UNIDO.

<sup>40</sup>Twenty supply-side cards (5 \* capital/loans, 5 \* quality product, 2 \* machines, 3 \* knowledge, 2 \* manpower/skilled labour, 1 \* electricity, 1 \* product specialization, 1 \* production skills) versus 10 demand-side cards (4 \* competitive price, 2 \* timely delivery, 1 \* quality service, 1 \* reliability, 1 \* market information, 1 \* co-operation).

<sup>41</sup>Seventeen demand-side ticks (7 \* market information, 5 \* timely delivery, 3 \* competitive price, 1 \* quality services, 1 \* reliability) and 13 supply-side ticks (6 \* quality product, 2 \* production, 2 \* capital, 1 \* machines, 1 \* manpower, 1 \* knowledge).

The next exercise was to discuss the question: Which of the main issues require local cooperation? Entrepreneurs were asked to tick a maximum of two of the four key issues for which they thought local cooperation would make relatively more sense. All entrepreneurs indicated that it would make sense to cooperate on getting better access to market information, seven out of ten mentioned that improving product quality could sensibly be achieved through local cooperation, while timely delivery got one vote. On the issue of competitive pricing, all entrepreneurs indicated that this was something they wished to decide on their own, and did not see a potential for local cooperation.

One additional exercise was prepared in advance, a so-called cooperation feasibility assessment. The intention was to ask the group of entrepreneurs to indicate, for each of the key issues, whether: (a) it is an immediate problem; (b) it leads to short-term real savings; (c) it is distant enough from core activities; (d) it is protected from cheating?

The outcome of such a discussion could make it clearer which key issue offers the best potential and incentive for initiating local cooperation. "Access to market information" was first discussed, and it was concluded that it is an immediate problem and it could lead to short-term real savings when it avoids duplicating efforts. However, it remained unclear whether entrepreneurs felt that getting access to market information is a core activity, and they did expect attempts of others to manipulate the distribution of jointly collected market information. At this point, the chairperson indicated that it was necessary to conclude the workshop. In the concluding discussion, it was made clear that most entrepreneurs would see getting better access to market information as the most likely area of local cooperation. However, they also made it clear in various ways that because of a lack of tradition in working together, the whole idea of local cooperation seemed a distant option.

## **2. Mesolevel joint action in Ethiopia**

From additional meetings with entrepreneurs, managers, officials and local researchers, the general idea of a lack of experience in joint action is confirmed, and appears to apply to all the subsegments of the footwear industry. The standard response to reducing risk and coping with change or crises appears to be continued vertical integration or temporary withdrawal, instead of joint action or daring to depend on market relations. This can perhaps be illustrated with two examples. First, all main private groups that produce shoes for the high end of the domestic market sell these shoes predominantly through their own retail shops. From discussions it became clear that having such shops is seen as the best guarantee for continued market access because it provides control.

The second example concerns an anecdote from a few footwear producers with export potential who visited a shoe fair in England. They were jointly to develop contacts with potential buyers, but the trip was overshadowed by opportunistic behaviour. So, when the relatively few footwear producers with export potential in Ethiopia, who even as a group hardly have a threshold production capacity, cannot get their act together in approaching international buyers, it seems clear that joint action is a remote possibility.

### 3. Mesocard exercise in Viet Nam

In Viet Nam, the mesocard exercise took place in Hai Phong, with 11 members of the Hai Phong section of the Viet Nam Leather and Footwear Association, the main footwear association in North Viet Nam. The meeting was held in the compound of one of the largest export processors in Hai Phong, and was organized and led by the chair of the Hai Phong footwear association, who is also the owner of its main factories. Some of the entrepreneurs at the meeting appeared to be managing some of the units owned by the president of the association. His personal assistant provided simultaneous translation between the president of the association and the research team.<sup>42</sup>

During the two-hour meeting, only a few of the 11 entrepreneurs directly became active in the discussion. The main channel of communication continued to be between the research team and the president, through his personal assistant. Most entrepreneurs looked for support to their president when writing main issues on their cards. After the mesocard exercise, it became clear that the president and his assistant also wanted to use the meeting to put forward the five-point leather shoe industry development strategy for the next five years (see below). From that discussion, it became clear that there was a strong common agreement on the main overall challenge for the Vietnamese footwear industry, as reported in chapter II, to move from processing to direct exports.

The first main question put forward at the mesocard workshop was: “What is required to become direct exporters?”. With three cards for each entrepreneur, there was an almost equal split between demand (16) and supply (17) issues, with designing, independent (international) marketing, access to capital and technology as the four main issues.<sup>43</sup> In the second round, each entrepreneur could put a maximum of two ticks on the main issues, which resulted in seven ticks for “designing”, six for own marketing and three for customers, all demand-side issues.

The second question in the workshop was formulated as: “Which requirements need local cooperation?”. The president made it clear that the whole process of developing capabilities to become direct exporters required strong local cooperation, and that such local cooperation was ensured because of the leading role of the association. He then presented the five-point strategy. To move from processing to direct exports (in 2003 around 15 per cent of exports were direct; the aim is to get to 50 per cent of direct exports by 2010), the president identified the development of designing capability in Viet Nam as the first key issue.<sup>44</sup> He identified developing independent marketing as the second key issue, which can only be done once they have acquired designing capabilities to produce samples that can convince international buyers.

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<sup>42</sup>In addition to Peter Knorringa, Adam McCarty and Luong Thanh from Mekong Economics, Paolo Casilli from UNIDO and a representative from the Viet Nam Leather and Footwear Association, Hanoi, were present.

<sup>43</sup>Demand issues (8\* international marketing, 7\* designing, 1 \* customers) and supply issues (8 \* capital, 7 \* technology, 1 \* management, 1\* material supply).

<sup>44</sup>This could be done, for example, through sending Vietnamese staff abroad to learn designing skills.

The remaining three key issues (to improve technology, create access to cheaper loans, and develop a better domestic material supply base and/or smoother import of inputs facilities) were seen as relatively less important. Finally, lengthy discussions were held also during the following factory visit and lunch in Hai Phong with the president and his assistant, on the sensitive issue of developing direct export relationships without antagonizing intermediaries from the Republic of Korea and Taiwan Province of China.

#### **4. Mesolevel joint action in Viet Nam**

In other discussions with sectoral representatives in Viet Nam, it became clear that they are acutely aware of the need for, and difficulty of, moving from processing to direct exports. The most common approach appears to be to continue processing in existing production facilities (and aim for step-by-step product and process upgrading in cooperation with the intermediaries from the Republic of Korea and Taiwan Province of China), and simultaneously to build new facilities (often with formally distinct ownership) for direct exports. Many of the processors have long-term contracts with their intermediary buyers and they are adamant about fulfilling those contracts.

The Vietnamese associations have so far not allowed foreign footwear entrepreneurs to become members. The advantage of incorporating the foreign entrepreneurs would be to be able to learn from them, but apparently the Vietnamese consider the potential disadvantage of openness more important than the potential for learning. More generally, there appears to be a dominant feeling among officials and owners of large-scale (public) processing plants to see independence and control as critical features for success.<sup>45</sup> There also exists a critical mass of people in key positions who see this as an extension of old competition thinking, and are pushing for a more open and flexible approach to developing relationships with other key players in the global footwear industry. On the whole, the Vietnamese associations have been able so far to reconcile these various viewpoints, and are slowly but surely positioning themselves also as potential direct exporters towards some of the main global buyers.<sup>46</sup>

#### **5. Conclusions**

The Vietnamese institutions are strong, characterized by a specific mix of hierarchy and bonding social capital, but both associations and individual entrepreneurs appear to find it difficult to develop bridging social capital with foreigners. By contrast, in Ethiopia, bonding social capital appears to be mainly confined within the main private groups, and the impression is that this bonding social capital does not (yet) seem to significantly extend to footwear producers as a group. The recently established Ethiopian Footwear Association could potentially play an important role in facilitating a broadened perception of allegiance, but, for the time being, attempts to strengthen social capital at the mesolevel appear to be an uphill struggle.

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<sup>45</sup>This appears to fit with the overall Party ideology on how to develop Viet Nam.

<sup>46</sup>At the same time, some smaller producers are already making inroads as direct exporters.



In summary, both in Ethiopia and Viet Nam, footwear producers face a challenge in building bridging social capital, but at different levels. In Ethiopia, the first challenge is to develop bridging social capital between the various groups of producers in Ethiopia itself, possibly also including informal sector entrepreneurs. Building such local bridges is made even more difficult given the overall crisis in the Ethiopian footwear industry, where most producers are (more than) fully occupied with keeping their business alive. In the relatively booming Vietnamese footwear industry, associations and groups of producers are in a more comfortable position to consider longer-term strategic issues, for example, how to develop direct relationships with global buyers. Sustaining and further developing social capital appears to be even more difficult in Ethiopia as compared to Viet Nam, due to differences in the macrolevel conditions. A macrolevel assessment of social capital indicators is discussed in the next section.

#### **D. CONTEXTUAL FACTORS: MACRO LEVEL INDICATORS OF SOCIAL CAPITAL**

Assessing the macrocontext for social capital formation involves considering variables, such as institutional efficiency and reliability, the nature of State-civil society relations, levels of social integration/cohesion, trust and shared values and norms. Relatively tangible indicators of these variables are land ownership regulations, legal systems, tax and industry incentives, State-society participative structures and the general stability and openness of political processes. As an outcome of institutional relations that affect present and future relationships, social capital is mainly intangible.

As such, the focus is on a sociopolitical assessment of the macroenvironment and its ability to encourage social capital formation. For instance, the existence of a relatively autonomous and flourishing civil society appears to be important to the promotion of social capital (Hyden [74]; see also the literature review presented in chapter II of the present report). Practical experiences gained from such space to experiment with various forms of cooperation, with civil society more or less closely tied to State institutions, may help to lead to the development of generalized trust and shared values.

At the same time, it is argued that social capital is reflected in those actions that fill the gap between the private and public spheres (Evans [43]). Ideally, public agencies and private agents engage in complementary activities and, over time, this promotes (increasingly dense) networks of embedded trust-based behaviour. Incentive structures, the transparency of processes, the fairness of the rules of the game etc. indicate the state of the playing field. In addition to summarizing the macrolevel playing field of each country and its relation to the footwear industry, this section attempts to demonstrate the practical relevance of these civil society and political economy debates to the process of social capital formation in the footwear industry of each country. For instance, a low level of inclusion of particular business interests in processes of State-society relations may seriously limit possibilities for trust formation.

Thus, power asymmetries represent an important issue within a discussion of the macroenvironment, as their (continued) existence may stifle domestic social capital formation. More specifically, the prospect of promoting positive social capital formation at the microlevel and mesolevel, and then moving beyond the mesolevel, may be constrained by a macroenvironment, which prevents the bridging of conflicting interests at the macrolevel. The next two subsections summarize and compare the history and current features of the macroenvironment, especially in respect to the footwear industry.

### **1. Ethiopia: need for clearer signals and a kick-start**

The changing focus of the Ethiopian government during the twentieth century has shaped the present industrial playing field. Italian occupation (1935-1941) provided no real incentives for manufacturing beyond certain basic consumables. Basic exports were predominantly oriented towards the Italian economy, alongside limited encouragement of domestic investment. The 1950s saw a greater degree of manufacturing, in part spurred on by certain backward linkages flowing from the rise in coffee demand. Yet, the imperial government (1941-1975) did little to change the fundamentals, except that it allowed greater foreign control of incipient manufacturing—leaving continuing imbalances in the structure of industry, infrastructure and key services. This import substitution model had a familiar ring—limited capital deepening, input shortages, inefficient and technologically backward local capabilities and few linkages between agriculture and industry.

The attempt by socialist governments (1975-1991) to correct these structural imbalances through a State-based planning model met with limited success. Large and medium-sized industries were nationalized, leaving only segments of small-scale production and services to the private sector. Large farms and cooperatives were encouraged as part of a strategy to provide better quality and more regular inputs to a fledgling (now State-controlled) manufacturing sector. Institutions (such as the National Leather and Shoe Corporation) were also set up to guide this process. Yet these initiatives, plus the 1986 ban on exports of raw hides and skins, have not yet led to a significant deepening in the productive base of leather manufacturing.

The key strategy document of Ethiopia is entitled “Agricultural Development-led Industrialization”, which serves as the framework for the national economic development efforts (UNIDO [131], p. 16). A recent white paper by the Government launched, in August 2003, the Ethiopian industrial development strategy, based on a number of principles that at first sight seem suitable to redress these structural weaknesses and gaps in private sector and civil society participation. The two most important are: (a) the creation of an enabling environment for the promotion of a strong and independent private sector; and (b) a more concrete desire to construct dynamic backward and forward linkages for manufacturing (and export) development.

As a result of government policies, the private sector has grown significantly. An attempt is being made to make the legal system more transparent, efficient and neutral; there are similar

proposals for making the tax system more transparent and efficient; and a variety of investment codes and incentives signal a more open desire to help exporters and the private sector. Similarly, the Government is in more open dialogue with industry and civil society as to the direction of overall policy and, specifically, in terms of production and export assistance. In addition, a public-private sector platform has been established.

Nevertheless, at the time of the field study, in October 2003, there were also remaining uncertainties and ambiguous aspects in the Government strategies, as well as fundamental structural/social weaknesses in the economy. Overall, it is important to highlight that the economy is still overwhelmingly dominated by small-scale subsistence agriculture. This lack of breadth, depth and dynamism is reflected in very low income levels and in the fact that more than 50 per cent of the population struggles to gain basic subsistence. Correspondingly, savings and investment (domestic and overseas) levels and growth remain low, notwithstanding recent indications of small but significant improvements starting from a low base.

Despite fast growth in recent years (as a result of the promotion of the private sector and privatization), the industrial sector is still small (12 per cent of national income) and a vast proportion of businesses are small, informal and of low capital/skill intensity. While the private sector dominates ownership of small and medium enterprises (74 per cent), the State still controls 50 per cent of large enterprises and dominates output, value added and employment in industry. Within this context, some private sector actors continue to complain about a perceived lack of transparency, efficiency and fairness within the tax, land ownership/distribution (still public) and legal systems.

The Ethiopian industrial development strategy notes the need to involve other actors and to help industry to work up the value chain and, that this must be based on linkages between raw (and better-quality/reliable) materials and quality manufacturing. Yet, some observers feel that Government businesses are being favoured and some private sector actors feel that participatory processes leave much to be desired. Exports per se (and imported inputs for them) are given priority in the industry/trade incentive structure, and, thus, it would appear that the Ethiopian industrial development strategy may need some redirection and strengthening for it to truly promote final industrial production and export (as opposed to continued incentives for semi-processed exports).

As a key sector of the industrial economy, the specific experience of the tanning, leather and footwear sector is highly illustrative of this situation. For example, semi-finished and finished leather products come a close second to coffee as the main export group of the country. By far, most leather export concerns semi-finished products, even though Ethiopia, in principle, has the capacity to supply all or most other inputs for manufacturing final products.

These structural aspects of the sector (see also section A) are an important backdrop for an understanding of the balance of power between various industrial groups and the implication of this for social capital formation. After all, the characteristics of this sector suggest that it should provide a model sectoral strategy within the agricultural development-led

industrialization programme. The following paragraphs add to the above-mentioned general comments on the lack of unity, confidence and trust among and between the different entrepreneurial interest groups involved in the Ethiopian leather, tanning and footwear subsector. These points highlight how macrolevel socio-political conditions have been less than helpful to a strategy which desires to promote synergy (and a stock of trust) between the State, tanners and manufacturers of footwear.

First, there is a lack of neutrality of incentives between final product manufacturers and exporters of semi-processed hides and skins. The export incentives coordinated by the Ethiopian Investment Commission grant exporters duty exemptions, credit guarantees, discounts on land (still leased, however) and subsidies on infrastructure and equipment. For example, the fact that firms can gain a five-year tax exemption if they export more than 50 per cent of their output (plus gain duty-free capital equipment imports) appears, in an uncertain environment,<sup>47</sup> to offer a stronger incentive to sell semi-processed hides and skins than to further process. At the time of the field study, the tanning sector appeared to have an overcapacity, while there was a capacity shortfall in leather finishing. This makes it even more difficult to increase manufacturing and exports of final products, like footwear.

Secondly, the difference between the level of unity and influence of organizations representing tanners versus footwear firms is indicative of the power asymmetries evident within public sector policy. For example, the body representing tanners (the Ethiopian Tannery Association) includes the bulk of tannery enterprises and output. Eighteen tanners (14 public and 4 private) are members, and the vast majority of these (90 per cent) are predominantly exporters of semi-processed hides and skins.

At the time of the study, this organization also claimed that they are afforded insufficient attention within Government policy-making, while they have actively pursued their objectives of promoting internal and governmental cooperation to achieve better-quality hides/skins and higher standards. Nevertheless, they had been instrumental in establishing a National Leather Forum, a Leather and Leather Products Technology Institute, a Livestock Marketing Authority and various Africa-wide associational links— all of which appear to support their strategic interests over and above those of final processors.

In summary, Ethiopian manufacturers face an uphill battle due to the “thinness” of the industrial structure, poor levels of infrastructure and skills and a Government struggling with the transition to a more market-based economy. More specifically, footwear producers, as a group, are also less organized, less cohesive and more outside the process of public-private sector dialogue as compared to exporters of hides and skins. On the whole, at the time of the study, macrolevel conditions appeared to be relatively unfavourable to social capital formation. This situation provides some contrast with macroconditions and opportunities for Vietnamese footwear producers. The next subsection explores these differences, as well as the similarities between them. It thus exposes the challenges to the continued development of social capital and competitiveness for the Vietnamese footwear subsector.

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<sup>47</sup>See also UNCTAD [130].

## **2. Contrasts and comparisons with Viet Nam: more positive conditions, but questions about how to move towards direct exports**

Broad indicators suggest that the Vietnamese economy has exhibited a much more positive situation at the macrolevel than that of Ethiopia, especially in the period between 1992 and 1998. GDP growth has been solid, export growth has been as strong as that of its Chinese competitor, and the manufacturing sector has shown good (albeit patchy) progress. While macrolevel stability has been underscored by low inflation and deficit control, poverty levels (while still a concern) have been halved over the past 10 years.

Indicative of inherent and growing structural weaknesses (discussed below) is a concern about sectoral balance and the attitudes of the Vietnamese in that regard. For instance, a number of studies point to the high levels of optimism of the Vietnamese population and within the institutional environment. “They do well when they want to” (Boye [18]) and have a strong belief in the primary role of the Government in ensuring this. Yet, while the private sector has grown significantly in recent years, it is still small and incipient. Commentators highlight this as a possible constraint on further phases of sustainable growth (Boye [18]). In contrast, growth up to the late 1990s was spurred on by the opening up of the economy by the Government in the early 1990s. The period up to the mid-1990s saw domestic demand and investment (both domestic and foreign direct investment) grow quickly, combined with massive export growth. Labour absorption problems did not occur to any great extent due to this growth and the relatively high skill levels of the population.

The experience of the Vietnamese footwear sector reflects this (guarded) optimism and the difference with Ethiopia. The institutional trade environment driving much of this growth also looks generally favourable. Increasing exports to Europe (80 per cent) are likely to continue due to the quota regimes under the generalized system of preferences and European Union action against exports from Brazil, China, India and Thailand, and the United States could be a very promising market due to potential reductions in United States duties.

There are some specific difficulties associated with this situation, which, interestingly, show contrasts and similarities with the Ethiopian context. For example, the quality of domestic leather is also very low, yet the vast majority of inputs required for this export-oriented sector are imported. The other key contrast, discussed at some length in section A, is that the Vietnamese are predominantly processors for other Asian intermediaries. Thus, while they are involved in exports and vertical value chains to a much greater extent than their Ethiopian counterparts, further linear expansion may have its limits.

The macroenvironment has had a powerful effect on this situation. Whether and how it changes may determine whether the Vietnamese footwear sector builds on its strong skill base and collective will and encourages the scaling up of social capital relations beyond the mesolevel. Further challenges to such upgrading and expansion in industrial competitiveness are clearly related to the nature of incentives, the balance of power between sectors and the degree to which civil society is permitted to play an active and social-capital-enhancing role.

For example, despite constitutional changes in 1992, which gave more liberty to the private sector and to more autonomous State-civil society relations, the State still plays an important role in the economy.

Since the enterprise reform law of 1999, 55,000 new privately owned enterprises have been established. In 2002, the private sector still encompassed only 22 per cent of total investment and 9 per cent of gross national product. The State controls large and strategic industries and seems likely to continue to do so, despite the claim that their use of over 50 per cent of available investment funds yields no real employment gains and is resulting in a rising investment–output ratio year on year (Boye [18]). Nevertheless, a rapidly increasing number of private household businesses are using the increased room to manoeuvre and encourage transparency within the slowly evolving economic system.

In line with constitutional reform, there have been moves to make decision-making more participatory, and the legal system and planning processes are being made more transparent. Yet this is within the bounds of a strong State—one which still insists on checks and balances and participatory involvement to be kept in tune with its State-facilitated development model. From a company perspective, this situation is heightened by the lack of inclusiveness within the present structure of business associations for the footwear sector. Local firms fear that membership by foreign-owned firms will get unfair gains from the information and government access that association membership can bring. Thus, they do not allow such firms to be members—despite the fact that foreign entrepreneurs may bring important marketing expertise to association members.

Further potential weaknesses to this model emanate from the structure of actual incentives—to both internal and external business groups. For example, land is scarce and, like in Ethiopia, it remains publicly owned. Leases have been made more available for industrial use, yet the system is still considered to be cumbersome and a disincentive to investment. Another barrier relates to tariffs. The tariffs applying to imported goods might usefully be reduced. Future international/regional trade association membership will require this. The tariff regime may also be affecting foreign direct investment flows (which dropped significantly since 1997), and is possibly a key institutional factor behind the reported low technological level of domestic industry.

The link between encouragement of foreign direct investment and attempts to strengthen domestic research and development capacity is different from the situation in Ethiopia (where foreign direct investment has never been high). During the first stage of the recent boom in the Vietnamese economy, foreign direct investment was high. Neighbouring countries invested in the footwear sector due to low labour costs, labour intensity and available skills. This led to a move away from making shoe uppers for former socialist States to simple processing for suppliers to European markets.

### **3. Conclusions**

In both Ethiopia and Viet Nam, it is easy to find examples of policies or State functioning that inhibit industrial development through exporting and upgrading. In both countries, it is

often difficult to pin down what is really public and what is really private. At the same time, it seems clear that in Viet Nam potential conflicts are in the end dealt with through consensus governance, while, in Ethiopia, antagonism between various groups of actors appears to be more common. Besides, the national context in Ethiopia might well make it more difficult to reinforce social capital from the microlevel or the mesolevel to the macrolevel. On the other hand, the Vietnamese national context appears to facilitate reinforcing social capital as long as it emerges from a politically correct environment and/or is negotiated through the checks and balances of the Vietnamese governance model.

This chapter provided clear indications of how difficult it is, under current conditions, for footwear entrepreneurs in Ethiopia to enhance productivity and flourish. The national and sectoral settings provide footwear entrepreneurs with very little indications that more generalized trusting behaviour will be rewarded. The mesolevel discussion indicates that only very selective investing in specific and rather closed networks is seen as a sensible strategy. The overall sectoral crisis evidently pushes entrepreneurs to be even more reserved about trusting others and investing in new relationships.

By contrast, the Viet Nam case provides an example of a period of growth in which bonding social capital has served as a facilitating factor, while, for a next period of successful expansion, bridging social capital appears to be required but not yet in place. But, and this is again in contrast to the Ethiopian case, actors at both the mesolevel (associations) and macrolevel (Government) appear to be ready to support attempts at the microlevel to build bridging social capital, as long as it is carried out within the ruling ideological paradigm.

## **E. CONCLUSIONS ON CASE STUDIES**

Three different types of conclusions may be drawn from the two modest experimental field studies on the footwear industry in Ethiopia and Viet Nam. First, some conclusions about the extent to which specific variables seem to provide useful information to get a better handle on operationalizing social capital. Secondly, a brief consolidated description of the two cases shows how the understanding of social capital issues can be enhanced through integration of data collected at the micro-, meso- and macrolevel. Thirdly, a preliminary assessment is given of the value added of a focus on social capital issues.

First, including the same question as used in the world values survey, the most frequently used data source for empirical social capital studies shows no statistically significant relation with any of the key indicators, and most respondents found the question most difficult to answer. Indicators of social capital that measure what entrepreneurs actually do, in terms of building or using social capital, provide a more useful operationalization of social capital as compared with indicators that measure general attitudes.

Secondly, a summary of the findings from Ethiopia and Viet Nam shows clear differences in levels of social capital, and in the interaction between the various levels of analysis. To

start with Ethiopia, its footwear industry is in crisis, both because of Chinese imports and because of an inability to enter international value chains, due to the lack of availability of finished leather, as well as the lack of a critical mass of export-ready producers. Main private business groups consider footwear a sideline to their core activities (around tanning). In all, the Ethiopian footwear sector is fragmented, and its footwear association is new and still weak. Most informal workshops in Ethiopia can operate only a few months per year because of a lack of orders, but also relatively larger firms often do not perform well due to the overall crisis.

At the time of the study, the Government still had a long way to go, in terms of establishing an enabling environment for private sector development. Social capital at the microlevel is low, and rather isolated pockets of social capital are not easily scaled up to mesolevel, due to the weakness of sectoral institutions. Macrolevel constraints, such as uncertainty and volatility, make the scaling up of social capital even more unlikely. These findings fit well with a wave of recent other studies on the ways in which macroeconomic uncertainty and volatility in Africa inhibits private sector development (Hyden [74], Pedersen and McCormick [102], Platteau [105] and Rothstein [111]).

The findings on Viet Nam show that all segments of the footwear industry performed quite well in recent years. In Viet Nam, a clear relation was found between better performance and more upgrading by more formalized firms that supply more attractive market channels with higher levels of social capital for Vietnamese firms. The Vietnamese export footwear sector has rapidly expanded in recent years, mainly as processors for intermediaries in the Republic of Korea and Taiwan Province of China.

The key challenge for the Vietnamese export sector is to move from processing to direct exports. The strong and hierarchically organized Vietnamese associations are acutely aware of this challenge and are trying to carefully move forward without antagonizing intermediaries in the Republic of Korea and Taiwan Province of China. Even though also Viet Nam has a long way to go, in terms of establishing an enabling environment for private-sector led industrial development, the Vietnamese party and State carefully moves forward through a managed consensus governance, which progresses slowly but predictably for relative insiders. Social capital at the microlevel is already significant in Viet Nam, and it can be more effectively broadened to the mesolevel because of stronger and more focused associations with solid party/State connections. Moreover, social capital at the mesolevel more easily reinforces social capital at the macrolevel in Viet Nam, as long as it conforms to the ruling ideological paradigm.

Finally, the issue of whether the inclusion of social capital leads to a better understanding of industrial development processes is briefly considered. The microlevel survey indicates that the social capital characteristics do not provide a significant value added to understanding. However, the microlevel survey indicates that the economic effects of social capital, in terms of reduced transaction costs, enhanced collective action and increased learning spin-offs do provide value added in understanding the situation in Viet Nam, but not so much in Ethiopia. Analysis of



social capital at the mesolevel and macrolevel provides at least a partial explanation for the differences in findings in the microlevel survey on Ethiopia and Viet Nam. Therefore, it can be argued that combining the micro-, meso- and macrolevel of analysis helps to put the intangible aspects of industrialization processes into perspective.





## **V. CONCLUSIONS AND RECOMMENDATIONS**

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The present report started from the widely shared feeling that less tangible elements of development processes do not receive sufficient attention in the (industrial) development discourse, dominated by economic and technocratic approaches. While all entrepreneurs that were met, and quite a few (industrial) development practitioners, readily agree that intangible aspects are crucial, most practitioners, at the same time, have so far steered clear of focusing interventions on these intangible aspects. The dominant view among practitioners with field exposure appears to be that: “Of course, trust, networks, social cohesion, norms and values are crucial ingredients of successful development, but that does not necessarily mean that they explain successful development, nor does it mean these variables can usefully be enhanced through policies.”

In this final chapter, the aim is to address both these thorny issues in more detail. Section A presents the main lessons learned in an attempt to operationalize the concept of social capital in industrial development processes in marginalized countries. No prior conceptual or field-based studies on social capital with a clear focus on industrialization in marginalized countries existed, so the report has been very exploratory. There is first a review of the booming social capital literature in economics, followed by an overview of the recent literature on industrialization in developing countries that increasingly identifies a set of intangible aspects as crucial to industrial development, without using the label of social capital.

These two sets of literature have been used to extract a set of indicators to get a grip on the container concept of social capital. It was found useful to distinguish between indicators at the microlevel (for example, trust and cooperation in interfirm relationships), the mesolevel (such as institutional thickness of clusters and inclusive collective action) and the macrolevel (such as State-civil society-private sector relations). Next, the conceptual operationalization was experimented within two very modest and initial case studies on the footwear industry in Ethiopia and Viet Nam. Put together, this means that most of the conclusions concern finding more appropriate ways to move forward, instead of providing a final assessment on the importance and usefulness of social capital in industrialization policy. The final subsection suggests future research methods and issues to make social capital research more directly useful to technical assistance programmes.

Section B presents preliminary policy recommendations for UNIDO at three levels. First, general policy advice will be offered on how to focus attention, in an integrated way, on the intangible aspects inherent in thinking about industrial development processes, strategies and policies. Secondly, suggestions are made on how UNIDO can build capabilities to mainstream attention on the role of social capital in the formulation of new competition industrial policy. Finally, some examples are cited from UNIDO programmes and projects that are already actively aiming to provide more systematic attention to the less tangible elements of industrial

development processes, or are planning to do so. Before going into the policy recommendations, the main conclusions on making social capital an operational concept for industrial development are presented in the next section.

## **A. OPERATIONALIZING SOCIAL CAPITAL FOR INDUSTRIAL DEVELOPMENT**

The overarching question for this research project was to provide UNIDO with an operationalization of social capital that is tailored to an improved understanding of industrial development processes and interventions, especially in marginalized countries.<sup>48</sup> The findings on what might be an appropriate operationalization of social capital within the context of industrial development can be summed up in six main points, each of which is elaborated upon below. In short, the argument is as follows:

(a) The existing literature on social capital provides only limited handles for an industry-specific operationalization. This literature focuses on either macrolevel secondary data or on microlevel household surveys, neither of which seems to capture the key dimensions of social capital in the context of industrialization processes;

(b) Definition of social capital is proposed—in short: the economic effect of social relations—that emphasizes the mesolevel and recognizes that social capital resides not in individuals but in relationships. Besides, an appropriate definition must avoid circular reasoning, explain what social capital is and what it does, and be sensitive to exclusionary tendencies;

(c) Social capital cannot be viewed as an additional key production factor, like financial or physical capital, labour, technology and human capital, but as a factor that enables the allocation and influences the productivity of each of these more basic production factors. This conceptualization stresses the logic of measuring social capital in relation to these main factors of production. The most sensible way forward to get a grip on this elusive and intangible concept of social capital appears to be to unpack it. This has been done in two ways: identifying distinct types of social capital, and looking at distinct levels of analysis;

(d) A key distinction exists between bonding and bridging social capital. Both play distinct roles, with strengthening bridging social capital as especially important to open up new opportunities for industrial development in marginalized countries;

(e) In attempting to unpack the container concept of social capital, indicators at the micro-, meso- and macrolevel were developed. It is assumed that an operationalization of social capital useful to UNIDO focuses on: the mesolevel of sectoral and regional issues; and the interaction between social capital indicators at the micro-, meso and macrolevel;

(f) UNIDO can provide value added through its focus on mesolevel institutions, by increasing awareness of the importance of social capital, and by enabling mesolevel institutions to build especially bridging social capital, not as separate interventions, but loaded upon tangible interventions related to the basic production factors. While discussing the recommendations for UNIDO policy and intervention strategies in the next section, each of the six main points mentioned above is first elaborated upon.

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<sup>48</sup>The second objective, “to assess how social capital can usefully be promoted”, is dealt with in section B.

## 1. Limited usefulness of existing literature

The first conclusion is that the existing literature on social capital provides only limited handles for a useful industry-specific operationalization. Much of the mainstream social capital literature in economics uses broad survey data at the country level to measure through, for example, a regression function the causal relationship between levels of economic growth and supposedly generic indicators for country-level social capital, like group membership, trust, or social values. Even though such studies possibly provide some useful general insights,<sup>49</sup> in attempting to explain the relative success or failure in specific sectors and specific regions within a country, it evidently does not provide significant insight.

The very general variables most frequently used are open to a variety of interpretations. For example, in the microlevel survey, the one question on trust that is also included in the World Values Survey, was included. This question is a key resource for mainstream social capital studies.<sup>50</sup> Respondents in the survey found this by far the most difficult question to answer, and many respondents made it clear that they could not answer such a question in general, but that it depends on the type of other person.

As such a situation was anticipated, a more specific set of questions was included in the questionnaire about the extent to which they trusted various types of typical groups of actors in their specific industry. In the end, the World Values Survey question on trust shows no statistically significant relation with any of the other social capital variables, nor with any of the other indicators. More generally, it was found that indicators that aim to measure what entrepreneurs actually do, in terms of building or using social capital, provide more insight as compared to indicators that measure general attitudes.<sup>51</sup>

From an empirical perspective, a more interesting branch in the economic social capital literature is the new wave of econometric studies at the microlevel, in particular household surveys in marginalized countries as part of poverty reduction assessments by the World Bank and related researchers. However, the microlevel focus of these studies makes this approach less suitable, for lock, stock and barrel adoption, for a sectoral organization with a clear mesolevel focus like UNIDO.<sup>52</sup> Connected to this point is the observation that such studies tend to see, for example, levels of trust as individual characteristics, while it is felt that social capital resides in relationships. Finally, these studies do not pay much attention to macrolevel issues, like general levels of inequality and exclusion. These are important in understanding why in some places social capital can be reinforced and broadened, while in other places it only seems to exist and be reproduced within small groups.

The literature on industrialization processes in developing countries provides a number of entry points into operationalizing social capital, even though the label is not used much in this

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<sup>49</sup>For a critique, focusing on especially unconvincing proxies that are often used for measuring levels of social capital, see Durlauf and Fafchamps [37].

<sup>50</sup>The formulation of the question is given in footnote 34.

<sup>51</sup>See chapter IV.

<sup>52</sup>Some observers indicate that the World Bank approach might be moving towards including mesolevel aspects (Bebbington and others [10] and Durlauf and Fafchamps [37]).

literature. Nevertheless, a common theme in various strands in this literature is the increased need for mesolevel coordination and cooperation combined with competition, in order to be successful in the era of the new competition. An increasing awareness exists about the fact that the competitiveness of one firm depends significantly on the overall competitiveness of the cluster, the value chain and the business association in which that firm participates.

In this literature, with abundant case studies of industrial sectors and clusters in developing countries, connections are also increasingly made to include macrolevel issues around, for example, trade policy (Thoburn and Nadvi [128]). This mesolevel focus is an important point of departure for the operationalization of social capital. As explained below, given the UNIDO mandate as a multilateral organization with a sectoral specialization, the report focuses on the mesolevel, and analyses how a synthesis of micro-, meso- and macrolevel findings provides key entry points for a better understanding of social capital.

## **2. Definition of social capital**

The literature review started with a broad and simple definition of social capital: the economic effect of social relations. It is important to recognize that these social relations are not necessarily developed to gain access to economic resources. Therefore, the economic effect of social capital may well be unintended. Based on the literature review and the two modest case studies, the definition of social capital is proposed below for entrepreneurs in industrial settings.

Social capital is the set of social relations that enable entrepreneurs to gain, maintain or expand access to economic resources and that entrepreneurs use to reinforce the productivity of these economic resources. For (groups of) producers, this would refer to ways in which social relations—with, for example, buyers, suppliers, other producers, workers, facilitators and officials from business associations, civil society organizations and Government—enable them to gain, maintain or expand access to markets, new designs, raw materials, credit, licences, testing facilities etc. The economic effect of social capital is that it reduces transaction costs, it enables and reinforces collective action, and it generates learning spin-offs.

Defined in this way, a clear distinction is made between what social capital is, and what it does. Obviously, the formation of social capital and its effects are constrained by various forms of power in society, expressed in various levels of inequality, exclusion and control. Moreover, while this definition emphasizes the mesolevel, it also requires data collection at the microlevel and macrolevel, and it recognizes that social capital resides not in individuals but in relationships.

## **3. Role of social capital in the development process**

One of the most difficult aspects of this report was to develop a solid argumentation for the role of social capital in the development process. This is partly due to the fact that social capital is many different things to many different people. But it is also about the more fundamental question of whether the impact of social relations is a separate key production factor or whether social relations influence the effectiveness of all other production factors.

The latter perception is viewed as more plausible and useful, even though it makes empirical studies on social capital much more difficult. Nevertheless, it is assumed that various levels of social capital co-determine the allocation and productivity of basic production factors, like capital, labour and technology. This conceptualization stresses the logic of measuring social capital in relation to these main factors of production, instead of developing correlations between certain levels of social capital and levels of economic growth. Therefore, social capital cannot be seen as a so far often forgotten but independent factor that can explain variations in levels of development.

The extent to which, for example, improved skills, increased knowledge and upgraded technology actually promote productivity enhancement and bring the world closer to fulfilling the Millennium Development Goals, at least partly depends on the extent to which levels of social capital enable more efficient and effective connections and synergies. Such a view of social capital makes it a necessary but not sufficient condition for productivity enhancement, in a way similar to a transparent and efficacious legal system. The role of UNIDO in relation to most of the Millennium Development Goals might be seen as indirect. Since access to education and health care and related social issues are not part of the UNIDO mandate, the Organization cannot be expected to contribute directly to the realization of those goals. The indirect route consists of two options.

The first option consists in creating enabling conditions for the realization of the goals, in particular through overall UNIDO efforts to contribute to increased knowledge, productivity and, as a consequence, the incomes of people in developing countries. But this is at a very general level and does not necessarily guarantee that the knowledge, productivity and income increases end up with those who suffer most from inequalities in education, health and other social goals.

The second option, however, provides an opportunity for UNIDO to link its work more concretely to the Millennium Development Goals. This option is not so much concerned with enabling conditions for the realization of the Millennium Development Goals as such, but with the more specific enabling conditions for effectiveness of the goals for development in general and poverty reduction in particular. The Millennium Development Goals are concerned with reducing inequalities between groups of people, and preventing further exclusion of groups of people from the process of development.

As evidenced in this report, social capital tends to be more effective in a context of lower levels of inequality and exclusion, as such contexts more effectively enable a reduction in transaction costs, enhanced collective action and increased learning spin-offs. For the Millennium Development Goals, there is a parallel development: reduced inequalities will, together with a facilitation of bridging social capital, enable the effectiveness of higher levels of education, better health conditions and the achievement of other Millennium Development Goals.

Higher levels of education will only result in higher incomes if people have access to labour markets or credit and land to create productive self-employment. Better health conditions will only result in improved labour productivity in unsegmented labour markets and with the

absence of wage discrimination, or in credit markets that are not rationing on the basis of social characteristics of borrowers, or land markets operating in unequal property rights systems. In short, the Millennium Development Goals will only translate to reduced poverty and more widespread development if markets for production factors—labour markets, credit markets and land markets—as well as markets for resources and intermediate and final products do not exhibit distortions that would eliminate the gains from attainment of the goals.

Finally, and more generally, governments and multilateral organizations have an important role to play in creating enabling conditions for social capital formation, by working towards reducing inequalities and power asymmetries in societies, reducing uncertainty and improving participation.<sup>53</sup> Moreover, while different perceptions exist about the extent to which it is possible to construct trust-based market relationships in the least conducive environments, the existing literature agrees on the general point that it is clearly easier to develop bridging social capital in more stable and transparent institutional settings.<sup>54</sup>

The most sensible way forward to get a grip on the elusive and intangible concept of social capital appears to be to unpack it. In the next two subsections, the aim is to unpack the concept in two ways. First, two main types of social capital are introduced and their respective roles in the industrialization process are briefly discussed. Secondly, a set of indicators at the micro-, meso- and macrolevel that can be used to provide a more concrete meaning to the container concept of social capital is identified.

#### **4. Bonding and bridging social capital**

Within the social capital literature, a key distinction is made between bonding and bridging social capital. Bonding social capital emerges from common social ties, like family, kinship, ethnicity, or religion. Bonding social capital can be strong, but also easily leads to exclusion of individuals and groups with different identities. Bridging social capital emerges from interaction between heterogeneous groups of people that share some common (business) values, and build earned trust through repeated and voluntary interactions. In practice, bonding social capital more often is found in horizontal relationships between firms, for example, in a cluster, and between firms and providers of business development services and business associations. Bridging social capital, in contrast, is more often found in vertical relationships within value chains, for example, between local producers and global traders.

In terms of the metaphors often used in the social capital and network literature, an insightful distinction can be made between bonding and bridging social capital. Authors who refer to social capital as “glue” or “cement” that tie the various actors together in, for example, a cluster clearly have bonding social capital in mind. By contrast, those who refer to metaphors like “lubricant” or “oil” seem to be focusing on bridging social capital. Bonding and bridging social capital result from quite distinct processes and are also not simple substitutes. While bridging social capital is seen as a key to extending modern market relationships, the important

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<sup>53</sup>See, for example, Field [46].

<sup>54</sup>See chapter II, section C.



role of bonding social capital cannot be ignored. Bonding social capital is especially important in the context of small and medium enterprises in marginalized countries, in terms of generating a critical mass of like-minded and complementary producers and suppliers that makes a location attractive for outside buyers.

In some situations local social chasms prevent local cooperation from emerging, making it often difficult to see how a group of producers in a marginalized country can achieve access into broader value chains without a preceding process of bonding social capital formation. At the same time, bonding social capital formation can have strong exclusionary tendencies. Besides, in different periods of a cluster life cycle, bonding social capital may be crucial again for cluster survival and revitalization.

As argued below, the most promising niche for a multilateral organization with a sectoral focus appears to lie in a focus on bridging social capital. Notwithstanding the remarkable successes by the cluster programme in promoting bonding social capital in a few clusters in India,<sup>55</sup> bonding social capital formation seems to lend itself less easily to being promoted through policy interventions. So, without denying the importance of bonding social capital, most attention will be given to bridging social capital.

Bridging social capital appears to be a very relevant issue for industrial development in marginalized countries. The case studies show that the type of social capital most needed changes over time. For example, until recently, the main managers and entrepreneurs of larger footwear processing units in Viet Nam relied on their bonding social capital with government officials and their long-standing relationships with intermediaries from the Republic of Korea and Taiwan Province of China.

Now that many entrepreneurs and the main footwear associations have identified becoming direct exporters as the latest challenge, entrepreneurs need to develop new forms of bridging social capital with foreign buyers in, for example, Europe and the United States. In the case of Viet Nam, the associations are relatively strong and enjoy significant Government support. The associations have internalized this challenge and are trying to carefully move forward without antagonizing the intermediaries from the Republic of Korea and Taiwan Province of China.

Unfortunately, this does not appear to be a very common situation in marginalized countries. Individual entrepreneurs are bound to underinvest in bridging social capital formation. The main reasons are a perception among individual entrepreneurs of too high risks and costs for too distant prospects from a short-term perspective. For producers in more marginalized countries, the logic of investing in bridging social capital is further undermined because they are often “boxed” into in a less conducive environment. The least conducive market environments are characterized by high risk, high volatility, unreliable institutions and lack of opportunities to sanction opportunistic behaviour by trading partners.

In such least conducive market environments, especially smaller, poorer and more scattered producers, inevitably depend on bonding social capital, and in many cases even literally only

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<sup>55</sup>See project documents of the UNIDO Cluster programme.

do business with family members. In such situations, a transition towards developing bridging social capital is very unlikely to take place. While a dependence on bonding social capital can compensate, in an ad hoc fashion, for better functioning markets, it does stifle dynamism, prevents new combinations and thus synergies, and shows strong exclusionary tendencies.

In short, an initial transition from bonding to bridging social capital at least partly depends on the extent to which entrepreneurs feel they can rely on their market environment. Clearly, most smaller, poorer and more scattered producers in marginalized countries have every reason not to expose their business more than is absolutely necessary to the very volatile market environments in which they operate. An argument appears to exist for a donor intervention in finding ways to stimulate formation of initial bonding social capital when necessary, and initial bridging social capital when possible.

However, the scope for outsider support in this process, although potentially catalyzing, seems to be rather limited and should be of a modest and complementary nature. In the words of Field: “They (‘Outsiders’) can bring people together, and ensure that the conditions exist for instrumental cooperation. They cannot force people to like each other, fall in love, or enjoy time in each other’s company—and then go the extra mile in terms of trust and regard.” (Field [47], p. 133).

Business interest organizations potentially have an important role to play here, among other reasons because they are based on a sectoral “identity” and have an interest in broad membership. However, business associations are sometimes too weak and/or serve the interests of a small group of firms too much to realize their potential contribution to bridging social capital formation, while guarding and broadening bonding social capital.

Donor interventions that support business associations often have a too short time horizon, while social capital formation is a process that is slow and difficult to monitor. Nevertheless, from a social capital perspective it makes sense to develop institutional capacity-building programmes in consultation with business associations with at least the potential of becoming broad-based membership organizations. However, in some contexts, business associations may not be well placed to support the generation of social capital, and this could be more effectively stimulated through alternative facilitating agents.

## **5. Unpacking social capital: indicators at the micro-, meso- and macrolevel**

In the two case studies, experiments were conducted with a set of social capital indicators at the micro-, meso- and macrolevel. The microlevel survey data indicate that an operationalization of social capital can more usefully focus on indicators that measure what entrepreneurs actually do in terms of building or using social capital, instead of indicators that measure general attitudes or character traits. By and large, the social capital indicators related to levels of trust and extent of network participation are weakly associated with other indicators. By contrast, indicators measuring the economic effects of social capital through lower transaction costs, more collective action and stronger learning spin-offs, are relatively more strongly associated with performance, levels of upgrading and the various firm typologies.

For future studies, it is recommended that the focus should be on further unravelling the economic effects of social capital, to focus on when entrepreneurs take the step to enter into a (new) relationship, how they try to balance their exposure to opportunistic behaviour, and when they pull out of a relationship. Such aspects of revealed behaviour or asking entrepreneurs to participate in simulation games probably provide a more promising avenue for future research as compared to trying to get at general character traits through the blunt instrument of a survey.

The mesolevel data collection for case studies reveals the crucial importance of a critical mass of producers with similar interests, established business associations and the type of government connections. Basically, it would be possible to agree with those who maintain that, in principle, levels of social capital at the microlevel do not differ much in different parts of the world, but that the difference lies in whether these small beginnings can be replicated, reinforced and broadened to cluster and sector level. Therefore, an important factor is the extent to which mesolevel institutions enable or inhibit social capital formation.

At the macrolevel also, the extent to which various types of State-civil society-private sector relationships are conducive to specific types of social capital formation plays an important role in the economic effect on social capital and future opportunities for enhancing social capital. A more profound understanding of the boundary conditions resulting from existing State-civil society-private sector constellations and, for example, the efficacy of the legal system are important to better assess the opportunities for microlevel and mesolevel social capital to be nurtured and reinforced at the macrolevel.

Notwithstanding the importance of these preliminary findings at the separate levels of analysis, the key point is that, to improve the understanding of social capital in industrialization processes, the interaction of micro-, meso- and macrolevel indicators needs to be examined. It is only in the interaction that the way in which the intangible aspects of industrial development processes hang together begin to emerge, in producing and reproducing virtuous and vicious cycles of social capital formation. For example, in Viet Nam, the party and State carefully move forward in terms of developing a more conducive market environment through a managed “consensus governance”.

While for outsiders this process is less than transparent, it is quite predictable for relative insiders, like footwear exporters and footwear association leaders with good government contacts. Viet Nam possesses a critical mass of relatively like-minded exporters, and the survey also showed that Vietnamese find it relatively easier to trust other actors (as compared to producers in Ethiopia), which may well reflect a more stable and conducive market environment, with more credible sanctions on opportunistic behaviour. In recent years, this positive trajectory has led to substantial social capital formation at each of the three levels of analysis. The positive trends at the separate levels of analysis also reinforce social capital formation at the other levels. However, as already discussed in the previous subsection, a group of entrepreneurs and footwear association staff have identified becoming direct exporters as their next challenge.

To successfully face this challenge, the existing “stock” of bonding social capital cannot suffice, as becoming direct exporters requires entrepreneurs to initiate new relationships in Europe

and the United States. They must develop and/or acquire new skills in, for example, designing and logistics. They need to invest, collectively where they can and individually where necessary, in developing bridging social capital. While their stock of bonding social capital is no guarantee for successful development of bridging social capital, the observation that levels of social capital are relatively high also at the mesolevel and macrolevel does help to improve their chances for success.

Unfortunately, such virtuous social capital formation cycles are not a very likely phenomenon among smaller, poorer and more scattered producers in marginalized countries. Poor producers in the least conducive market environments often try to maintain their position by relying on bonding social capital with a severely limited set of other market parties, and do not have an individual incentive to take the risk of investing in relationships based on bridging social capital. While low levels of social capital are not seen as a main cause of underdevelopment, finding ways to enhance social capital may be one of the entry points to break the vicious cycle of poverty and marginalization.

## **6. Implications for the United Nations Industrial Development Organization**

The second objective of this report was to assess which forms of social capital can usefully be promoted by UNIDO. But before moving to the recommendations, it is useful to briefly explore where UNIDO could provide value added through developing a specific niche in the social capital debate. Social capital remains a contested and controversial concept.<sup>56</sup> Nevertheless, social capital as a container concept spanning the micro-, meso- and macrolevel of analysis might serve the purpose of integrating policy-oriented research on how to include less tangible aspects of development processes in interventions.

For UNIDO, it would make sense to organize an additional focus on the intangible aspects of development under a social capital heading. In cases where advice on concrete programmes and projects is provided, the more operational concepts filling the container should probably be used. It is proposed that UNIDO, as a multilateral agency with a sectoral specialization, could probably provide most value added at the mesolevel, through directly and indirectly promoting bridging social capital through mesolevel institutions, such as business associations, regional development agencies, or alternative facilitating agents and providers of business development services. This focus can be complemented by systematically incorporating lessons and raising awareness on constraints related to social capital formation at the microlevel and macrolevel.

When thinking about promoting bridging social capital, it is possible to envisage three bridges that need to be crossed. UNIDO could support producers in crossing those bridges: *(a)* by strengthening the mesolevel institutions that directly assist producers; and *(b)* through its global and macrolevel support to establish enabling environments for private-sector-led industrial development. The three bridges are as follows:

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<sup>56</sup>Academically, the concept of social capital, while perhaps playing a useful role in broadening the debate in economics, does not seem to offer any value added to the economic sociology of development and strands within political science. This literature already uses more precise and more operational concepts such as trust, networks, social cohesion, inclusion/exclusion, power asymmetries, embeddedness and State-civil society regimes.

- Between groups of producers with export experience and importers—to achieve direct exports;
- Between groups of producers with export potential and national (or international) intermediaries—to achieve entry into international value chains;
- Between groups of informal sector producers and their formal sector counterpart entrepreneurs, workers and traders—to provide learning and market opportunities to informal sector producers and achieve a more dynamic domestic informal-formal interaction. At least two steps could be envisaged in building this bridge: first, providing support for organizing the informal sector, for example, through identifying and supporting more catalytic informal sector participants; and, secondly, finding ways for formal and informal entrepreneurs to learn about each others real capabilities.

In some cases, crossing these bridges would need to be preceded by a stage of bonding social capital formation.<sup>57</sup> A social capital initiative in marginalized countries by UNIDO could feasibly focus on a systematic attempt to facilitate formation of bridging social capital in the three situations mentioned above. However, such a social capital initiative should not be developed separately, but would more feasibly be “loaded” upon more tangible interventions, working through mesolevel institutions that lay the foundations for the respective bridges. Before moving on to how the preliminary conclusions can be translated into recommendations for UNIDO policies and interventions, it is necessary to briefly mention a few suggestions for follow-up research.

## **7. Agenda for follow-up research**

The literature survey and case studies point to a refinement of research methods for future research on social capital, a narrower focus in terms of target group, a further elaboration of some key variables and an additional topic to increase the direct relevance of social capital research for technical assistance.

The initial case studies provide two snapshots of the same sector in two different countries. In a next phase, longitudinal studies are recommended, to deepen the understanding of the role of social capital in development processes. A mix of more qualitative and more quantitative methods at the three levels of analysis is envisaged. For clusters in marginalized countries, there could be a combination of anthropological participatory observation and action research over a period of several years, including an econometric analysis of surveys among producers and households at a number of fixed points within that time frame.

In the initial case studies, an attempt is made to cover the whole range of footwear producers in Ethiopia and Viet Nam, from seasonal household production to fully export-oriented factories with thousands of workers. In a follow-up phase, a more limited choice of target group is recommended, to allow a more in-depth coverage of the intangible issues in the operation of their businesses. More specifically, this could mean focusing on one of the three bridges to demarcate more clearly the type of challenge at stake. While it is nowadays conventional wisdom that household production operates with a different rationale from

<sup>57</sup>This has been successfully undertaken by UNIDO in a number of its cluster development projects.

medium- and large-scale formal sector enterprises, it must be recognized that issues of concern to social capital research also differ for these distinct types of enterprises.

Three key variables could be developed further in follow-up studies. First, learning spin-offs can be seen as an increasingly important variable in the present economic era of innovation and learning as key components of global competitiveness. Learning spin-offs can be further elaborated through inclusion in the analysis of human capital and labour market variables, like types of on-the-job training and extent of labour mobility and labour market segmentation. In essence, interfirm and sectoral issues of social capital would need to be connected to intrafirm issues of trust and cooperation between entrepreneurs, managers and workers to further explore learning spin-offs.

Secondly, on the variable targeting benefits derived from collective action, a significant difference existed between the case study evidence and the potential benefits often mentioned in the literature. The very low levels of collective action reported by individual entrepreneurs in the microlevel survey, and the mixed indications on the extent to which business associations were able to catalyze collective action, contrast sharply with the high potential of collective action according to the literature. Further research might address this gap between potential and practice of collective action by asking how and when higher levels of social capital lead to intensified collective action, and how does this impact upon productivity enhancement?

Thirdly, more could be done through investigating the way in which uncertainty and volatility in the macrolevel context influence behaviour of entrepreneurs. Many recent policy documents emphasize the importance of a stable and reliable institutional setting for private sector development. However, most small and medium enterprises in marginalized countries will, for at least a long time to come, have to deal with volatile environments without credible sanctions against opportunistic behaviour by business partners. More focused attention could be given to how such uncertain contexts influence the behaviour of specific groups of entrepreneurs, to what extent this indeed inhibits the build-up of bridging social capital, and how they might circumvent the negative impacts from a given volatile environment.

Upon completion of the field studies, a new and additional topic was discovered: the role of leadership in creating and sustaining social capital.<sup>58</sup> This seems an important additional topic, especially with a view to making social capital research more directly relevant to technical assistance programmes. What role does leadership play in developing networks, in localizing trust, and in spreading credibility? Can such a leader be an outsider, is it preferable to have an outsider as a leader, or must it be one of the more dynamic local entrepreneurs? What makes a good catalyst? How can a catalyst be deployed most effectively? How far can one or a few individuals push the process, and when is broader ownership required? These would be a few of the questions that need to be addressed through a pre-feasibility study on bringing in catalysts to stimulate social capital formation. More generally, an additional focus on leadership seems a sensible next step in policy-oriented mesolevel social capital research on clusters, networks and value chains.

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<sup>58</sup>See Durlauf and Fafchamps [37].

## **B. RECOMMENDATIONS FOR THE UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION**

As part of this report, the importance of intangible aspects in industrial development processes were discussed with many different staff members within UNIDO. The general impression from these encounters is that many individual staff members are at least partly convinced of the importance of these intangible aspects. At the same time, they understandably hesitate to get involved in what might be seen as yet another rather new and vague set of issues. This section aims to provide both conceptual and practical handles on how to connect social capital issues to UNIDO activities, ranging from its corporate strategy to specific projects. Recommendations are made on how social capital dimensions can be incorporated into various UNIDO activities.

The first subsection discusses how attention for intangible aspects could be integrated into recent UNIDO general policy documents, in particular, “Operationalizing UNIDO’s corporate strategy; services and priorities for the medium term 2004-2007” [132] and “UNIDO’s methodology for strategic industrial diagnosis”. Ways in which UNIDO could reinforce its technical cooperation services, through incorporation of attention for social capital in a number of its service modules are specified.

The second subsection provides some initial ideas for possible contents of training courses and workshops on new competition industrial policy, within which attention for social capital dimensions is mainstreamed. The final subsection will present some examples from UNIDO programmes and projects that are already explicitly focusing on less tangible elements of industrial development processes, or are planning to do so in programmes that are currently in the pipeline.

### **1. General policy advice**

To show how social capital already plays an implicit role in the UNIDO approach, and why it might help to make that role more explicit, the report entitled “Operationalizing UNIDO’s corporate strategy; services and priorities for the medium term 2004-2007” (UNIDO [132]) is reviewed. In this strategy document, UNIDO proposes to focus on productivity enhancement through better access to information, improved skills, increased knowledge and upgraded technologies. In the conclusions, it is argued that levels of social capital influence the extent to which improved skills, increased knowledge and upgraded technology actually translate into productivity enhancement.

In such a view, bonding social capital, for example, can provide the glue between groups of entrepreneurs in clusters, and bridging social capital, for example, can serve as a lubricant to stimulate development of new business relationships in value chains. In other words, productivity enhancement, the increased effectiveness of key factors of production, such as labour, capital and technology, is partly co-determined by levels of social capital within firms, among firms, and within the sector and country at hand. In this way, social capital can be seen as a necessary but not sufficient condition for sustained productivity enhancement, similar to, for example, clear property rights.

In this strategy document, UNIDO identifies two areas of comparative advantage, and social capital fits squarely in the analytical cluster of capacity-building for market access and development, which focuses on: "... activities aimed at promoting the readiness of SME to face external competition, both internationally and domestically, ..., value chain integration, ... small business export consortia and export-oriented clusters and networking and support to enable SMEs to respond to changing market conditions in increasingly opened economies.' (ibid., p. 18).<sup>59</sup>

When it comes to the service modules, a focus on social capital fits well in service module 4 on private sector development. Within this service module, attention is already given to some of the less tangible aspects in private sector development. What can usefully and feasibly be done is to more systematically support and facilitate attempts at developing especially bridging social capital, aimed at opening new windows of exchange, such as finding and approaching a new category of potential buyers.

Within the UNIDO private sector development approach, three target groups are distinguished: medium, small and microfirms (ibid., p. 37). First, the business partnerships support programme for medium firms aims at "...competitive insertion into national and global value chains...". Secondly, the small and medium enterprises cluster and networking development support programme focuses on (clusters of) predominantly small firms that may engage in some "... first attempts in export markets". Thirdly, the rural and women entrepreneurship development support programme focuses on "moving from survivalist into growth mode".

Part of this last challenge is arguably to develop bridging social capital to cross the third bridge: between groups of informal sector producers and their formal sector counterpart producers and traders—to provide learning and market opportunities to informal sector producers and achieve a more dynamic domestic informal-formal interaction. Similarly, the small and medium enterprises cluster and networking development programme aims to cross the bridge between groups of producers with export potential and national (or international) intermediaries—to achieve entry into international value chains.

Finally, the first group of business partnerships aims at developing various sorts of bridging social capital with other value chain actors in regional and global markets. Therefore, the private-sector-development service module offers easy entry points for an additional focus on social capital, which is also reflected in the priority service of promotion of small and medium enterprises export consortia (ibid., p. 76), and in the research component on private sector development (ibid., p. 91).

Many other service modules can be strengthened through the incorporation of a social capital component. Several priorities in the strategy document<sup>60</sup> basically deal with attempts to reinforce appropriate selection and effective application of technology, skills and institutions in order to enhance productivity. In line with the third conclusion presented above in section A,

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<sup>59</sup>More specifically, the direct value added of a focus on social capital is most clearly seen in the discussion on networks and clusters of small and medium enterprises (stylized fact 4, p. 15) and on the lack of market incentives (stylized fact 5, p. 16).

<sup>60</sup>Emerging from stylized facts 1, 3 and 5, pp. 14-16.



subsection 3, it can be argued that a focus on social capital formation would contribute to improving the effectiveness and allocation of production factors. In terms of service modules, this would especially relate to mainstreaming attention for social capital in capacity-building efforts in service modules 2, 3, 4 and 5.<sup>61</sup>

Additionally, and related especially to widening productivity differentials between and within countries (stylized fact 2), more awareness of social capital can strengthen formulation and especially implementation. This relates to the third conclusion on the important role of organizations like UNIDO in attempting to reduce inequalities and uncertainty, and improve participation, in order to enable social capital formation. It also relates to the fourth conclusion on the need, in some cases, to strengthen and broaden bonding social capital in order to reduce exclusion of weaker market parties from productivity-enhancing interventions.

Such a pro-poor implementation is probably especially important for service module 5 on agro-industries, where so many of the often scattered and poorest producers, many of them women, are caught in volatile and uncertain environments (see also section A, subsection 4). Finally, as part of overall awareness-raising on the importance of social capital in industrial development processes, it is recommended that this issue be taken up in future policy reports and studies under service module 1.<sup>62</sup>

In short, a focus on bridging social capital formation could be a sensible way to mainstream attention for more intangible aspects in UNIDO policy formulation. It would be a way to strengthen policies aimed at promoting interactive learning in horizontal, but especially vertical, networks, tapping external sources of knowledge while avoiding lock-in. In essence, a social capital mainstreaming effort to these more general policy objectives would provide handles for a more context- and relationship-sensitive implementation.

In practical terms, a first step in this process could be to prepare an assessment of which tangible interventions would lend themselves better to social capital loading, to improve the effectiveness of these tangible interventions.<sup>63</sup> For example, a capacity-building programme for a business association that focuses on strengthening its capacity to mediate and resolve conflicts between entrepreneurs is more dependent on social capital formation, as compared to a programme to support a local testing facility.

In the more operational document entitled “UNIDO’s methodology for strategic industrial diagnosis”, an initial attempt is made to provide a comprehensive methodology to assess the industrial system in a particular country. The methodology aims to support the formulation, implementation and monitoring of industrial policies and strategies by providing an insight

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<sup>61</sup>Service module 2—investment and technology promotion: under investment promotion, (a) institutional capacity-building; under technology promotion, (b) support services for strengthening national technology management systems and (c) capacity-building in emerging technologies. Service module 3—industrial competitiveness and trade: (d) accessing global subcontracting and supply chain networks. Service module 4—private sector development: see main text above. Service module 5—agro-industries: (a) product design and development; (b) technology centres; (c) demonstration operations.

<sup>62</sup>Service module 1—global forum and research activities: (c) economic research; (d) industrial development reports; (e) sectoral studies; and (f) policy studies.

<sup>63</sup>These could be interventions from existing UNIDO service modules or new interventions proposed by the private sector development or COMPID Research Programme.

into the performance and drivers of industrial performance in a given country. This is then to be supplemented with more detailed analyses of other important issues, such as the industrial governance and support system, through a combination of quantitative and qualitative analyses that should be fine-tuned to fit the specific conditions and characteristics of the country to be analysed. The findings and conclusions are to be discussed and validated with the key stakeholders to agree on a common vision on which to base the future strategies and policies to boost their industrial performance.

Intangible aspects of the industrial system are just below the surface in much of this report, and it all depends on how broadly or narrowly the various headings and subheadings would actually be interpreted and investigated. For example, in the section on support systems, an attempt is made to assess the effectiveness of support institutions by raising questions such as: “Are supporting institutions well coordinated?”; or “Are supporting institutions well-run by experienced and skilled staff?”

From the perspective of poverty reduction and paying attention to intangible aspects in the process, the idea of what can be considered well coordinated or well run would need to be further operationalized. This would mean including queries around, for example, the relative inclusiveness of support institutions, and the extent to which they put up formal or informal barriers for other entrepreneurs. In essence, it is felt that what can be used here is the subset of indicators that emanates from operationalization of mesolevel social capital.

Similarly, the section on industrial governance has a subheading entitled “Government’s organizational structure and interaction with other stakeholders”. Such an item may or may not include some or all of the variables that were used to operationalize social capital at the macrolevel (such as, the extent of autonomy of the private sector and extent of selectiveness in government support to specific sectors or companies). In the more general policy documents, it can be concluded that it is relatively easy to show where issues of social capital can be made more explicit, and that a further operationalization of the methodology for strategic industrial diagnosis can make use of subsets of the operationalization of social capital.

## **2. Capacity-building for social capital sensitization**

This section provides some initial ideas for possible contents of training courses and workshops to reinforce awareness of how to deal with social capital issues as part of a broader intervention strategy. In essence, a set of activities is proposed, somewhat similar to the first drive of gender-awareness training in the early 1990s, to mainstream attention in dealing with social capital issues within UNIDO.

In a first round, it seems to make sense to target combinations of small groups of staff and consultants that already deal with social capital issues with groups for whom this would be a relatively new experience. A key starting point, in terms of contents, is: “relationships matter”. While few people would deny this in general, it is not common practice to systematically weave this into policies, programmes and projects, supposedly because it would be too idiosyncratic.

However, in the end, each programme and project component, and each field officer, is placed within a specific implementation context, and needs to find a way to fit into that context. Even though most development professionals are often quite confident about their technical expertise, they might sometimes be unsure about the extent to which they possess the tools to systematically ensure context-sensitive and pro-poor implementation.

A central objective of the training modules could be to support UNIDO staff in taking a step back and reassessing their own role in project implementation. Generally speaking, it would be advisable for staff to critically assess the more technocratic approach to programmes and projects as simply suppliers of objective technological or organizational improvements. They should then seek to become more sensitive to their role as participants in a multilevel and multistakeholder game where a variety of interests co-determines the extent to which sensible plans are also sensibly implemented. In terms of learning methods, this necessarily means that the role of lectures is very limited, and that most material would be offered through exercises and simulation games.

A crucial component in many relationships is dealing with conflict. Constructively addressing conflict is a necessary and healthy part of group formation. A key to conflict resolution is establishing credible sanctions. A starting point for developing course material in this topic area is existing materials on consensus-building and conflict resolution that are used for organizational development and management skills courses. Another dimension would be simulation games that have in recent years been developed in experimental economics. Such simulation games confront participants and observers with revealed behaviour on usually rather simplified choices, frequently including elements of the famous prisoners' dilemma. Such more interactive learning methods can be used in combination with a set of lectures and role plays around best practices in new competition industrial policy, within which attention for social capital dimensions is mainstreamed.

### **3. Examples of social capital incorporation in technical assistance**

This final section briefly presents some examples from UNIDO programmes and projects that are already explicitly focusing on less tangible elements of industrial development processes, or for which there are plans to do so in programmes currently in the pipeline. But first the project cycle is considered, using the example of the UNIDO programme formulation manual (guidelines for the formulation of integrated programmes). This manual provides implicit space for a more context-sensitive programme formulation and evaluation, but this space is not always used. In other words, field officers know that specific social or cultural dimensions play an important role in assessing the overall situation at the base line, but these are not explicitly incorporated in the programme formulation.

In a subsequent evaluation, these underlying factors are given due weight, in order not to evaluate implementation difficulties in a specific project too harshly. But these balancing acts by evaluators are not always fed back into programme formulation in a next phase as a way to focus systematic attention on the intangible aspects of industrial development processes. Accordingly, it is suggested that more systematic attention be given to these issues in project

identification, formulation, implementation and evaluation. This would allow UNIDO to be better able to assess:

- How interventions themselves can be strengthened by consciously exploiting existing levels of social capital, and/or finding ways to downplay the negative effects of exclusion as a result of bonding social capital among dominant groups of entrepreneurs;
- What can realistically be expected from specific interventions when they are carried out in more, or much less, conducive market environments.

Finally, the examples given below are from programmes that already explicitly devote attention to specific elements from within the container concept of social capital. An obvious example of best practice within UNIDO is the cluster and networks development programme. This programme not only pays attention to issues of trust-building, it has also made trust-building efforts one of its key components, with special attention focused on the delicate initial stages of such efforts. The programme clearly emphasizes on building (or rebuilding) trust among local small and medium enterprises through a catalyst, a so-called cluster development agent. In this way, it focuses on strengthening and broadening social capital through an outsider intervention.

The cluster programme experience is that a period of three to five years is required to mend inner conflicts, revive trust among stakeholders, revitalize producers associations, build local delivery capacities of business development services, and change mindsets. Clearly, this is often a crucial initial phase for further cluster development. While UNIDO does not necessarily have a comparative advantage in direct cluster assistance vis-à-vis institutions, like chambers of commerce, producers associations, local government or well-established non-governmental organizations, it might be necessary for UNIDO to illustrate how bonding social capital can be stimulated, and convince such local actors of the methodology used and the results delivered.

Those involved in the UNIDO cluster programme are increasingly disseminating their extensive experience in trust-building to more locally rooted organizations, and are also reinforcing their activities around the formation of bridging social capital with external buyers and suppliers. UNIDO partnerships with organizations of the private sector and of civil society are another example of a programme that already devotes significant attention to social capital, focusing on locally rooted organizations and institutions.

In the informal sector, civil society organizations are institutions that most often represent informal enterprises and individuals in the form of small membership-based industry and business associations, community-based organizations and cooperatives. As representatives of the informal sector, the cornerstone of the economies of most developing countries, these home-grown institutions have the capability to provide a bridge between the informal and formal sector in the economy, and can help to generate social capital through local partnerships. Capacity-building of civil society organizations in, for example, the informal sector evolves around gaining and expanding access to a variety of relevant resources, which is clearly related to social capital as defined above in section A, subsection 2.

Finally, an example of a new integrated country programme is provided. In the new UNIDO programme of cooperation with Viet Nam, UNIDO includes social capital elements in its project on development-oriented joint ventures, which aims at finding a common ground between the interests of private investors and public objectives of socio-economic development. An innovative approach proposes to initiate commercial cooperation between foreign buyers and domestic producers. The assumption is that both sides need to overcome some initial doubts and insecurities, and that private investors may hesitate to come forward. The modest funds are used to kick-start a process of cooperation between foreign buyers and domestic producers that may well lead to a win-win situation through the generation of bridging social capital.





## ANNEX I. QUESTIONNAIRE FOR SHOE PRODUCERS IN ADDIS ABABA

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ISS/UNIDO, Social Capital study, 2003. (The questionnaire for Viet Nam is almost identical, see last page for some additions)

Interviewer:  
Date:

Interview no.:

### General information

1. Main product:

	<i>Upper made from:</i>	<i>Bottom made from:</i>
Men's shoes	Leather	Leather
Women's shoes	Non-leather	Non-leather
Children shoes		

2. What is the average price at which you at present sell your main product?

Birr

3. Do you mainly produce fashion-oriented shoes or more classic type of shoes?

Fashion-oriented shoes      Classic shoes

4. Do you use an own brand name?

Always      Mostly      Regularly      Sometimes      Never

5. What is the total number of people working in this unit in this season?

6. What is the total number of people working in this unit in peak periods?

7. To whom do you mainly sell your products (tick one category only):

Wholesalers selling to shops in Addis Ababa	Own shops in Addis Ababa
Wholesalers selling to rural traders	Export agents
Retailers in Addis Ababa	Foreign buyers
Roadside market stalls in Addis Ababa	
Retailers from outside Addis Ababa	Other: specify
Directly to consumers	

**Now I would like to ask you some questions about the main buyer of your products**

8. In the last year, how much of your production have you sold to your main buyer?
- |      |        |     |        |         |
|------|--------|-----|--------|---------|
| <25% | 25-50% | 50% | 50-75% | 75-100% |
|------|--------|-----|--------|---------|
9. Have you made significant investments in equipment or tools that are only useful in producing for your main buyer?
- Yes                      No
10. Does your main buyer provide you with:
- |                                 | <i>Always</i> | <i>Sometimes</i> | <i>Never</i> |
|---------------------------------|---------------|------------------|--------------|
| .....<br>Designs                |               |                  |              |
| .....<br>Product specifications |               |                  |              |
| .....<br>Leather or soles       |               |                  |              |
| .....<br>Technical assistance   |               |                  |              |
11. When you get the feeling that your main buyer is not being fair/honest with you, what do you do?
- |                                       |  |                                       |
|---------------------------------------|--|---------------------------------------|
| Try to arrange a face-to-face meeting | Threaten to tell everybody about his bad behaviour | Will never do business with him again |
|---------------------------------------|--|---------------------------------------|
12. How often do you actively search for new buyers?
- |              |       |           |           |       |
|--------------|-------|-----------|-----------|-------|
| All the time | Often | Regularly | Sometimes | Never |
|--------------|-------|-----------|-----------|-------|
13. Did you sell your last three orders to the same buyer or shop?
- Yes                      No
14. Are there a few buyers or shops with whom you have more regular contact?
- Yes                      No
15. Have you ever produced for exports?
- Yes                      No
- If Yes,
16. How much of your production do you export at present?
- |      |        |     |        |         |
|------|--------|-----|--------|---------|
| <25% | 25-50% | 50% | 50-75% | 75-100% |
|------|--------|-----|--------|---------|

**In every group of people, some people get along with others and trust each other, while others do not.**

1. Generally speaking, would you say that most people can be trusted, or that you can't be too careful in your dealings with people?
- |                            |                          |
|----------------------------|--------------------------|
| Most people can be trusted | You can't be too careful |
|----------------------------|--------------------------|



*Now I want to ask you how much you trust different types of people. Your answers can range from trusting someone to a (very) small extent to a (very) great extent.*

2. To establish trust in a business relationship, does it matter that a person is your kin or relative or comes from around your native area?

Yes                      No

3. Shoe producers from your own ethnic/tribal background?

To a very small extent      To a small extent      Neither small nor great extent      To a great extent      To a very great extent

4. Shoe producers from another ethnic/tribal background?

To a very small extent      To a small extent      Neither small nor great extent      To a great extent      To a very great extent

5. People from whom you buy leather or soles?

To a very small extent      To a small extent      Neither small nor great extent      To a great extent      To a very great extent

6. People to whom you sell your shoes?

To a very small extent      To a small extent      Neither small nor great extent      To a great extent      To a very great extent

7. Government officials?

To a very small extent      To a small extent      Neither small nor great extent      To a great extent      To a very great extent

8. Strangers?

To a very small extent      To a small extent      Neither small nor great extent      To a great extent      To a very great extent

**In general, do you agree or disagree with the following statements? The answers can range from agree strongly, to agree somewhat, to neither agree nor disagree, to disagree somewhat, to disagree strongly.**

9. In running your business you now and then take a risk in trusting someone you hardly know

Agree strongly      Agree somewhat      Neither agree nor disagree      Disagree somewhat      Disagree strongly

10. After doing satisfactory business for some time with someone who at first was a stranger, it becomes easier to trust him

Agree strongly      Agree somewhat      Neither agree nor disagree      Disagree somewhat      Disagree strongly

11. Given the chance, your main buyer might try to take unfair advantage of you
- |                   |                   |                               |                      |                      |
|-------------------|-------------------|-------------------------------|----------------------|----------------------|
| Agree<br>strongly | Agree<br>somewhat | Neither agree<br>nor disagree | Disagree<br>somewhat | Disagree<br>strongly |
|-------------------|-------------------|-------------------------------|----------------------|----------------------|
12. Your business reputation is your most important asset
- |                   |                   |                               |                      |                      |
|-------------------|-------------------|-------------------------------|----------------------|----------------------|
| Agree<br>strongly | Agree<br>somewhat | Neither agree<br>nor disagree | Disagree<br>somewhat | Disagree<br>strongly |
|-------------------|-------------------|-------------------------------|----------------------|----------------------|
13. When you are cheated in a business deal within Ethiopia, you can take the cheater to court and get what you deserve
- |                   |                   |                               |                      |                      |
|-------------------|-------------------|-------------------------------|----------------------|----------------------|
| Agree<br>strongly | Agree<br>somewhat | Neither agree<br>nor disagree | Disagree<br>somewhat | Disagree<br>strongly |
|-------------------|-------------------|-------------------------------|----------------------|----------------------|
14. When a producer cheats a buyer, this buyer will find a way to punish him directly and severely
- |                   |                   |                               |                      |                      |
|-------------------|-------------------|-------------------------------|----------------------|----------------------|
| Agree<br>strongly | Agree<br>somewhat | Neither agree<br>nor disagree | Disagree<br>somewhat | Disagree<br>strongly |
|-------------------|-------------------|-------------------------------|----------------------|----------------------|
15. Cheating your main buyer is very risky, because finding a good alternative takes time and is difficult
- |                   |                   |                               |                      |                      |
|-------------------|-------------------|-------------------------------|----------------------|----------------------|
| Agree<br>strongly | Agree<br>somewhat | Neither agree<br>nor disagree | Disagree<br>somewhat | Disagree<br>strongly |
|-------------------|-------------------|-------------------------------|----------------------|----------------------|

The following questions are about networks in which you participate

16. How closely do you feel to be part of the local shoe business community?
- |                |  |   |  |   |
|----------------|--|---|--|---|
| Feels isolated | Vaguely feels<br>part of shoe<br>community | Feels he/she<br>belongs to the<br>community but<br>is passive | Feels he/she<br>belongs to the<br>community but<br>and is active | Feels he is<br>an active leader<br>in the shoe<br>community |
|----------------|--|---|--|---|
17. To what extent do you normally do business with people from the same or different ethnic/tribal background?
- |   |   |  |  |  |
|---|---|--|--|--|
| Only with<br>people from<br>same family/<br>kin group | Only within<br>same ethnic/<br>tribal group | Also sometimes<br>with people from<br>other ethnic/<br>tribal groups | Also often with<br>people from<br>other ethnic/<br>tribal groups | Most business<br>is done with<br>people from<br>other ethnic/<br>tribal groups |
|---|---|--|--|--|
18. What is your own ethnic background?
19. Do you feel part of an informal group of some like-minded shoe producers with whom you can discuss your problems?
- |     |    |
|-----|----|
| Yes | No |
|-----|----|

20. Is your unit also part of a larger group, with either other shoe producers or connected to a tannery?

Yes                      No

21. When you go out with your friends, can you also discuss shoe business?

Yes, all of my friends are also in the shoe business	Yes, many of my friends are also in the shoe business	Some of my friends are in the shoe business	No, few of my friends are in the shoe business	No, none of my friends are in the shoe business
--	---	---	--	---

22. Do you participate in political meetings, not necessarily related to shoe issues?

All the time              Often              Regularly              Sometimes              Never

23. Do you feel that you have the power to make important decisions that change the course of your life?

Totally unable to change life	Mostly unable to change life	Neither able nor unable	Mostly able to change life	Totally able to change life
-------------------------------	------------------------------	-------------------------	----------------------------	-----------------------------

**The following set of questions is about how you use your networks**

1. For your type of products, are there enough or too few suitable leather suppliers in Ethiopia?

Plenty                      More than enough                      Enough                      Too few                      Far too few

2. Do you in practice normally buy from the same one or two leather suppliers?

Yes                      No

3. In your view, how much time did you spend last year on finding new alternative suppliers of leather or soles?

A lot of time	A significant amount of time	Not very much, not very little	Rather little time	No time at all
---------------	------------------------------	--------------------------------	--------------------	----------------

4. In your view, how much time did you spend last year on acquiring credit?

A lot of time	A significant amount of time	Not very much, not very little	Rather little time	No time at all
---------------	------------------------------	--------------------------------	--------------------	----------------

5. In your view, how much time did you spend last year on checking whether your business partners did what they promised?

A lot of time	A significant amount of time	Not very much, not very little	Rather little time	No time at all
---------------	------------------------------	--------------------------------	--------------------	----------------

6. Do you exchange information and experiences with some other producers?

All the time              Often              Regularly              Sometimes              Never

7. Do you share machines with other producers?  
 All the time      Often      Regularly      Sometimes      Never
8. Do you market your products together with some other producers?  
 All the time      Often      Regularly      Sometimes      Never
9. Do you purchase leather or soles jointly with some other producers?  
 All the time      Often      Regularly      Sometimes      Never
10. Do you share designers to develop new products with some other producers?  
 All the time      Often      Regularly      Sometimes      Never
11. In the last year, have you been part of a group of producers that tried to lobby with the Government to stop Chinese imports?  
 Yes      No
12. To what extent do you feel that you have benefited from the inputs of other local firms in making improvements in your own unit:  
 Very much      Significantly      Reasonably      Not so much      Not at all
13. To what extent do you feel that you have benefited from the inputs of buyers and suppliers in making improvements in your own unit?  
 Very much      Significantly      Reasonably      Not so much      Not at all
14. To what extent do you feel that you have benefited from the inputs of support organizations in making improvements in your own unit?  
 Very much      Significantly      Reasonably      Not so much      Not at all
15. In the last three years, since the Chinese imports started in 2000, have you been part of any joint initiative to develop new quality control or testing facilities?  
 Yes      No

**Now I would like to ask you a few indications about your performance in the last 3 years**

1. What has happened to the following since the Chinese imports started in 2000?

Increased a lot: ++; Increased: +; Same: =; Decreased: -; Decreased a lot: --.

	++	+	=	-	--
1. Output in number of pairs					
2. Average price of products					
3. Average quality of products					
4. Number of workers					
5. Average speed of delivery					
6. Fashion content of products					



To what extent do you feel this Association has been effectively assisting shoe producers in upgrading quality standards?

Very effectively	Effectively	Not effectively, not ineffectively	Ineffectively	Very ineffectively
------------------	-------------	------------------------------------	---------------	--------------------

To what extent do you feel this Association has been effective in solving business conflicts between members of the association?

Very effectively	Effectively	Not effectively, not ineffectively	Ineffectively	Very ineffectively
------------------	-------------	------------------------------------	---------------	--------------------

Do you feel you get more out of being a member of this organization than what you need to put in (in terms of time and money)?

Get a lot more out of it	Get a bit more out of it	Balance between what I get out and need to put in	Need to put a bit more into it	Need to put a lot more into it
--------------------------	--------------------------	---	--------------------------------	--------------------------------

**Thank you very much for your cooperation!**

**This part is only for firms in the informal sector**

**Finally, I would like to ask you a few questions about yourself, but first:**

1. Does your unit operate throughout the year?

Yes, except for special circumstances like festivals	No, but production of more than 6 months in last year	No, production is limited to peak periods, less than 6 months per year
--	---	--

2. Is shoe production your only or main source of income?

Only source of income	Main source of income	One of several sources of income	Relatively small source of income
-----------------------	-----------------------	----------------------------------	-----------------------------------

3. When you could get a job as an employee with a regular income, would you prefer that to running this unit?

Yes	No
-----	----

4. How did you acquire the technical and business skills to run this unit?

Learning by doing only	Learning by doing plus some on-the-job training as a worker in other workshops	Worked for years in factory	Worked in factory plus some formal training	Worked in factory plus some formal technical and business training
------------------------	--	-----------------------------	---	--

**Thank you very much for your cooperation!**

The following additional questions were asked only in Viet Nam

To what extent do you feel that this Association has been effectively providing a forum for meeting other owners of shoe units and tanners?

Very effectively	Effectively	Not effectively, not ineffectively	Ineffectively	Very ineffectively
------------------	-------------	------------------------------------	---------------	--------------------

To what extent do you feel this Association has been effectively lobbying the government on behalf of the shoe producers?

Very effectively	Effectively	Not effectively, not ineffectively	Ineffectively	Very ineffectively
------------------	-------------	------------------------------------	---------------	--------------------

To what extent do you feel this Association has been effectively assisting shoe producers in upgrading quality standards?

Very effectively	Effectively	Not effectively, not ineffectively	Ineffectively	Very ineffectively
------------------	-------------	------------------------------------	---------------	--------------------

To what extent do you feel this Association has been effective in solving business conflicts between members of the association?

Very effectively	Effectively	Not effectively, not ineffectively	Ineffectively	Very ineffectively
------------------	-------------	------------------------------------	---------------	--------------------

Do you feel you get more out of being a member of this organization than what you need to put in (in terms of time and money)?

Get a lot more out of it	Get a bit more out of it	Balance between what I get out and need to put in	Need to put a bit more into it	Need to put a lot more into it
--------------------------	--------------------------	---	--------------------------------	--------------------------------







## ANNEX II. FROM SURVEY QUESTIONS TO COMPOSITE

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The questionnaire consisted of six parts: a general part, sets of questions on trust, on networks and on performance, and a special section for formal and informal sector firms. The following questions from the survey were used to construct the key indicators:

Buyer relationship: General 7-11, 13, 14.

Market channel: General 1-4, 7, 15, 16; Trust 20.

Owner typology: Formal 1-5; Informal 1-4.

Firm typology: General 5, 6.

Trust composite: Trust 3-8.

WVS (World Value Studies) question: Trust 1.

Bonding social capital: Trust 2.

Bridging social capital: Trust 10.

Network participation: Trust 16, 17, 19, 21.

Transaction costs: General 12; Network 1-5.

Collective action: Network 6-11.

Learning spin offs: Network 12-14.

Performance: Performance 1-4.

Upgrading: Network 15; Performance 5-8.

For example, the composite indicator on performance (and upgrading) is based on equal weighting of a set of questions on whether, for example, output in number of pairs has increased a lot, increased, remained the same, decreased or decreased a lot. Similarly, composite indicators on trust, network participation, transaction costs, collective action and learning spin-off offs are based on equal weighting of sets of questions with answer categories like “very much”, “significantly”, “reasonably”, “not so much” and “not at all”. These composite variables can be ordered qualitatively, in a rather limited number of ordered classes. For this data set, the Kendall correlation coefficient is used, which is probably more appropriate than the Spearman rank correlation coefficient because a relatively large number of cases are classified in a relatively small number of ordered classes (Nie and others [110], p. 289). Alternatively, Gamma is a measure of association specifically for data arranged into ordered classes (Hays [74], p. 844). However, Gamma does not take “ties” into account. To leave out ties, a frequent occurrence in the UNIDO data set, means to be left with a more crude measure which relies strongly on a more intuitive interpretation (Nie and others [110], p. 228), and which more rapidly takes on higher values. It was indeed found that values for both the Spearman rank correlation and Gamma were consistently higher than the Kendall correlation coefficient, but that, in terms of statistically significant associations, no differences were found. To be clear, a Kendall correlation matrix does not imply a direction of causality, but provides information about the extent of association between variables.





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