

EXPLORING THE IMPACT OF SOCIAL CAPITAL ON SMES' ESG STRATEGY

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Abstract

Sustainable development has emerged as a prominent global trend for business corporations, leading to a significant increase in awareness of the importance of Environmental, Social, and Governance (ESG) strategies for business sustainability. However, the adoption of ESG strategies among Malaysian small and medium enterprises (SMEs), which constitute a substantial portion of the economy, remains low. Social capital is one of the key factors that can enhance ESG strategies among SMEs. Grounded in the Resource-Based View (RBV), this study aims to explore the link between social capital and ESG strategies. Based on data collected from 200 small Malaysian firms and analysed using partial least squares structural equation modeling (PLS-SEM), the study highlights the significant role of social capital in enhancing ESG strategies. Overall, the model demonstrates strong predictive power, offering both theoretical insights and practical implications that can guide future research in improving the ESG strategies of SMEs.

Keywords: Social capital, ESG, SMEs.

Introduction

Corporate sustainability has emerged as a crucial concern in today's business landscape, driven by the need to create stakeholder value through multidimensional strategies encompassing environmental, social, and governance (ESG) aspects. Traditionally, corporate sustainability has been measured primarily through profitability data, reflecting the investor focus on financial health as a benchmark for investment decisions due to the belief that strong financial performance ensures a corporation's longevity and profitability. However, true corporate sustainability extends beyond financial metrics and involves an integrated approach that includes operational management, human capital management, environmental stewardship, and corporate social responsibility (Mokbel Al Koliby et al., 2024).

The global business environment has shifted its focus towards sustainability, especially following the adoption of the Sustainable Development Goals (SDGs) in 2015 by all United Nations Member States. As a result, ESG strategies have become central to strategic business planning, emphasising not only profit but also the impacts on economic, environmental, and social conditions to ensure long-term benefits and business continuity. The positive relationship between robust ESG strategies and corporate financial performance has garnered increasing attention (Zhou et al., 2022). Recent studies highlight that businesses that adopt comprehensive ESG strategies are often more sustainable, possess long-term resources, and demonstrate stronger financial outcomes (Chen et al., 2023). Recognising ESG strategies as essential economic fundamentals helps mitigate risks associated with sustainability, including resource constraints, regulatory pressures, competitive actions, and workforce-related issues. Consequently, integrating ESG criteria has become a strategic imperative for businesses seeking to achieve a competitive edge within their industry.

While much of the focus on ESG strategies has emphasised environmental and governance aspects, the role of social capital in planning and implementing these strategies is equally critical. Social capital, an intangible asset arising from human interactions, includes

elements such as employee relations, workplace culture, social justice, community involvement, and social responsibility (Cofré-Bravo et al., 2019). Unlike technological resources, human capital contributes creativity and problem-solving capabilities that are essential for fostering innovation and addressing complex challenges (Ooi et al., 2023). Social networking, a core component of social capital, fosters the development of shared values and mutual respect among stakeholders. This network-based foundation of trust not only reinforces internal collaboration but also enhances the firm's public reputation and brand value through active participation in community initiatives. Such efforts can be particularly appealing to investors who are inclined to support socially responsible businesses that prioritise social development alongside profitability, thereby enhancing the firm's competitive advantage.

This study holds significant implications for both academia and the small and medium enterprises (SMEs). By conducting this study, the aim is to enhance the understanding of the determinants influencing ESG strategy, ultimately leading to a stronger competitive advantage for SMEs in Malaysia. The findings have the potential to provide valuable insights that can inform the creation of targeted interventions and strategies to promote sustainable practices within small firms.

Research Objectives

This study explores the impact of social capital on SMEs' ESG strategies, considering the vital role that social networks and relationships play in enhancing sustainability practices and fostering long-term resilience and competitive advantage for the SMEs. Specifically:

1. This study explores the role of social capital in enhancing ESG strategies within SMEs in Malaysia.

Scope of the Research

Population Scope:

The study focuses on small and medium enterprises (SMEs) in Malaysia. This demographic was selected due to the significant role that SMEs play in the Malaysian economy and their potential for impactful adoption of ESG strategies (Ooi et al., 2020).

Variable Scope:

The key variables examined in this study is social capital, operationalised as a higher-order construct consisting of three dimensions: bonding, bridging, and linking (Cofré-Bravo et al., 2019; Ooi et al., 2023). These dimensions collectively represent various types of social interactions and relationships that can influence the adoption of ESG strategies among SMEs. Meanwhile, ESG strategy, refers to a strategy integrated with ESG factors, serving as a dynamic and effective intermediate measure for managing sustainability performance (Eide et al., 2020).

Time Scope:

This research is designed as a cross-sectional study, with data collection carried out over a three-month period in Malaysia. This timeframe was chosen to ensure sufficient responses and robust data for analysis, enabling comprehensive insights into the relationship between social capital and ESG strategies within SMEs.

Theoretical Framing and Hypothesis Development

Grounded in the Resource-Based View (RBV), social capital is considered an essential intangible asset that can contribute to a firm's competitive advantage. RBV postulates that resources that are valuable, rare, inimitable, and non-substitutable can enhance a firm's

strategic capabilities and performance (Memon et al., 2024). Social capital, which encompasses the quality of relationships, trust, networks, and shared values within and outside an organisation, fits this criterion (Ooi et al., 2023). For SMEs, which often face resource constraints, leveraging social capital can be particularly impactful in adopting and implementing ESG strategies.

Social capital can be broken down into three dimensions: bonding, bridging, and linking. Bonding social capital refers to the strong connections within close groups, such as employees and close stakeholders, which foster trust and collaboration. Bridging social capital pertains to the connections with more diverse groups outside the immediate network, providing access to broader information and new opportunities. Linking social capital involves connections with external entities in positions of power, such as regulatory bodies and community leaders, which can facilitate the adoption of strategic practices, including ESG initiatives (Cofré-Bravo et al., 2019; Ooi et al., 2023).

Thus, based on RBV and the multifaceted role of social capital in strengthening organisational capabilities, the following hypothesis is proposed:

Hypothesis: Social capital positively influences the adoption of ESG strategy among SMEs.

The conceptual framework illustrating the relationship between social capital and ESG strategy among SMEs is presented in Figure 1.

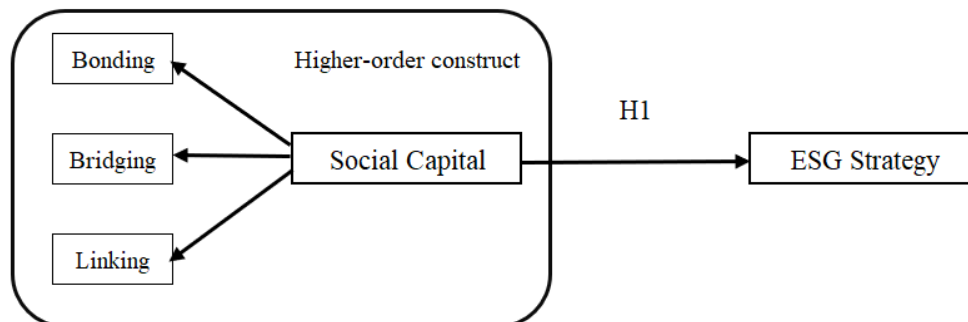


Figure 1: Conceptual framework

Research Method

This study focused on SMEs in Malaysia, employing a purposive sampling approach to survey top management. Data for the empirical analysis were collected through a questionnaire survey. A total of 600 questionnaires were distributed to the top management of SMEs, selected from a comprehensive list of SME companies provided on the official SME website. The Drop-Off and Pick-Up (DOPU) method was utilised (Ooi et al., 2020). The survey was conducted over a three-month period.

Microenterprises were excluded from the survey due to their small size, typically having fewer than five employees, as their limited resources, knowledge gaps, perceived complexity, costs, and short-term focus make it challenging for them to implement ESG strategies. After discarding incomplete questionnaires, 200 valid responses were obtained, resulting in a response rate of 33.3%. The responses comprised 41.5% from the services sector, and the remaining 58.5% from the manufacturing sector.

To establish the content validity of the survey instrument, measurement indicators were sourced from established literature (Cofré-Bravo et al., 2019; Eide et al., 2020) and utilised a five-point Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree). Social capital was operationalised as a higher-order type 1 reflective-reflective construct (Sarstedt et al., 2019) with bonding, bridging, and linking dimensions, measured through ten adapted items from Cofré-Bravo et al. (2019). ESG strategy was assessed using three adapted items from Eide et al. (2020). Recognising that firm size, firm age, and industry type are significant factors influencing sustainability performance, these were included as control variables. This approach ensured a comprehensive assessment of the impact of the social capital on predicting ESG strategy of the SMEs.

Analysis and Findings

The data collected for this study were analysed using partial least squares structural equation modeling (PLS-SEM), a method known for its robustness in handling higher-order constructs and strong predictive capabilities, making it particularly suited for this study (Ooi et al., 2023). The analysis followed a two-stage process: first, the measurement model was assessed to ensure its reliability and validity; subsequently, the structural model was evaluated based on the quality established in the first stage (Memon et al., 2024).

Table 1 presents the results of measurement model. In PLS-SEM, three key criteria are used to assess reflective measurement model: internal consistency reliability, convergent validity, and discriminant validity (Hair et al., 2019). Internal consistency reliability was the first metric evaluated, with all composite reliability (CR) values exceeding the recommended threshold of 0.7, confirming that the constructs exhibit sufficient reliability. Convergent validity was then assessed by examining the outer loadings and the average variance extracted (AVE). All outer loadings were above 0.707, and the AVEs for all constructs exceeded the minimum benchmark of 0.5, confirming the establishment of convergent validity (Hair et al., 2019).

Table 1: Results of Measurement Model

Constructs	Indicators	Loadings	CR	AVE
Social capital (Second-order construct)	Bonding	0.747	0.834	0.627
	Bridging	0.802		
	Linking	0.824		
Bonding (First-order construct)	BOND1	0.904	0.926	0.807
	BOND2	0.904		
	BOND3	0.886		
Bridging (First-order construct)	BRI1	0.914	0.907	0.766
	BRI2	0.879		
	BRI3	0.830		
Linking (First-order construct)	LINK1	0.777	0.913	0.726
	LINK2	0.919		
	LINK3	0.909		
	LINK4	0.794		
ESG strategy	ESG1	0.938	0.965	0.902
	ESG2	0.959		
	ESG3	0.952		

Note: CR=Composite reliability, AVE= Average variance extracted

Meanwhile, discriminant validity was assessed using the heterotrait-monotrait (HTMT) ratio of correlations (Henseler et al., 2015). As presented in Table 2, all HTMT values were below the threshold of 0.90 (Memon et al., 2024), confirming that discriminant validity was achieved. These findings indicate that the constructs are distinct and that the measurement items reliably represent their respective constructs.

Table 2: Discriminant Validity

	1	2	3	4	5
1. Bonding					
2. Bridging	0.518				
3. ESG Strategy	0.554	0.431			
4. Linking	0.429	0.577	0.499		
5. Social Capital*	-	-	0.621	-	

Note: *Social capital = second-order construct

The significance of the path relationships was assessed using the bootstrapping procedure recommended by Hair et al. (2019). As outlined in Table 3, social capital positively and significantly influences ESG strategy ($\beta = 0.523$; $t = 7.471$; $p < 0.01$). Furthermore, the f^2 value of 0.349 indicates a large effect size, demonstrating that social capital has a strong and meaningful impact on ESG strategy within the model. This suggests that social capital substantially contributes to explaining the variance in ESG strategy adoption among SMEs. A large effect size implies that social capital plays a critical role in driving ESG initiatives, reinforcing its importance as a strategic resource for enhancing sustainability practices. This finding highlights the need for SMEs to develop and leverage social capital to improve their ESG strategies effectively.

Table 3: Results of Structural Model

Path relationship	Path coefficient	Std. error	t-value	95% confidence interval	f ²
Social Capital -> ESG	0.523	0.070	7.471**	[0.398, 0.627]	0.349

Note: ** p<0.01 (one-tailed)

Besides, the control variables in this study: firm size ($\beta = 0.006$, $p > 0.05$), firm age ($\beta = 0.098$, $p > 0.05$), and industry type ($\beta = 0.173$, $p > 0.05$), did not show any significant relationship with ESG strategy. This indicates that these factors do not have a meaningful impact on the adoption or implementation of ESG strategies among the SMEs analysed.

Discussion

The results confirm that social capital serves as a valuable and strategic resource that can enhance the sustainability practices of SMEs. The study's analysis demonstrated that the three dimensions of social capital: bonding, bridging, and linking, contribute to the successful implementation of ESG strategy.

Bonding social capital, which relates to internal relationships and trust within the firm, was found to be essential in fostering a collaborative culture and a shared commitment to sustainability goals. Bridging social capital enabled SMEs to access diverse external networks, facilitating the acquisition of new insights, resources, and best practices from a broader community. Linking social capital, which involves relationships with influential external parties such as regulatory agencies, proved crucial in obtaining support for ESG initiatives (Cofré-Bravo et al., 2019; Ooi et al., 2023). Together, these three types of social capital empower SMEs to effectively manage stakeholder expectations and align their practices with the broader sustainability agenda.

The strong effect size and predictive power of the model highlight the importance of considering social capital as a strategic asset in enhancing ESG practices. The findings align with previous literature, reinforcing the notion that intangible resources like social capital can provide competitive advantages.

However, while the results are promising, it is important to acknowledge potential limitations, such as the cross-sectional nature of the study, which may not fully capture changes over time. Future research could explore longitudinal data to better understand the evolving relationship between social capital and ESG strategies. Additionally, incorporating qualitative insights could provide a deeper understanding of how specific social capital practices influence ESG outcomes.

Conclusion

This study provides valuable insights into the role of social capital in influencing the adoption of ESG strategies among SMEs in Malaysia. By leveraging social capital as an intangible resource, SMEs can enhance their strategic approach to sustainability, aligning with the principles of the RBV. The findings highlight the importance of fostering strong social networks and relationships to support ESG initiatives, offering both theoretical contributions and practical implications for sustainable business practices. This research highlights the need for SMEs to prioritise social capital to achieve long-term competitive advantages and improved sustainability outcomes.

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