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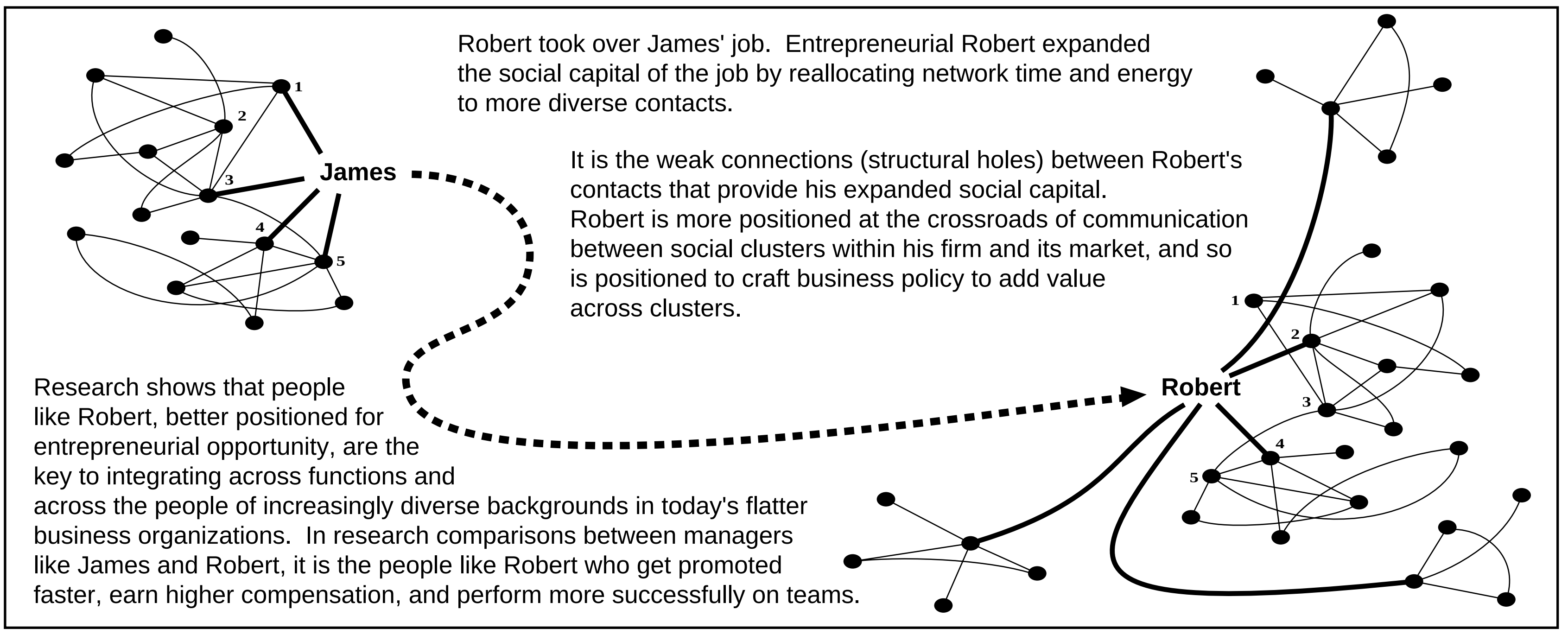

The Social Capital of Entrepreneurial Managers

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His theoretical work describes preference formation and entrepreneurial opportunities in competitive environments.

Applications focus on the contact networks of high-performance managers (how people of diverse backgrounds create social capital) and the network structure of market profits (how the structure of producer, supplier, and customer relations defines competitive advantage among producers).

Recent years have seen a dramatic shift in the way companies organize. The shift is away from bureaucracy. Layers of formal control within and across functions are being replaced with fewer layers of negotiated informal control.

The shift away from bureaucracy means that managers cannot rely as much on directives from above. They are now more than ever the authors of their own work. The upside is that firms can identify, and adapt more readily to, needed production changes and market shifts. The downside is new costs for managers. The coordination costs once borne by corporate bureaucracy — each person having responsibility for coordination within a limited domain of responsibility — are now borne by individual managers who have responsibility for coordination across broader domains of business activity.

Which is why the adage about working through others is taking more concrete form at leading business schools. Social science has made striking advances in theory and research over the last twenty years on the principles of adding value through other people. The core concept is social capital, the University of Chicago is at the frontier of theory and research on the issue, and the GSB is at the frontier of crafting courses that bring the work to the classroom.

Managers differ in their ability to survive and thrive without bureaucracy. What is an opportunity for some managers, is distress for many others. Coordination tasks are now broader, with a corresponding increase in uncertainty, stress, and potentially disruptive conflict. New issues emerge for human resource management.

Which is why social capital analysis can be useful. In social science terms, the shift away from bureaucracy is a shift to social capital as a critical performance factor. Social capital refers to the wealth of a manager's relationships within and beyond the firm. This form of capital can be measured, and enhanced, so analysis can be a powerful tool in human resource management. Specifically, social capital analysis has been useful to: (a) understand how a company really works (how people communicate, how information flows, and so on), (b) identify and develop needed skills in a broader range of younger managers, (c) identify the right people to manage cross-functional teams and transitions from the old to the new, (d) understand diversity issues, and (e) anticipate catalysts and bottlenecks to organization change (i.e., how reengineering, downsizing, merging, acquiring, and the like will be received by the organization).

There are two ways to understand social capital; relative to human capital, and as a form of network structure.

SOCIAL CAPITAL RELATIVE TO HUMAN CAPITAL

Human capital and social capital arguments explain why some managers add more value to their companies. Both arguments begin with inequality. Some managers enjoy higher incomes. Some are promoted faster. Some are leaders on the more important projects. The human capital story is that such inequalities result from differences in individual ability. The more rewarded managers are smarter, or better educated, or more experienced.

Social capital focuses on the value a manager adds through other people. The social capital story is that inequalities result from contextual differences between people. Returns to intelligence, education, and seniority depend on a manager's location in the social structure of an organization. Some portion of the value a manager adds to a firm is his or her ability to coordinate other people, where coordination refers to identifying opportunities to add value within an organization, and getting the right people together to take advantage of the opportunities. Certain network structures of relationships — deemed social capital — can enhance a manager's ability to identify and develop opportunities.

The summary points are two: (a) Social capital differs from human capital. Social capital is a quality created between people while human capital is a quality of individuals. Investments that create social capital are fundamentally different from the investments that create human capital. (b) Social capital is the contextual complement to human capital. Where human capital refers to individual ability, social capital refers to opportunity. Managers with more social capital get higher returns to their human capital because they can identify and develop more rewarding opportunities.

SOCIAL CAPITAL AS A FORM OF NETWORK STRUCTURE

Structural hole theory gives concrete meaning to the social capital metaphor. Hole theory describes how the structure of a network is a competitive advantage for certain people over others. In a perfect market, one rate of return clears the market. In an imperfect market, there can be multiple rates of return because disconnections between individuals, holes in the structure of the market, leave some managers unaware of the benefits they offer one another. Certain managers are connected to certain others, trusting certain others, obligated to support certain others, dependent on exchange with certain others.

In the above diagram, James has a network that spans one structural hole (the relatively weak connection between a cluster reached through contacts 1, 2, and 3 versus the other cluster reached through contacts 4 and 5). The structural hole between the two clusters does not mean that people in the two clusters are unaware of one another. It simply means that people in each cluster are so focused on the press of business within their own cluster that they pay relatively less attention to the activities of people in other clusters.

Robert took over James' job. Robert preserves connection with both clusters in James' network, but expands the network to a more diverse set of contacts. Robert's network, adding three new clusters of people spans ten structural holes.

These structural holes between people are entrepreneurial opportunities for third parties to broker the flow of <u>information</u> between people on opposite sides of the structural hole, and <u>control</u> the form of projects that bring together people on opposite sides of the structural hole. Structural holes separate nonredundant contacts. Each hole is a buffer, like an insulator in an electric circuit. As a result of the structural hole between them, two contacts provide network (information and control) benefits that are in some degree additive rather than overlapping. Social structures rich in disconnections between people are rich in the entrepreneurial opportunities of structural holes.

People better connected across structural holes are better positioned to broker otherwise difficult or unlikely exchanges, and so are likely to enjoy higher returns to their human capital. Specifically, managers with contact networks rich in structural holes are the individuals who know about, have a hand in, and exercise control over, more rewarding opportunities. They have broader access to information because of their diverse contacts (information access benefit of holes). That means they are more often aware of new opportunities, and aware earlier than their peers (information timing benefits). They are also more likely to be the people discussed as suitable candidates for inclusion in new opportunities (referral benefits). They are also more likely to have sharpened and displayed their capabilities because they have more control over the substance of their work defined by relationships with subordinates, superiors, and colleagues (control benefits). These benefits reinforce one another at any moment in time, and cumulate together over time.

Through their entrepreneurial opportunities, managers with contact networks rich in structural holes can add value above and beyond the value of their human capital. They monitor information more effectively than bureaucratic control. Gossip moves faster, and to more people, than memos. Entrepreneurial managers know the parameters of organization problems early. They are highly mobile relative to bureaucracy, easily shifting network time and energy from one solution to another. Entrepreneurial managers tailor solutions to the specific individuals being coordinated, replacing the boiler-plate solutions of formal bureaucracy. To these benefits of faster, better solutions, add cost; entrepreneurial managers offer inexpensive coordination relative to the bureaucratic alternative. In short, entrepreneurial managers operate somewhere between the force of corporate authority and the dexterity of markets, rushing coordination to disconnected parts of the firm that could be productively brought together.

Further reading:

R. S. Burt **Structural Holes: The Social Structure of Competition**. Harvard University Press (1992)

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