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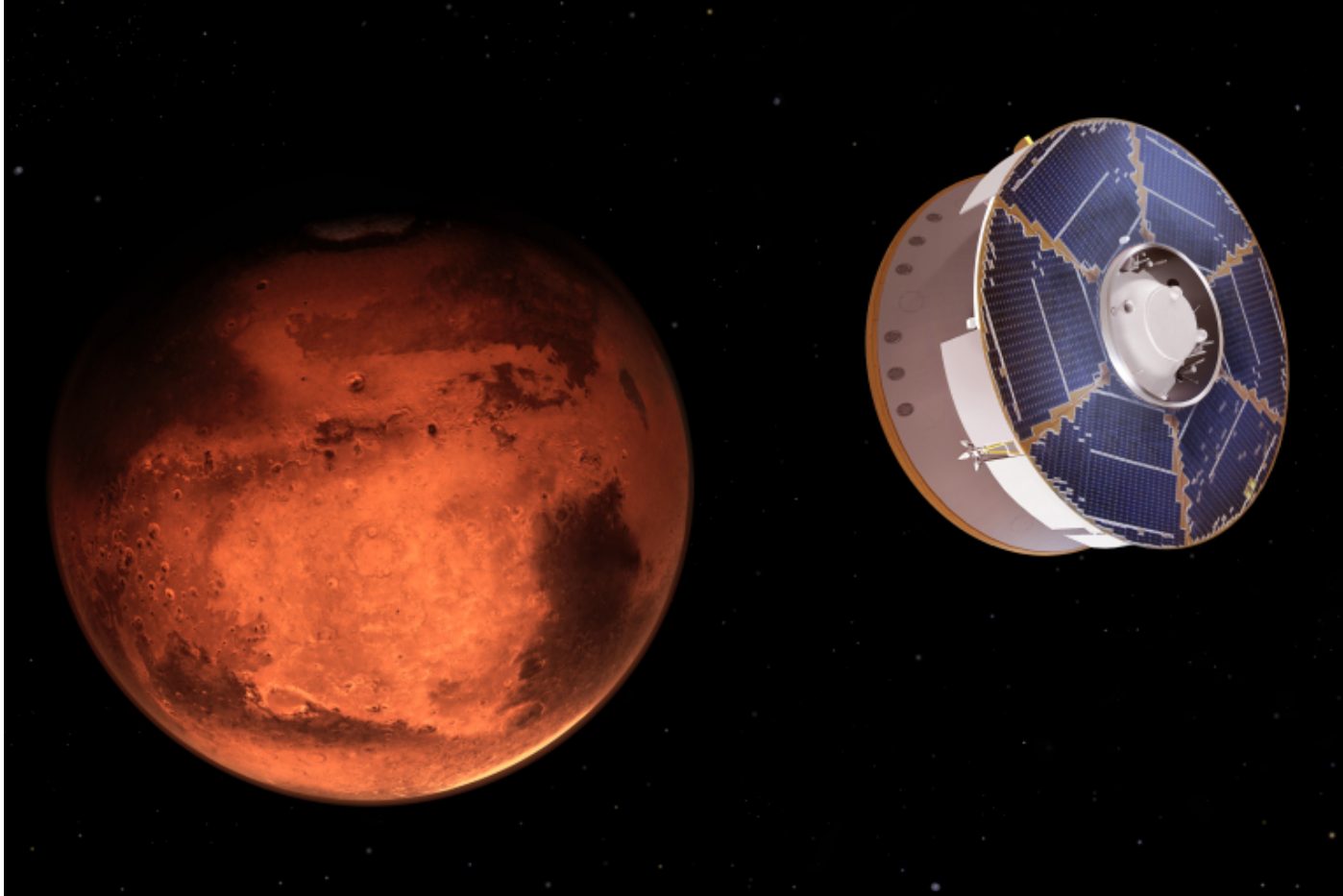
Lecture Six: Social Capital



Order of presentation

1. Announcement
 - ✓ Journal review-Group 1
 - ✓ Term paper assignment
2. Recap
3. Social Capital

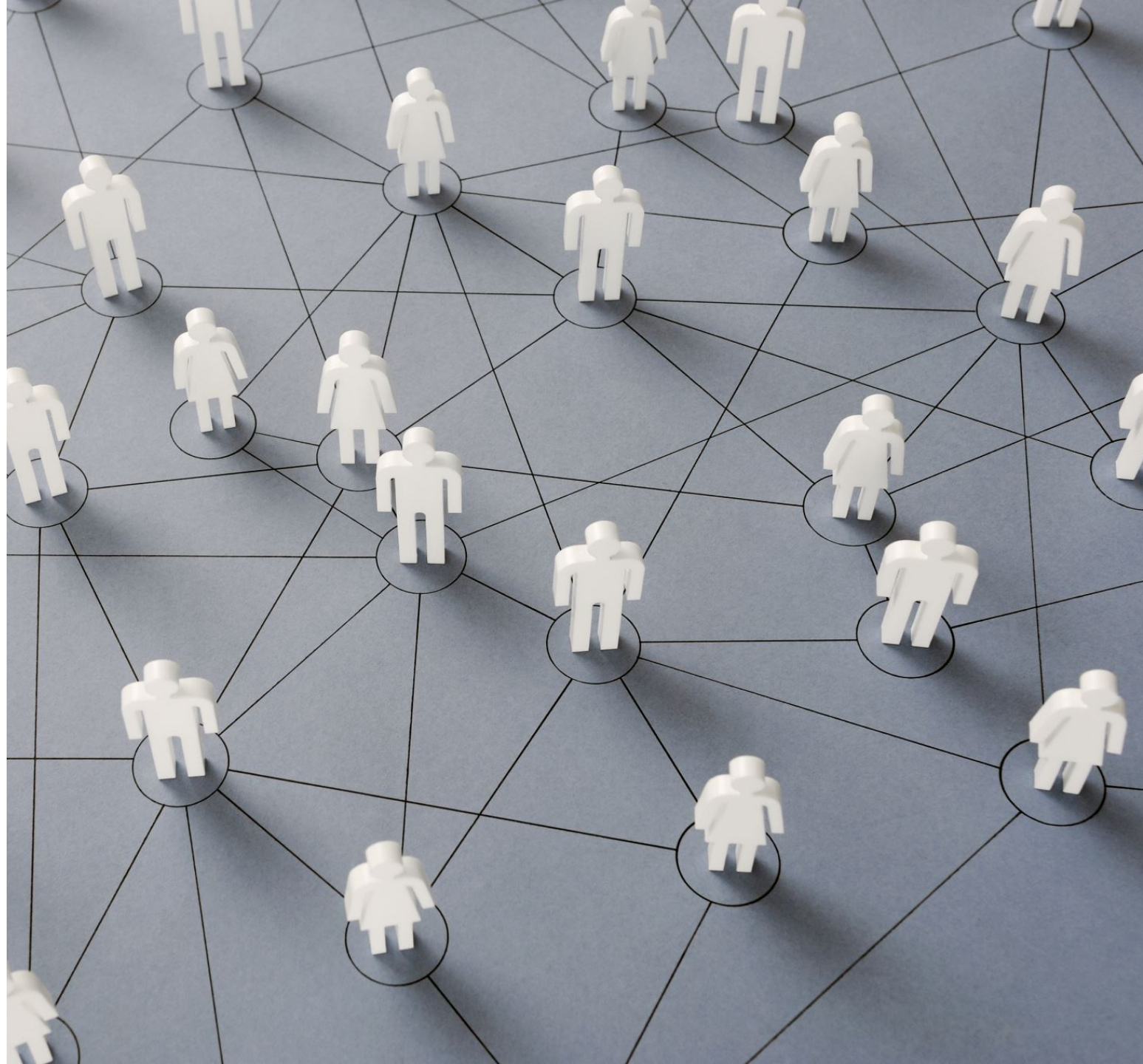
Journey to Mission MarsInsEcon2023



- Flight is MarsInsEcon-2023
- Vessel id is Mars-Ins-Econ-2023
- Currently in the 6th week of our flight
- Almost entering the Martian atmosphere
- Hope that we will enter the Martian atmosphere at the end of the class



Social Capital





BONDS

*family, close friends,
people who share our
culture or ethnicity*



BRIDGES

*distant friends,
colleagues,
associates*

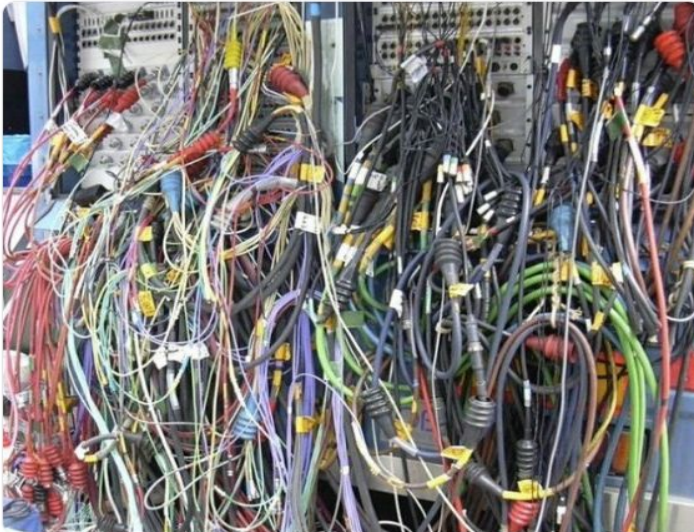


LINKAGES

*people or groups
further up or lower
down the social ladder*

**Hii Kenya bila
connection, ata
earthquake huwezi
skia** 😂😂

The connections you need to get a job in
KENYA



When your friends with very good jobs are discussing weird things like forgetting to book their flights so you decide to think about avocados



Introduction

- ❖ “It’s not what you know, it’s *who you know*.”
- ❖ Sustainable development has been defined as a process whereby future generations receive as much capital per capita as — or more than — the current generation has available
- ❖ Traditionally, this has included **natural capital, physical or produced capital, and human capital**
- ❖ Physical capital entails assets may be in the form of land and equipment, some of which may be in the form of sunk costs without alternative use, or movables that be applied in different types of operations such as trucking equipment
- ❖ Human capital embodied in people’s skills, health status and mental programming: attitude, worldview, mindset, values, etc.

Introduction

- ❖ Together these forms of capital constitute the wealth of nations and form the basis of economic development and growth
- ❖ In this process the composition of capital changes
- ❖ Some natural capital will be depleted and transformed into physical capital
- ❖ It has now become recognized that these **three types of capital determine only partially the process of economic growth because they overlook the way in which the economic actors interact and organize themselves to generate growth and development**

Introduction

- ❖ The missing link is social capital
- ❖ At this broad level of conceptualization there is **little disagreement about the relevance of social capital**
- ❖ There is, however, **no consensus about which aspects of interaction and organization merit the label of social capital, nor in fact about the validity of the term capital to describe this**
- ❖ Least progress has been made in measuring social capital and in determining empirically its contribution to economic growth and development

The concept of social capital

- ❖ The term social capital has **found its way into economic analysis only recently**, although various elements of the concept have been present under different names for a long time
- ❖ In the political science, sociological, and anthropological literature **social capital generally refers to the set of norms, networks, and organizations through which people gain access to power and resources, and through which decision making and policy formulation occur**
- ❖ Economists have added the **focus on the contribution of social capital to economic growth**
- ❖ At the microeconomic level this is seen primarily through the ways social capital improves the functioning of markets
- ❖ At the macroeconomic level institutions, legal frameworks, and the government's role in the organization of production are seen as affecting macroeconomic performance

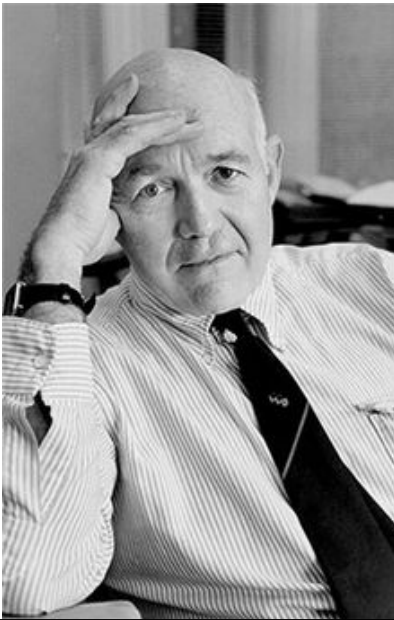
The concept of social capital: Definition one



Pierre Bourdieu
(1930-2002)

- ❖ Bourdieu's concept relates to his theoretical ideas on class
- ❖ He identifies three dimensions of capital each with its own relationship to class
- ❖ His concept of social capital **puts the emphasis on conflicts and the power function (social relations that increase the ability of an actor to advance her/his interests)**
- ❖ Social positions and the division of economic, cultural and social resources in general are legitimized with the help of symbolic capital. From the Bourdieuan perspective, **social capital becomes a resource in the social struggles that are carried out in different social arenas or fields**
- ❖ Here, social capital is another tool in the armory of the elite, deployed to ensure that the 'wrong' kind of people don't enter their circles
- ❖ The Bourdieu approach is an important reminder that social capital can be exclusionary

The concept of social capital: Definition Two



James Coleman
(1926-1995)-Chicago

- ❖ Social capital is "a variety of different entities, with two elements in common: they all **consist of some aspect of social structure, and they facilitate certain actions of actors — whether personal or corporate actors — within the structure**"
- ❖ This broadens the concept to include **vertical as well as horizontal associations**, and also the behaviour among other entities such as firms
- ❖ Vertical associations are characterized by hierarchical relationships and an unequal power distribution among members

The concept of social capital: Definition three

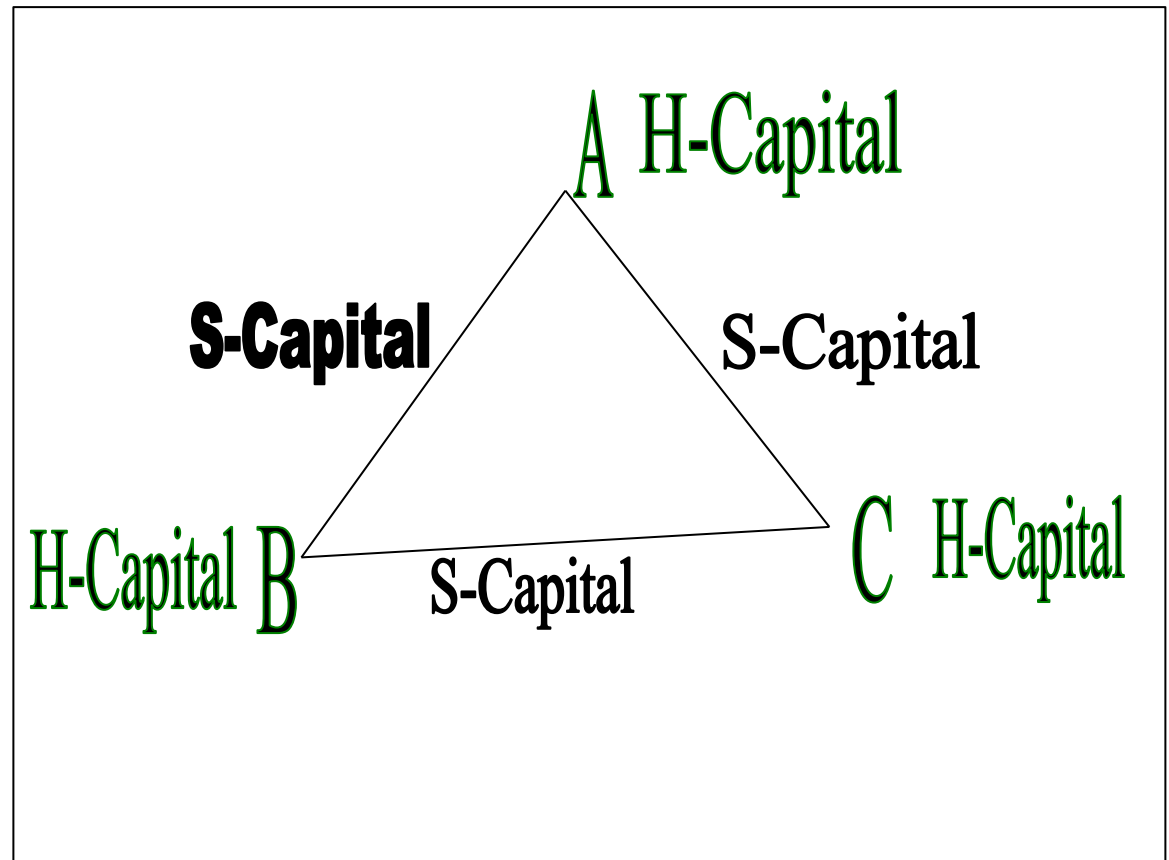


Robert Putnam
(1941-date)-Harvard

- ❖ The narrowest concept of social capital is associated with Putnam (Putnam 1993; Putnam and others 1993)
- ❖ He views it as a set of "horizontal associations" between people: social capital consists of features of social organization, such as trust, norms and networks that can improve the efficiency of society by facilitating coordinated actions
- ❖ Three empirical presumptions underlie this concept: moral obligations, norms, and social values are empirically associated, and these have important economic consequences.
- ❖ While originally this concept of social capital was limited to associations having positive effects on development, recently it has been relaxed to include groups that may have undesirable outcomes as well, such as associations with rent-seeking behaviour
- ❖ The key feature of social capital in this definition is that it facilitates coordination and cooperation for the mutual benefit of the members of the association (Putnam 1993)

The concept of social capital: Definition Two & Three combined through the relationship between Human and Social Capital

- ❖ We have already shown that human capital is complementary to social capital. Let A be a child and B an adult who happens to be A's parent. For B to increase A's cognitive skills, there must be human capital in both A and B, as well as some social capital in the child – parent relationship. Assuming that C is another adult, C's human capital attributes are critical for relationship with B, which relationship is social capital creating



The concept of social capital: Definition Four

- ❖ A fourth and most encompassing view of social capital includes the **social and political environment that enables norms to develop and shape social structure**
- ❖ In addition to the largely informal, and often local, **horizontal and hierarchical relationships of the first two concepts**, this view also includes the **more formalized institutional relationships and structures, such as government, the political regime, the rule of law, the court system, and civil and political liberties**
- ❖ This focus on institutions draws on North (1990) and Olson (1982), who have argued that such institutions have an important effect on the rate and pattern of economic development
- ❖ This suggests that four definitions of social capital are not alternative views, but rather complementary dimensions of the same process
- ❖ All link the **economic, social, and political spheres**
- ❖ They share the belief that social relationships affect economic outcomes and are affected by them

-
- ❖ All recognize the potential created by social relationships for improving development outcomes but also recognize the danger for negative effects
 - ❖ Which outcome prevails depends on the nature of the relationship (horizontal versus hierarchical) and the wider legal and political context
 - ❖ All focus on relationships among economic agents and how the formal or informal organization of those can improve the efficiency of economic activities.
 - ❖ All imply that “desirable” social relationships and institutions have positive externalities.
 - ❖ Because these cannot be appropriated by any one individual, each agent has a tendency to under invest in social capital; hence, there is a role for public support of social capital building.

What is capital about social capital?

- ❖ What makes social capital a resource with capital attributes?
- ❖ Concrete personal relations and networks are important in generating trust, establishing expectations and in creating and enforcing norms
- ❖ All these are important in reducing uncertainty and transactions costs
- ❖ Social capital is therefore important in the functioning of economics systems, and is capital in that sense

Paradigms of Relationships

❖ What promotes relational proximity or reduces relational distances? Literature suggests five paradigms of relational proximity

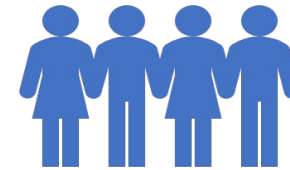
1. **Parity**, which means treating each other as moral equals, whatever our situations in life
2. **Directness**, which means face to face interactions as opposed to electronic and other interactions
3. **Multiplexity**, which mean meeting people in different, less formal situations rather than meeting people only under structured interactions
4. **Continuity**, which means repeated interactions have a greater chance of blasting relational distances than single encounter situations
5. **Commonality of interests or activities** that are likely to bring people together



Different Forms of Social Capital: Obligations and expectations



Suppose A does something to B trusting that B will reciprocate at some point in the future. This establishes an expectation in A for an obligation in B to keep the trust. This obligation can be perceived as a 'credit slip' or promissory note held by A to be redeemed when B performs. If A holds many such promissory notes from several persons, the analogy with financial capital is direct. The promissory notes or credit slips constitute a large pool of credit that A can draw on at leisure. Of course, if the placement of trust by A on B has been unwise, then the credit slips represent bad debt that will not be honored. Generally, there would be a large number of obligations on each side of a relationship



There are however two critical elements of this form of social capital

The level of trustworthiness in the social environment which determines the extent to which obligations will be met.

The actual extend of outstanding obligations, which in turn depends on

- Actual need that people have for help
- Existence of other forms or sources of aid
- Degree of affluence
- Cultural differences in the tendency to seek for and extend assistance
- The degree of closure of social networks
- The logistics of social networking.

Different Forms of Social Capital: Information Potential

- ❖ There is information that inheres in social relations. Such information is important in providing a basis for taking specific actions. Information acquisition is costly. One means of sourcing for information is through social relations that are kept for other purposes. For example, people save time required in reading newspapers by staying close to those who read newspapers consistently. This is a form of social capital that simply provides information that facilitates action

Different Forms of Social Capital: Norms and Sanctions

- ❖ Where a norm exists, it provides a form of social capital. For example, norms that inhibit crime in certain parts of the city of Nairobi make possible for older people to leave their homes without fear. A norm that encourages people to forgo their selfish interest and act at the interest of the larger group is an important part of social capital. Such norms are important in overcoming the public good problem
- ❖ Another example is by Shi (2019): The Role of Social Norms in Old-age Support: Evidence from China
- ❖ Hornuf, L., Rieger, M. O., & Hartmann, S. A. (2023). Can television reduce xenophobia? The case of East Germany. *Kyklos*, 76(1), 77-100.

Different Forms of Social Capital: Authority Relations

- ❖ If A transfers rights of control over certain activities to B, these B has social capital available is those rights of control. If more people transfer similar rights to B, then B acquires an extensive body of social capital in the form of rights of control
- ❖ Concentration of rights to B increases total social capital and can overcome the free rider problem where individuals with similar rights lacks a common authority. That authority gets invested in B

Different Forms of Social Capital: Appropriable Social Organizations

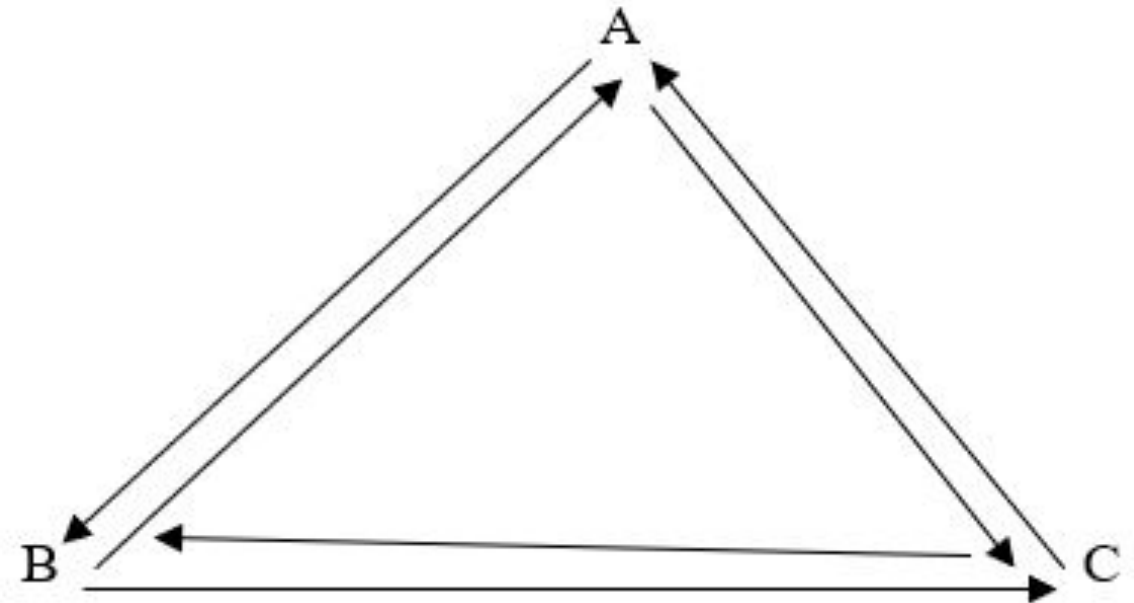
- ❖ When organizations that are established for a specific purpose are used for another, such organizations are considered appropriable. Appropriable organizations constitute social capital that becomes available for many uses. An example is a residents' association put together for the purposes of managing common services but which end up dealing with issues of insecurity and underwriting medical bills encountered by neighbors

Some Typologies of Social Capital

1. Family and kinship connections: these relate to single households, extended families and clans based on strong blood ties or ethnicity. Can also extend to the village and neighborhoods
2. Social networks: associational life related to groups and organizations that link people belonging to different families and kinships brought together by common activities for differing purposes which may be economic, socio/cultural or economic. These approximate the common definition of social capital-networks of civic engagement
3. Cross cultural linkages or contacts that span differences in sectors and power. Can be considered as networks of networks. Generate complementarity in the form of mutually supportive relations

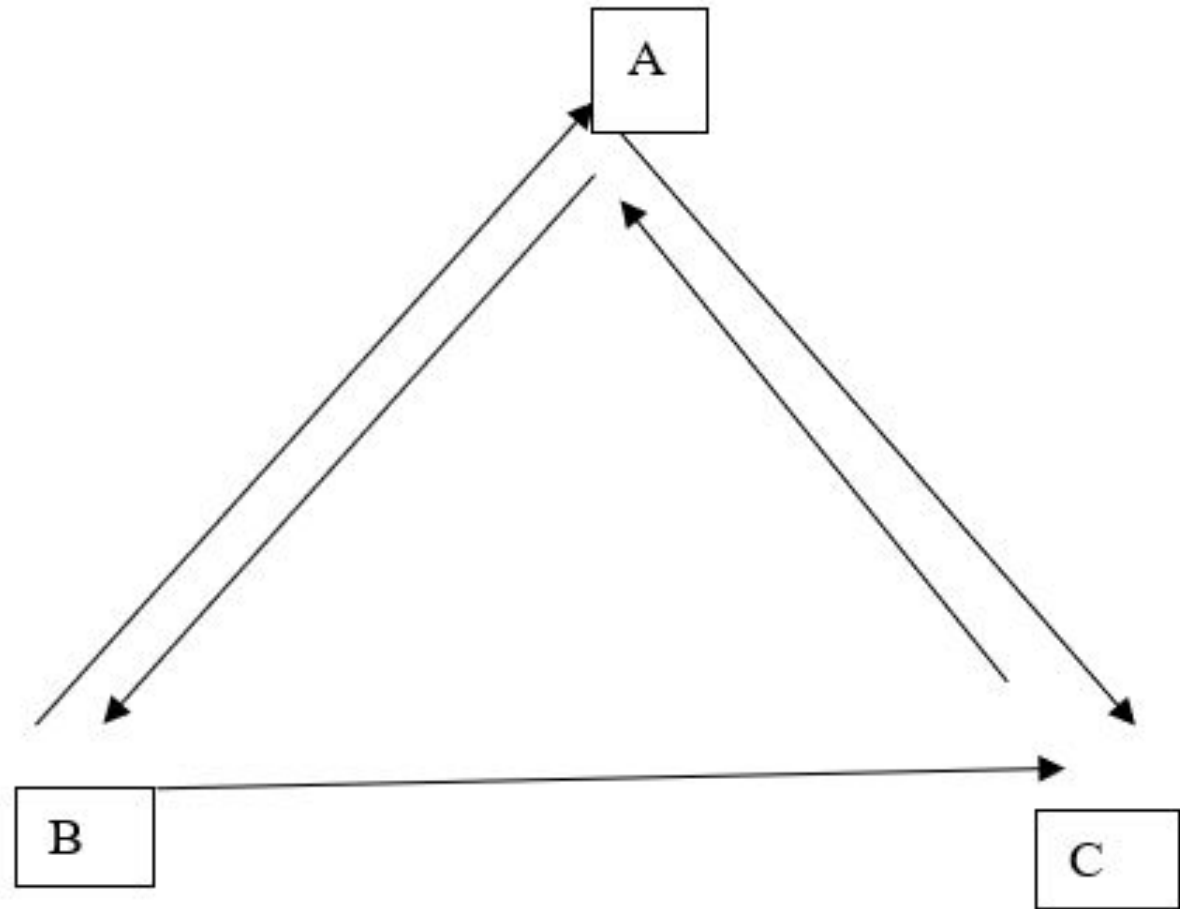
Relative Quantity of Social Capital: Case one

- ❖ This figure represents a 3 – actor system. Arrow running from A to B shows that A is interested in events controlled by B or that A depends on B. Similarly, since an arrow runs from B to A, we can conclude that B is interested in an activity or activities controlled by A
- ❖ Considering other arrows that run in this three actor system, we came to the conclusion that each actor depends on the other



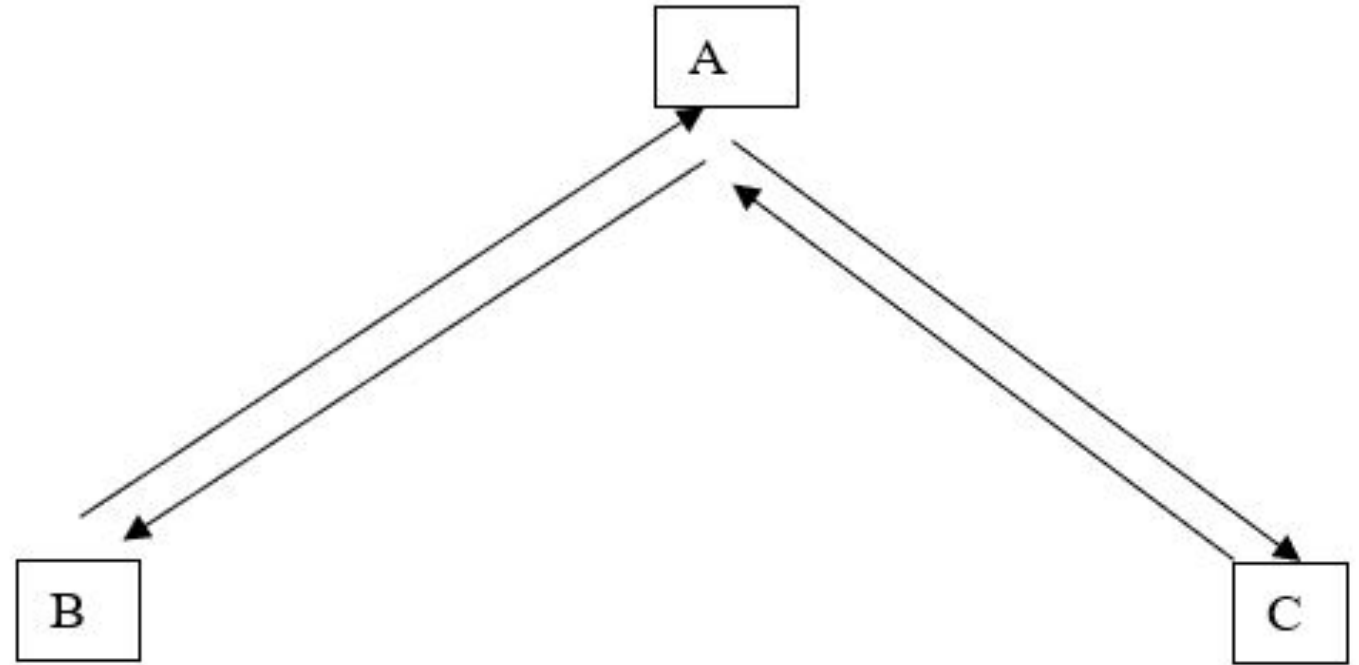
Relative Quantity of Social Capital: Case two

- ❖ But it is possible to define a three-actor system which is slightly different. For example, it is possible to find a system where at least one of the actors is not interested in an action controlled by another actor
- ❖ Note in the figure that although B is interested in an activity under the control of C, C is not interested in activities under the control of B. In other words, there is no reciprocity between B and C and the flow of interest is one directional: from B to C



Relative Quantity of Social Capital: Case three

- ❖ Indeed it is possible to have an interaction where the two actors only meet through a common proxy
- ❖ In this case, B and C do not interact directly. Neither B nor C has any obligation to each other



Creation of Social Capital: Ingredients

- ❖ Closure is important for the creation of social capital because it leads to emergence of norms and trust which is important for further secondary interactions and deepening of social capital. Closure of a social network leads to emergence of norms and generation of trustworthiness
- ❖ Stability of the Social Structure: Every form of social capital depends on the stability. The disruption of social organizations or relations can destroy social capital. Social inventions of organizations having positions rather than persons as elements of the structure provide for stability in the face of instability of individuals. Where individuals simply occupy positions, only the performance of the occupant, not the structure itself, is disturbed by the mobility of individuals. For every social capital, the movement of individuals constitute a potential action that can destroy the structure itself and therefore the social capital depends on it
- ❖ Ideology: Ideology creates social capital by imposing on the individuals who hold it demands that he acts on behalf of someone else rather than himself. For example religious schools tend to have a lower drop out rates than secular schools because of the ideological driven social capital available in religiously affiliated schools
- ❖ Welfare: societies with a high level of welfare the state provides assistance (e.g. social security payments) in the event of (social) problems. That decreases the mutual dependence of persons and has, thus, a negative impact on social capital.
- ❖ Time: Social capital loses value over time like physical or human capital. Concretely, social relations fragment, expectations and obligations lose importance and norms expire

The Public Goods Side of Social Capital

- ❖ As you know, there are broadly three types of goods, namely:
- ❖ Private goods that are perfectly excludable and rival, in that what one person enjoys is no longer available for other persons, and it is possible to exclude others from the consumption of private goods
- ❖ Public goods which are neither excludable nor rival. Where exclusion is possible, it tends to be costly. When people know they cannot be excluded, they tend to be unwilling to contribute to the provision of the good
- ❖ In between goods which are either rival but non-excludable, or excludable but non-rival
- ❖ Social capital is usually non-rival and non-excludable
- ❖ Social capital generates externalities or benefits that go beyond those directly involved in the networking

How does social capital affect economic outcomes?

- ❖ There is growing evidence that social capital, under any of the three definitions, can have an impact on development outcomes — growth, equity, and poverty alleviation
- ❖ Associations and institutions provide an informal framework to organize information sharing, coordination of activities, and collective decision making
- ❖ What makes this work is peer monitoring, a common set of norms and local-level sanctions

Effects of social capital: Information sharing

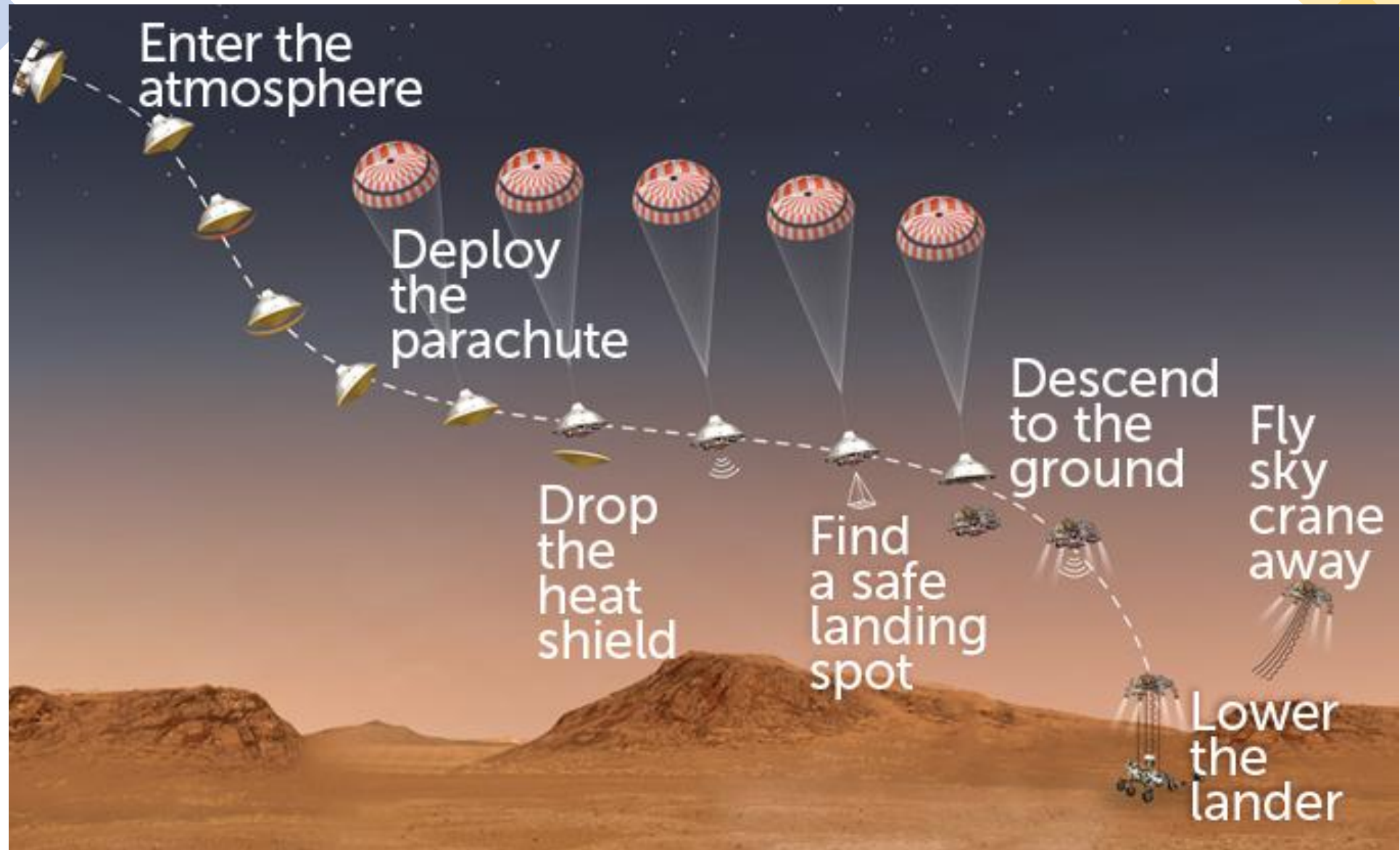
- ❖ Decisions by economic agents are often inefficient because they lack adequate or accurate information.
- ❖ In some circumstances one agent derives a benefit from relaying incorrect information to the other.
- ❖ These situations represent cases of market failure
- ❖ Social capital, under any of its definitions, can contribute to alleviating such failures.
- ❖ Social capital does not remove the uncertainty, but it may create mutual knowledge about how agents will respond to different states.
- ❖ It may also serve as an enforcement mechanism to ensure that these expectations about mutual behaviour are in fact realized.
- ❖ This reduces contracting costs

Effects of social capital: Coordination of activities

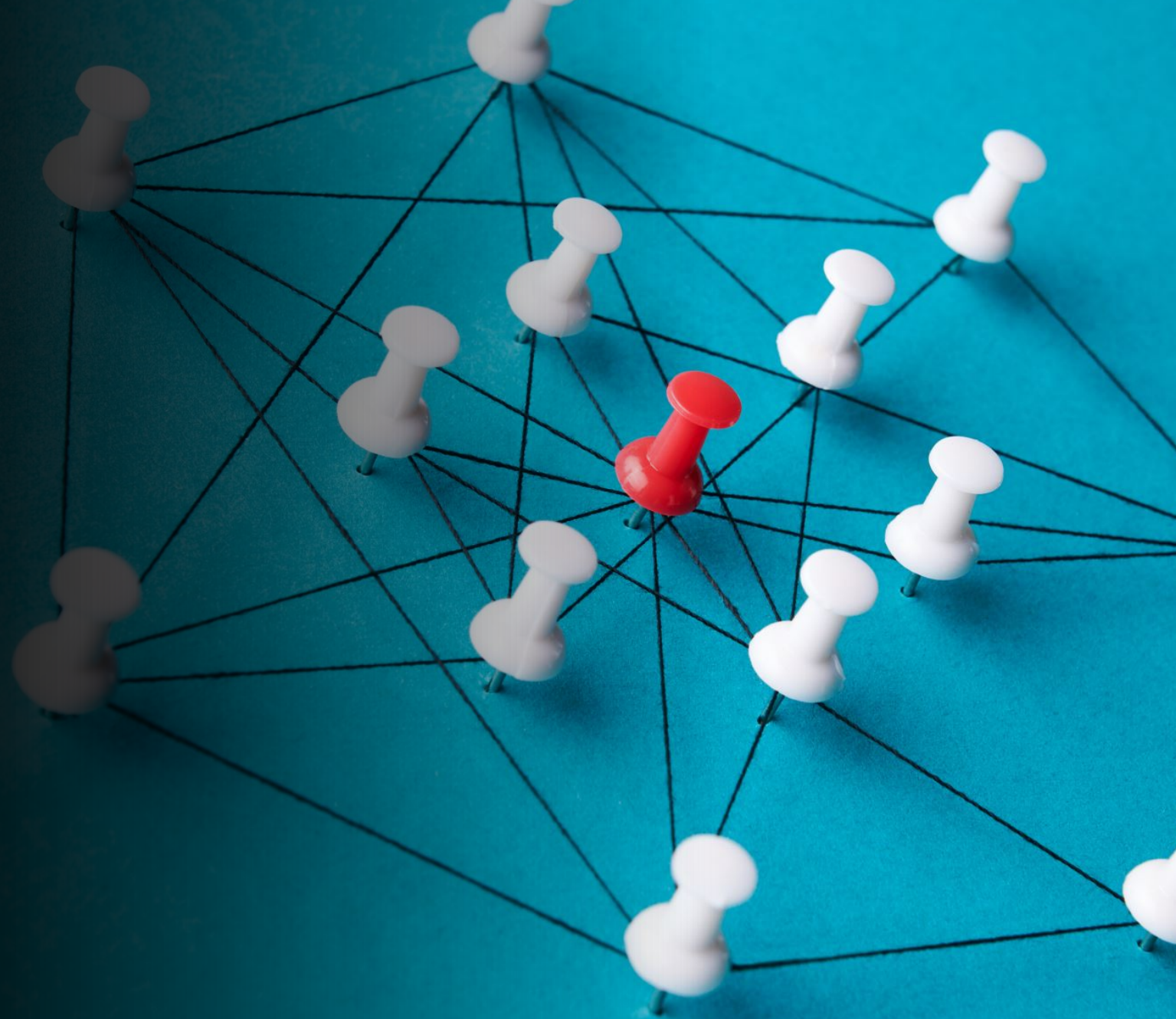
- ❖ Uncoordinated or opportunistic behaviour by economic agents can also lead to market failure
- ❖ This can occur as a result of imperfect information (see above) but also simply because the benefits of not complying with an agreement or an expected line of behaviour (a "norm") are greater than the expected penalty
- ❖ Associations reduce opportunistic behaviour by creating repeated interaction among individuals, which enhances trust
- ❖ One implication of a trust-based functioning of networks and associations is that it is helped by stability of membership and damaged by mobility

Effects of social capital: Collective decision making

- ❖ This is a necessary condition for the provision of public goods and the management of externalities to market processes
- ❖ Some times, government decisions are in the best interest of their constituencies, local and voluntary associations do not always effectively maximize their joint utility
- ❖ The extent to which they do this depends upon how well they address the information and incentive problems. One important aspect of this is equity
- ❖ There is some evidence that local institutions are more effective at enforcing common agreements and cooperative action when the local distribution of assets is more equal and the benefits are shared more equally
- ❖ This then provides a "local" case of how efficiency and equity go together: better sharing provides an incentive for better coordination in managing local public goods, which increases productivity for everyone



Linking social capital with utility theory



Introduction

- ❖ Neoclassical perspective $U = f(x, y)$
- ❖ However, in reality social forces exist bring about shift in the utility function, which shifts could be either upwards or downwards depending the structure of the change in the social forces, just like incomes
- ❖ Suppose we assume, for example, that such social forces are summarized in social capital (we will come back to this concept shortly), represented by s . Then it is possible, at least in theory, to imagine a utility function of the form: $U = f(x, y; s)$
- ❖ In this case, exogenous changes in social capital have the same effect as changes in either x or y
- ❖ Usually, it is assumed that s is complementary to both x and y in consumption. This means that an increase in s increases the marginal utilities of x and y
- ❖ You are more inclined to use a Laptop for class assignments if you classmates also use laptops even if word processing is optional
- ❖ You are also more inclined to wear jeans if your classmates wear jeans

Time-Inconsistency and Social Capital

- ❖ Economists generally assume that people's preferences are **time-consistent**. In other words, we normally assume that people's relative wellbeing at an earlier date over a later date remains unchanged. This assumption implies *an exponential discount function* which in turn means that people's discount rate is constant over time
- ❖ But the reality is that people's preferences can have either a **present bias** or a **future bias**. This constitutes time-inconsistency
- ❖ Most of the literature on time-inconsistency typically models *present-biased inconsistencies*. This means that when considering trade-offs between two future moments, *a strong relative weight is given to the earlier moment as it gets closer*
- ❖ People's actual inter-temporal behavior depends on their level of awareness about their own time inconsistency

Time-Inconsistency and Social Capital

- ❖ Two rather extreme paradigms are used to model this self awareness
- ❖ One is **sophistication** and the other is **naivete**
- ❖ *The sophisticated* are assumed to be fully aware of their time –inconsistency and are therefore aware of their future time inconsistency and *fully anticipate their own propensity to experience preference reversals*
- ❖ By contrast, *the naïve* are *fully unaware of their future time inconsistency and therefore fail to anticipate preference reversal*
- ❖ In between are **the partially naïve** in the sense that they are *aware of their self-control problems but underestimate the magnitude of such self control problems. Put another way, the partially naïve anticipate preference reversal but mis-predict their extent*
- ❖ Those who are sophisticated *voluntarily impose self-limiting commitment-devices that are costly to violate*. Example of such devices include participation in clubs

Summary of time inconsistency

Economic Theory: Assumes that peoples preferences are time consistent i.e. no preference reversals. This not always the case because people preferences can have either a present or future bias	Time consistency: People's preference for relative wellbeing at an earlier date over a later date remains unchanged. People's preferences and time inconsistent	This implies an exponential discount function OR constant discount rate Most models of time inconsistency assume a present bias
Peoples' inter-temporal behavior shaped by levels of awareness about own time inconsistency	Two extreme paradigms about this self awareness	1.Sophistication: people are fully aware about their time inconsistency and probability of preference reversal. 2. Naivete: people are fully unaware about their time inconsistency, fail to anticipate preference reversal
Sophisticates impose self-limiting commitment devices that are costly to violate	- This is where social capital comes in through norms and sanctions	Examples of these are Rotating Savings and Credit Schemes, Christmas clubs



Economics Perspectives of Corporate Social Responsibility

Introduction

- ❖ European Commission (2002) defines CSR as “a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis
- ❖ The World Bank states: “CSR is the commitment of businesses to behave ethically and to contribute to sustainable economic development by working with all relevant stakeholders to improve their lives in ways that are good for business, the sustainable development agenda, and society at large.”
- ❖ Vogel (2005) or McWilliams and Siegel (2001), characterize CSR as “the fulfillment of responsibilities beyond those dictated by markets or laws,” or to “self regulation” as suggested by Calveras, Ganuza, and Llobet (2007)
- ❖ Ideally, essence, CSR is corporate social or environmental behavior that goes beyond the legal or regulatory requirements of the relevant market(s) and/ or economy(s)

Introduction

- ❖ Activities provided under CSR are to be provided by the government as per Classics. Such that the government is to provide public goods or reduction of negative externalities
- ❖ Friedman (1970) argued that the only responsibility of firms was profit maximization and that public preferences combined with democratic empowerment implied that governments, and not firms, should manage externalities and provide public goods
- ❖ Governments are endowed with the necessary democratic legitimacy and have the power to correct related market inefficiencies such as collective action problems or free riding
- ❖ The standard argument goes on to state that private firms do not have sufficient incentives to efficiently internalize the costs they cause, but they will comply with regulation or taxation

Why should private firms engage in CSR?

- ❖ Due to the doing well by doing good concept (to enhance profitability and firm value)
- ❖ Due to doing good by doing well (only well-performing firms that can afford to invest in CSR)
- ❖ For employee satisfaction, environmental protection , corporate philanthropy , or consumer satisfaction
- ❖ Refer to Kitzmueller and Shimshack (2012) and Liang and Renneboog (2017) for more details

Some empirical works on Social Capital

- ❖ Ajwang, F. (2020). Relational Contracts and Smallholder Farmers' Entry, Stay and Exit, in Kenyan Fresh Fruits and Vegetables Export Value Chain. *The Journal of Development Studies*, 56(4), 782-797.
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- ❖ Fuchs, A., Rose, A. K., and Schmidt, S. S (2020): Is Davos More Than a Boondoggle?
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Some empirical works on Social Capital

- ❖ Macchiavello, R., & Morjaria, A. (2015). The value of relationships: evidence from a supply shock to Kenyan rose exports. *American Economic Review*, 105(9), 2911-2945.
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- ❖ Li, J., Liu, H., & Xie, Q. (2023). Bilateral relations and exports: Evidence from Google big data. *China & World Economy*, 31(1), 182-210.
- ❖ Safarzynska, K., & Sylwestrzak, M. (2023). Impact of bridging social capital on the tragedy of the commons: experimental evidence. *Journal of Institutional Economics*, 1-20.

The bad side of social capital

- **Exclusivity:** When market enthusiasts proclaim that one person's money is as good as any other persons in the marketplace, it is anonymity they invoke. In allocation mechanisms governed by networks, however, 'names' matter. Transactions are personalized. This, as has been noted, implies inefficiencies; resources are unable to move to their most productive uses
- **Inequalities:** The benefits of cooperation are frequently captured by the more powerful within the network.
- **Exploitation Within Networks:** That there can be exploitation in long-term relationships should not be doubted. In Indian villages, access to local common-property resources is often restricted to the privileged (e.g. caste Hindus), who are also among the more prosperous landowners. The outcasts (euphemistically called members of 'schedule castes') are among the poorest of the poor

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