

## Entrepreneurial strategies and trust: structure and evolution of entrepreneurial behavioural patterns in "low trust" and "high trust" environments of East and West Europe; part 1, a review

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## **Entrepreneurial Strategies and Trust**

**Structure and Evolution of Entrepreneurial Behavioural Patterns in “Low Trust”  
and “High Trust” Environments of East and West Europe**

**Part 1: A Review**

**Hans-Hermann Höhmann and Friederike Welter (editors)**

## **Arbeitspapiere und Materialien – Forschungsstelle Osteuropa, Bremen**

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Part 1: A Review

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## **Preface**

The following three papers review the role trust plays in determining the behaviour of small businesses in different institutional and socio-cultural environments in Eastern and Western Europe. All three papers represent contributions within an international project titled “Entrepreneurial strategies and trust: Structure and evolution of entrepreneurial behavioural patterns in East and West European environments” (2001–2003). Höhmann/Welter review theoretical concepts of trust in the light of results from the empirical work carried out within this project. Welter et al. review the role trust has at different stages of business development, in intra- and inter-firm relations and in different environments, whilst Kautonen et al. discuss approaches to measure trust. In addition, an extensive bibliography of academic publications related to the project has been compiled by Elena Malieva with Teemu Kautonen and Nina Slaby.

The research has been conducted by an international team. Prof. Hans-Hermann Höhmann, Research Centre for East European Studies at the University of Bremen and PD Dr Friederike Welter, Rhine-Westphalia Institute for Economic Research (RWI) in Essen, Germany are the project co-ordinators, team members are Elena Malieva, Teemu Kautonen and Dr. Bernd Lageman. The Russian Independent Institute for Social and Nationalities Problems (RIISNP), represented by Dr Alexander Chepurenskiy, is the Russian project partner. In Estonia, the research is performed by Prof Urve Venesaar from the Institute of Economics at the Tallinn Technical University. The studies in Italy and Great Britain are conducted by Prof Gabi Dei Ottati, University of Florence and Prof David Smallbone and Fergus Lyon, Centre for Enterprise and Economic Development Research (CEEDR) at the Middlesex University Business School.

We gratefully acknowledge support by the Volkswagen Foundation, which funded this research within its programme “Unity amidst variety? Intellectual foundations and requirements for an enlarged Europe”.

## Trust and Entrepreneurial Behaviour – A Comment

### Setting the stage

#### Distinguishing between personal, collective and institutional trust

With respect to conceptualizing trust, one important aspect refers to *forms of trust*. Williamson (1993) distinguishes between personal trust which he however limits to non commercial relations, risk, which characterizes commercial transactions, and institutional trust, which refers to the social, cultural, political and organizational embeddedness of economic transactions. Other authors differentiate forms of trust according to their evolvement. For example, Raiser (1999) identifies trust based on processes, based on kin-ship relations and extended or generalized trust, which allows us to enter into relations with unknown partners.

In our research project we set out to distinguish between personal, collective and institutional trust. For *personal trust* “a record of prior exchange, often obtained indirectly or by imputation from outcomes of prior exchange, provides data on the exchange process” (Zucker, 1986: 60). In other words, trust builds on initial knowledge about the partner. Personal trust may depend on the characteristics of a group such as a ethnic group or kinship, but it also occurs in bilateral (business) relationships, often longstanding ones, where persons have come to know each other. In both cases, they know or assume that the partner/friend will not behave in a way detrimental to the relationship, even when there are no written or explicit rules set out. That means, these kind of relationships are governed by informal norms and rules.

*Collective trust* could be based on the initial knowledge of a person, but it also refers to group behaviour in a wider sense. In this context, shared norms and mutual business conventions, which differ across sectors or business groups, play an important role in shaping business relationships. Trust occurs where the participants value the reputation of their commercial partner against the possibility of him or her breaching these goodwill-based agreements. However, the borders between personal and collective trust are blurred. It is not (always) easy to distinguish between both types of trust.

*Institutional trust* refers to the institutional environment, both to the formal organisations, sanctioning mechanism and informal codes of conduct and values. Contrary to collective norms and values, the institutional ones apply across different sectors and business groups. Institutional trust is essential for an efficient market economy. In an economy dominated by institutional trust agents enter into transactions with only limited information about the partner’s specific attributes (Raiser, 1999). In other words, the scope of trust extends beyond the number of people we know personally (Putnam, 2000). In this regard, institutional trust allows for the use of ‘anonymous’ sources in business relationships (such as new partners, or consultants for business assistance), because there are legal safeguards and sanctions in case the relationship fails. Again, collective and institutional trust have no clear cut boundaries, because collective trust also relies on informal rules within a certain group such as a sector.

#### Operationalising our trust concepts

These three trust concepts guided both the design of the survey questionnaire and the case study guidelines within our research project on entrepreneurial strategies and trust in East and West Europe. For interpreting our results, we *proposed that the following situations could reflect the use of personal trust*:

(1) Entrepreneurs govern business relations informally. This implies that they do not necessarily use (written) contracts, employing person and reputation-based criteria for deciding on new deals. They also do not regulate credit relationships formally. Moreover, they use informal criteria when recruiting new employees. On the whole, personal contacts play an important role in developing, governing and enforcing business relations within and between firms. We also might expect differences in governance behaviour in those cases where friends are clients or suppliers.

(2) Entrepreneurs prefer informal sources such as family, friends or business associates when looking for information, advice and assistance, or credits. They also prefer informal and person-based criteria (such as personal knowledge of the business partner) in order to decide on new business partners or deals. When addressing the business environment (e.g., dealing with authorities), entrepreneurs often use third parties they know such as friends and business associates.

(3) Decision making within the firm is regulated informally. Moreover, entrepreneurs have a high regard for employees' creativity and initiative. There is no explicit or felt need on behalf of the entrepreneur to control his/her employees.

Most of what has been said above with regard to cues and situations reflecting personal trust, more or less also applies to *collective trust*, although it is difficult to distinguish between personal and collective trust. For example, there might be personal trust when somebody relies mainly on informal information channels in selecting business partners. But this could also indicate collective trust, especially where this selection is not based on personal knowledge, but on third party recommendations or the new partner's reputation. Collective trust is especially apparent in those cases, where entrepreneurs rely on sector-specific business conventions. When selecting new business partners, or when dealing with contract breaches, they then would draw on unwritten rules in their trade or sector.

*Institutional trust* appears difficult to capture empirically. This applies especially to our research project, which concentrated on analysing trust in entrepreneurial behaviour, thus operating on a micro level. Therefore, we mainly used an indirect approach in operationalising this trust category. In our survey and case study material, institutional trust is indirectly reflected in different ways. These include a larger reliance on formal governance mechanisms, relying on courts when enforcing contracts, turning to more 'anonymous' sources such as business support agencies or banks when asking for assistance or credits respectively.

To sum up, whilst personal and collective trust are characterized by the predominance of informality, institutional trust is characterized by a priority of formality. In this regard, trust appears both as an ingredient of human behaviour and an element of the environment where entrepreneurs behave in.

## Looking back: some troublesome questions

The empirical results from all participating project countries led us to review our conceptual background and initial propositions. The discussion within the project group focused on several 'troublesome' questions, where the empirical results appeared to indicate shortcomings of our initial concepts.

A *first problematic area* concerns the topic of *conceptualising and measuring trust in entrepreneurial behaviour*. Three questions occurred:

(1) *Has trust been confirmed as a crucial element of entrepreneurial behaviour that could clearly be identified?*



Empirical results from all project countries indicate that trust exists and that it can influence forms of entrepreneurial behaviour. Russian results also show that the roles for different forms of trust appeared to have changed over time. Personal trust, originating from ‘non-business’ relations with relatives, friends, etc. has lost its relevance as transition progressed. This is reflected in survey results, which show that up to three quarters of the surveyed entrepreneurs did not need any longer to turn to friends and close business partners when starting their venture. On the other hand, personal trust, which emerges from long-term and stable relationships with clients and/or customers, plays an important role – especially, in determining terms of contracts or preferring partners for new deals. In this regard, trust appears a crucial element for entrepreneurial behaviour. However, our research methodology, does not allow us to quantitatively assess the importance of trust in entrepreneurial behaviour.

(2) *Was it possible to discern different types of trust (personal, collective, institutional) in an analytically sufficient way?*

Empirical results allow for the conclusion that there was *no difficulty in identifying* the category ‘personal trust’ in entrepreneurial behaviour. Case study evidence in Germany illustrates this clearly. For example, entrepreneurs during venture creation frequently draw on friends to find their first customers. The empirical work in NE England also demonstrated the role of personal trust in relation to the sharing of information; helping others to generate ideas; assembling resources, using network links (that are sometimes latent and/or used intermittently) for the purpose.

Empirical results are *less clear with respect to the category of collective trust*, which is difficult to discover. This is partly due to our unclear concept, partly due to the empirical methodology. Based on North’s institutional theory, Chepurensko suggests a further distinction, namely, classifying collective trust as containing mainly informal elements (norms, values, conventions) and institutional trust as being mainly formal. Whilst this draws on our operationalisation of both concepts for the survey, this differentiation does not solve the underlying problem, i.e., the lack of conceptual clarity.

Instead, our results might lead us to conclude that we better ‘merge’ the concepts of personal and collective trust, instead distinguishing different elements and layers of personal trust and their role for entrepreneurial behaviour.

- In this context, the UK colleagues Smallbone and Lyon pointed out that the concept of personalised trust based on pre-existing relationships, membership of particular communities, or through brokers/guarantors remains important. Norms and business conventions of a particular community can also shape how personalised trust is built up and relates to collective trust. There is a clearer distinction between personalised and institutional trust; both of which are based on, and built up from, a number of processes. The most important of these are working relationships based on learning and secondly collective relationships (membership of a work or social community, and relationships with intermediaries, brokers, guarantors).

*Institutional trust is visible* (or non-visible in those cases where it still does not exist, such as Russia) from the empirical results. The empirical work in NE England also suggested that trust in formal institutions such as Chambers appears less important in an UK context than trust between individuals. This backs up previous results of Bachmann (2001), who indicated that personal relationships carry more weight in the deregulated British environment, compared to Germany. However, case study results from all countries also demonstrate that even in a functioning institutional environment institutional trust needs to be complemented by personal trust. This especially applies to entrepreneurs who deal with sensitive data such as in accountancy, or in some computer business, for example, when designing customized computer software.

(3) *Are there indications that the level of trust and its impacts on enterprise behaviour can be measured by quantitative instruments?*

The answer is yes and no. Our *survey* data allows us to measure the *prevalence of forms of trust-related enterprise behaviour*, such as oral agreements, advice from friends, credits from family and vice-versa. Our survey data also allows us to assess the importance of trust in business behaviour, but only as evaluated by entrepreneurs themselves. However, we *cannot measure the level of trust*. We also cannot measure the quantitative impact of trust on enterprise behaviour (see comment to question 1). In this context, we conclude that any attempt to measure trust quantitatively needs different survey instruments. However, there is no conclusive answer whether we need to measure trust quantitatively in order to determine its impact on enterprise behaviour.

The *second troublesome area* concerned *levels of trust and trust-related typologies* for analysing the role of trust in entrepreneurial behaviour. Again, there are three important questions:

(4) *Is it possible to discern regions or sectors according to their level of trust and how could this be done?*

This question refers to the sectoral and regional embeddedness of entrepreneurial behaviour and trust. For example, sector determines payment regimes and contract arrangements. Case study evidence from Germany clearly illustrate this. Work in NE England also shows considerable sectoral variation in the level of involvement of firms in sector-based associations and organisations, which are one of mechanisms for developing trust-based relationships.

- In this context, Smallbone and Lyon suggest, that we should think in terms of the importance attached to personal trust and the importance attached to institutional trust in a particular milieu or sector, as the balance between PT and IT is not necessarily a zero sum. Sectors/milieu could be classified based on the frequency or use of different types of relationships and the risk involved in each relationship.
- The Russian colleague developed ideas for quantitative indicators, in order to measure trust levels across sectors and regions. In his view, institutional trust could be measured by the quotient “% of those who estimated a share of shadow business <25% / % of those who estimated this share between 75% and 100%”. Personal trust could be measured by different indicators:
  - PTEP (personal trust in established partners): share of those who had to give collaterals for all or more than 50% of a credit / those who did not give collaterals or less than 50%;
  - PTC (pt in customers): share of those who offer credit to customers / share of those who only set cash payment on delivery or bank transfer;
  - RI (reputation indicator): share of those who were offered supplier credits / the share of those where supplier prefer advance payments;
  - NBDTI (new business deal trust indicator): share of those who relies on familiarity with partners when deciding on new deals / share of those who prefer advance payment (v220) and who relies on guarantees.

Whilst this is an intriguing concept, we need to carefully check the sample, ensuring that enough entrepreneurs answered the relevant questions. As Chepurensko rightly points out, our sample is relatively small, thus not allowing for generalizations. Moreover, using these one-dimensional indicators we are in danger of oversimplifying. A better idea could be the construction of composite measures, taking together several relevant questions.

(5) *Is it possible to identify the interdependencies between the role of trust and other factors (constraints) influencing enterprise behaviour?*

In principal, the answer is yes. But again, this is not possible with our survey material. Instead, this relies on a process-based investigation of the emergence of trust, which asks for a different research design than we employed, namely a longitudinal one. For example, empirical work done in NE England and evidence from the cases in Germany suggest that personal trust in

business relationships typically develops through trial and error and people *learning* to trust each other. Thus, personal trust in business partners often is linked (not surprisingly) to long-standing relationships. Mutual respect is necessary for personal trust to develop, which could evolve through, e.g., repeated sales. People have come to know each other.

- The research from Italy, which concentrates on one industrial district, shows that trust becomes important from an economic point of view whenever there is a risk associated with the behaviour of the other party. As this risk and the loss associated with an opportunistic behaviour is increased by specific investments of some kind (machinery, human capital), a market transaction that requires some specific investment from one or both parties is associated with trust relations. Also uncertainty is a factor, which increases the need for trust: the variability of demand requires adaptations to unforeseen contingencies that are difficult and too costly to handle without relying on trust-based relations.
- The British colleagues add that we might think about distinguishing the development of 'organisational' trust over time, based on experience, which may be sustainable over time even if personal links are broken. This may involve relationships between two individuals leading to relationships between other individuals within a firm, resulting in a range of personalised relationships linking two organisations. In principle, David thinks it may also lead to a level of trust developing in a firm or organisation that goes beyond that between 2 individuals, based on a long term relationship.

*(6) Are there specific constellations of these factors?*

With regard to this question, the answer is yes. Evidence from all country reports clearly illustrate the local and sectoral embeddedness of entrepreneurial behaviour, which in turn influence the role trust plays for entrepreneurship.

A *third troublesome area* is related to the emergence of trust and our empirical data: *(7) Were processes of growth or decline of trust discernible and which factors influenced such developments?*

This question is difficult to answer. Our survey data allows for an indirect analysis, based on our concepts. One such example would be to use indicators such as the changing importance of sources of advice during business development. Here, the use of informal sources during business start would reflect personal trust, whilst the use of formal sources in later stages of business development would reflect institutional trust. However, this change does not necessarily imply either a growth in institutional trust or a decline in personal trust. On the contrary, learning throughout business development also might explain this result. Case studies and key expert interviews give additional insights. For example, the Russian evidence appears to demonstrate overall growing trust into the institutional environment during the transformation process, which represents a growth from 'zero-level'.

Although the cases provided some insights into the emergence of trust, conclusive evidence to answer question (7) is lacking. This applies especially to the factors of influence in the growth or decline of trust. All we can offer at this stage is a general assessment of potentially important factors. *Growing trust* partly stems from deepening business relationships, but also from the necessity to have to trust. Groups such as business associations or sectors might act as facilitators, 'prescribing' specific (often implicit) rules for business deals (in theoretical terms these reflect North's informal institutions).

- Related to this is dei Ottati's suggestion that there is an *asymmetry* between growth and decline. Trust would usually grow step-by-step, i.e., slowly. On the contrary it could be destroyed rather quickly. If deviant behaviour cannot be fully explained immediately by referring to external factors, a spiral of suspicion is set in motion and distrust is engendered. Besides direct personal contact, time is therefore an important factor in developing trust relations.

- Dei Ottati also draws attention to the importance of looking at external conditions. In her view, adverse *external conditions* such as a prolonged recession might trigger a process of unfair competition among entrepreneurs in a region, a district, or sector. In these circumstances, it is difficult to distinguish whether the attempt to cut costs, for instance, is due to external pressure or to an unfair use of market power. Moreover, if deviant behaviours are increasing and are not sanctioned, collective trust based on shared norms of behaviour will quickly vanish. Also in this case formal institutions, which allow to sanction deviant behaviour, are needed.

In this context, a cross-sectional empirical approach clearly has its limitations. This mainly refers to a restricted dynamic orientation in researching trust processes, the changing nature of trust and the reasons for (not) trusting one another in business relations. With respect to our question, this again implies that we need more process-oriented qualitative insights.

The *fourth 'troublesome' area* contains two questions with respect to the surveyed entrepreneurs:

*(8) Did interviewed owners/managers accept the importance of researching trust?*

Evidence from England and Germany indicates that trust seldom is considered explicitly by the interviewed entrepreneurs, as it is largely habitual behaviour. Case study evidence from all countries also demonstrates that all interviewed entrepreneurs appeared to have accepted the importance of researching trust. Russian evidence additionally shows that some of them even exaggerated it, which can be put down to a lack of entrepreneurial experience.

*(9) Were entrepreneurs inclined to pretend to trust?*

This question is difficult to answer, but more likely they did not pretend. Both survey and case study guidelines were carefully phrased in a way, which was aimed at excluding this option. When conducting case interviews, an experienced interviewer often can tell where entrepreneurs report 'half-truths'. But again, as trust is habitual behaviour, it is difficult to identify why entrepreneurs seem to know "what it is that may make his business partner appear to be trustworthy" (Bachmann, 2001: 357).

## Looking forward: Lessons learned and further research topics

*Results and concepts:* The empirical results so far suggest that personal trust is typically based on an element of both calculation and habitual action, influenced by assumed norms of behaviour. This is in line with previous research studies. In general, institutional trust needs to be backed up by personal trust, except where contracts involve standardised goods. Evidence from all case studies suggest that many inter-firm relationships combine elements of institutional and personal trust.

*Methodology:* We designed the project using a cross-sectional methodology and combining a survey, case studies and expert interviews. However, as already stated above, some of our empirical results cast doubt on the value of a survey for this topic, especially in terms of analyzing and measuring different trust categories and trust levels across firms, sectors, regions. For example, for Germany we need to question the apparent role of the written contract as a safeguard and of oral or no agreements as standing for personal trust, because case studies revealed that written agreements often were needed for bookkeeping and internal revenue.

In retrospect, it might have been better to have concentrated on a longitudinal case-study approach. A survey researching trust in entrepreneurial behaviour is only really useful in reporting how frequently or common particular forms of trust-based behaviour are. A longitudinal case study approach would have allowed us to better capture the process nature of trust-based relations and their value for entrepreneurship and to gain deeper insights in their emergence.

**Further research:** One issue that could be more systematically investigated is the *experience and 'trust' that exporters have in foreign institutions*. For example, the evidence from North Eastern England indicates that where entrepreneurs lack trust in foreign institutions, they either find intermediaries that can have contracts under British Law or demand payment in advance.

Another potential topic arising from our results relates to the *evolvment of trust in business relations, e.g. to the cognitive processes involved*. Question here could refer to how much knowledge of the other person is necessary in order to develop trust, what is the influence of different environmental conditions, when is trust destroyed, etc. The environment might well play a decisive role insofar, as personal trust appears to develop quicker in certain environments (such as ethnic groups, or within business associations or certain regions), whilst naturally institutional trust is slower to develop, especially in fragile environments, and vice versa.

A methodological topic results from the discussion above on how to measure trust. Developing indicators and applying them to our research results might broaden (maybe even contradict) our current views on local, sectoral and national trust levels. Moreover, this would allow us to make cross-national comparisons in those project countries, where we conducted empirical surveys, i.e., Estonia, Russia, Germany.

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## **Trust in Enterprise Development, Business Relationships and Business Environments – a Literature Review**

This paper is concerned with the role trust plays in different stages of enterprise development and in business relationships, in particular also with respect to different environments. Trust is considered to perform two functions relevant to this topic: On the one hand, it reduces uncertainty through providing information (e.g. Lewis & Weigert 1985, Sztompka 1999), while on the other hand it provides a mechanism for coping with opportunistic behaviour (e.g. Bradach & Eccles 1989, Nooteboom 2000). Both of these functions contribute to the reduction of transaction costs, thus making the concept of trust interesting in economic terms.

The economic analyses of trust have often used the theoretical framework provided by the New Institutional Economics (NIE) (see Frambach 2003 for an overview). Within this broad framework, the agency theory, Transaction Cost Economics (TCE) as well as Douglass North's (1990) theory of formal and informal institutions have been used to analyse trust from different economic perspectives. In the following review, specific attention is paid to the social and institutional embeddedness of both trust and entrepreneurial behaviour. The absence of embeddedness has been presented as perhaps the most important criticism of NIE in particular by economic sociologists (e.g. Granovetter 1985, Swedberg & Granovetter 2001, Zukin & DiMaggio 1990).

The paper sets forth to review relevant literature and empirical studies, in order to analyse the role of trust for different aspects of entrepreneurial behaviour as well as in different stages of business development. After briefly discussing definitions of trust, we concentrate on reviewing literature firstly with regard to the role trust plays for new ventures and during business growth, secondly trust in intra- and interfirm relationships as well as relations with third parties within the business environment (personnel, supplier, consumer, cooperation, credit relations, assistance used, etc.) and thirdly reviewing the nature and extent of trust in different environments.

### **Defining trust**

Since trust has been studied by several disciplines such as economics (e.g. Dasgupta 1988, Williamson 1993), business management (e.g. Ganesan & Hess 1997, Sako 1992), philosophy (e.g. Baier 2001), political science (e.g. Hardin 2001, Offe 2001), psychology (e.g. Becker 1994) and sociology (e.g. Coleman 1990, Luhmann 1988), there is no single comprehensive *definition of trust* in the literature. Several authors (e.g. Borch & Arthur 1995, Lane 1998) recommend an interdisciplinary approach for an adequate analysis of trust as an economic phenomenon. Following this proposal, we approach trust by combining economic, psychological and sociological theories and concepts.

Gambetta (1988) defines trust as an expectation of beneficial or at least non-harmful behaviour when this behaviour is not controlled. The condition that the behaviour is not controlled is essential to the concept of trust, for complete control would make trust redundant (Dasgupta 1988). Lack of control reduces the predictability of future events and thus causes uncertainty. However, if uncertainty is complete, also in this case trust is not a feasible concept. As Lewis & Weigert (1985) point out, under complete uncertainty one can gamble but not trust. Therefore, trust appears to require some information to be based on in order to be viable. If, based on the available information, we decide to trust, we implicitly assess that 'the probability that [the trustee] will perform an action that is beneficial or at least not detrimental to us is high enough for us to consider engaging in some form of co-operation with him' (Gambetta 1988: 217).

Since we are talking about probabilities, there is also a certain level of risk involved in the trust decision. Risk is understood as ‘the probability of adversity related to our own actions, due to our own commitments’ (Sztompka 1999: 30). The concept of risk assumes that the actor has a free will whether or not to accept the risk (Gambetta 1988). It is this element of active decision of accepting risk that distinguishes trust from confidence, which is a more passive form of faith that something good will happen (Sztompka 1999). Thus when confidence is let down, it is attributed to external factors (e.g. the economic situation did not improve after all), but when trust is let down, it is attributed to one’s own decision to accept the risk and can be regretted (Luhmann 1988).

In sum, building on the preceding discussion, trust can be defined as a voluntary bet with a certain degree of risk. The trust decision also involves certain stakes, i.e. how much can be won or lost by trusting. The resulting ‘bets of trust’ may be classified as more or less prudent depending on two factors (Sztompka 1999): First, the risk of trusting, i.e. the probability that the trustee will act in a trustworthy manner and, second, the value of what is at stake, i.e. what can be gained if trust is kept and what will be lost if it is let down. In general, it appears prudent to avoid high risks and imprudent to waive opportunities with a low risk. However, if the value of the possible gain is sufficiently high, even a high-risk bet may be prudent. Or similarly, if the value of the possible loss is high, it is prudent to engage safeguards even if the risk of trusting were low.

A central question is to find out *under what circumstances to trust or distrust* (defined as the opposite of trusting)? This argument also implies that both trust and distrust have their functions and dysfunctions – it is equally functional to trust the trustworthy as it is to distrust the untrustworthy (Coleman 1990, Sztompka 1999). The approach adopted here gives information a central role, assuming that ‘trust cues’ from different sources provide the basis on which the risk of trusting is assessed. From a cognitive perspective we can argue that economic actors build their knowledge through perception by connecting external impulses to existing cognitive structures, i.e. to their mental maps (Koch 1998, Schwenk 1988). Therefore each piece of new information – in this case each new trust cue – is interpreted based on already existing knowledge, resulting in a dynamic and path-dependent process. Furthermore, following Kirchgässner (1998) it is assumed that individuals act rationally given the information that they possess. Different from the common use of ‘bounded rationality’ (Simon 1955), the concept of subjective rationality emphasises individual perception and the dynamic, cumulative nature of the knowledge on which the trust decision is based. This implies that the risk assessment in the trusting decision is rational, but only subjectively so. The trusting behaviour may well appear irrational to an outside observer.

In this context, a major debate in the trust literature concerns the *motives for trustworthy behaviour*. Whilst some authors see trust as based on risk calculation (e.g. Coleman 1990, Williamson 1993), others stress goodwill trust (Sako 1992, Nooteboom 2000). Other conceptualisations in this context include for example egoistic and non-egoistic trust (Williams 1988) as well as self-interested and socially-oriented trust (Lyons & Mehta 1997). Despite of the multitude of concepts, the essential debate has concerned a self-interested behavioural model and a more socially oriented one that allows for a degree of goodwill (see Lane 1998 for an overview). However, it is very difficult to distinguish between self-interested and altruistic behaviour (as implied by the notion of goodwill) both empirically and conceptually. Therefore we accept Kirchgässner’s (1998) argument that the assumption of self-interested orientation usually provides a true description of our (economic) behaviour, given that we also allow for social orientations to be included in the business motives. According to this behavioural model, social orientations such as a friendship are assumed a value of their own in business relations. Thus, refraining from opportunistic behaviour because the business partner is a friend can be interpreted as a self-interested preference of maintaining the friendship, which is valued higher than the potential benefit produced by opportunistic behaviour at a certain point of time. However, at some other

point of time a “golden opportunity” (Dasgupta 1988) may emerge, which changes the balance between the two values and leads to opportunistic behaviour.

To sum up the discussion so far, we understand trust as a bet, which is voluntarily placed, subjectively rational and motivated by self-interest. It involves both a certain level of risk as well as a certain level of possible gain or loss. The assessment of the trust situation is subject to the individual's knowledge about the restrictions relevant to the trust decision. Since this knowledge is dynamic and path-dependent, also trust is considered dynamic and path-dependent.

## Trust in different stages of enterprise development

Few studies have researched the role of trust in creating and developing a new venture. Most related research has focused on the importance of social networks for venture creation and business growth. This allows us to assess the role of trust in an indirect way, as social networks reflect a certain degree of personal trust. Moreover, networks assist a new venture in creating legitimacy, thus helping to establish a new venture on the market. In this context, we review studies on networking in different stages of business development to discuss the potential role of trust and its importance during venture creation, survival and business growth.

Many research studies have demonstrated that networks are important during the establishment, development and growth of small businesses (e.g. Brüderl & Preisendörfer 1998, Chell & Baines 1998, Jenssen 2001, Shaw & Conway 2000). Social networks play a role for example in mobilising complementary resources, getting support and help, and establishing viable business relations (Greve 1995). In a review on business networks, Blundel & Smith (2001: 37) conclude that during venture creation most entrepreneurs rely on informal sources in their personal networks in order to mobilise resources, especially so before the venture is set up. Here, in their sample for German business founders in Bavaria, Brüderl & Preisendörfer (1998) found support from strong ties more important for enterprise survival and success in the venture creation stage than that from weak ties. In his study of 106 Norwegian entrepreneurs, Greve (1995) found that while it is important for entrepreneurs to maintain a number of weak ties in order to obtain non-redundant information (see also Burt 2000), it is also important to belong to a relatively dense network, where the relationships contain trust. Trust, the author argues, is important in the foundation process in particular because the entrepreneurs have to discuss their idea with several people, whereby the risk of one of these people copying the idea arises.

Jenssen (2001) analyses the impact of social networks on start-up success, using a sample of 100 Norwegian enterprises. He shows that social networks have both a direct and an indirect effect (through access to resources) on the degree of start-up success. This applies especially to the number of initial weak ties and emerging strong ties. Jenssen also emphasizes the role networks play in creating legitimacy for new ventures. This is directly trust-related, as the lack of legitimacy reflects a lack of trust insofar as new firms are not known, therefore not being ‘trusted’ by their potential customers and suppliers. In this context, Aldrich (2000: 217) indicates that successful new entrepreneurs are more likely to build networks of trust, which assists them in creating legitimacy within the market. He refers to an earlier, unpublished paper by Gartner & Low (1990), where the authors argue that ‘organizations emerge when entrepreneurs are successful in achieving an understanding among the trusting parties – potential customers, creditors, suppliers, and other individuals and organizations – that things will work out’. This is done through trust-building activities, which thus gain particular importance during the venture creation stage.

Such trust-building activities during venture creation are even more important for innovative new entrepreneurs, who bring new forms or activities into a market (Aldrich 2000: 218). Aldrich points out that these entrepreneurs are likely to find themselves in a bootstrapping situation, where they have to develop an identity as a trustworthy person. This happens through en-



entrepreneurial actions, with clients, customers and suppliers trying to make sense of the entrepreneur's behaviour as they observe his/her market entry. Trust-building might be hampered throughout this process because people perceive and assess entrepreneurial actions differently. Here, Gartner et al. (1992) stress that entrepreneurs need to act in a meaningful and, albeit seemingly risky, responsible way in order to be able to build trust and an entrepreneurial identity.

Moreover, Jenssen (2001) points to differences between networks during venture creation or the pre-start up phase and those, which the entrepreneur develops later. Personal relations and contacts play an important role not only to establish new firms, but also to develop them, although this apparently has mixed consequences for business growth (Blundel & Smith 2001). Most empirical studies confirmed a link between networking and positive business development. For example, in their study of UK owner-managers Chell & Baines (1998) found that their data appeared to confirm earlier results (e.g. Aldrich & Zimmer 1986, Dubini & Aldrich 1991, Birley, Cromie & Myers 1991), namely that network activity and business performance are closely linked. They stated that especially weak ties influence business growth. All this is also reflected in the different sources of information and assistance that entrepreneurs use in various contexts.

With respect to trust, this leads us to conclude that during venture creation personal trust, as reflected in strong ties, dominates, whilst in later stages empirical results apparently indicate a change in trust forms. Trust is the 'lubricant' without which network activities would not be possible. Although trust might be considered higher in strong ties (such as family or friends), it is the use of weak ties within a network, which most studies found to be related to business growth and vice versa. In this context, entrepreneurs need to calculate the risks involved in using weak ties such as obtaining information or assistance from unknown and unfamiliar persons, who might let the entrepreneur down, against the possible adverse influence of strong ties on business development. Moreover, trust needs to be built up in order to establish the venture on the market, and it is here that networks can assist.

Finally, changes in trust go hand in hand with stages in business development. This can be illustrated using a model of network evolution developed by Butler & Hansen in the early 1990s (cited by Blundel & Smith 2002: 39). During the pre-start-up phase entrepreneurs mainly rely on social networks, which implies a dominant role for personal trust. When the business is set up, the networks become more business-oriented. Collective trust as is apparent in recommendations or reputations of business partners complements personal trust. This is supported by a recent study by Lechner & Dowling (2002) in the Munich IT cluster, where the authors found that the interviewed firms would not have been able to establish business relationships without their existing social networks, which were usually established with the former employer. However, whereas the trust-based social relations are functional as a basis for business in the initial phase, an exclusive reliance on social networks would become a constraint when the business develops. During business development entrepreneurs develop and use a strategic network. This could result in a re-emergence of strong ties and personal trust, as entrepreneurs and their firms 'develop' along with their business partners, concentrating the network on strategically selected business relations. In this context, the next parts of this paper review the role of trust in different business relationships.

## Trust in business relationships

### Intrafirm relations

Trust within the organisation has been studied from different perspectives (see e.g. Kramer & Tyler 1996 for an overview). Given the usually central role of the entrepreneur in a small business, the principal-agent approach appears particularly interesting. In this context the entrepre-

neur would be the principal who trusts his or her employees and managers as agents, whereby the information asymmetry is favourable to the agent. On the other hand, since trust is always reciprocal, the employees also need to trust the principal and his or her promises (Frambach 2003). Here, the question of appropriate incentive structures to ensure cooperative (non-opportunistic) behaviour emerges (Bénabou & Tirole 2003, Kreps 1997). On the one hand, there is the argument of setting proper extrinsic incentives to stimulate the desired organisational behaviour. These incentives can include both rewards as well as monitoring and control procedures (cf. also Bradach & Eccles 1989). On the other hand, several authors argue that a too extensive use of extrinsic incentives could impose a negative effect on the intrinsic motivation of the employees (see also Kreps' 1997 critique of the concept of intrinsic motives). For example, Cialdini (1996) has argued that too much monitoring can diminish trust or even breed mistrust. If people feel coerced into a certain behaviour they may resist and even honest employees might try to cheat or sabotage monitoring systems. Then again, as Frambach (2003) points out, it is possible for the principal to build both trust and intrinsic motivation by trusting the employees already in the initial stage instead of using formal control and monitoring systems.

Other approaches of intraorganisational trust research include focusing on interpersonal work relationships and relationships between different business units. Six (2003) studied the impact of trouble events on trust in interpersonal work relationships. Her multiple-case study included 26 interviews and observations of meetings in two Dutch companies in the professional services industry. The main finding was that the more explicit the organisation is about what it expects from its employees in interpersonal interactions and the more it stimulates the development of their interpersonal skills, the higher the individual's ability to maintain trust in the face of trouble appeared to be.

Tsai & Ghoshal (1998) investigated different dimensions of social capital in relationships between 15 business units in a multinational electronics company. Three managers in each unit were asked to respond to the mailed questionnaire. The measured dimensions of social capital included social interaction, trustworthiness and shared vision. Trustworthiness was operationalised as restraining from opportunistic behaviour and keeping promises. The results show that both social interaction and shared vision positively affect trustworthiness, while social interaction did not appear to be a prerequisite for shared vision and vice versa. Moreover, the trustworthiness of an actor was found to be related to the amount of resource exchange conducted with him or her, which is argued by the authors to promote productivity and product innovations.

The cited studies indicate that fostering open communication and social interaction contribute to trust-building in intraorganisational relations. While these results refer to personal trust, the question arises concerning how collective and institutional trust cues affect trust within organisations? Also intraorganisational relations are part of a wider social and institutional framework. For example, industry conventions as well as formal and informal rules set by business associations could contribute collective cues to intraorganisational trust. Also reputations can be a significant trust cue if the market for potential employees/employers is relatively small e.g. due to the industry being very specific or the employees preferring to be employed locally. Institutional trust, on the other hand, affects intraorganisational relationships through e.g. laws on working times and occupational safety as well as standards set for professional education. An empirical examination of the effects of collective and institutional trust cues on intraorganisational trust would be an interesting issue for future research.

## Interfirm relations

A central topic in the literature concerning interfirm relations and trust has been the governance problem as conceptualised in Transaction Cost Economic literature. Basically the governance problem refers to coordinating transactions in a way that economises in terms of transaction costs given bounded rationality and the threat of opportunistic behaviour (Williamson 1996). In

coping with opportunism, an interfirm relationship is governed by a structure consisting of a variable mix of three independent governance mechanisms – price, authority and trust (Bradach & Eccles 1989). Price provides for efficient governance when standardised products or services are exchanged (Lunnan & Reve 1995). However, once the transaction object becomes more complex, either authority or trust is required for effective governance. Authority refers to governance by formal rules and procedures (Haugland & Grønhaug 1995). However, it is more expensive than price since it is often based on a written contract. Trust plays an important role as an informal governance mechanism, for it is both efficient as well as applicable in complex transactions and can thus complement or even substitute formal, authority-based mechanisms.

Trust as a governance mechanism plays a particularly important role in the interfirm relations of small firms. Schumacher & Moyle (2001) provide two reasons for this: First, small businesses often lack the necessary resources to implement formal governance mechanisms adequately. Second, the costs of intricate safeguards may be unjustifiable given the often small scale of transactions and moderate profit expectations involved. Moreover, as Lyons (1994) points out, the absence of contracts and other safeguards may also reflect the informality and absence of bureaucracy in small firms. This raises the question on which information do small firms base their decision to trust instead of regulating formally (or waiving the transaction and the associated benefits in case the formalisation resources are not available)?

In their study of 191 German SMEs, Schumacher & Moyle (2000) found that trust-based relationships often emerged out of initial market-based, and thus price-governed, transactions. Signals that led to a perception of trustworthiness included meeting deadlines, social interaction, being present when needed and personal attributes of the involved actors such as keeping confidence and acting honestly. Another interesting piece in the so far modest empirical literature on the governance of small-firm interfirm relations is Larson's (1992) study of alliances of high-growth entrepreneurial firms in the US. She found that a foundation of mutual trust stemming from personal reputations as well as individual friendships was set down before the companies began transactions. As the alliances matured, the companies and individuals moved incrementally closer and closer as they built on the initial foundation of trust.

These findings emphasise the cognitive evolutionary aspect of (personal) trust: As information on the partner's attributes and behaviour cumulates in sequences of transactions, also the uncertainty present in the risk assessment decreases and trust grows. On the other hand, these studies have paid little attention to the institutional and social embeddedness of interfirm relations and trust, which is an important aspect of the perspective chosen for this paper. As Williamson (1993) points out, institutions define the framework within which governance structures are designed. Not only is the informal governance mechanism trust affected by the institutional framework, but also formal governance mechanisms require a certain degree of institutional trust in order to be feasible, that is, credibly enforced. Furthermore, an interfirm relation is always embedded in a network of further business and social relationships, which provide important collective trust cues such as reputation (Granovetter 1985, Håkansson & Snehota 1995). Hence there appears to be a need for further research on trust in interfirm relationships that particularly addresses the social and institutional embeddedness of these relations.

## Credit relations

According to Saporito (2000), lender-borrower relationships have been almost solely examined as a principal-agent problem. However, the author adds that the agency approach has also been criticised for focusing on the investor's problems as the principal, while he argues that a more reciprocal conceptualisation would be more appropriate. This would do justice to other aspects of bank-firm relationships, such as cash management, payroll services and investment advisory, where the firm takes the role of the principal.

Saparito (2000) discusses different mechanisms that the bank can use to safeguard against opportunistic behaviour. These include collaterals and equity investment requirements, which basically provide a potential formal sanction mechanism for the bank, as well as inquiries of the borrower's general reputation at credit ratings agencies. Good general reputation in this context can be valuable to the entrepreneur as it can result in lower interest rates. Furthermore, Saparito (2000) confirms that also in bank-firm relationships, personal trust grows over time as the information asymmetry decreases over the sequences of interactions.

In his Likert-scale based study of 906 small-firm customers in 22 banks in the US, Saparito (2000) found that over time the trust basis changes from primary reliance on contractual controls to an increasing use of social controls, i.e. from institutional towards personal trust. This development of trust is affected both by the behaviour of the customer as well as the behaviour of the bank during the course of the relationship. Petersen & Rajan (1994, cited in Saparito 2000) argue that a high level of personal trust can positively influence a small firm's access to debt financing.

However, any discussion regarding the role of trust in credit relations needs to take into account the regulatory environments prevailing in different countries as well as differing attitudes to risks, which might in turn influence both the level of trust and the formal regulations of credit relations. Here, a study conducted by Lane & Quack (2002), based on empirical surveys for Britain and Germany, clearly illustrates that the respective institutional environment shapes the way in which banks construct and manage risk, thus leading to different credit relationships between banks and SMEs, with implications for the level of trust involved. This brings us to the question of the role of trust in different environments, which is reviewed in the next section.

## Trust in different environments

### Empirical evidence: Trust levels in different institutional environments

Levels of trust differ even among West European countries, in particular due to different cultural traditions, but also due to differences in the economic, political and juridical frameworks. For example in Germany inter-firm relations are strongly governed by regulations, whereas personal relationships appear to carry more weight in the deregulated British environment (Bachmann 2001). In this context, previous research on the German institutional environment (Bachmann 2001, Bachmann & Lane 2001) has emphasised that German inter-firm relations (however, not specifically ones involving small firms) are strongly governed by regulations related not only to the institutional framework, but also to self-regulations within and amongst business associations. In such an environment institutional trust is facilitated and opportunistic behaviour of business partners appears a calculated risk (Bachmann 2001, Bachmann & Lane 2001).

However, the fact that trusting behaviour has been found to vary between East and West Germany indicates an important role for social norms and other informal codes of conduct, which are referred to as informal institutions by North (1990). Schwarz (2000) found that East German entrepreneurs tend towards formal arrangements more often than their West German counterparts. One explanation is that this practice is rooted in the socialist past of strongly institutionalised and regulated relations outside one's social sphere in East Germany (Nuisl et al. 2002), which underlines the role of path-dependence in the evolution of informal institutions. Furthermore, trusting behaviour differs not only in different regions within a country, but also other types of 'trust milieus' affect it. As pointed out by Kautonen & Welter (2003), different sectoral and market environments play a significant role in determining the trusting behaviour in business networks of small enterprises in Germany. Besides the business conventions specific to

certain sectors or markets, the authors found especially social networks and reputations to play a crucial role in determining trust in this context.

Besides using evidence from single country studies, trust levels in different institutional environments can be assessed through large-scale surveys. There exist a few international surveys, which evaluate and measure different features of institutional environments. With regard to *transition environments*, several relevant papers are based on the Business Environment and Enterprise Performance Survey (BEEPS) conducted by the World Bank and the European Bank for Reconstruction and Development. BEEPS is a survey of over 4000 managers and owners of firms in 22 countries in Eastern Europe, the former Soviet Union and Turkey (<http://info.worldbank.org/governance/beeps>). With regard to those countries we are interested in, we can obtain data on Russia and Estonia from this survey using the interactive database on the Internet. Data show a picture, which in terms of the quality of the institutional environment clearly differentiates between both countries. Not surprisingly, more Russian than Estonian firms see corruption as a major or moderate obstacle (13.7 % and 15.4 % compared to 5.4 % and 11.4 %, respectively). Moreover, a significant minority (10 %) of the Russian firms mentioned organised crime and the mafia as a major constraints, whilst the overwhelming majority of Estonian firms saw this as either no obstacle (65.9 %) or only a minor one (24.6 %). Interestingly, both Estonian and Russian firms appear to have problems with contract violations by customers and suppliers. Whilst 13.9 % in Estonia and 12.1 % in Russia stated this as a major problem, another 25.3 % and 23.9 % respectively saw it as a minor problem, all of which indicates institutional trust still being a problem.

In 2002, Gallup International and the World Economic Forum conducted a world wide poll on trust, in which 36,000 people from 47 countries across six continents participated (<http://www.weforum.org/site/homepublic.nsf/Content/Annual+Meeting+2003%5CResults+of+the+Survey+on+Trust>). The results show a comparatively low level of trust in governments both for EU and for Eastern European countries, with 49 % and 40 % stating that they trust in government. Interestingly, in Eastern European countries more interviewees (51 %) express trust into media compared to EU countries (42 %). However, results for trust into parliament appear to confirm transition countries as 'low-trust' environments. Here, 65 % of the surveyed persons stated that they had little or no trust into these institutions, and only 27 % showed some or a lot trust, compared to 49 % and 46 % for European states respectively.

More detailed results from a follow-up poll for 15 countries shed more light on the level of civil society in various countries, which is one of the requirements for establishing trust into institutions. For example, UK rates high in trust both in NGO leaders (64 %) and in NGOs (68 %), whilst Italy and Germany show lower shares for NGO leaders (both 52 %), but higher percentages for NGOs (73 % in Italy, 68 % in Germany). Here, the results also demonstrate a low level of civil society in Russia, where only 38 % would trust leaders of NGOs, another 45 % into NGOs themselves.

Huther & Sha (1998) use comparative data based on a governance index (GQI) constructed by the World Bank in 1992, which indirectly reflects the trustworthiness of the institutional environment. The quality of governance results from the product of citizen participation (CP), a so-called governance orientation index (GO) reflecting judicial and bureaucratic efficiency as well as lack of corruption, a social development index (SD) and an economic management index (EM), which consists of outward orientation, the Central Bank independence and the inverted debt to GDP ratio. Interestingly, Russia rates as a country with fair governance (GQI: 46), whilst countries such as Germany, UK and Italy show good governance. The former reach 71 and 66 respectively, Italy has a GQI of 53. With regard to single components, Russia rates lowest on GO (32), followed by EM (46), which despite the overall good result would support the conclusion of Russia being more of a 'low-trust' country. The same would apply to Italy, which ranks especially low on GO (43).

Delhey & Newton (2002) analyse the Euromodule data from a trust perspective. These data were collected in Germany, Hungary, Slovenia, South Korea, Spain and Switzerland between 1999 and 2001. The data are representative of citizens 18 years and older and concern individual living conditions, subjective well-being and the quality of society. The authors found little evidence that membership of voluntary organisations or education level are associated with trust, whereas being involved in informal networks of friends and a feeling of public safety appeared as significant correlates of trust. According to the results, close networks of personal friends do not appear to be any more important in transition countries than they are in Western market economies. Similar findings have been made also in other studies (e.g. Nussli et al. 2002), indicating that personal trust is not such a substitute to institutional trust in transition countries anymore as it was in the early 1990s. Moreover, Delhey & Newton (2002) argue that lack of trust in transition environments is not the cause of social and political upheaval and conflict in these countries, but an expression of them.

### Low versus high trust environments?

Following the embeddedness argument, the institutional and social business environment is a broad concept that basically affects all stages of enterprise development and aspects of entrepreneurial behaviour discussed above. However, relationships between trust and environments are complex and recursive. As Williamson (1993) points out, institutions define the framework within which governance structures are designed. Formal governance mechanisms require a certain degree of institutional trust in order to be feasible, that is, credibly enforced. However, also an informal governance mechanism trust is affected by both formal and informal institutions, such as legislation and law enforcement or social norms and codes of conduct, respectively.

But trust itself also acts as an informal institution. Whilst formal institutions such as the legal regulations are normally enforced and enforceable by the state only, this will always be imperfect because these institutions are always based on imperfect information of the people who design them. Here, trust supplements formal institutions and assists in enforcing them. Furthermore, as Granovetter (1985) points out, personal trust complements institutional trust in case an individual does not want to rely solely on institutional arrangements and cultural norms. On the other hand, when the institutional framework is incomplete, such as in Eastern European transformation countries, personal and collective trust do not complement but substitute for the institutional framework. In such cases formal governance does not work because it is not (always) backed up by the state. Thus, whereas personal trust can exist regardless of any formal institutions, the availability of institutional trust is highly dependent on the institutional structure of the society. Williamson draws attention to the fact that 'transactions that are viable in an institutional environment that provides strong safeguards may be nonviable in institutional environments that are weak...' (Williamson 1993: 476). In this context, we can assume both differences in the trust related institutional framework between transition countries in Eastern Europe and mature market economies in Western Europe as well as differences in the roles of personal, collective and institutional trust respectively.

In this context, there has been an extensive discussion on whether we may classify institutional environments as 'low-trust' versus 'high-trust' (e.g. Fukuyama 1995, Panther 1998). A 'low-trust' environment is said to restrict market entries, enterprise growth and free competition whilst encouraging unproductive and parasitic entrepreneurship. A 'high-trust' environment, on the other hand, is said to foster competition and enterprise growth. On country level, several transition countries would be characterised as 'low-trust' and mature market economies such as (West-)Germany as 'high-trust' countries.

In *mature market economies* the trust framework is more developed. It usually allows a better allocation of resources and lower transaction costs compared to transition economies. However,

this distinction on country-level neglects that trust levels could differ both across regions (i.e. within countries) and sectors. For example, although both East and West Germany share the same formal institutional framework of a mature market economy, we assume that there may be differences in the informal institutional framework – trust culture – between these regions. This refers to the far slower transformation of informal institutions in comparison to formal institutions.

With respect to *transition economies*, several authors describe how in an environment where institutional trust is lacking and norms are unstable, individuals use social contacts and individual networks dominated by mutual trust in order to pursue business (e.g. Chepurensko 1994, Manolova & Yan 2002, Peng 2000, Welter 2003, Welter & Smallbone 2003, Yan & Manolova 1998). Höhmann and Malieva (2002) also emphasise the importance of (personal) previous experiences. In such a context, personal trust substitutes for insufficient formal and informal institutions such as weakly specified legal regulations and inadequate law enforcement, all of which encourages the entrepreneurs' lack of institutional trust. Whilst in this context networking and the use of personal contacts are rational reactions to secure resources in a turbulent environment, it casts doubt on long term development and growth prospects for entrepreneurs in these countries.

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## Researching Trust Empirically – A Note

Trust is one of the most difficult concepts to handle in empirical research (Misztal 1996). It is a pronouncedly dynamic and culturally as well as socially embedded phenomenon, which performs different functions and assumes different meanings depending on the context. Dasgupta (1988: 51) emphasises the key role of context in empirical trust research by pointing out that although ‘there are no obvious units in which trust can be measured, its value can be measured in any given context’. Hence the central trust question should concern the conditions under which a person or an institution can be trusted in a certain respect (e.g. competence, benevolence etc.), rather than the amount of trust in this person or institution (Six & Nooteboom 2003).

The context is also particularly important in empirical trust research because it allows to examine behaviour based on tacit knowledge, which is essential in understanding trusting behaviour (Nuissl et al. 2002, Smallbone & Lyon 2002). The central role of context underlines the importance of an adequate choice of empirical indicators. Here, a careful conceptualisation and an appropriate use of the theoretical framework are crucial in avoiding the risk of preconception or ethnocentricity (Borch and Arthur 1995). This means that the researcher should try to avoid prejudices in choosing indicators in order not to bias some aspects exaggeratedly while leaving more subtle ones out.

Considering the diversity of definitions for trust in the literature (cf. Lane 1998), it is hardly surprising that a variety of different measures and methods have been used in empirical trust research. In fact, in their review of ten empirical investigations concerning interorganisational trust, Blomqvist et al. (2002) discovered that replication studies are seldom and that researchers tend to develop their own unique measures, which the authors attribute to the different theoretical backgrounds. Also a variety of methodological approaches have been used ranging from laboratory experiments to surveys and different qualitative methods, all of which have their pros and cons depending on the specific research issue.

This paper sets out to provide a review of empirical trust research by focusing on problems faced by researchers in two key areas: operationalisation of trust and the choice of adequate empirical methods. The pros and cons of possible solutions to these problems are illustrated with examples from recent investigations of trust in different contexts. The review does not seek to be comprehensive, but rather aims at providing an overview of and enlightening some of the most important issues to consider in researching trust empirically.

### Operationalising trust

The central problem in operationalising trust is *how to ask about it*. In this context, Bertrand and Mullainathan (2001) draw attention to the fact that wording questions in particular ways might result in unwanted cognitive effects. With regard to trust, Offe (2001) rightly rejects questions asking for ‘how much trust do you have in...’ because of cross-cultural and intra-cultural semantic differences concerning the meaning of trust. Moreover, phrasing questions in this way would imply that individuals are capable of identifying and evaluating the level of trust in their actions. Since part of trusting behaviour is habitual and based on tacit knowledge, such a direct question approach appears inadequate, as explained by Bertrand and Mullainathan (2001), who state that ‘people may not really be good at (...) understanding why they did what they did.’ On the other hand, an indirect approach to trust in the context of interfirm cooperation applied by Nuissl et al. (2002) appeared to have worked well. The authors report that their interviewees were able to exactly explain why cooperation is sought after, how it should be organised and which qualities should be primarily considered when assessing the potential partner.

A further problem in phrasing questions about trust is the social desirability of answers (Nuissl et al. 2002, Saporito 2000). Social norms shape individual behaviour, and individuals as a rule do not want to present themselves as acting differently in front of an interviewer. Therefore, direct wordings as those mentioned above might easily provoke interviewees (at least in the context of mature market economies) to answer very positively, simply because they perceive this being the socially accepted answer, although this might be more of a problem in face-to-face interviews than in telephone surveys. However, the same applies to questions such as 'Which role does trust play in your business relations?', indicating that this question type be better used as a control measure.

Perhaps the most prominent direct operationalisation of trust is associated with the General Social Survey (GSS), which uses the question 'Generally speaking, would you say that most people can be trusted or that you can't be too careful in dealing with people?' to measure trust (see e.g. Alesina & LaFerrara 2000). The same question is used also in other general surveys such as the World Values Survey or the Euromodule (see e.g. Zak & Knack 1998 and Delhey & Newton 2002, respectively). These data have been used in macro level studies that focus on the effects of different socio-economic variables on trusting behaviour. However, the behavioural validity of such attitudinal trust questions has been doubted by experimentalists. In fact Glaeser et al. (2000) argue that attitudinal questions measure trustworthiness rather than trusting behaviour and point out that most work using the GSS question needs to be somewhat reinterpreted. The authors further indicate that trust could be measured more accurately with questions concerning past trusting behaviour. This advice has been taken into account in their own study as well as in later studies that have elaborated the authors' work further (Fehr et al. 2002, Gächter et al. 2003).

Direct operationalisations have been used in micro level studies too. For example, in his study of R&D cooperations Rindfleisch (2000) asked the respondents to assess their general trust in cooperation partners as one of his five Likert scale trust measures. However, most of the micro level studies reviewed for this paper used indirect questions. Dyer and Chu (2002), who also used a Likert-scale based survey to study buyer-seller relationships in the car manufacturing industry, operationalised trust by asking the respondents (sellers) to assess the fairness and reputation of the buyer as well as the likelihood of the buyer taking advantage of them. A further example is Six's (2003) study of the effect of trouble events on interpersonal working relationships in an organisation. She asked the respondents to describe their actions and reactions in trouble events as well as to assess the cause of trouble and how the event affected the working relationship. Some studies need to take the embeddedness of economic activity in the surrounding socio-economic environment into account. One such example is Radaev's (2003) investigation of trust in economic relations in Russia, where the author also examines especially the institutional embeddedness of those relations. His operationalisation included questions on topics such as corruption, contract enforcement, use of force in business relationships and problems experienced during market entry.

Institutional embeddedness was a key concept also in our cross-cultural study of trust in Estonia, Germany, Italy, Russia and the UK within the research project 'Entrepreneurial strategies and trust in East and West Europe' (financed by the Volkswagen Foundation). Hence, an indirect approach to operationalisation was adopted. With regard to business linkages and networking relationships, our survey featured questions related to the forms and regularity of regulation and to the criteria by which the form of regulation is chosen. We analysed credit relationships and internal relations with employees, for the former emphasising sources and regulations, for the latter decision delegation and motivation systems. Finally, we asked entrepreneurs for linkages with the regulatory environment as well as for sources of assistance in various stages of business development.

## Empirical approaches in researching trust

Another question concerns the empirical approach in researching trust. Laboratory experiments based on game theory and quantitative surveys appear to be the most common approaches. However, recently qualitative studies as well as combined-method studies have become more common. The following provides an overview of the different methods and their pros and cons.

### Survey studies

Survey studies are characterised by causal analysis, which argues based on figures and systematic statistical links between them (Alasuutari 1996). Their aim is to draw conclusions for a population of individuals or firms. The main advantages of surveys are that they provide information on the numerical dimensions of processes known to occur and they enable the researcher to ask the respondents a host of questions about their objective situation, subjective feelings and behavioural intentions (Curran & Blackburn 2001, Fehr et al. 2002). But surveys have also disadvantages both compared to experiments and qualitative approaches.

The main disadvantages of surveys compared to qualitative approaches are that they often lack answers to 'why' questions and that survey results reflect populations in terms of a certain level of statistical confidence, but these associations may or may not be valid in individual cases (Curran & Blackburn 2001). The main disadvantage compared to experiments is that surveys lack economic incentives (Fehr et al. 2002). It is a different thing to say that one trusts somebody than to actually trust this person with a certain amount of real money at stake. In measuring certain types of trusting behaviour, e.g. lending money or making specific investments, the lack of economic incentives in surveys may lead to an increased risk of gaining socially desirable answers. Another difficulty in applying the survey method in trust research is that quantitative data on trust is difficult to collect, especially with respect to the evolvement of trust, its intensity or the risk and value of different business relations (Smallbone & Lyon 2002). Thus, the authors recommend that survey-based studies should concentrate on investigating the nature and extent of trust-based business linkages.

Bart Nooteboom and his colleagues have done just that in their several survey-based studies on trust and governance in interfirm relations (Berger et al. 1995, Nooteboom et al. 1997, DeJong & Nooteboom 2000, as summarised in Nooteboom 2002). Nooteboom (2002) argues that although the theory of governance is often complained to be difficult to operationalise, it is possible to treat variables such as asset specificity, transaction costs and trust as 'latent' ones, which can be measured by indicators, often as judgement by people, on Likert scales. The research issue in the aforementioned studies concerned the effect of trust and other variables of governance (e.g. specific investments, contracts) on the perceived dependence or the perceived risks involved in such dependence in interfirm relations. Most indicators were measured on five-point Likert scales (see also Dyer & Chu 2002 for a similar example).

Berger et al. (1995) conducted a postal survey of 80 suppliers to a Dutch producer of copying machines examining the dependence of the supplier on the buyer. Nooteboom et al. (1997) surveyed ten companies in the electronics industry for ten customer relations each focusing on the emergence of routines and common norms in these relations. DeJong & Nooteboom (2000) analysed the data on buyer-supplier relations in the car manufacturing industry gathered by Mari Sako and Susan Helper in the US (665 observations), Japan (472) and Europe (268). The large data set enabled the authors to use the LISREL method, which on the other hand allows an analysis of not only causal relations between indicators, but also circular causality. In general, all of these studies confirmed the basic theory of governance in Transaction Cost Economics. Trust was found to have the expected negative effect on perceived dependence in Berger et al. (1995) and have a significant effect on perceived probability of incurring a loss due to opportunism in Nooteboom et al. (1997). Further, DeJong & Nooteboom (2000) found that longer rela-

tionships, in which routines develop, foster commitment, mutual investment, value creation and dependence. Interestingly, the causal structure appeared similar in all three studied countries.

### Qualitative studies

Qualitative research does not refer to a single method, but is rather ‘an umbrella term to refer to several research strategies that share certain characteristics’ (Bogdan & Biklen 1992: 2). The main analytical difference between survey-based and qualitative studies is that the latter require such absoluteness that is not known in statistical analyses: qualitative studies often view the material as a whole and even with multiple interviews the argumentation cannot be built on differences between individual interviews with regard to certain variables (Alasuutari 1996). Instead, the author argues, qualitative studies focus on collecting clues and connecting them on the basis of other studies and theoretical frameworks.

Qualitative studies have two major advantages. One is the depth and richness of detail especially when the study is constructed using data triangulation and cross-checking (Borch & Arthur 1995). The other advantage is that since there are no well-established analysis practices in qualitative research, the researchers are forced to think and be creative instead of following a ‘cookbook approach’ (Curran & Blackburn 2001). The lack of well-established practices is also a weakness of qualitative research. Researchers must be particularly careful in designing the study in order to make it methodologically adequate e.g. by using a theoretically justified replication logic in multiple-case studies (Yin 2003). Moreover, care should be taken in interpreting the results so that the researchers review the accounts offered by respondents critically, but do not misrepresent them, impose their own values and views or take sides with one respondent against another (Curran & Blackburn 2001). Since qualitative studies usually examine actual events rather than attitudes, the lack of economic incentives should not be a problem as it may be in survey-based trust studies.

An example of a qualitative approach to empirical trust research is the investigation by Klein Woolthuis et al. (2002). The authors examined the substitutive and complementary nature of formal control and trust while focusing on the ‘why’, ‘when’ and ‘in what temporal order’. Due to the dynamic research issues the authors decided to conduct four longitudinal case studies, each one examining a different trust/formal control constellation in a two-by-two matrix with the dimensions high/low trust and high/low formal control. The studied cases concerned joint projects between firms, which were subsidised by an external agency. The authors used data triangulation: one data source consisted of documents from the project administration such as contracts, annual reports, project plans, correspondence etc., while the other source of information comprised face-to-face interviews with consultants involved in the project. The results of the study indicate that formal control and trust can be both substitutes and complements depending e.g. on the function of the written contract. Moreover, the development of trust does not necessarily begin with a stage of formal control, but it may be the other way around e.g. because contracts can be expensive and risky investments which need a certain amount of prior trust.

### Experimental studies

The key advantages of experiments are the possibility to include real economic incentives, tight control over environment under which the subjects make their decisions and replicability (Fehr et al. 2002). Thus the results obtained can be proven in further experiments in which the conditions are replicated, and results related to certain variables can be further examined by varying these variables. In fact, the authors point out, exogenous variation of variables in a controlled environment is the only reliable way to draw causal conclusions. However, experiments have their limits too. The most frequent criticisms of experiments are that they are ‘artificial’, lack ‘external validity’ and use a constrained subject pool (Fehr et al. 2002). The first two critiques are in turn criticised by the authors as often lacking clarity. When critics attack the simplicity of

experiments compared to the much more complex real world situations, the authors argue that it is important to understand the simple cases first and hence hold the criticism for misplaced.

However, Fehr et al. (2002) admit that the constrained subject pool is indeed a problem. This refers to the experimenters often using students as subjects, whose behaviour might differ from the behaviour of other groups in the society. Gächter et al. (2003) compared students and non-students in their combined survey and experimental study (see below for a detailed discussion of the method) in Russia. They found that background variables such as socio-economic status and age, which of course vary between student and non-student populations, do affect trust attitudes which, in turn, correlate with contribution behaviour in the public goods experiment used in the study.

In sum, experiments do appear to deliver important results on trusting behaviour. But since they lack the actual social and cultural context in which real-life decisions are embedded, the results need to be considered critically when applied in real situations. One way to improve the connection of experimental results to real-life situations is to combine them with surveys, as discussed below.

### Combined-method studies

Combining *quantitative and qualitative elements* enables the researcher to gain triangulation and some of the advantages of both methods. Studies using such combinations in trust research take two forms. One is to use in-depth interviews or case studies to illustrate and add depth to survey results. An example of such study design is Radaev's (2003) investigation of the emergence and development of economic relations in Russia. As formal rules are not effectively enforced and both individuals and institutions are not trustworthy in Russia, the context set by the business environment plays a central role. The author surveyed 227 heads of non-state owned enterprises in 21 regions in Russia to cater for regional differences in the business environment. Additionally, 96 in-depth interviews were conducted to add the 'behind the figures' dimension to the study.

A similar design was also chosen for the studies in Estonia, Germany and Russia in our project 'Entrepreneurial strategies and trust in East and West Europe'. First, we surveyed 102 entrepreneurs in Estonia, 197 in Germany and 400 in Russia. The surveys in Russia and Estonia were implemented as face-to-face interviews, while the one in Germany was conducted over the telephone (CATI). The interpretation of the survey results was enhanced and deepened through case studies in each country (10 in Estonia, 16 in Germany and 27 in Russia). For example, the survey results showed that the formal contract is a common form of regulation in business relationships in all three countries. This would indicate institutional trust, for contracts can be interpreted as indicators of reliance on credible enforcement of contracts by the state. However, the case studies showed that the primary role of the contract is not always focused on safeguarding against opportunism, but it is used e.g. as a sign of commitment or memory aid and it is often a requirement of the institutional environment e.g. due to tax and accounting regulations. Data triangulation in the Estonian and Russian studies was further enhanced through selected expert interviews e.g. in Ministries, the inland revenue, and Chambers of Commerce and Industry. The whole study was aimed at exploring different trust milieus. Therefore, rather than focusing on representativeness, the study design was built around a set of key variables indicating different trust environments. These included, besides country, region (East and West Germany), size (micro and small enterprise) as well as sector (food industry, trade and business services).

The other approach is what Borch & Arthur (1995) coined the 'rapprochement solution'. This approach aims at developing case study research through implementing ideas from quantitative tradition by stressing rigour and comparative logic. The basic principles of the rapprochement solution are to select a larger set of cases, design a coding scheme to quantify the qualitative case descriptions and to analyse the coded data statistically. The main advantage is the im-

proved generalisability of the results, while the main risk is that the complex phenomena are unduly simplified in the coding phase. The rapprochement approach has been applied in the trust context for example by Six (2003), who studied the effect of trouble events on trust in interpersonal work relationships. She interviewed 26 people and observed meetings in two Dutch organisations in the professional services industry collecting a total of 278 trouble events. Based on a qualitative analysis variables were identified, the data quantified accordingly and finally a statistical analysis conducted.

Another combined approach used in trust research is to integrate *survey and experiments* (Fehr et al. 2002, Gächter et al. 2003, Glaeser et al. 2000). The method of how experiments can be integrated in representative surveys is presented in detail in Fehr et al. (2002), while the following attempts to provide a summary of the key points. The main idea is to overcome deficits in both methods (e.g. add representativeness and real-life context to experiments and behavioural validity to surveys) and cross-validate data. The authors argue that experiments are relatively easy to integrate in surveys as long as the participants do not need to interact or, even if they do, when the decisions are simultaneous and independent. However, most interesting experiments require sequential interaction, which is more difficult to realise. Fehr et al. (2002) integrated a sequential social dilemma game in a representative survey. The game involves two groups of participants, A's and B's, both of which receive €10 and can invest any amount between €0 and €10, which the recipient receives doubled by the experimenter. Thus both players would benefit from full exchange. Player A makes the first move to which Player B responds.

One possible solution to implement this experiment without having to survey the participants sequentially would be to require Player B to make a decision for each possible transfer by Player A before knowing what the actual transfer has been. The main advantage would be the large amount of information, while the central disadvantage is that responding to imaginary moves is less emotionally arousing than being confronted with an actual transfer. Player B might also raise his transfer for each euro added to A's potential transfer, although B's decision in an actual situation would not be this consistent. The solution proposed by Fehr et al. (2002) is to use previous experimental knowledge to determine an ex ante distribution of first mover actions, hence confronting Player B with a randomly chosen action by Player A and having him only respond to this one action. The actions of both players can be collected simultaneously and matched ex post. If there are more specific transfer amounts from B's than A's, each A is randomly matched with a B leaving some B's unmatched. However, even the unmatched B's receive their reward as their payoff is known. If there are more A's and B's for a specific transfer amount, some B's will be repeatedly matched with an A so that the decisions by some B's become decisive for more than one A.

## Conclusions

Researching trust empirically appears particularly difficult due to the versatile and context-dependent nature of the concept. This is also evident in the variety of different measures and empirical approaches implemented so far in empirical studies. This paper provided a preliminary review of problems and their possible solutions in empirical trust research with respect to two problematic areas: operationalisation and the choice of adequate empirical methods.

The discussion on operationalisation focused on how to ask about trust. Direct questions were rejected due to cross-cultural and intra-cultural semantic differences concerning the meaning of trust, the disregard of habitual behaviour, and the implicit assumption in direct questions that individuals could identify and evaluate the level of trust in their actions. A further problem identified concerning the phrasing of questions about trust relates to the risk of receiving socially desirable answers, which might be provoked in particular by direct wordings. Hence, indirect



operationalisation was deemed more appropriate. This can take many forms as was demonstrated in the examples (Dyer & Chu 2002, Radaev 2003, Six 2003).

The other focal point of this paper was the choice of empirical methods. The pro's and con's of different approaches were discussed including surveys, qualitative approaches, experiments as well as combined methods. Each of these methods appears to have its pro's and con's depending on the specific context in which trust is studied. In this respect the combined-method approaches appear particularly interesting, for the used methods not only cross-validate each other, but also add triangulation to the study design. For example in case of representative surveys, integrating either experiments or case studies could add behavioural validity or depth to the analysis.

A further argument in this context concerns the comparison of cross-sectional and longitudinal research designs. Although trust is a dynamic phenomenon, most researchers choose cross-sectional designs for pragmatic reasons. In fact, the only longitudinal design in the introduced studies was in the investigation of the substitutive and complementary roles of formal control and trust by Klein Woolthuis et al. (2002). Longitudinal designs would appear particularly relevant for studying the process of how trust is built (Smallbone & Lyon 2002, Welter et al. 2003). For this purpose, Ring & Van de Ven (1994) suggest that collecting 'events' would be an effective method.

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