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Exploring the Role of Trust in Entrepreneurial Activity

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Introduction

Trust is a phenomenon which, over the past decade, has gained attention across many disciplines and fields of study, e.g., psychology, organizational theory, sociology, economic theory, and business management. There is no single comprehensive definition of trust, and even within disciplines several definitions often exist. However, in terms of business behavior, trust is based on a perception of the probability that other agents will behave in a way that is expected (Gambetta, 1988). In addition, there is a danger that academics concerned with different aspects of human behavior may sometimes be guilty of exaggerating the role of trust, which emphasizes the importance of developing robust methodologies to identify and assess it. As Endreß (2004, p. 15) stated, “we are confronted with an inflationary use of the concept of trust in several scientific disciplines, while its use in everyday life is much rarer.” Compared with their contemporaries in fields such as management studies, entrepreneurship scholars have only recently started to pay attention to trust-related issues, which may or may not be justified. This special issue aims to contribute to a discussion of the role of trust in the field of entrepreneurship, both conceptually (Goel & Karri, 2006; Zahra, Yavuz, & Ucbasaran, 2006) and empirically (Howorth & Moro, 2006; Neergard & Ulhøi, 2006).

Trust—An Elusive Concept

Trust has proved difficult to define conceptually, with consequences for its operationalization empirically. In reviewing the concepts of trust, Höhmann and Malieva (2005) found that most disciplines attempt to analyze the role that trust can play in lowering risk and uncertainty, as well as the need for control in complex situations. They analyze sources, forms, and the level of trust, search for trust milieus in order to establish rules for the emergence and loss of trust, deal with political and economic strategies that can be implemented in order to build or rebuild trust, and examine whether or not, to what extent and with which methods, trust can be explored empirically.

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A closer look at the definitions and concepts of trust shows several possible links between trust and entrepreneurship. For example, Niklas Luhmann (2000) concentrated on the role that trust plays for modern societies, understanding trust as a mechanism that reduces the complexity in everyday life. Luhmann argues that trust can be a substitute for the risks that are inherent in decisions or situations. For an entrepreneur, this suggests that not all business relationships need to be regulated via contracts, thus allowing him/her to reduce the transaction costs.

Oliver Williamson (1993) focused on various forms of trust, distinguishing between personal trust, which according to him is apparent only in noncommercial 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 the forms of trust according to their evolution, distinguishing between process-based and generalized trust or according to the sources of trust into calculative or relational trust. According to Williamson, both in personal and commercial relations, trust is often based on a calculated risk, i.e., the person trusting is convinced that trusting is a rational behavior because the risks associated with the bestowed trust that is not being fulfilled are justified by the potential gains if the trust is maintained. In extending Williamson's understanding, one needs to take into account that trust can also involve variable degrees of goodwill, which is partly due to behavioral routines that facilitate decision making in view of limited individual information capabilities. Routinized behavior contains an element of goodwill trust if it is applied to new situations where it may not be justified and could be broken (Nooteboom, 2002), as in the case of new venture creation or when seeking new business partners.

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, p. 60). In other words, trust builds on the initial knowledge about the partner. Personal trust may depend on the characteristics of a group such as an ethnic or kinship group, but it also occurs in bilateral (business) relationships, often long-standing 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 that is detrimental to the relationship even when there are no written or explicit rules set out. This means that these relationships are governed by norms, values, and codes of conduct inherent in a business environment (e.g., a business association) and/or a wider society.

The key concept of *institutional trust* refers to trust in the institutional environment, which includes formal organizations, sanctioning mechanisms (such as through the implementation of the legal process), and informal codes of conduct and values. Contrary to collective norms and values (such as the conventional ways of doing business and making business agreements within a particular sector or interest group), institutional norms apply across different sectors and business groups. Institutional trust is essential for the efficient operation of a market economy because economies characterized by a high level of institutional trust agents are able to enter into transactions with only limited information about their partner's specific attributes (Raiser, 1999). In other words, the scope of trust extends beyond the number of people that are known 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.

Is There a Role for Trust in Entrepreneurship (Research)?

So far, few entrepreneurship studies have researched the role of trust in creating and developing a new venture (Liao & Welsch, 2005; Zahra et al., 2006). Most related research has focused on the importance of social networks for venture creation and business growth, although much of this research only assesses the role of trust indirectly. Networks contain trust, which has been described as the “glue and lubricant” that holds networks together (Anderson & Jack, 2002). Moreover, networks assist a new venture in creating legitimacy. This is directly trust-related as the lack of legitimacy reflects a lack of trust insofar as new firms are not known, and therefore not “trusted” by their potential customers and suppliers. In this context, Aldrich (2000, p. 217) indicates that successful new entrepreneurs are more likely to be those who can build networks of trust, which assists them in creating legitimacy within the market. He refers to an earlier, unpublished article by Gartner and Low (1990) who 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.”

Such trust-building activities during venture creation are particularly important for innovative new entrepreneurs who bring new forms or activities into a market (Aldrich, 2000, p. 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 occurs through entrepreneurial actions with clients, customers, and suppliers trying to make sense of the entrepreneur’s behavior as they observe his/her market entry. Trust building might be hampered throughout this process because people perceive and assess entrepreneurial actions differently.

In this context, many research studies have demonstrated that networks are important during the establishment, development, and growth of new and young businesses (e.g., Brüderl & Preisendörfer, 1998; Chell & Baines, 1998; Greve & Salaff, 2003; Jenssen, 2001; Lechner & Dowling, 2003; Witt, 2004), with a role for trust implicit or explicit. In a review of business networks, Blundel and Smith (2001, p. 37) concluded that during venture creation, most entrepreneurs rely on informal sources in their personal networks in order to mobilize resources, especially before a venture is set up. In their sample of German business founders, Brüderl and Preisendörfer (1998) found that support from strong ties was more important for enterprise survival and success in the venture creation stage than support from weak ties.

Changes in the forms of trust go hand in hand with stages in business development. Empirical results from a variety of Western and Eastern Europe economies (for example, see the country studies in Höhmann & Welter, 2005) illustrate that personal trust appears to play a less important role during periods of business growth and in stable (regional) environments, whereas institutional trust gains importance, although without dominating the nature and extent of entrepreneurship. By contrast, institutional trust needs personal trust to develop, regardless of the regional and sector environment. This implies that entrepreneurship is typically affected by a mixture of personal and institutional trust.

Entrepreneurship, Context, and Trust

New venture creation is likely to be influenced by personal circumstances, individual opportunity recognition as well as by a specific set of external conditions. This emphasizes the importance of viewing entrepreneurship in its social context (Davidsson, 2003; Johannisson, Ramirez-Pasillas, & Karlsson, 2002), whereas there has been a “tendency to

underestimate the influence of external factors and overestimate the influence of internal or personal factors when making judgements about the behaviour of other individuals” (Gartner, 1995, p. 70).

In linking entrepreneurship and context, trust plays a role as a sanctioning mechanism by complementing the overall institutional framework. Institutions such as legal regulations are normally enforced and enforceable by the state. However, enforcement is always likely to be imperfect because individuals behave opportunistically, pursuing their own interests, which might contradict the rules set by the state. In this regard, trust reduces the transaction costs through providing information and a means to enforce contracts, thereby diminishing the possibility of opportunistic behavior. Moreover, as Granovetter (1985) points out, personal trust complements institutional trust in those cases in which an individual does not want to rely merely on institutional arrangements or in which these institutional arrangements are unfamiliar.

On the other hand, research undertaken in a context of low institutional trust, such as in the former post-Soviet countries, often emphasizes the role of trust in substituting for an incomplete institutional framework. For economies that are in the process of transformation from centrally planned to market-based systems, formal institutions that are essential for the large scale and sustainable development of private sector businesses are either nonexistent or inadequately focused on the needs of entrepreneurs. This results in distrust on the part of the entrepreneurs in institutions, especially in those countries where economic, political, and societal reforms have been slow (Raiser, 1999; Rose-Ackerman, 2001). Höhmann and Malieva (2005) argue that a successful formal institutional transformation does not guarantee a successful transition process because this alone cannot change the culturally embedded entrepreneurial behavior.

The link between trust and the overall context for entrepreneurship is complex and recursive. Both the extent and the forms of trust to be found within a society are affected by the nature of the overall institutional framework. Formal institutions will only operate successfully if individuals are able to establish a basic level of trust not only in the reliability of any exchanges but also in the enforcement of sanctions and penalties when required. This indicates an important role for institutional trust, which allows for the “missing middle” between families and the state to develop (Fukuyama, 1995, p. 56), i.e., the emergence of relationships between unrelated and unknown individuals and the development of new social and business groups. Personal trust gains importance in those cases where formal sanctioning mechanisms fail or are absent and/or where particular social groups are excluded from the mainstream society, such as in the case of ethnic minority and/or immigrant groups in host countries. However, 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 and the actual behavior of institutions. Williamson (1993, p. 476) summarized the complex relations stating that “transactions that are viable in an institutional environment that provides strong safeguards may be nonviable in institutional environments that are weak (. . .).”

Whereas personal trust can exist regardless of any legal and political context, institutional trust requires stability and predictability in the institutional context, reflecting a legitimization of formal institutions through societal norms and values. Institutional distrust arising from a malfunctioning institutional framework could be reinforced by mistrust resulting from previous experiences. For example, in the case of post-Soviet countries, individuals may have had strong mutual ties with family and friends while mistrusting public institutions (Raiser, Haerpfer, Nowotny, & Wallace, 2001). Fukuyama (1995, p. 56) recounts similar strong ties within families for Latin Catholic countries such as Spain and Italy as well as in China, indicating that strong family bonds may go hand

in hand with weak ties beyond the family: “[. . .] there is a relatively low degree of trust [in the sense of institutional trust, the authors] in Chinese society the moment one steps outside the family circle.” In such situations, entrepreneurs will have to rely on networking in order to mobilize resources and to cope with the constraints imposed by highly bureaucratic structures (Fukuyama, 1995; Ledeneva, 1998; Smallbone & Welter, 2001a). Several authors have described this extensive use of social contacts and networks as dominated by mutual personal trust in environments where institutional trust is lacking and the normative framework is unstable (e.g., Peng, 2000; Radaev, 2005; Welter & Smallbone, 2003; Yan & Manolova, 1998). In these circumstances, personal trust may substitute for the deficiencies in the institutional environment for business, becoming dominant where institutional trust is low or absent.

Researching Trust Empirically

With regard to trust, one must be aware that trust is not an “objective” phenomenon that can easily be measured and understood across cultures and countries. Trust, in particular its understanding and interpretation, is very much also a socially constructed phenomenon, which renders its measurement and empirical analysis difficult. Key issues concern the operationalization of different concepts of trust and the choice of adequate empirical methods. The game theory provides some examples of how to research trust empirically although relying on artificial laboratory experiments (e.g., Glaeser, Laibson, Scheinkman, & Soutter, 2000; Sigmund, Fehr, & Nowak, 2002) while in the organization theory, most trust-related studies build on large-scale surveys and quantitative methods.

How to gather empirical data on trust? Large-scale cross-national surveys such as the General Social Survey or the World Values Survey measure trust by asking for people’s attitude toward trust, using 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?” However, the behavioral validity of such attitudinal questions with respect to trust has been questioned. Glaeser et al. (2000) argue that such attitudinal questions measure trustworthiness rather than trusting behavior. The authors further indicate that trust could be measured more accurately with questions concerning past trusting behavior.

Offe (2001) rejects the use of explicit questions that ask respondents “how much trust do you have in . . .” because of cross-cultural and intracultural semantic differences concerning the meaning of trust. More fundamentally, however, such questions imply that individuals are capable of identifying and evaluating the level of trust in their actions, which are likely to be emergent rather than the result of prior planning. Trust frequently results from habitual behavior where individuals implicitly draw on habits and norms without calculating or justifying their behavior beforehand (Smallbone & Lyon, 2002). In this context, the authors conclude that quantitative data on trust is difficult to collect, especially with respect to how trust-based relationships evolve, the intensity of trust, and the value of different types of trust-based business relations. Thus, quantitative survey-based studies should concentrate on investigating the nature and the extent of trust-based business links and relationships while a more qualitative approach is needed in order to explore the emergence of trust-based relationships as well as the circumstances in which trust may be lost.

Interestingly, both empirical articles in this issue employ qualitative methods in researching trust. Neergard and Uthøi (2006) use a multiple-case approach drawing on five in-depth case studies, critical incident technique in interviewing and adopting a focal

firm perspective while Howorth and Moro's (2006) article is based on semistructured interviews with 20 entrepreneurs and representatives of six banks. The question remains whether or not this is specific for a trust-related entrepreneurship research. For example, in organizational research or international business studies, trust research is dominated by quantitative methodologies. This appears to differ for entrepreneurship research: Of the empirical submissions received for this special issue, a total of six articles employed quantitative methodologies and another four used a qualitative approach.

Trust building is a topic that, surprisingly perhaps, has received little attention in empirical investigations, including the submissions for this special issue. This might be due to the fact that trust is a dynamic phenomenon, which ideally requires a longitudinal approach to convincingly investigate. Not surprisingly, for pragmatic reasons, most researchers choose cross-sectional designs. Ring and Van de Ven (1994) suggest that collecting "events" would be an effective method in order to research the process-based nature of trust. As Smallbone and Lyon (2002) indicate, relevant questions relate to how trust is built up, which includes the extent of knowledge that an entrepreneur needs of the other person in order to trust him or her.

The Articles in this Special Issue

This special issue includes two conceptual and two empirical articles. The articles written by Goel and Karri (2006) and Zahra et al. (2006) conceptually extend the role that trust can play with respect to entrepreneurship and in entrepreneurship research as outlined above.

Goel and Karri (2006) suggest a model of "over-trust" where entrepreneurs tend to trust more than what is warranted by a particular situation or decision. In their model, "over-trust" suggests either an *unwillingness* to predict the future by taking into account the potential risk involved in a relationship, or an *inability* to assess the intentions of the other party and the nature of the relationship. The authors suggest that entrepreneurs choose not to predict the future because this would involve confronting situations where objective risk assessments are not possible. Furthermore, Goel and Karri (2006) focus on exploring the relationship between personal characteristics of entrepreneurs and their tendency to over-trust, concluding that effectuation (Sarasvathy, 2001) leads entrepreneurs to over-trust.

Goel and Karri (2006) add to our understanding of the role that trust-related research could play for entrepreneurship by linking trust with decision-making processes. In applying the effectual logic developed by Sarasvathy (2001) to a case, the authors demonstrate how effectuation favors over-trust since effectual logic is applied in uncertain situations with unknown outcomes, while entrepreneurs tend to frame trust as uncontrollable, and thus over-trust. In doing so, the authors direct our attention to the "black box" of trust, implicitly indicating a need to delve deeper into the cognitive aspects of trust-related entrepreneurial behavior.

Interestingly, the authors emphasize that the fact that entrepreneurs may over-trust more often than nonentrepreneurs does not necessarily mean that over-trust will negatively influence entrepreneurship. Negative effects of trust have received surprisingly little attention in research so far, and those that have are mainly in connection with research studying corruption and its effects on either economic development or individual behavior.

Zahra et al. (2006) set out to review some of the so-called dark sides of trust in entrepreneurship, focusing on venture creation within established companies. They

discuss how this could be hampered by entrepreneurs who trust too much. Based on the different stages of business creation, the authors map out both the positive and the negative effects of trust. In doing so, they draw attention to the downside effects of trust including lock-ins, overconfidence, and the lack of effective controls because of an overreliance on trust as influences on new business creation. Zahra et al. argue for a more balanced view on trust and its role for entrepreneurship, taking into account both the positive and the negative effects.

This article highlights an important perspective on the role of trust and its influence on business relationships, which has been long neglected in the trust literature. Their article brings in an important perspective by indicating the costs and counterproductive effects that a high level of relational trust could have on entrepreneurship within the firm. With this, they illustrate the complex links between relational trust, which needs personal relations to develop, and malfeasant behavior, which could result from too much relational trust (Granovetter, 1985), thus illustrating the complex role of trust in entrepreneurship.

Two articles explore the complex relationships between entrepreneurship, trust, and the contexts in which it occurs. Howorth and Moro (2006) draw on a study of entrepreneur-banking relationships in two communities in Northern Italy, showing how both bankers and entrepreneurs use trust in their dealings with each other. These authors illustrate that within closely knit communities, it is the information from third parties, together with reputation, "gossip," and community involvement, that foster the emergence of trust. They conclude that bestowing trust will tend to increase a trustworthy behavior in the other party, which may lead to an ensuing spiral of trust. Entrepreneurs who perceive that high levels of trust are being placed on them are more likely to act in a trustworthy manner and thus *ceteris paribus*, the likelihood of moral hazard and/or loan default is lessened.

In this, the authors empirically contribute to illustrating the *asymmetry* between the growth and decline of trust. Trust would usually grow step-by-step, i.e., slowly. On the contrary, it could be destroyed rather quickly. If a deviant behavior 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.

While the Howorth and Moro (2006) article has potential implications for policy, Neergard and Uhløi's (2006) contribution is explicitly concerned with the role of government intervention with respect to the development of business networks in Denmark, with implications for trust-based relationships. Drawing on a multi-case study, Neergard and Uhløi illustrate how individuals enter into new relationships with some degree of trust and how a single betrayal makes individuals more perceptive and wary. The authors show that top-down measures will at best trigger an interest in new forms of cooperation, but at worst unintentionally destroy existing relationships and even companies. In this regard, Neergard and Uhløi complement existing research on the role of public institutions for trust, which mainly concentrated on analyzing on a macro level the relationship between the people's attitude toward government and corruption (e.g., the overview in Rothstein, 2005).

An open question is how to best build trust. Trust building is an under researched topic, both in other disciplines and in this special issue as well. At the most, the emergence of trust is tackled indirectly, but existing research so far has mainly focused on the forms and elements of trust. Partly, the problem is one of a lack of adequate data. Neergard and Uhløi (2006) take up this challenge, demonstrating the value of qualitative approaches in sketching developments over time.

Conclusions

In making an assessment of the extent to which entrepreneurship research needs to pay more attention to trust, some words of caution need to be applied. It is rare that research discusses the negative sides of trust such as overconfidence or lock-in effects in trust-based groups. Most take it for granted that trust has a (mainly) positive role to play in reducing the complexity of business operations, in allowing (business) relationships with strangers, in lowering transaction costs for business, and in facilitating network activity. In this regard, authors in this special issue highlight both the positive role that trust can play for entrepreneurship, such as with respect to new venture creation, while also, implicitly or explicitly, emphasizing the dysfunctional effects of trust on entrepreneurship. Future research on entrepreneurship and trust should pay attention to that “both enormous trust and enormous malfeasance, then, may follow from personal relations” (Granovetter, 1985, p. 62) instead of overoptimistically emphasizing the role that trust plays in embedding entrepreneurship.

Furthermore, we need to be careful not to put the label “trust” on every entrepreneurial phenomenon that involves some form of cooperation that we cannot otherwise explain. Williamson (1993) raised the question of whether or not such a concept as genuine trust really exists in commercial relationships, which is reflected in his concept of trust as a calculated risk. So far, research has demonstrated that trust within commercial relationships consists of a mixture of personal (or relational) trust and a more calculative attitude, and the individuals involved are able to “hold simultaneously different views of each other” (Lewicki, McAllister, & Bies, 1998, p. 442). In this context, more research is needed in order to identify the processes by which trust is created and destroyed.

With regard to entrepreneurship, context, and trust, there has been an extensive discussion concerning whether or not institutional environments may be divided into “low-trust” and “high-trust” categories (Fukuyama, 1995). A “low-trust” environment is said to restrict market entry, enterprise growth, and free competition while encouraging unproductive and parasitic entrepreneurship. A “high-trust” environment, on the other hand, is said to foster competition and to enterprise growth. Using this distinction, several transition countries, especially those in the early stages of transition (Smallbone & Welter, 2001b), and emerging market economies such as China (Fukuyama, 1995) would be characterized as being “low-trust”, while mature market economies such as the U.S., the U.K. or most other European countries could be called as “high-trust” countries. However, this distinction on a country level overlooks the fact that trust levels can differ across regions and localities (i.e., within countries) and also between sectors. For example, in the case of Italy, how do we classify a country that is characterized by a low institutional trust at the national level, but by a high level of interpersonal trust in business relationships within clusters of economic activity as evidenced by the literature on industrial districts or in the banking relationships of entrepreneurs in Northern Italy (Howorth & Moro, 2006)?

More generally, it appears that there is a need for greater conceptual clarity with respect to the various forms of trust and the interrelationships between them. It may be argued that an effective operationalization of trust through empirical investigation requires it. Another priority is a greater emphasis on the process-oriented investigation of trust-building and trust-breaking behavior, offering insights into how and in what circumstances trust-based relationships evolve, contributing positive and/or negative effects on entrepreneurship. Associated with this is a need for studies that are able to convincingly demonstrate the importance of trust in entrepreneurship and business development (e.g., with respect to business networks) rather than just its existence. Our conclusion is that

further research in this area is undoubtedly justified, particularly that which starts from a critical perspective with regard to the role of trust rather than assuming that trust is necessarily an inherently positive influence on entrepreneurial behavior.

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