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THE STRUCTURE OF OPTIMAL TRUST: MORAL AND STRATEGIC IMPLICATIONS

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In this article we discuss trust in ethics and management as a qualified and conditional good, arguing that researchers should focus on optimal trust—a mixture of trust and distrust appropriate in most contexts, including business. Trust is an important part of strategic choice, and managers who develop optimal trust in relationships with stakeholders will improve firm performance. We offer a definition of optimal trust, develop propositions based on the definition, and include indicators managers might use to assess whether trust is optimal in relationships with various stakeholders.

A recent explosion of interest in trust has generated a large and rapidly expanding body of literature, demonstrating trust's importance to economic life (e.g., Gambetta, 1988; Misztal, 1996; Rousseau, Sitkin, Burt, & Camerer, 1998; Smith, Carroll, & Ashford, 1995). Trust seems to be a good markets and firms can't get enough of: it helps facilitate cooperation (Mayer, Davis, & Schoorman, 1995; Smith et al., 1995), lowers agency and transaction costs (Frank, 1988; Jones, 1995), promotes smooth and efficient market exchanges (Arrow, 1974; Smith, 1981), and improves firms' ability to adapt to complexity and change (Korsgaard, Schweiger, & Sapienza, 1995; McAllister, 1995). Indeed, several recent works highlight that trust largely has been underappreciated within the management literature and that managers have not devoted sufficient time, energy, and resources to creating it within organizations. According to this stream of research, managers can find a wealth of benefits from trust, including cost savings and enhanced organizational capacities.

What is also evident is that the willingness of managers to create mutually trusting relationships is a matter of strategic choice. That is, managers can, through their behavior, help determine levels of trust in relationships between the firm and its various stakeholders. Thus, we discuss trust as an integral part of the strategy formulation process. This focus for research on trust is important because it highlights that trust is good—but a conditional good. In other words, it is possible to both over and underinvest in trust, and neither is desirable from either a moral or strategic point of view.

Firms that overinvest in trust—trust too much or invest in trusting relationships that have little value for the firm—may be misallocating precious resources and/or taking unnecessary risks that could have a substantial negative effect on firm performance. At the same time, firms that underinvest in trust—trust too little or do not invest in creating trusting relationships that have substantial value for the firm—may miss out on opportunities to create cost savings or develop organizational capabilities vital for the realization of firm objectives.

Thus, rather than focusing on trust, we begin to discuss—and theorize in terms of—the notion of *optimal trust*. We use Aristotle's ethics, which focuses on finding the "golden mean" between excess (what we call "overinvestment" in trust) and deficiency ("underinvestment") in human conduct, as a conceptual backdrop to help us ground the notion of optimal trust. This article advances the literature by indicating why optimal trust is important, offering a definition of the term, discussing its core elements, deriving

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a set of research propositions linking optimal trust to improved firm performance, and outlining implications and potential further developments of this work. Our research propositions operationalize optimal trust as a function of the match between trust levels and levels of interdependence in firm-stakeholder relationships. We focus on the actions of managers as key decision makers of the firm. Thus, when we discuss a firm's relationships with stakeholders, we include relationships with stakeholders that could be considered part of the firm (e.g., employees).

BACKGROUND ON OPTIMAL TRUST

A Definition of Trust

We begin by searching for a definition of trust that provides a conceptual foundation for a discussion of optimal trust. Research within management has focused on trust primarily in terms of what Lewis and Weigert call "rational prediction," wherein agents focus on collecting and processing information to project likely outcomes of certain future events (1985: 969). That is, agents think about trust in a highly calculative and risk-oriented fashion (e.g., Barney & Hansen, 1994; Williamson, 1985). For example, Barney and Hansen define trust as "the mutual confidence that no party to an exchange will exploit another's vulnerabilities" (1994: 176), whereas others have equated trust with cooperation in a prisoner's dilemma game (Lewis & Weigert, 1985). Conditions of trust arise when parties have something at risk. Trust is important because (and to the extent that) it promises to create preferred economic outcomes for the firm or individual (such as lower transaction or agency costs), given the risks in question (e.g., the potential for shirking or opportunism).

Although rational prediction is clearly an important part of trust, it provides a grossly incomplete understanding of trust on its own. Rather than discussing trust, authors of rationally predictive accounts of trust "appear to eliminate what they say they describe" (Becker, 1996: 47), removing core elements of trust and reducing it instead to prediction (Baier, 1994; Flores & Solomon, 1998; Lewis & Weigert, 1985). To warrant the label of trust, other conditions must be present. We identify two such other characteristics, which are closely related, that are essential to a complete discussion of trust. First, affect—that is, emotion (Weiss & Cropanzano, 1996)—is a critical element of trust between persons (Lewis & Weigert, 1985). Trust occurs because an emotional bond is created between people, enabling them to move beyond rational prediction to take a "leap of faith" that trust will be honored (Lewis & Weigert, 1985).

Second, the affective element enabling trust has a clear moral element. The emotional bond in question is not just in the relationship but is, in large part, a belief in the moral character or "goodwill" of the trustee in the trusting relationship. Ethicists have consistently stressed the importance of this belief in the moral character of the trustee (at least with respect to behaviors linked to the trusting in question) to any adequate discussion of trust (Baier, 1994; Becker, 1996; Gilbert, 1996; Hosmer, 1995). As Baier has claimed,

> If one actually reviewed all the possible bad outcomes of some avoidable dealing with another before embarking on it, the calculated risk which one then would take, if one went ahead, would scarcely warrant the label "trust." Trusting is taking not-so-calculated risks, which are not the same as ill-judged ones. Part of what it is to trust is not to have too many thoughts about possible betrayals. They would turn trust into mistrust (Baier, 1994: 196).

Indeed, this is what makes trust economically valuable. Without some element of emotional investment and self-restraint embedded within trust, agents are faced with either opportunism or higher agency or transaction costs to prevent opportunism (Jones, 1995). Because of its moral dimension, trust can mitigate both problems. For the sake of convenience, because we see the moral aspect of trust (i.e., belief in moral character) as part of affect, we will refer to these dimensions of trust as *affect-based belief in moral character.*

We highlight these features because all are critical to a discussion of optimal trust: *rational prediction* is important because it helps prevent agents from trusting blindly or foolishly; *affect* and *belief in moral character* (now affect-based belief in moral character) are critical for developing and sustaining mutually trusting relationships, as well as realizing the benefits that flow from trust. Thus, trust begins where some element of affect-based belief in moral character enters into decision making (e.g., having less than a fully effective deterrent, such as mutually assured destruction) and extends up to the point where trust is so complete as to constitute "blind faith" in the moral character of others (e.g., that between mother and child).

Based on this understanding of trust, we adopt Hosmer's formal definition of trust (1995), particularly since it highlights the importance of affect-based belief in moral character:

> Trust is the expectation by one [entity] of ethically justifiable behavior—that is, morally correct decisions and actions based upon ethical principles of analysis—on the part of the other [entity] in a joint endeavor or economic exchange (1995: 399).

We include other factors in our discussion of optimal trust. First, we discuss trust as based in particular relationships (Flores & Solomon, 1998; Rousseau et al., 1998). Other forms of trust exist and are relevant to this discussion (e.g., institutional trust; see Baier, 1994), but we focus on *mutual trust in relationships between persons—specifically, manager-stakeholder relations in a business setting.* Because of our interest in discussing trust at the macro level—between managers and stakeholder groups—the trust levels we use (e.g., low, moderate, and high) refer to the aggregate trust levels between managers and individuals within a given stakeholder group (e.g., a given supplier).

Second, our concern is primarily on the *willingness to trust,* rather than on being trustworthy. The latter element of trust is clearly important and becomes relevant when we introduce embeddedness factors, but in this article we discuss trustworthiness in terms of its implications for one's willingness to trust.

Third, *trust is socially embedded* (Granovetter, 1985). Trust exists in context and is shaped by dynamics specific to particular social settings. In his discussion of embeddedness, Granovetter demonstrates that the models used in classical and neoclassical economics (such as transaction cost economics) are undersocialized and omit "the role of concrete personal relations and structures (or networks) of such relations" in behavior (1985: 490). His analysis demonstrates the fundamental conceptual inadequacy of undersocialized approaches to trust (i.e., theories not taking embeddedness seriously), particularly for both describing and creating trusting relations.

Fourth, trust is a *dynamic and continuous variable,* rather than an either/or phenomenon (Flores & Solomon, 1998). Indeed, one can both trust and distrust people at the same time (Lewicki, McAllister, & Bies, 1998). There is a wide spectrum of trust that can vary substantially both within and across relationships, as well as over time. Relationships unfold so that individuals continually update their information base and their decisions to trust.

On The Need for Optimal Trust

In the beginning of the article, we argued that researchers need to focus on optimal trust because it is possible to both under and overinvest in trust. Further illustration of and support for this central claim is necessary.

First, it is possible to overinvest in trust. Consider the practice of lifetime employment in Japan. Many analysts see that the level of trust needed to create and sustain this practice is too great, because lifetime employment has become a substantial financial and strategic liability for many firms. Also consider "crony capitalism"—a practice that is prevalent in Southeast Asia, particularly Indonesia (McDermott, Linebaugh, & Solomon, 1998). Here, high trust among a dense network of friends and family impedes the creation of economically viable institutions in both the public and private sectors.

In similar fashion, moral philosophers have argued that people can trust foolishly, that excessive trusting can be culpable, and that "saintly trust" (i.e., trust without suspicion) can be dangerous and exacerbate abusive behavior (e.g., trusting too much, including not monitoring, can enable opportunists to steal from the firm with relative impunity; Becker, 1996; Flores & Solomon, 1998; Hardin, 1996). Take, for instance, the case of Stevens, the butler in Ishiguru's (1989) novel *Remains of the Day,* who trusts his employer, Lord Darlington, almost blindly. As a result, Stevens' trust makes him an accomplice to his employer's unwitting assistance to the Nazi war effort.

At the same time, people may underinvest in trust. Ghoshal and Moran (1996) claim that Williamson's transaction cost economics makes decision makers too suspicious of others. As a result, managers may become reluctant to use trust as a method of handling transaction problems. According to their analysis, the logic of transaction cost economics results in a spiraling of distrust, where both parties in a relationship erect costly, elaborate protections to guard against opportunism, even though both would be better off (and the transaction much less costly) if they could create more trust.

Others have put forth a similar argument with respect to the work in strategic management, especially given the influence of transaction cost economics and game theory within this literature stream. Gilbert (1996) and Solomon (1992) isolate the prisoner's dilemma as a key factor in creating an environment where individuals are less willing to trust. Gilbert argues that researchers move from the fact of misbehavior (e.g., Williamson's opportunism) to the "axiomatic use of misbehavior" as the basis for theorizing about human interactions. They each claim (along with Baier, 1994) that our attitudes about trust can be a self-fulfilling prophecy. Indeed, Gilbert argues that opportunism (or agency and transaction problems) abounds "if we go looking for it" (1996: 174). The more we assume opportunism or see the world in terms of the prisoner's dilemma (or any other heuristic, like transaction cost economics, which predisposes one against trusting), the more likely we are to think and act like the prisoners in the model and become "prisoners of the prisoner's dilemma."

Frank (1988) and Pfeffer (1994) cite several studies which suggest that when people (e.g., employers) assume that others (e.g., workers) are untrustworthy, greater amounts of opportunism are likely to occur. Reinforcing this claim, Weick (1979), Dees (1992), and Lee and Mitchell (1994) all offer evidence that the script, or conceptual frame, that agents take to an interaction can substantially affect the outcome. Thus, while overinvestment is problematic, underinvestment is also undesirable. It bypasses opportunities for more efficient and mutually beneficial exchange and creates significant added risks (e.g., opportunism) and costs (e.g., monitoring), while draining human interaction of a morally desirable trait.

THE STRUCTURE OF OPTIMAL TRUST

Background on Optimal Trust

As a prelude to defining optimal trust, we briefly discuss Aristotle's ethics to provide a conceptual framework for optimal trust. His approach to ethics led us to focus on optimal trust, rather than trust. Even though we found no specific discussion of trust in Aristotle's writings, our notion of optimal trust fits naturally within his ethical thought. His work also provides a framework in which the elements of trust discussed so far—rational prediction and affect-based belief in moral character—are interconnected and part of a larger moral theory.

Aristotle's work (1986) focused on individual character understood in the context of the polis (i.e., community). The highest good for human beings—eudamonia (living well)—came through cultivation of virtues or human excellence. Virtues are golden means between extremes; excess or deficiency in these tendencies represents vices. For instance, in response to danger, the extremes are cowardice and recklessness; the mean is courage. We position optimal trust as a form of the "golden mean" Aristotle discussed. From his work on the golden mean, we can infer that one ought to have a stable and ongoing commitment to trust but that judgments about trusting others should be made carefully, realistically, even prudently. Aristotle's golden mean does not dictate that there should always be "moderate" levels of a trait, such as trust. Rather, it implies that trust levels should be appropriate to the context and may fall anywhere on the spectrum, from minimal trust to high trust, depending on the person and situation. We suggest that Aristotle's "virtuous person" would be an astute creator of what we term optimal trust: knowing whom to trust, how much to trust them, and with respect to what matters.

It is also important to indicate why trust is morally desirable. First, it is a characteristic of human flourishing within community—a form of excellence within individuals that also enables the community to thrive. Second, the emotional states associated with trust suggest its goodness. As Baier (1994) claims, mutual trust in relationships—when people feel they can trust others and are worthy of trust in return—provides a critical basis for self-esteem and a sense of security. In contrast, when people feel distrust toward others or are themselves not trusted, their self-esteem can be harmed and their sense of security compromised. Since trust is a moral good, persons should strive both to cultivate trusting relations and to be seen as trustworthy. These qualities are themselves a mean between extremes that Aristotle might have described as naiveté (trusting too much) and cynicism or distrustfulness (trusting too little). For it to be morally good, trust should not perpetuate or facilitate evil, should be self-strengthening, and should produce metatrust: trust in trust-involving relationships (Baier, 1994).

Now that we have provided a conceptual backdrop for discussing optimal trust, we offer the following interpretation of the term:

> *Optimal trust exists when one creates (and maintains)* prudent economic relationships biased by a willingness to trust. *That is, agents need to have stable and ongoing commitments to trust so that they share affect-based belief in moral character sufficient to make a leap of faith, but they should also exercise care in determining whom to trust, to what extent, and in what capacity. Optimal trust is an* embedded construct, *suggesting that it is determined in context and shaped by a variety of factors, such as the trustworthiness of the agent, local and broader social norms regarding trust, and other features of the relevant social structure(s).*

Background Discussion of Prudence with a Bias Toward Trust

The term *prudence* captures both the rational prediction and affect-based belief in moral character elements that are part of a complete account of trust. Rather than being an endorsement of unconstrained greed or opportunism, prudence presupposes a moral foundation and moral constraints—it is driven by a broader sense of the term *self-interest* (i.e., particularly the desire for community and the respect of others) and shaped by an array of moral concerns (e.g., fairness, decency, and respect). Werhane (1991) makes a compelling case that Adam Smith, who was both moral philosopher and economist, had a very similar understanding of self-interest in his classic writings on capitalism (Smith, 1981). That is, prudence is placed in a larger moral context while it retains the calculative elements found in the strategic management literature.

Both individuals and organizations should seek to trust and be trusted (Baier, 1994), not only because it is a desirable moral quality but because it also creates economic benefits for the self and others. However, as the above discussion highlights, this posture is quite different from naiveté. Our definition of optimal trust makes the bias toward trust explicit to express the importance of this good and the need for all parties within a given community to uphold it. That is, persons should be more willing to take risks with trust because such decisions are now driven by factors other than rational prediction and because of their commitment to trust.

Two computer simulations in game theory offer support for the idea that prudence biased by a willingness to trust leads to positive performance. First, in Axelrod's (1984) "tournament" of various strategies in a repeated-play prisoner's dilemma, the winning strategy was "tit for tat." This protocol specified an opening play of cooperation, with subsequent plays that imitated the behavior of the opponent on the previous play. A central feature of this strategy was consistent punishment of opportunism and forgiveness when the other returned to cooperation. This approach was proven far superior to approaches that were fundamentally uncooperative (i.e., defection) or universally cooperative. When "noise," an inability to precisely identify the move of one's opponent on the previous play, was introduced to the game, the winning strategy was "tit for two tats" (i.e., retaliation only after two defections). This, too, suggests that a leaning toward trust is desirable but that such trust needs to be tempered by a willingness to punish uncooperative behavior and to foster trust in one's partners.

Second, similar results have been found in variations on a prisoner's dilemma computer simulation done by psychologists (e.g., Messick, 1994). When Messick placed together unconditional cooperators ("saints"), unconditional defectors ("rogues"), and conditional cooperators ("pragmatists") who cooperate with cooperators but not defectors, he found that pragmatists dominated the other two strategies. This indicates that a bias toward trust, shaped by prudence, offers an appropriate balance for economic relationships (i.e., relationships are often among relative strangers, each of whom is likely to be self-interested). Although certain market conditions may limit the advantages of this strategy (e.g., high information distortion, nonrepeated exchanges, or weak or absent markets for reputation), prudence biased by a willingness to trust would appear to be a viable strategy even in these contexts (Frank, 1988).

Research on enactment and trust in economic relationships also reinforces the idea that a bias toward trust is beneficial. The above discussion on behavioral assumptions and scripts leading to a self-fulfilling prophesy demonstrates the value of an affect-based belief in moral character. Skeptical or indifferent behavioral attitudes can undermine the potential for developing trusting relationships. Without a bias toward trust, managers may miss out on important opportunities to create trust and gain the associated benefits. Allowing prudence to temper this inclination also helps avoid inappropriate risk taking and can help discourage opportunistic behavior by one's partner.

Having provided this explanation and support of the definition, we now turn to a more specific application of optimal trust. We operationalize optimal trust in terms of a related variable, interdependence within relationships, and develop research propositions on that basis. In the final section we further discuss embeddedness and its implications for the theory and application of optimal trust.

THEORY DEVELOPMENT AND PROPOSITIONS BASED ON PRUDENCE WITH A BIAS TOWARD TRUST

Matching Interdependence and Trust Levels

One highly relevant way to theorize about optimal trust is to link various levels of trust to levels of interdependence in manager-stakeholder relationships. When trust and interdependence levels are appropriately linked, we argue that there is a "match." Our use of matching derives from Venkatraman's (1989) discussion of the term. He introduces matching as one of several possible uses of the notion of "fit" in theory construction. In the case of matching, the focus is on the fit between two distinct variables "independent of any performance anchor" (Venkatraman, 1989: 430–431). However, propositions will typically explore the presence or lack of fit in terms of their implications for performance. When a match is present, performance usually is enhanced; when there is a mismatch, performance declines. We discuss firm-stakeholder relationships in terms of levels of interdependence on a continuum that ranges from interdependence to moderate interdependence to independence. In the sections below, we define interdependence in terms of its role in firm strategy and discuss both matching and mismatching, developing associated research propositions that predict the performance implications of each.

Management scholars use the term *interdependence* to suggest the presence of mutual dependencies between two parties (Calton & Lad, 1995; Garud & Kumaraswamy, 1995; Powell, 1987). That is, the degree of interdependence in a relationship is a function of the degree to which both parties are dependent on each other to achieve their desired outcomes (Bresser & Harl, 1986; Calton & Lad, 1995; Garud & Kumaraswamy, 1995; Geyskens, Steenkamp, Scheer, & Kumar, 1996; Powell, 1987; Thorelli, 1986). *Dependence,* here, is understood as the extent to which outcomes are controlled by, or contingent upon, the action of another party (Victor & Blackburn, 1987). Where manager-stakeholder relationships have (virtually) no significant dependencies, they are *independent.* If mutual dependencies are significant but not high, we consider them moderately interdependent. If the mutual dependencies are high, we consider them interdependent. Calton and Lad's (1995) typology of market, hierarchy, and network provides a useful illustration of the points along our spectrum of interdependence: reliance on markets is an example of an independent relationship; hierarchy indicates some, but limited amounts of, interdependence (i.e., moderate interdependence); and networks are a classic example of interdependence.

This focus on (inter)dependence is useful for theorizing about trust in an economic context, for several reasons. First, trust becomes both possible and important in contexts where parties have something at risk. Thus, where dependence (i.e., risk) exists, trust becomes a potential coping mechanism; as it increases, so too does the potential need for trust. Second, resource dependence theorists (Pfeffer & Salancik, 1978) highlight the strategic importance of (mutual) dependence between managers and other stakeholders: firms may depend on a wide variety of stakeholders to gain access to—or utilize—resources critical to firm performance and competitive advantage. Thus, interdependence provides not only a useful conceptual link to trust but, particularly from a resource dependence standpoint, it underscores the value of trust as an efficient mechanism to help manage stakeholder interdependencies. Third, like trust, managing interdependence has become highly important to firm strategy. According to several authors, numerous organizations across a broad array of industries utilize strategies that involve significant levels of interdependence with various stakeholders. Factors such as increased competition, the growth of technology, the importance of information and risk sharing, and the pace of change all help drive this emphasis (Calton & Lad, 1995; Oliver, 1990; Powell, 1987; Thorelli, 1986). In short, trust and interdependence, as independent constructs, have considerable and growing significance for firms.

In this article we select the interdependence continuum—that is, cases where the level of dependence between parties in a trusting relationship are roughly comparable—as the focus of our theorizing about optimal trust. Other forms of dependence (e.g., unidirectional dependence) exist and deserve further study. Particularly when managers are dependent on other stakeholders who possess key resources, the ability to trust those stakeholders may be especially valuable for the firm. As with interdependence, managers need to consider the costs, benefits, and risks, as well as embeddedness factors (see the section "The Influence of Embeddedness on Creating Optimal Trust") in making trusting decisions. However, we leave these cases for future work, owing to the special problems they raise, particularly for discussing mutual trust in relationships. For example, without roughly similar levels of dependence, mutual trust is impossible (i.e., because one party need not trust in cases where dependence is unidirectional) or can become unstable (i.e., both parties desire substantially different levels of trust in the relationship, which, in turn, may lead to cognitive dissonance and/or conflict). Attending to these issues creates significant theoretical issues that require more detailed consideration than is feasible in this article.

We suggest that interdependence can vary substantially across firm-stakeholder relationships and that this is often dictated by the conscious choices of managers (as well as the stakeholders with whom they interact). Our use of "interdependence" indicates that even though certain categories of stakeholders (e.g., workers, suppliers, or customers) may be essential to making the firm an ongoing concern, firms choose different levels of interdependence with them. That is, even though a firm may be dependent on a class of stakeholders (e.g., suppliers), it may or may not depend on a specific stakeholder group (e.g., supplier X), according to how managers choose to structure such relationships.

Consider the case of suppliers. Some companies develop close, exclusive, and ongoing relationships with suppliers, which we would consider interdependent, based on our definition. Toyota, for example, has developed a "pattern of dense, reciprocal ties" with its suppliers (Powell, 1987: 76). This involves actively fostering high degrees of information and resource sharing, mutual dependence, and fidelity (i.e., minimal reliance on markets) and relies extensively upon voluntary cooperation (Powell, 1987). At the other extreme are firms that rely on multiple suppliers, make no investments in an ongoing relationship with any of them, and use market factors to select suppliers—characteristics we would consider independent. U.S. auto manufacturers provide a classic example of this in their relationship with suppliers in developing countries (Powell, 1987). Thus, as we move across firms, industries, and markets, we expect to find a range of interdependence between firms and specific stakeholder groups—even those groups that are nonetheless necessary to making the firm an ongoing concern.

Matching refers to the degree of fit between trust levels and interdependence levels in a given firm-stakeholder relationship. It provides a conceptual mechanism to help identify appropriate levels of trust so that firms can avoid over and underinvestment, and it provides a way to identify optimal trust levels within a particular relationship: when trust and interdependence are matched, trust levels are optimal for that relationship. Matching the firm-stakeholder relationship to a given trust level does not provide a road map for achieving this level of trust or indicate whether either the degree of interdependence or trust level in question can feasibly be created in a given situation. Careful attention to "embeddedness factors" (which we discuss in "The Influence of Embeddedness on Creating Optimal Trust" section) underscores important contextual information that is vital for firms determining what relationship (and trust level) is desirable with a specific stakeholder.

Mismatching occurs when the wrong levels of trust are linked to a given level of interdependence. One version of mismatching occurs when the firm does not have enough trust to sustain the level of interdependence it is attempting to create (e.g., firms trying to develop single supplier relationships or forms of team production in low-trust relationships). For example, in the late 1980s many of the American auto makers shifted to more interdependent firm-stakeholder relationships in the face of Japanese competition. However, a key stumbling block to the effective implementation of these initiatives was the history of labor-management distrust, a problem which was clearly in evidence within the U.S. automobile manufacturing industry. Qualitative research on the NUMMI auto manufacturing plant provides a specific example of the debilitating effects on productivity when significant levels of interdependence are pursued in a low-trust environment. The example also underscores the critical importance of creating trust—something that took substantial effort and investment for NUMMI managers to do—to the dramatic productivity improvements that were created in the plant (Adler, 1993).

Mismatching also can occur if the firm invests too much in creating and maintaining levels of trust that go beyond that indicated for a given relationship with a stakeholder. Consider, for example, the position of a supplier. If its relationship with the management of a given firm has low or moderate interdependence, investing in creating and sustaining a high-trust relationship could cost both firms precious resources. In addition, if the supplier tries to create a high-trust relationship and acts on that basis, it may face severe penalties, including having trust-based agreements renegotiated (e.g., for lower cost and/or greater quality specifications than were agreed to) or canceled (Bowie [1994] and others note behavior of General Motors toward its suppliers that is consistent with this example). Selecting a trust level that is too high creates a suboptimal hedge against opportunism (i.e., too few incentives to deter opportunism, given the interdependence level) and misuses the resources of both organizations (i.e., too many resources invested in creating or sustaining trust).

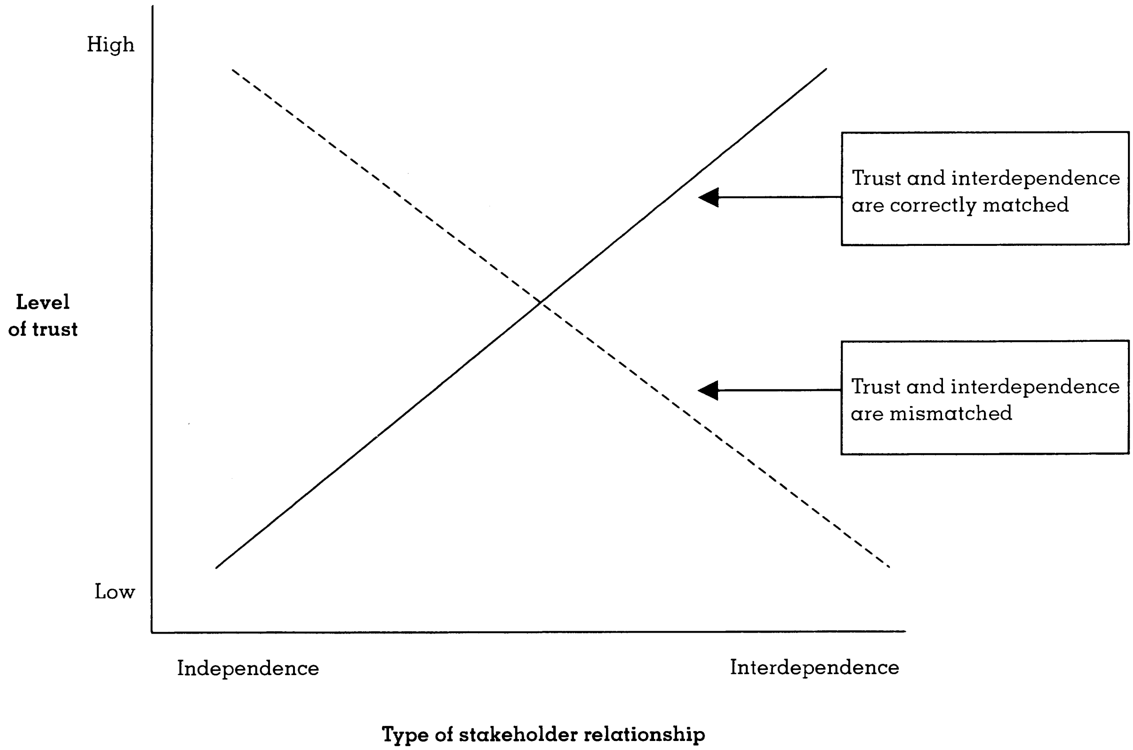
Note, however, that we may find examples of investment in trust beyond the match that are desirable (certainly ethically and possibly strategically as well). For instance, there may be cases where higher levels of trust are relatively easily created, cost the firm little, and do not pose significant risks. In such cases, overinvestment is not a concern, because it does not appear to create significant negative effects on organizational performance. Thus, matching refers to the wise creation of trust to support firm-stakeholder relationships (see Figure 1).

Our theorizing focuses on the trust-interdependence interface. Because of this, in our development of research propositions, we assume that managerial decisions about interdependence levels within firm-stakeholder relationships are strategically sound. Indeed, in order for trust levels to positively affect firm performance, managers need to pursue strategies—and types of relationships—that make sense for the firm.

The Link Between Matching and Firm Performance

In Table 1 we outline the benefits, costs, and risks associated with different levels of trust. This provides key conceptual resources for our claim that various levels of interdependence in relationships with stakeholders and trust levels can be matched. We expect a relationship between matching and firm performance because firms that create a match between the level of interdependence and trust level avoid the costs associated with over and underinvestment in trust (see Figure 2). Overinvestment is problematic because it requires significant costs and risks to sustain trust, which can negatively impact firm performance. Underinvestment is also undesirable because firms miss out on the potential to use trust to lower costs as well as to enable certain organizational processes that may be crucial to firm performance. In short, Table 1 begins to specify much of what Aristotelean analysis typically leaves ambiguous when discussing the golden mean: it highlights some of the specific factors and indicators that determine whether trust levels are indeed optimal.

FIGURE 1
Matching Trust and Interdependence Levels



Trust Levels

Table 1 also helps clarify how consideration of optimal trust is part of the strategic choice process. Firms need to consider the dynamics of trust—specifically, how different trust levels offer certain benefits, costs, and risks, as well as the kinds of interaction with which they appear best suited. We outline these characteristics in Table 1, focusing on three levels of trust—low, moderate, and high—which we see as representative points across the continuum of trust. They are meant to signify levels of trust that go beyond ambient levels of trust in a classic economic exchange between self-interested strangers. The points on the continuum indicate a shift of emphasis from

- **low:** primary reliance on rational prediction (e.g., monitoring, incentives, and penalties to induce cooperation) with small elements of affect-based belief in moral character, to
- **moderate:** significant emphasis on both rational prediction and affect-based belief in moral character, to
- **high:** primary reliance on affect-based belief in moral character and some reliance on rational prediction.

Building on these associations, Table 1 helps to operationalize the idea of optimal trust. By "optimal" we mean levels of trust that meet either (or both) of two criteria: (1) provide essential capacities that enable the effective implementation and maintenance of organizational strategies and processes (e.g., team production or single supplier relationships) and (2) provide benefits to the firm (e.g., cost savings, reduced risk, and/or strategic advantage) that outstrip the costs and risks required to develop and maintain trust. When trust and interdependence levels are matched, trust is optimal.

High trust. In high-trust relationships, firms rely extensively on affect-based belief in moral character and shared values to maintain their relationship with various stakeholders and rely comparatively little on incentives. The basis of this mutual confidence typically will be what social network researchers term *strong ties:* extensive interaction, mutual affection, and a history to their relationship (Krackhardt, 1992).

High trust levels are optimal for firms in interdependent relationships with stakeholders, given the profile of benefits, costs, and risks

TABLE 1
Profile of Trust Levels and Associated Costs, Benefits, and Risks

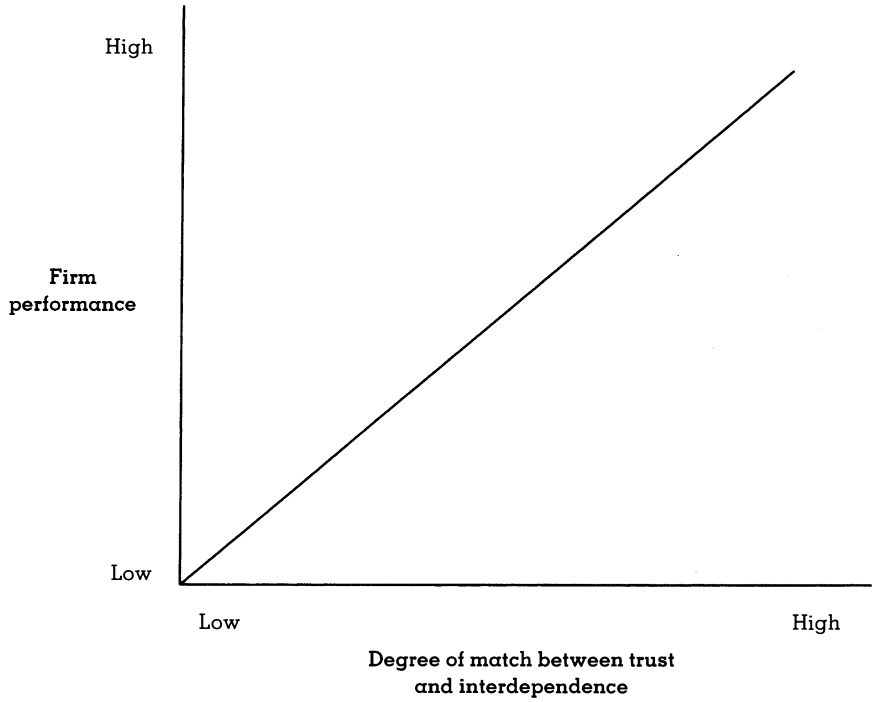
Level	Costs	Benefits	Risks	Associated With
High trust	Few options and alternatives	Low agency and transaction costs	Assessing betrayal	Strong ties
	Limited monitoring ability	Preferred trading partner	Betrayal	Interdependent relationship
	Costs of creating and maintaining relation	High capacity for adaptation, cooperation, and commitment	Divorce	
			Stifled creativity	
Moderate trust	Some agency and transaction costs	Significant options and alternatives	Worst or best of high trust and low trust?	Weak ties
	Some capacity for adaptation, cooperation, and commitment	Some monitoring ability	Reputation	Moderately interdependent relationship
	Some costs of creating and maintaining relation	Preferred trading partner		
Low trust	High agency and transaction costs	Many options and alternatives	Opportunism	Few or no ties
	Low capacity for adaptation, cooperation, and commitment	Low cost of relationship	Encouraging opportunism	Independent relationship
	No preferred partner	Great deal of monitoring	Insufficient commitment	

associated with high trust (as well as the link between strong ties and high trust in network analysis). The strategic intent behind utilizing interdependent relationships relies heavily on developing the benefits from high trust to enable their strategic processes and to enhance firm performance. When high levels of trust are present, both agency costs (e.g., monitoring costs, bonding costs, search costs, warranty costs, and residual losses) and transaction costs can be reduced substantially (Aoki, 1988; Frank, 1988; Hill, 1990, 1995; Jones, 1995)—factors that help justify the investment in an interdependent relationship. One example of this saving is the potential to invest in specialized assets (e.g., highly unique components for an auto manufacturer), given the commitment of a partner to engage in an ongoing relationship based on high trust (Aoki, 1988; Hill, 1995).

Other benefits include the ability to have stakeholders (e.g., workers or suppliers) engage in more complex tasks, act as willing partners who readily adapt to change, cooperate without explicit incentives, and act in the firm's interest (Aoki, 1988; Hill, 1995; Lewicki & Bunker, 1996; Pfeffer, 1994). Many new organizational forms (networks, strategic alliances, and joint ventures) and management initiatives (team production and total quality initiatives) entail significant degrees of interdependence and rely either directly or indirectly (e.g., via the importance of cooperation and organizational commitment) on trust to function properly (Calton & Lad, 1995; Frank, 1988; Hill, 1995; Jones, 1995; Pfeffer, 1994). Especially if the mutual dependencies are linked to highly valuable resources, then the efficiency, complex coordination, commitment, and creativity that high trust can create will be particularly valuable—perhaps even essential. These characteristics within such a relationship are also likely to be difficult to imitate, therefore increasing their potential to create competitive advantage (Barney, 1991).

In essence, high trust allows interdependent relationships to function smoothly and realize the strategic objectives behind their creation. Trust provides the "glue" to hold such relations together and the lubrication needed to facilitate complex coordination in a highly efficient manner (Calton & Lad, 1995; Hill, 1995; Hosmer, 1995;

FIGURE 2
Degree of Match and Firm Financial Performance



Jones, 1995). At the same time, the creation of an interdependent relationship can provide a foundation for developing and sustaining high levels of trust. When parties are willing to invest in their relationship and create interdependence—if it is anchored in affect-based belief in moral character—there is a foundation for parties to take a leap of faith and create high levels of trust.

The costs and risks of creating high trust are significant. Especially if the resources in question are highly valuable, the costs and risks of opportunism may be particularly acute. However, for firms that decide to pursue an interdependent relationship, these costs and risks appear to be explicit tradeoffs the firm is prepared to accept. The limitations of high trust are outweighed by the comparative benefits found from combining high trust and interdependent relationships. Investment in the relationship is costly, but firms do gain significant cost savings when high trust is present. Most important, they enable value creation from interdependent relationships (e.g., task complexity and voluntary cooperation), which should outstrip the costs and risks of relationship investment. Without high trust, stakeholders may attempt to extract higher rents, refuse to cooperate willingly, and fail to identify with the firm's interest, all of which can add agency and transaction costs, as well as undermine the potential to generate the key benefits of an interdependent relationship (e.g., introducing complex processes). In short, building mutually trusting relationships creates flexibility, commitment, durability within the relationship, creativeness, and strong social ties. Given this, we expect the following:

> *Proposition 1: In terms of stakeholders with whom managers have an interdependent relationship, firms with managers who are able to create high levels of mutual trust will exhibit higher levels of performance.*

> *Proposition 2: In terms of stakeholders with whom managers have an interdependent relationship, firms with managers who create low levels of mutual trust will exhibit lower levels of performance.*

Low trust. In low-trust relationships, firms depend primarily on rational, prediction-based inducements to limit opportunism, although some affect-based belief in moral character may be present. Here, a firm typically will have few or no ties with the stakeholder, so they operate as virtual strangers, and each does not have (or does choose not to extend) sufficient belief in moral character to develop significant levels of trust in the relationship (Krackhardt, 1992).

Low trust levels are optimal for independent firm-stakeholder relationships, given this profile of benefits, costs, and risks associated with low trust. Firms seeking independent relationships attempt to economize on costs with respect to a specific stakeholder and to avoid the risks and costs associated with interdependent relationships (see Table 1). Although low trust may entail higher agency and transaction costs, firms may rely on market mechanisms to economize on costs and engage in monitoring to help guard against opportunism. All of these benefits are important within an independent relationship as firms try to limit their ties to specific stakeholders and rely on markets to enhance performance. When pursuing an independent relationship, firms do not need the high levels of trust required to get stakeholders to go the extra mile and actively cooperate or advance the interests of the firm, particularly since creating higher levels of trust can be costly. In resource dependence terms, managers are not (or need not be) dependent on that stakeholder to either create or gain access to strategically important resources. In short, firms seek to do their business in ways not requiring high levels of trust to function (e.g., relative task simplicity; relatively weak stakeholders and/or strong markets of alternative stakeholders with which to contract).

Although trust may be valuable even in an independent relationship, the comparative costs (e.g., investment in relationship or limited ability to seek alternative partners) and risks (e.g., inability to monitor or tying their fate to that of a given stakeholder) of creating high trust outweigh the benefits it provides. Indeed, if high trust is present and the firm seeks an independent relationship, the stakeholder in question (e.g., a supplier) may feel taken advantage of when the firm contracts with rivals (e.g., another supplier), which may undermine the potential for sustaining high trust levels in the relationship. Without a credible commitment to invest in a relationship based on belief in moral character, the foundation for high levels of trust appear to be minimal. Given this, we expect the following:

> *Proposition 3: In terms of stakeholders with whom managers have an independent relationship, firms with managers who do not make substantial investments in creating high levels of mutual trust will exhibit higher levels of performance.*

> *Proposition 4: In terms of stakeholders with whom managers have an independent relationship, firms with managers who make substantial investments in creating trust will exhibit lower levels of performance.*

Moderate trust. In moderate-trust relationships, there will be a relatively balanced reliance on affect-based belief in moral character and incentives to preclude opportunism. The foundation of the relationship will be some history of interaction and mutual affection (i.e., what social network analysis terms *weak ties*), but to a lesser extent than that found in high trust.

Moderate trust levels are optimal for moderately interdependent relationships given the profile of benefits, costs, and risks associated with moderate trust (as well as the link between weak ties and moderate trust in network analysis). Strategies that foster moderately interdependent relationships rely on the benefits of trust needed for interdependence but to a lesser degree. Firms in moderately interdependent relationships clearly want trust levels significant enough to lower agency and transaction costs, as well as to enable moderately interdependent activities (e.g., task complexity with workers or suppliers). A firm may have significant mutual dependencies that are critical for its ability to create—or gain access to—key resources, but various strategic concerns lead it to limit both interdependence and trust (e.g., concerns about the costs and risks of opportunism). In short, firms seek many of the benefits of high trust/interdependence discussed in support of Proposition 1. However, they also want to economize on costs.

Managers in this section of Table 1 either have limited dependence on a given stakeholder for strategic resources, or they see a favorable cost/benefit/risk scenario for limiting their interdependence. Involved firms typically want some market flexibility and/or want to ensure that their own fate is not too closely linked with that of any of their specific stakeholders. They also may want significant protections against opportunism. That is, they desire many of the benefits of low trust/independence discussed in support of Proposition 3. Particularly if firms have sufficient reputation for maintaining trusting relationships in the past, new partners have a foundation for extending affect-based belief in moral character and creating moderate levels of trust, even without significant previous interaction. Given this, we expect the following:

> *Proposition 5: In terms of stakeholders with whom managers have a moderately interdependent relationship, firms with managers who create moderate levels of mutual trust will exhibit higher levels of performance.*

THE INFLUENCE OF EMBEDDEDNESS ON CREATING OPTIMAL TRUST

We conclude theory development by elaborating further on embeddedness and its importance to optimal trust. To this point, we have focused on creating relevant theory-based targets—matches between trust and interdependence levels—for firm-stakeholder relations. We now shift to emphasize how embeddedness both supplements and complicates such decisions. Like other virtues, appropriate trust levels can only be determined in context and may vary substantially depending on the person, subject of trust, relationship, and broader context. Work within the management literature helps to specify this dynamic and relative quality of trust.

Trustworthiness of the Trustee

Mayer et al. (1995) claim that decisions to trust depend on three critical factors that determine the "trustworthiness" of the trustee: ability, benevolence, and integrity. If the potential trustee has the requisite competence to perform the tasks they will be entrusted with, if they are perceived as benevolent (having goodwill) toward the trustor, and if the trustor believes that they have a high level of integrity, then trust is—other things being equal—likely to occur. Particularly the latter two characteristics suggest that agents who are more likely to be trusted will shun opportunism and act with decency, fairness, and respect and will keep their promises—all factors that limit the range of strategic thinking and emphasize the complex mixture of rationally predictive and affect-based belief in moral character elements necessary to create trust. Thus, as managers determine appropriate levels of trust within relationships, they need to consider the trustworthiness of stakeholders in their decision making.

Context of Trusting

Context moderates how the variables from Mayer et al.'s (1995) model influence trusting. Thus, we treat it as a separate variable. There are empirical studies showing that the levels of trust and opportunism vary across cultural context (Fukuyama, 1995; Hill, 1995; Shane, 1994). Although to a certain extent such shifts should play out in terms of evaluations of individual characteristics (i.e., they affect judgments about benevolence and integrity), they may add a new dimension to choices of whether to trust. That is, in certain contexts a particular individual may be highly rated in terms of Mayer et al.'s model, but the larger context may make trusting them unwise, may suggest alternative arrangements that are less visibly trusting, or may indicate the need for lower levels of trust.

For instance, consider employees. Based on Mayer et al.'s model, a firm may decide to develop higher levels of trust with a given employee because of their rating highly across the three dimensions and because of management's belief that such trust may create significant benefits (i.e., lower monitoring and administrative costs). Yet, if the context shifts from a background environment (i.e., the broader culture, industry, and/or institutional setting) that has customs and incentives reinforcing integrity to one where defection and opportunism are common, the decision about trusting may also change, even though the estimation of the trustworthiness of that particular individual may not change. This may well be because high integrity and benevolence are not enough to assure us that the agent will not defect, or because of the signals sent to other groups that arise from trusting that individual (e.g., resentment, damaged reputation, and/or inviting opportunism).

Avoiding Opportunism

Several different works on trust indicate that managers cannot approach trust in a purely rationally predictive way if they are to create optimal trust. That is, there needs to be consistency in managerial behavior over time in avoiding opportunism. As indicated above, Mayer et al. (1995) identify integrity as a critical factor in shaping whether others will trust. If management acts opportunistically toward a given stakeholder, this is likely to have an effect not only on future interactions with that stakeholder but on other relationships as well (i.e., a "spillover effect"). Because of these actions, other stakeholders likely will rethink their attitudes about the trustworthiness of management. Managers who do not restrain from opportunism will find their capacity to generate trust substantially diminished. As Jones claims, "[A] reputation for trustworthiness is really a reputation for not being opportunistic" (1995: 421). Thus, we would expect firms that attempt to create substantial levels of trust in relationships (i.e., moderate to high trust) with stakeholder groups to be consistent in terms of avoiding opportunism.

Commitment to Trust

Having an affect-based belief in moral character approach to trust also appears critical. Frank's (1988) work on trust reinforces this idea. He found that managers who trusted primarily for selfish reasons would sometimes behave opportunistically and were caught with sufficient frequency that it was very hard for them to sustain a reputation for trustworthiness. Thus, although managers can shift trust levels over time in particular relationships, Frank's work suggests that an affect-based belief in moral character commitment to trust is extremely important to generating and maintaining trust over time. He also suggests that it is difficult to fake because of various facial expressions, gestures, and other emotional cues that tend to reveal one's true motivation (e.g., goodwill or purely strategic motivation).

Firms wanting to develop substantial levels of trust with stakeholders must employ managers who are more than opportunists and rational predictors. Here again the bias toward trust becomes important, for it can demonstrate a willingness by management to take a leap of faith to create trust. This, in turn, builds up management's credibility as trustworthy and further enables it to maintain and/or extend trusting relationships. In short, managers will have to do the hard work of creating trusting relationships—a task that requires considerable investment, both morally and financially, but that also promises substantial rewards along the same dimensions.

Implications of Embeddedness for Optimal Trust Propositions

These embedded aspects of trust suggest the messy reality of trying to create and sustain trusting relationships. They complicate how we actually make optimal trusting decisions. Context prevents trust from being a variable that can simply be rationally manipulated as the propositions might otherwise imply. Recognizing these various contextual factors and appreciating their importance should inform managerial decision making, for these factors provide additional inputs that need to shape how managers approach strategic decision making, particularly with respect to trust levels.

For instance, managers may be highly confident that, given the workers the firm has, high levels of trust will be either very difficult to create—owing to a history of mistrust—or too costly. One might think of the daunting task of creating interdependent strategies in U.S. auto manufacturing given the history of mistrust and conflict between management and workers. If managers determine that desired optimal trust levels are either unattainable or too costly to create, they can use this information to either alter the kind of relationship they want to create with workers (e.g., to one matched with trust levels that are feasible) or seek out a new workforce. This reality does not alter the propositions offered in this article, but it does indicate how embeddedness provides additional factors that help managers find trust-interdependence matches that are appropriate for their particular situation.

IMPLICATIONS AND DIRECTIONS FOR FUTURE RESEARCH

Increased attention to trust has opened up important new avenues in management research and enabled firms to create added value across moral and strategic dimensions. Yet, the emerging literature has paid insufficient attention to the core dynamics of trust and its status as a conditional good. This article demonstrates how trust is relevant to all organizations and is a significant part of the strategy formation process. These insights have led to the development of optimal trust—a concept that can help firms avoid both under and overinvesting in trust. We have defined optimal trust and developed a series of empirically testable research propositions linking optimal trust to firm performance.

One important step involves empirical testing of the propositions. We have made a conceptual case for the predicted relationships, but extant empirical support for them is minimal. Given our use of the matching concept, Venkatraman's work (1989) suggests the development of scales for both the interdependence and trust constructs. The testing of the research propositions would then assess the correlation between deviation scores and performance. Our theory suggests that higher performance would be related to lower deviation scores. Based on the research cited here suggesting that optimal trust levels will likely vary across context—especially country (Fukuyama, 1995; Shane, 1994) but also industry and individual levels—we recommend that empirical work begin with localized studies (e.g., keeping country and industry the same). Researchers could then, based on multiple studies, determine if (and under what conditions) any broader generalizations about trust are true.

One interesting test of the propositions offered here would involve an investigation of the evolving firm-stakeholder relationships in Japan. Historically, Japanese firms have developed relatively high levels of interdependence and trust within firm-stakeholder relationships (Aoki, 1988; Hill, 1995). Current economic restructuring has led many firms to scale back their commitment to various stakeholders (e.g., workers), thereby potentially eroding trust levels. Based on our theory development, Japanese firms involved in such relationships would either need to scale back the level of interdependence to match the trust levels that are attainable in the present environment or face significant limitations on firm performance.

There is also a need for additional theorizing regarding optimal trust. We have focused our theorizing in terms of matching trust and interdependence levels in firm-stakeholder relationships, but there are two clear limitations to this approach. First, there may be a number of other variables that could be used to theorize about optimal trust. Indeed, there may be a range of other factors or frameworks that might help managers more accurately and consistently understand what constitutes optimal trust and enable them to create it in context. Second, we have employed a specific form of the notion of fit (Venkatraman, 1989), but other forms of fit may also help describe the relationships between trust and interdependence. Such creative theorizing is an important priority for future work on optimal trust.

There are some related empirical studies on how trust occurs that may provide critical insights for future discussion of optimal trust. One such avenue would include further study on how trust is created and sustained over time. This would involve research that can better clarify the role and significance of both the willingness to trust and the various embeddedness factors on how trust works. Another focus for future work is the interaction between the rationally predictive and affect-based belief in moral character elements of trust.

Such studies would help to identify the proper blend of these elements in various relationships. In particular, such examination could help managers ensure that rational prediction does not erode trust and affect-based belief in moral character does not breed naiveté and abuse. Further, empirical study of interdependent networks of stakeholders (Calton & Lad, 1995; Rowley, 1997) can cast light on how trust evolves in context among groups. This research would prove fruitful for empiricists striving to learn more about how trust works, and it would also be valuable for ethicists trying to gain insights into how rule building evolves in context and seeking to provide guidance for how it ought to proceed

(Donaldson & Dunfee, 1994; Wicks, Gilbert, & Freeman, 1994).

Optimal trust also could be applied at other levels of analysis. The primary focus of this article has been manager-stakeholder relationships, but the analysis could extend easily to trust at the institutional or macrosocietal level. This work appears especially relevant, particularly given the critical role that institutional trust plays in shaping trust levels in business transactions. In the wake of works like Fukuyama's (1995) and the emerging evidence that societies need to optimize trust levels, which may be significantly different based on their needs, traditions, and goals, such an undertaking would appear highly fruitful. The benefits of trust would appear to be that much greater and more attainable for most businesses if societies can shore up "the commons" of trust—particularly certain forms and levels of trust that have special social and economic value. In addition, optimal trust may also be usefully applied at the micro level, although doing so adds additional nuances and complexities for theory creation (see, especially, Sheppard & Sherman, 1998, who discuss trust and interdependence; Lewicki et al., 1998; and Jones & George, 1998).

Research exploring the normative and philosophical underpinnings of optimal trust is also warranted. We have already highlighted connections between Aristotle and optimal trust, but more developed and systematic analysis would provide important additional insights into optimal trust and its moral foundations. Extant moral theories can help analyze the normative merit of different approaches to trust and help illustrate where the logic of trust may constrain or fundamentally alter "strategic thinking." In addition, empirical studies may reveal new insights into how trust actually operates (e.g., insights into human behavior), which may entail revisions of ethical theories.

We have built upon and suggested the need for significantly altering research on trust in this article. While previous research helped set the stage for its development, this article offers the first effort to specify optimal trust and systematically discuss it. Given the growing interest in trust and the significance it has for business, further development of this avenue of research appears warranted.

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