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A Note on Trust, Networks, Social Capital and Entrepreneurial Behaviour

This short paper presents perspectives on the concepts of 'networks', 'social capital' and 'trust', focusing on their potential relevance to understanding entrepreneurial behaviour. It aims to complement the contributions of other partners by drawing specifically on previous work undertaken by the authors on trust based relationships and entrepreneurship in agricultural economies in West Africa (Lyon), trust in the context of the development of industrial clusters in N.E England (Lyon) and studies of network links and the use of social capital in the context of ethnic minority entrepreneurship in the UK (Smallbone)[1].

Networks

The study of networks has attracted growing attention in recent years, in a number of disciplines. For example, in sociology, the mapping and study of the number and extent of networks has generated considerable interest over the last 30 years.

"People are limited by bounded rationality, suffer from limited or biased information and poor communication, and are subject to processes of social influence and reconstruction of reality. Hence comprehensive explanations of entrepreneurship must include the… social relationships through which people obtain information, resources and social support" (Aldrich and Zimmer, 1986 p11).

Networks refer to the inter-personal linkages that make up social life. There are many cases of networks, both bilateral and multilateral, which impinge on and help to shape the economic sphere. However, to understand how these networks impact on social and economic life, it is necessary to examine their qualitative nature and the strength of the ties that hold networks together, as well as simply demonstrating their existence. Networks can range from weak ties of acquaintances who can move between groups carrying both ideas and information, to the strong ties of families where in-group solidarity may actually militate against multiple identities and co-operation with outsiders (Granovetter, 1973).

In a business management context, networks are sometimes seen as a key element of the social resources (or social capital) which small businesses are able to exploit in order to overcome some of their size-related resource constraints and potential institutional barriers (Starr and Macmillan, 1990; Shaw and Conway, *op cit.*) by providing access to other (physical) resources that can be used to develop the business.

From a business perspective, Curran *et al* (1995.) have pointed out that firms can enter into a wide variety of external relationships with suppliers, customers, accountants, solicitors, banks, trade associations and business support agencies. Some of these relationships are voluntary, whilst others may be a necessary part of undertaking business activity, although such relationships need not have been expressly formed for such a purpose. Those links which are essentially transaction based may be considered value added network links if, for example, the firm receives market information from the customer that goes beyond that necessary to complete an individual transaction. The working definition of networks used in a previous CEEDR project broadly follows Curran *et al* (1995) in encompassing all potential external relationships as network activity, whilst seeking to assess the role of different types of network to the business, both formal and informal (Fadahunsi et al, 2000). This includes personal networks, particularly those associated with entrepreneurship, and a variety of inter-firm linkages and links with support institutions of various types.

In terms of the contents of network ties, Johannisson (1999) identifies three essentially interdependent forms. These are *information* networks which provide business intelligence (and can

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[1] This work is being undertaken with another CEEDR colleague Dr Akin Fadahunsi

additionally also provide access to a variety of external resources); *exchange* networks which provide operational resources and *influence* networks which also carry information but tend to operate in the main as barriers for potential competitors. In addition to content, the project will also need to investigate how such network links are created and how they develop over time, which are essentially process oriented questions, requiring qualitative methodologies.

The ethnic minority business literature often highlights the importance of 'social' networks, which typically have two components namely, the personal network, which as mentioned earlier links the business owner with specific individuals, and the cultural dimension in which the actors are immersed in (Saker, 1992, cited in Ram, 1994). In essence, it is the 'family' and the 'community' that lie at the heart of the social networks of ethnic minority firms (Ram, *ibid.,* p 43). Such networks are often viewed as a vital element in the development of ethnic minority enterprises in that their closed nature offers members access to the networks in ways that are otherwise denied to non-members of that group. This access is said to give them some operational advantages over their indigenous counterparts (e.g. with respect to accessing finance, customers, labour). They are therefore viewed by some authors as an important potential strength of ethnic minority businesses (Waldinger *et al*, 1990).

Social networks may be either formal or informal in nature. The more formal links refer to those built with co-ethnic membership business associations and other organisations, which emphasise ethnic links in their establishment and development. Informal links are primarily personal or community related. Personal networks in this case are mainly developed around friends and the extended families of the business owners, whilst informal community networks operate as an extension of personal links into the wider co-ethnic community, or alternatively through tribal, religious or various socio-cultural organisations.

Thus, the family and kinship networks may be viewed as vital building blocks for business development in the ethnic minority community. Furthermore, the pooling of resources provides the 'trust', security and reliability, which come from dealing with persons from the same ethnic background. Social network ties are often presented as relying on the trust of its members for its sustenance over time, and such trust is itself a key business resource which can be a source of competitive advantage (Aldrich and Zimmer, 1986; Ram, 1994; Honig, 1998; Smith et al, 2001). The element of trust in such relationships also presupposes that such personal ties will often be informal in nature. Thus the small business literature has tended to highlight the preference of small businesses for informal networks over formal ones (e.g. Fadahunsi *et al*, 2000) usually because of reasons to do with small business owners' need to be in control of their environment or their unwillingness to invest the time or funds necessary to sustain such networks.

Social Capital

Bourdieu (1985) was one of the first to use the term 'social capital', contrasting it with economic and cultural capital. Much of the debate about social capital has been theoretical (e.g. Granovetter, 1973) and working definitions have been varied, although frequently unquantified and often vague. Pennington and Rydin (2000) have offered a working definition of social capital which includes "levels of trust, the extent of networks, the density of relationships within networks, knowledge of relationships, obligations and expectations about relationships, leading to reciprocity, forms of local knowledge, operating norms and existence and use of sanctions to punish free riding".

Linking social capital to social networks, Wellman and Wortley (1990) have suggested that: "the social support that community members provide is the principal way by which people and households get resources, along with market exchange…… institutional distributions …and coercive appropriations.". Community ties with friends and relatives provide social support that transcends narrow reciprocity. They make up much of the social capital that people use to deal with daily life, seize opportunities and reduce uncertainties.

Trust

Trust has been examined in a variety of social science contexts and defined in a number of different ways (Misztal, 1996). A dictionary definition of trust is "a firm belief in the reliability, truth or strength of a person: a confident expectation and a reliance on the truth of a statement without examination" (OED, 1996). Empirical studies of the concept of trust always face linguistic difficulties and a lack of a single word that has the same meaning as the English word 'trust'. Care needs to be taken when using the many 'arm chair classifications' produced by theoreticians that prove very difficult to operationalise empirically.

Interpersonal trust is vital in all market transactions when those involved are unwilling to rely on institutional arrangements or cultural norms alone (Granovetter, 1985). It is based on a perception of the probability that other agents will behave in a way that is expected (Gambetta, 1988). It is therefore a calculation and an assessment of risk, although the means by which an individual makes a calculation are shaped in part by the social forces affecting them. This is evident throughout the case studies in Ghana and UK, undertaken by one of the co-authors (Lyon, 2000; Lyon and Atherton, 2001), whether it is trust between individuals, trust through intermediaries or trust in the actions of other members of groups. Individuals will weigh up the perceived risk and act according to their perceptions. They will draw on information based on the reputations of other network members and also evaluate the extent to which sanctions can be applied. The sanctions may be peer pressure, exclusion from future benefit, or recourse to authority. (In a small number of cases sanctions can be threats of violence) Thus knowing where a creditor lives is often a crucial factor in the decision to lend money in Ghana, and knowing the academic background of a researcher and the scientific community they belong to shapes the decisions about collaboration in UK pharmaceutical industry.

However, trust can exist without calculation, such as when someone acts out of habit. Habits are drawn on by all if us, in order that we can assume away some risks and make other calculations possible (Hodgson, 1988). This was evident in cases in both West Africa and in UK where people were asked why they co-operated when there was risk that the other party would default. A common response was for people to laugh at this question because it was not something they had considered explicitly before. There is also reference to acting on 'gut reactions'.

Norms define what actions are deemed acceptable and are the foundation on which trust is constructed. Norms also relate to the types of sanctions that can be used to ensure other individuals co-operate. There has been considerable debate over the role of norms in economic development (Platteau, 1994; Moore, 1994), although the intangible nature of norms makes them difficult to observe empirically. Most studies of norms rely on game theory modelling or historical studies, with only limited attempts to draw on ethnographic studies that have illuminated the subject within the context of their wider objectives (Granovetter, 1993). The cases referred to above are based on a wide range of norms that shape how people behave, the nature of the co-operation, and how they reciprocate. The sanctions applied to people are also shaped by the moral values and the sanctions exerted through 'shame', in a social context. This form of ostracism or peer pressure is greater when people live in proximity or work in a specialist area of work such as a 'research community'. Where people do not live near each other, they were found to be looking for commonalties or shared values such a the same religion or church, shared membership of a professional or social group, or common ethnic group.

This suggests that norms cannot be created at will but can be seen as "historically rooted cultural endowments" (Platteau, 1994). They are learnt through socialisation especially during childhood through families, schools and religious organisations. The strengthening and sustaining of norms depends on the extent that civil society as a whole, or particular groups within it, are willing to take action and sanction norm breakers (Platteau, 1994). While the market can erode norms of society, by breaking down social relations, it also creates a new set of social relations and moral values that are common to those working in markets together (Moore, 1994; Hirschman, 1982). The new forms of group activities, especially those found in urban areas demonstrate this.

Institutional/intermediary based trust is prevalent when individuals have confidence in the economic, political and social institutions that they have to deal with. These formal institutions refer to issues of contract enforcement, standardisation of measurements and quality, and provision of information, as well as other areas of the economic system. This form of trust is established when there is a critical mass of individuals trusting in the system. However, every enterprise relies on both personalised and institutionalised trust, with one able to replace the other in most circumstances. Personalised trust involves transaction costs to initiate it in terms of building up a relationship. Institutionalised trust incurs transaction costs in terms of ongoing regulation and legal enforcement.

Studies which emphasise the role of network relationships in business development tend to be based on the premise that personalised forms of trust between businesses are more effective than other ways of securing trust in a changing competitive environment (e.g. Malecki and Tootle, 1996).

Since our study involves trust-based relationships in a transition context, it may be worth noting that historical perspectives on trust have identified a contrast between the pre-modern and modern conditions affecting trust, reflected in a shift from trust based on kinship, community and tradition to trust based on abstract systems (Giddens, 1990). This reflects an evolution from personal trust, founded on belief to system trust, based on mutual self-interest and functional interdependence (Luhmann, 1988). However, the importance of interpersonal trust found in empirical studies in Western European and African contexts challenges this simplification of difference. Examples of institution or abstract forms of trust are found throughout the world in a range of economic and political contexts. Examples range from banking and regulative systems in Western Europe to complex irrigation and common property management systems in subsistence agricultural economies.

Linking Trust to Economic Development

Attempts to look at different forms of trust and social capital have tended to concentrate on the different scales of networks (Harriss and de Renzio, 1997). For example, Woolcock (1998: 162–178) distinguishes between the macro level (formal business, political and social organisation of society) and the micro level (intra- and inter-community ties). He also distinguishes between those links that are highly embedded in a community, and those that are more outward looking.

Levi (1996: 51) notes that neighbourhoods are a source of trust and distrust as they "promote trust of those you know and distrust of those you do not, those not in the neighbourhood or outside the networks." Woolcock (1998:158–171) also warns of the limitations of certain networks based on close ties such as those found among certain ethnic groups. This he sees as "being characterised by an 'excess of community' built on such fierce loyalties and familial attachments that members are discouraged from advancing economically, moving geographically, and engaging in amicable dispute resolution with outsiders" (Ibid: 171). Members of such communities may therefore be restricted in participating in wider networks because of obligations. There is a need for inter as well as intra-community ties, what Putnam (1993) term weak ties of horizontal networks and Granovetter (1973) refers to as the 'strength of weak ties'.

While it is accepted that networks are important for the creation of trust, there is a danger of taking a romanticised view of networks, or 'the community'. For example, Amin (1996: 327) warns of the danger of ignoring the fact that civil society is an arena for social contestation. Power struggles exist and affect which groups control which resources and what they do with them. This raises the issue of who is included and excluded in certain groups or networks.

The definitions of trust raise a number of interesting dichotomies, namely:

- Intra community v outward looking relationships
- High density of linkages/relationships v low density
- High intensity/risk v low intensity/risk
- Personalised v institutional
- Calculated trust v habitual action

Empirical work has shown that individuals are constantly moving along these continua and each relationship may have a different balance. This raises particular challenges for identifying what is a high and low trust milieu.

Researching Trust

The extent of co-operation based on trust can be investigated by asking businesses who they work with, for what reason and in what circumstances. However, it becomes much harder to collect data on the intensity of trust, the risk involved in the relationship and the value placed on the relationship. A key question for this study is '*how*' trust is built up and how it contributes/is related to entrepreneurial behaviour. This section looks at some of the theoretical issues and goes on to present a means of collecting data to explore the issue of trust.

Research under the banner of New Institutional Economics (NIE) has attempted to explore the reasons behind collective action of different kinds. NIE has developed as neo-classical economists have attempted to modify their key assumptions to reflect real world situations more closely. NIE introduces the concept of transaction costs (Williamson, 1985) which are omitted from many neo-classical economics analyses because of the assumption about a "frictionless exchange process in which property rights are perfectly and costlessly specified and information is likewise costless to acquire" (North, 1990:11). North proposes that one of the key costs involved in transacting relates to information. The cost comes from measuring the quality of what is being exchanged as goods may not be homogeneous; protecting rights to the goods being exchanged; and policing and enforcing agreements. Trust can play a role in reducing transaction costs through providing information and the means to enforce contracts.

However, in much of the NIE approach there are functionalist views that assume institutions evolve to minimise the transaction costs (Granovetter, 1985). While institutions can and do reduce transaction costs in many cases, such a view is based on trying to explain existing collective forms by assuming institutions appear automatically to reduce transaction costs while not probing why co-operation occurs in one case and not in another. Bardhan (1989) criticises the assumption that inefficient institutions will be competed out as barriers to collective action can create barriers to entry that reduce the pressure for selection. It is therefore necessary to distinguish between those collective actions that reduce transaction costs for group members only and transaction cost minimising forms of collective action that benefit the wider society. Khalil (1994) states that there are many cases of inefficient rules and property rights that persist beyond their economic usefulness which cannot be explained by an analysis of transaction costs alone. Crude analyses that assume institutions are shaped by the minimisation of transaction costs and the drive to efficiency alone are forms of post hoc explanation (Mulberg, 1995) and ignore the social relations in which economic activity is embedded (Granovetter, 1985).

The need to explain how collective action occurs in some cases rather than others requires an understanding that attempts to go beyond functionalist answers which suggest that the motives for forming these institutions explain their occurrence (Granovetter, 1994). The challenge is to understand the processes by which these social institutions sustain co-operation.

The '*how*' question is best addressed through looking at particular examples of trust based relationships in case study firms. This can illuminate why firms acted as they did. It may also require interviews with several people in the firm who were involved in building the relationship i.e. more than just the owner or owner-manager.

Examples of questions that have been used in recent empirical studies (Lyon (2000) and Lyon and Atherton (2001) are listed below. They refer to each link/grouping identified:

- What do you get out of the link?
- What do they get out of the link?
- How did you know they would co-operate and not cheat you?
- When did you first have a link to them?
- Why did you decide to work with that company in the first place?
- Whose initiative was it?

- Who facilitated it?
- How have the joint activities changed since it started?
- How often do you have contact with them? Where? How long for?
- What difficulties have you faced in the relationship? Why? How did you get over this?
- Are the links formalised in any way? How and why?

Quantitative data on trust is difficult to collect as much of the trust in a trust-based relationship may be based on habitual action and norms of behaviour. Furthermore, important relationships are those that are available to be drawn on when necessary and may not always be recalled in a highly structured interview context. Some comparative data can be collected on the importance attached to particular factors and these can be quantified using a Likert Scale (indicate from one to ten how important the factor is). Key questions could include scoring the importance of the following:

- Information from others outside the firm
- Collaborative ventures
- Relationship with suppliers and customers
- Social contacts with business associations
- Social contacts with friends and family
- Membership of professional bodies (Chambers or business associations)
- Membership of social/religious/recreational societies

Clifton and Cooke (2001) compare similar factors to those listed above with scores for the importance of human resources and employees knowledge/skills; location; and equipment and technology.

Finally, there is an issue concerning the most appropriate unit of analysis i.e. the entrepreneur or the firm. If the latter, then it will be necessary to investigate the networks of key employees/other managers (i.e. than the owner-manager) which may have contributed/be contributing to the development of the enterprise.

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