Entrepreneurial strategies and trust: structure and evolution of entrepreneurial behavioural patterns in East and West European environments ; concepts and considerations

Höhmann, Hans-Hermann (Ed.); Welter, Friederike (Ed.)

Sammelwerk / collection

Forschungsstelle Osteuropa Bremen
Arbeitspapiere und Materialien

No. 37 - June 2002

Entrepreneurial Strategies and Trust

Structure and Evolution of Entrepreneurial Behavioural Patterns in East and West European Environments – Concepts and Considerations

Hans-Hermann Höhmann / Friederike Welter (eds.)

Forschungsstelle Osteuropa an der Universität Bremen
Klagenfurter Straße 3, D-28359 Bremen
Tel. +49 421 218-3687, Fax +49 421 218-3269
http://www.forschungsstelle.osteuropa.uni-bremen.de

Arbeitspapiere und Materialien – Forschungsstelle Osteuropa, Bremen
Working Papers of the Research Centre for East European Studies, Bremen
Hans-Hermann Höhmann and Friederike Welter (eds.)
No. 37: Entrepreneurial Strategies and Trust
Structure and Evolution of Entrepreneurial Behavioural Patterns in East and West European Environments – Concepts and Considerations
June 2002
ISSN: 1616-7384

Technical editor: Matthias Neumann

Forschungsstelle Osteuropa
Klagenfurter Str. 3
28359 Bremen
Telefon: +49 421-218-3687
Telefax: +49 421-218-3269
e-mail: anlorenz@osteuropa.uni-bremen.de
Internet-Adresse: http://www.forschungsstelle.uni-bremen.de

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Hans-Hermann Höhmann / Teemu Kautonen / Bernhard Lageman / Friederike Welter

Entrepreneurial Strategies and Trust: a Position Paper

Introduction

This paper is concerned with the role trust plays in determining the behaviour of small businesses in different institutional and socio-cultural environments in Eastern and Western Europe. It represents the initial position paper for the project titled "Entrepreneurial strategies and trust: Structure and evolution of entrepreneurial behavioural patterns in East and West European environments". The Rhine-Westphalia Institute for Economic Research and the Research Centre for East European Studies at the University of Bremen co-ordinate the project funded by the Volkswagen Foundation under the programme "Unity amidst variety? Intellectual foundations and requirements for an enlarged Europe".

Rationale and aims of the project

The main hypothesis of the project is that trust has a decisive impact on enterprise behaviour. Low levels of trust constrain market entry, enterprise growth and competition whilst encouraging unproductive forms of entrepreneurship. High levels of trust, on the other hand, encourage open and dynamic competition structures and foster enterprise growth. Researching the impact of trust on enterprise behaviour contributes to the understanding of East European transformation processes as well as to the understanding of different economic performances in East and West European countries. The complicated nature of trust requires an interdisciplinary approach. Political, social and economic factors need to be considered in order to understand the socio-cultural context in which trust operates. The programme of the Volkswagen Foundation provides an ideal framework for such an interdisciplinary project.
In this context, the project aims to investigate the role of trust in an attempt to determine its influence on entrepreneurial behaviour. The specific objectives are:

- to compare the effects of formal and informal institutional structures on the type and level of trust in East and West European countries,
- to gain greater understanding of the impact of different forms of trust on enterprise behaviour with respect to productive/unproductive/parasitic forms of entrepreneurship,
- to identify the role of intermediary institutions such as trade associations on trust formation,
- to evaluate transfer possibilities of West European models of intermediary institutions, civil societal structures and government policies for East European transformation contexts.

Methodology

Research will be undertaken at different levels of analysis, combining literature studies with quantitative and qualitative empirical research. The project concentrates on the microeconomic level, studying owner-managers and key decision makers in small businesses with up to 50 employees in the food industry, business services and trade. Small businesses reflect the impact of domestic environments better than medium and large enterprises, which are in many cases internationalised. The empirical part of the study consists of three elements: a standardised survey, case studies of small businesses and expert interviews with regional, local and sectoral key actors such as ministries, business associations, local governments and banks.

The project includes two East European and three West European countries. Russia and Estonia represent a problematic and a successful transformation process, respectively. Germany, Italy and Great Britain represent different models of West European capitalism, and different trust cultures. Empirical research will be conducted in Russia, Estonia and Germany whilst trust environments in Great Britain and Italy will be studied through desktop studies.

The project team

The research will be conducted by an international team. Prof Hans-Hermann Höhmann, Research Centre for East European Studies at the University of Bremen and Dr Friederike Welter, Rhine-Westphalia Institute for Economic Research (RWI) in Essen, Germany are the project coordinators, assisted by Elena Malieva and Teemu Kautonen, respectively. The Russian Independent Institute for Social and Nationalities Problems (RIISNP), represented by Dr Alexander Chepurenko, is the Russian project partner. In Estonia, Prof Urve Venesaar from the Institute of Economics at the Tallinn Technical University will carry out the research. The desktop studies in Italy and Great Britain will be conducted by Prof Gabi Dei Ottati, University of Florence and Prof David Smallbone, Centre for Enterprise and Economic Development Research (CEEDR) at the Middlesex University Business School.

Theoretical background: institutional economics

Enterprise behaviour results from a dynamic inter-relationship between internal and external conditions. External factors gain importance in transformation contexts where the institutional reforms have not yet been thoroughly implemented and where the socialist legacy influences the attitudes and behaviour of individuals. Empirical evidence shows that entrepreneurship under transition conditions takes a variety of different forms and enterprises use various strategies that partly reflect the external environment for private enterprise in these countries (Smallbone and Welter, 2001a).

In order to analyse the impact of the environment on entrepreneurship, we need a comprehensive theoretical framework that goes beyond conventional economics. As Welter discusses in her contribution, the evolutionary branch of New Institutional Economics, particularly the concept of formal and informal institutions introduced by Douglass North (1990), appears to be particularly suited for this purpose. An institutional perspective views the behaviour of firms in transition economies at the micro-level as a form of adaptation to the specific relevant external environmental conditions, namely the inadequate and incompatible formal and informal institutions (Welter and Smallbone, forthcoming).

Formal institutions include political, economic and juridical rules and organisations whilst informal institutions refer to values, norms and codes of conduct that are deeply embedded in culture. Institutions enable or constrain entrepreneurship. For example, formal institutions such as private property rights exert a major influence on the nature and extent of enterprise behaviour whilst cultural traditions of a society as an example for informal institutions influence patterns of entrepreneurial actions. Although formal institutions may be easily modified, Welter points out that changing informal institutions is a difficult and slow process due to their path-dependency. Moreover, formal and informal institutions are mutually dependent, especially if it comes to putting a new or changed institutional framework into action. Höhmann and Malieva emphasise this by arguing that a successful formal institutional transformation does not guarantee a successful transition process, because this alone cannot change the culturally embedded entrepreneurial behaviour.

Which role does trust play in institutional theory? Principally, trust is affected by both formal and informal institutions, such as legislation and law enforcement or social norms and codes of conduct, respectively. In this context, Welter discusses the question whether trust complements or supplements formal institutions, drawing attention to the mutual relations between trust and the respective institutional environments. Moreover, trust itself acts as an informal institution. As Smallbone and Lyon point out, trust reduces transaction costs through providing information

and a means to enforce contracts, so that the possibility of opportunistic behaviour diminishes. Therefore, trust is an important mechanism for (business) transactions as discussed in more detail by Kautonen, and contributes to the enforcement of (new) institutions.
Whilst institutional theory draws attention to the institutional embeddedness of entrepreneurship, it leaves little scope to explain emergent and 'irrational' behaviour, understanding enterprise behaviour mainly as a rational and calculated reaction to inadequate formal and informal institutions. Therefore, the theoretical framework as presented by institutional theory needs to be supplemented by concepts explaining the cognitive foundations of entrepreneurial behaviour as well as seemingly irrational economic behaviour.

The concept of trust

We characterised trust both as a means of reducing uncertainty through providing information and as a means of coping with opportunistic behaviour. Since trust has been studied by several disciplines, there is no single comprehensive definition, but there are different ways to approach the trust phenomenon, which is discussed in detail by Höhmann/Malieva, Kautonen, Smallbone/Lyon and Dei Ottati. One refers to the *objects of trust*, i.e., trust can be defined looking at the parties involved in the trust process. Self-confidence is fundamental for a person's ability to trust others. Interpersonal or interorganisational trust is a reciprocal, dynamic process between two individuals or organisations. Finally, institutional or intermediary based trust prevails in environments where individuals have confidence in the economic, political and social institutions they have to deal with.
Another aspect concerns the *determinants of (interpersonal) trust*. In this context, Kautonen, Smallbone/Lyon and Dei Ottati draw attention to the difference between trust based on pure risk calculation (e.g. Coleman, 1990) and goodwill trust (e.g. Sako, 1992; Yamagishi & Yamagishi, 1994). Indisputably, trust often has elements of risk calculation, albeit the risk calculation process can not be characterised as being fully rational. Smallbone and Lyon point out that individuals use reputations as sources of information and also assess the extent to which sanctions such as recourse to authority or exclusion from future benefit can be applied. Such trust is largely based on self-interest. However, trust goes beyond pure risk calculation and self-interest, for, as Nooteboom (1999, 8) argues, "you 'really' trust someone when you are willing to forego guarantees on the basis of coercion or self-interest". This implies that trust also involves a variable degree of goodwill.
Finally, we can distinguish different *types of trust* regarding its origin (see Höhmann and Malieva, Kautonen, Venesaar and Venesaar). The most important types of trust for the analysis of enterprise behaviour are process-based trust or personal trust and extended trust or institutional trust. In process-based trust "a record of prior exchange, often obtained indirectly or by imputation from outcomes of prior exchange, provides data on the exchange process" (Zucker, 1986, 60). In other words, trust builds on initial knowledge about the partner. This type of trust exists in all societies, because it mainly results from individual relationships or a network of relationships rather than from the external environment.
Extended trust is essential for an efficient market economy. In an economy dominated by extended trust agents enter into transactions with only limited information about the partner's specific attributes (Raiser, 1999). In other words, the scope of trust extends beyond the number of people we know personally (Putnam, 2000). Its availability in a society is highly dependent on the institutional structure. On the other hand, as Granovetter (1985) points out, process-based trust complements extended trust in those cases an individual does not want to rely only on institutional arrangements and cultural norms. This emphasises the dynamic nature of trust with the initial level of trust and its evolution over time being important determinants. Moreover, the way trust evolves depends on the stability of the environment. In this context, we might expect differences between established market economies and transition economies.

Trust in different environments

There has been extensive discussion on whether we may classify institutional environments as "low-trust" and "high-trust" (e.g., Fukuyama 1995; Panther 1998; Rosenbaum 1999). A "low-trust" environment is said to restrict market entries, enterprise growth and free competition whilst encouraging unproductive and parasitic entrepreneurship. A "high-trust" environment, on the other hand, is said to foster competition and enterprise growth. In this context, Estonia and Russia would be characterised as "low-trust" and Germany, Great Britain and Italy as "high-trust" countries.

However, this typology neglects the complex relations within political, economic and cultural environments. There are significant differences between different milieus within countries. Classifying environments as "high-trust" or "low-trust" does not take into account the predominant types and origins of trust in the respective milieu. Even if the level of extended trust were low or moderate, say in an industrial district, a high level of process-based trust can complement it. Moreover, a "high-trust" environment can be characterised by "genuine" trust or it can be created by coercion. The project therefore aims to determine an empirically based typology of trust milieus across and within countries.

In this context, we can observe differences in the trust related institutional framework between transition countries and West European countries. Lack of systemic trust and instability of norms often favour the extensive use of personal networks, as discussed by Welter and Smallbone/Lyon. With respect to Estonia and Russia, Venesaar/Venesaar and Höhmann/Malieva describe how in a low-trust environment individuals use social contacts and individual networks dominated by mutual trust in order to pursue business whilst Höhmann/Malieva also elaborate on the importance of (personal) experiences. An environment where process-based trust dominates and extended trust plays a minor role, prevents the optimal allocation of resources, consequently resulting in high transaction costs.

In mature market economies the trust framework is more developed. It usually allows a better allocation of resources and lower transaction costs compared to transition economies. Nevertheless, levels of trust differ even among West European countries, in particular due to different cultural traditions, but also due to differences in the economic, political and juridical frameworks. For example in Germany inter-firm relations are strongly governed by regulations, whereas personal relationships carry more weight in the deregulated British environment (Bachmann, 2001).

Trust and entrepreneurial behaviour

Trust determines ways into and forms of entrepreneurship as well as entrepreneurial behaviour. The latter includes intentional and habitual business actions whilst 'strategy' at the enterprise level refers to intentional actions without necessarily implying that these actions are planned beforehand. Enterprise behaviour results from a dynamic inter-relationship between internal (i.e., both organisational and entrepreneurial characteristics) and external conditions. It evolves over time from simple reactions to the business environment to more complex and pro-active strategies (Welter, 2002).

In situations where market reforms are slow or only partially installed, the institutional context becomes a critical factor, drawing attention to the specific role of trust in determining entrepreneurial (re-)actions. This requires a broad analysis of the interaction of formal and informal institutions at micro-, meso- and macro-levels. We can distinguish between factors of influence on the macro level (e.g. the political, juridical and economic framework, cultural norms and religious traditions), at the meso-level (e.g. business associations, industry-specific practices and codes of conduct, standardisation and trade unions) and on the micro level such as personal beliefs and values, contracts and organisational cultures (e.g. Bachmann, 2001; Granovetter, 1985; North, 1990; Zucker, 1986). They are reflected in individual economic behaviour such as strategy formulation, recruitment practices or networking behaviour as well as in the general

patterns of consumer, saving and investment behaviour in different cultures and societies, as indicated by Welter.

In transition countries, enterprises frequently operate in an environment characterised by an ineffective legal system, imperfect property rights, encroachments by the governmental bureaucracy, corruption and a general atmosphere of mistrust (Smallbone and Welter, 2001b). All this favours strategies which may reflect rational entrepreneurial reaction to the given institutions from an individual entrepreneur's point of view, although they might constrain the contribution of SMEs to the wider process of economic and social transformation and development. Enterprises are quick to engage in rent-seeking activities. Entrepreneurs tend to develop protective strategies against pressure from tax authorities, local bureaucracy and organised crime. These strategies include not letting their businesses grow beyond a certain threshold, investing in political and social resources or drifting into the shadow economy. Informal networks which involve business partners, friends, but also acquaintances in local authorities, gain importance in helping entrepreneurs to mobilise resources, win orders and cope with the constraints imposed by unstable and weakly structured environments (Smallbone and Welter, 2001a).

The papers in this volume discuss trust and entrepreneurial behaviour from various perspectives, drawing attention to the different levels of trust. Welter uses the viewpoint of institutional theory in order to link the social capital determinant of trust, as it manifests itself in networking behaviour, to entrepreneurial strategies. She also points out the general path dependency of entrepreneurial behaviour. This is evident in the origins of entrepreneurship in transition economies which often reflects the heritage of socialist entrepreneurship in state enterprises and the so-called second economy (see also Smallbone and Welter 2001a), as illustrated for the Russian example by Höhmann/Malieva. Both Höhmann/Malieva and Venesaar/Venesaar review the impact of trust on the level of the whole economy and society in Russian and Estonian contexts, respectively. Kautonen and Smallbone/Lyon examine the impact of trust on individual enterprises. Kautonen draws on the example of business relationships whilst Smallbone and Lyon analyse trust in the wider context of networking. Dei Ottati discusses trust at the meso-level, using the example of industrial districts.

Researching trust empirically

Trust is a versatile and complicated topic to research empirically, particularly because of its social and cultural embeddedness as well as its dynamic nature. Key issues concern the operationalisation of trust and the choice of adequate empirical methods. Game theory contributes successful examples of how to research trust empirically, especially with respect to cooperation, although relying on laboratory experiments instead of survey methods (e.g., Glaeser *et al.* 2000; Sigmund, Fehr, Nowak 2002; Yamagishi/Yamagishi 1994). Our research project will use survey-based methods to analyse entrepreneurial behaviour and trust which we consider more appropriate in a transition environment and with respect to small enterprises (Curran and Blackburn, 2001), although this leaves us with the problem of how to ask for trust. Offe (2001) rejects questions asking for "how much trust do you have in…" because of cross-cultural and intracultural semantic differences concerning the meaning of trust. Moreover, phrasing questions in this way would imply that individuals are capable of identifying and evaluating the level of trust in their actions.

However, as Smallbone and Lyon point out, trust frequently results from habitual behaviour, where individuals implicitly draw on habits and norms without calculating or justifying their behaviour beforehand. They conclude that quantitative data on trust is difficult to collect, especially with respect to the evolvement of trust, its intensity or the risk and value of different business relations. Thus, quantitative survey-based studies should concentrate on investigating the nature and the extent of trust-based business links. Relevant questions ask for links with regular and new customer and suppliers as well as with business partners, for relations within the enterprises with employees, and for relations with the external regulatory environment. Ring and Van de Ven (1994) suggest that collecting "events" would be an effective method, in order to re-

search the process-based nature of trust. As Smallbone and Lyon indicate, relevant questions refer to the 'how', i.e. how is trust built up, and how does it contribute to entrepreneurship.
Our project combines both quantitative and qualitative surveys of small enterprises and interviews with key experts on the local and regional level. The quantitative survey aims to describe comparative patterns of enterprise behaviour in different environments. In-depth case studies of selected enterprises and interviews with key experts will allow us to explore the institutional embeddedness of trust as well as its determinants and its evolution in different environments in more detail.

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Hans-Hermann Höhmann / Elena Malieva

Trust as a Basic Anthropological Category

> Thus, this prior or posterior form of knowledge about a human being wins: trust in him – obviously one of the most important synthetic forces in a society – a special evolution. Trust, as a hypothesis of future behaviour, which is safe enough to base practical action on it, is *qua* hypothesis a middle state between knowledge and non-knowledge about the human being. He who has total knowledge does not have to trust, he who has no knowledge at all can, sensibly speaking, not trust even once. (Georg Simmel, Soziologie)
>
> It is worth serious consideration whether one wants to advise sociology to use words of everyday usage and concepts of the traditional ethic world of ideas. (Niklas Luhmann, Vertrauen)

Preliminary Remarks

Trust, as "one of the most important synthetic forces in a society" (G. Simmel)[1] and "guiding medium of social interaction" (P. Antfang, D. Urban),[2] has more and more become the subject of sociological, psychological and in the end also economic theory formation as well as of empirical analysis. The degree of trust between people as well as between people and institutions determines to a large extent structure, quality and efficiency of those patterns of interaction and transaction which connect the various actors in societies that are based on the division of functions and labour, one might even say that trust is the precondition that in the last resort determines the normal functioning of a social system in all its facets on the whole. Not only trust in persons, but also trust in institutions ("trust in the system") and in technical structures play an important role. The basic hypothesis for the research project of our international and multicultural team is that potentials of individual trust "condense" into milieus of trust, which also determine direction and effectiveness of the transition processes in Eastern Europe.

As obvious as the meaning of trust as an everyday experience and "word of everyday usage" (N. Luhmann)[3] may be: trust is rarely defined so clearly and unambiguously that it can serve as a clearly defined and empirically operationalisable category. "Every man lives it, not many know it" (J. W. Goethe) probably holds true in this case as well and makes it appear expedient to draw a wide circle around concept and manifestations, so as to subsequently draw the conclusions necessary in order to formulate a strategy of research. From an interdisciplinary point of view, taking recourse to the discourse on trust in non-economic disciplines promises added perspectives, from which more specific economic contexts can in their turn profit.

D. Gambetta summarises the state of discussions on trust as a category in the social sciences as follows: "The importance of trust pervades the most diverse situations where cooperation is at one and the same time a vital and a fragile commodity: from marriage to economic development, from buying a second hand car to international affairs, from the minutiae of social life to the continuation of life on earth". Then follows the decisive sentence: "But this pervasiveness seems to have generated less analysis than paralysis: in the social sciences the importance of trust is often acknowledged but seldom examinated[*sic*], and scholars tend to mention it in pass-

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[1] Simmel G., Soziologie. Untersuchungen über die Form der Vergesellschaftung, Leipzig 1908, p.346.

[2] Antfang P., Urban D.: „Vertrauen"- soziologisch betrachtet. Ein Beitrag zur Analyse binärer Interaktionssysteme. Schriftenreihe des Instituts für Sozialforschung des Instituts Stuttgart, 1994, 1, p.2.

[3] Luhmann N., Vertrauen. Ein Mechanismus der Reduktion sozialer Komplexität, 4th edition, Stuttgart 2000, Vorwort, p.V.

ing, to allude to it as a fundamental ingredient or lubricant, an unavoidable dimension of social interaction, only to move on to deal with less intractable matters".[4]

Definitions and typologies

In the meantime, a number of definitions have been formulated for the concept of "trust", which describe both similar and diverging aspects of the phenomenon. As these definitions prompt a comprehensive discussion of the aspect of trust taking the subject of our research project into account, we would like to offer a short summary of some of these definitions following P. Antfang and D. Urban.[5] Later, we will return to one or another of these definitions within the context of detailed consideration.

Julian B. Rotter defines trust as generalised expectations "held by an individual that the word, promise, oral or written statement of another individual or group can be relied on".[6]

For P. Preisendörfer, trust is a mechanism that "overcomes the problem of time and bridges the insecurity of information, such that one actor, namely, the actor who gives trust, makes a one-sided concession."[7]

P. Dasgupta uses trust in the sense of a correct expectation "about the actions of other people that have a bearing on one's own choice of action when that action must be chosen before one can monitor the actions of those others".[8]

P. Barber, too, describes trust as expectation of the behaviour of others, focusing on three kinds of expectation of other people. "The most general is expectation of the persistence and fulfilment of the natural and the moral social orders. Second is expectation of technically competent role performance from those involved with us in social relationship and systems. And third is expectation that partners in interaction will carry out their fiduciary obligations and responsibilities, that is, their duties in certain situations to place other's interests before their own".[9]

James Coleman defines trust as a one-sided transfer of control over resources, actions or events.[10] For him, risk and a referral to the future are further characteristics always connected with trust.[11] In his study, he focuses on the theoretical model of the rational individual and poses the question under which conditions it would be right for an agent to trust: "The potential trustor must decide between not placing trust, in which case there is no change in his utility, and placing trust, in which case the expected utility relative to his current status is the potential gain times chance of gain minus the potential loss times the chance of loss".[12]

Psychological and sociological approaches

We can create a useful definition of the concept of "trust" as an anthropological basic category taking various disciplines as a starting point. For the time being, the psychological and sociological points of view appear to be promising.

From the *psychological point of view*, the working model "trust" is defined mainly as interpersonal trust. It believes that in everyday situations one can rely on expectations concerning the

[4] Gambetta D., Foreword, in: ibid. (ed.), Trust. Making and Breaking Cooperative Relations, Oxford 1988, p.IX–XII.
[5] Antfang P., Urban D.: „Vertrauen"- soziologisch betrachtet. Ein Beitrag zur Analyse binärer Interaktionssysteme. Schriftenreihe des Instituts für Sozialforschung des Instituts Stuttgart, 1994, 1, p.2f.
[6] Rotter J.B., Interpersonal trust, trustworthiness and gullibility, in: American Psychologist, 1980, 35, p.1.
[7] Preisendörfer P., Vertrauen als soziologische Kategorie. Möglichkeiten und Grenzen einer entscheidungstheoretischen Fundierung des Vertrauenskonzepts, in: Zeitschrift für Soziologie, Jg.24, Heft 4 (August), 1995, p.264.
[8] Dasgupta P., Trust as commodity, in: Gambetta D. (ed.), Trust..., op. cit., p.51.
[9] Barber B., The logic and limits of trust, New Brunswick 1983, p. 9.
[10] Coleman J.S., Systems of trust. A rough theoretical framework, in: Angewandte Sozialforschung, 1982, 10, p.302.
[11] Cf. Coleman J.S. ibid. p.302 and Coleman J.S. Foundations of social theory. Cambridge Mess. and London 1990, p.91.
[12] Coleman J.S., Foundations... op. cit., p.99.

behaviour of another person, on his promises and his willingness to co-operate.[13] Thus, trust becomes a central prerequisite for the shaping of a positive interpersonal relationship. At the same time, trust also has a cognitive dimension, as well as a dimension rationalising the decision-making process, as it limits amount and quality of information necessary to make decisions as well as the costs necessary to obtain information. Thus, Luhmann calls trust a "mechanism for the reduction of social complexity"[14] and emphasises that "personal trust is only created where it is needed".[15] Accordingly, the person who positively anticipates the future and acts as if the future is assured demonstrates trust. Simmel, too, sees trust as a "hypothesis of future behaviour, which is safe enough to base practical action on it".[16]

However, the possible irritations and deficits are also always connected with the complex "trust": for example, the aspects of uncertainty as well as (especially) the risk of a disappointment. In fact, "Cooperation and trust: some theoretical notes" (by M. Deutsch, 1962),[17] one of the first newer studies on the subject of trust, takes the risk aspect of trust as a starting point. Amongst the psychological authors, especially F. Petermann emphasised the aspect of "uncertainty, risk and the possibility of disappointment".[18]

Placing trust in a person means that one accepts that person as a personality on the whole. The trustor has the generalised expectation of other people that they act in terms of trustworthiness: only if one supposes that the others are trustworthy in the sense of expectations placed in them, will one grant them trust, which in its turn gives rise to various forms of communication.

However, an explanation of trust at the level of individual psychology is insufficient. Rather, it is necessary to understand trust as a general component of social relations at quite distinct levels, and current sociological discussion has taken precisely this direction. Trust is studied no longer merely at the individual level, but also at the level of the social system on the whole. For example, Preisendörfer sees trust as not being connected primarily to individual actors, but rather as a significant "characteristic of social relations".[19]

Socially relevant trust relationships (or their opposite) can exist not only between individual actors (persons), but also between persons and corporate actors (e.g., businesses, associations, political parties). This type of trust, which exceeds purely personal trust relationships, will expand to become "system trust" (or "system distrust"), if the actors' trust expands to include the totality or at least central elements of the institutional environment. Whoever "places trust in the stability of the value of currency and in the continuity of a variety of possibilities of expenditure, basically takes it for granted that a system works, and does not place his trust in persons known to him, but in the working of the system".[20] The introduction of the Euro as European currency can only succeed if trust is placed not only in the finance ministers, but above all in the "System Europe". Besides "trust in money" and "trust in informing authority", "trust in legitimate political power" plays a special role in Luhmann's analysis of system trust. While the two first-named manifestations of trust act as *typically decentralised forms* of the reduction of complexity, the organization of political and administrative power implies a *centralisation* of the process of reduction. In this case it is political power that determines binding decision parameters by its actions.[21] A special aspect of system trust arises if trust has to be placed simultane-

[13] See e.g.: Bierhoff, H.W., Buck, E.: Wer vertraut wem? Soziodemographische Merkmale des Vertrauens, in Schweer M.K.W.: Vertrauen und soziales Handeln: Facetten eines alltäglichen Phänomens, Berlin 1997, p.99–114; or: Kumbuck, Ch.: Digitale Signaturen und Vertrauen, in: Arbeit, Heft 4, Jg.9, 2000, p.105–118.
[14] Luhmann, N.: Vertrauen..., op. cit., p.1ff.
[15] Ibid., p.59.
[16] Simmel, G., Soziologie: ... op. cit., p.346.
[17] Deutsch M., Cooperation and trust: some theoretical notes, in: Jones, N.R. (ed.), Nebraska Symposium on motivation, 1962, 10, p.275–319.
[18] Petermann, F.: Psychologie des Vertrauens, Salzburg 1985, p.9.
[19] See, e.g.: Preisendörfer, P.: Vertrauen als soziologische Kategorie..., op. cit., p.264; or: Warren, Mark E.: Democracy and Trust; Paper prepared for delivery at the 1996 Annual Meeting of the American Political Science Association, San Francisco 1996.
[20] Luhmann, N., Vertrauen, op. cit., p. 64.
[21] Ibid., p.69f.

ously in the social control ability of a system (e.g., the management efficiency of a railway administration) and the performance of technical installations (condition of the track system, technical control systems and trains). In this case, trust in human structures is combined with trust in technology. As already M. Weber pointed out, in this case as well trust is an attitude that has to make do to a large extent without knowledge: "No normal consumer today has even the slightest knowledge about the production of his everyday goods, usually he does not even know out of which materials they are made and which industry produces them. He is interested in no more than the expectations of the behaviour of these artefacts which are important to him from a practical point of view."[22]

If "trust clusters" are created by the adding up of intensive trust relationships of different kinds between a large number of social actors within a society, then we can speak of "high-trust-milieus" (in the contrary case of "low-trust-milieus"). Both high-trust- and low-trust-milieus have the character of self-reinforcing reproduction cycles (A. Giddens),[23] which have to be broken in the case of negative cycles in order to have positive effects on direction and usefulness of social and economic transaction behaviour and (with a different conceptuality) to increase the "social capital". Analyses of social and economic history give rise to the supposition that the start of both positive and negative "trust cycles" depends on the one hand on potentials or sources of trust, which are amongst others a part of the historical paths of development of societies, but which on the other hand can also be triggered by positive or negative shocks (some examples: hyperinflation in Germany as a negative, traumatising shock with a long-lasting effect; the coming to power of Putin in Russia as a possibly positive shock).

G. Krampen offers a productive systematisation and theoretic categorisation of existing terms and definitions of trust.[24] He differentiates between three categories of trust: *self-confidence*,[25] *trust in others* and *trust in the future*.[26] These categories complement each other conceptually as well as analytically and functionally; Krampen examines them according to the following criteria: development phase, development contexts and areas, development mechanisms and development subject matter.

Self-confidence is the fundament of all trust. It refers both to the concentrated, subjectively internalised abilities to recognise and accept one's own potentials and to "correctly" (i.e., according to the intended transaction) assess the opposite number and to influence his actions in order to achieve the desired result of the transaction. We can also find this connection of trust and self-confidence in Luhmann's work, when we read that he argues "people are ready to trust if they possess inner confidence, if a kind of self-confidence is inherent in them that allows them to face possible disappointments of their trust with equanimity…"[27] The category of self-confidence has up to now been studied mainly by the disciplines of psychology and educational theory. Petermann, for example, characterises self-confidence in this context as a decisive condition for trust practised against others. For him, trust is an "active process, which depends to a crucial degree on the extent of one's own feeling of competence (= self-confidence)".[28]

Interpersonal (social) trust is the most frequent subject for study in specialised literature. Krampen defines it as *trust in others*. Again, he differentiates between references specific to

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[22] Weber, M., Über einige Kategorien der verstehenden Soziologie, in: Weber, M.: Gesammelte Aufsätze zur Wissenschaftslehre, 7th edition, Tübingen 1988, p.465.

[23] Giddens, A., Die Konstitution der Gesellschaft. Grundzüge einer Theorie der Strukturierung, Frankfurt and New York 1995, p.247.

[24] Krampen, G.: Zur handlungs-, persönlichkeits- und entwicklungstheoretischen Einordnung des Konstrukts Vertrauen, in: Schweer, M. K.W. (ed.), Vertrauen und soziales Handeln: Facetten eines alltäglichen Phänomens, Neuwied, Kriftel, Berlin, 1997, p.16–62. Krampen refers in his definition to the works of P. Becker, from which he also draws the triple meaning of trust. Cf.: Becker, P.: Die Bedeutung von Vertrauen für die seelische und körperliche Gesundheit. Logotherapie und Existenzanalyse, Sonderheft (special issue), 1994, p.52–64.

[25] Translator's note: trust in German is Vertrauen, self-confidence is Selbst*vertrauen*.

[26] Krampen, G., Die Vertrauenstrias. Handlungs-, persönlichkeits- und entwicklungstheoretische Einordnung und empirische Untersuchungsbefunde, in: Trierer Psychologische Berichte, Bd.24, 1997, 1, p.27.

[27] Luhmann, N.: Vertrauen, op. cit., p.102.

[28] Petermann, F.: Psychologie ..., op. cit., p.125.

situations or areas or generalised references. Friends, acquaintances, politicians, the mass media or socio-political institutions are the people or institutions that are related to in these cases. "Trust in others" has a communicative and reciprocal character: people who have made the concession of trusting behaviour expect the partner to reciprocate.

The third category is related to *trust in the future*. Here, too, one can distinguish between various areas, such as trust one's personal future, in the future of relatives and friends, or in the future of society. However, trust in the future does not have an autonomous quality, as both self-confidence and trust in others are in general always (also) directed to the future, and only exist if earlier positive experiences can be transferred to the future. As Preisendörfer notes: "Trust creates expectations or hopes for something in return in the future".[29]

Trust plays an important role as well in economic relationships. National economies that are based on the principle of the division of labour depend on transactions (exchange processes of goods, factors of production and information). These transactions imply recurring costs, which can be reduced on the basis of trust. An increasing number of studies are making it clear that besides the traditional "hard" factors, such as corporate structure or production technology, the so-called "soft" factors, such as corporate culture, the behaviour of market actors and of course the trust that exists between them are significant.[30] Indeed, trust and other "soft" factors determine direction and contents of transactions, range of the networks the market partners create, market strategies of corporations and the dynamics of innovation and entry into the market (i.e., the behaviour as a "Schumpeterian entrepreneur") to a significant degree. The task of analysis is the operationalisation of the factor "trust", so as to be able to define it conceptually and theoretically, and to measure it empirically and differentiate it from other factors.

Sources of trust

The question of how resilient trust is as a guiding force for communicative behaviour can only be answered on the basis of an examination of the sources of trust, as the ability to trust and the quality of trustworthiness are no fleeting phenomena. Rather, both are properties rooted in the personality of a human being, his personal history, but also in the culture surrounding him. Trust, too, is (according to D. North) one of those "informal constraints[, which] come from socially transmitted information, and [which] are part of the heritage that we call culture,"[31] for trust, too, the observation of I. Cornelssen holds true: "Culture does … guiding work in the process of the evolution of a system".[32]

First of all, *experience* is a very significant factor among the sources for trust. Experiences one makes lead to expectation patterns and influence new situations. These experiences might be one's own experiences with a potential transaction partner, which were made in a similar situation; they might also be experiences made by other persons and passed on. W. Schmid has shown convincingly that "the experiences an individual has and interprets according to sense and meaning belong to his very own possessions; they contribute to his power of judgement and the fund of his knowledge of life. Unlike the logic and systematics of scientific knowledge, knowledge gained by experience can take into account the logic of life, as it is experienced in the life one lives".[33] Positive experiences lead to a positive estimate of success in the future, both on the side of the trustor and on the side of the trustee. The respective positive experience and trust that has been won more than once will then clearly shape patterns of action and the

[29] Preisendörfer, P.: Vertrauen als soziologische Kategorie, op. cit., p.270.

[30] See e.g.: Siegenthaler, H.: Regelvertrauen, Prosperität und Krisen. Die Unregelmäßigkeit wirtschaftlicher und sozialer Entwicklung als Ergebnis individuellen Handelns und sozialen Lernens, Tübingen 1993.

[31] North, D. C., Institutions, Institutional Change and Economic Performance, Cambridge, Mass. 1990, p.37.

[32] Cornelssen, I., Der Fall Japan. Kultur als Triebkraft wirtschaftlicher Entwicklung, Frankfurt/Main. et al. 1991, p.47.

[33] Schmid, W., Philosophie der Lebenskunst. Eine Grundlegung, Frankfurt/Main 1998, p.302.

personal character of the respective individual. [34] Experiences play an important role in the creation of both personal and system trust. Experience is a triggering factor for the abovementioned reproduction cycles, which lead to trust becoming stronger or weaker or even vanishing completely. On the one hand, experience is a subjective factor: every person has his own experiences. On the other hand, experience is also always imparted by public processes of communication. Thus, e.g. economic situations that are not seen as being particularly unfavourable by the individual can be influenced negatively – and positively in the opposite case – by the media and opinion-forming politics.

Experience as a central source of trust is however not only embedded in "milieus of perception", which definitely can be influenced; deeper-rooted factors are also expressed in experience. These factors are connected on the one hand with genetic patterns, family structure and socialisation, and on the other hand can be traced back to history ("historical memory"), culture and religion, traditions and rituals. Researchers are most probably right in assuming that all of these factors influence the existence or absence of trust to a very significant degree. However, developments of research in this area are on the whole fairly unsatisfactory. In many cases, studies have not progressed any further than hypotheses, which appear plausible within the context of general typifications, but cannot be sufficiently proven empirically. Although we can assume the existence of "high-trust-" and "low-trust-milieus" – and we will work with these categories for good reasons in our project –, formulation of theories and empirical research must be continued in connection with the question what can be seen as a source of trust beyond straightforward experience and especially what effects cultural and religious patterns have on the creation of trust. One might for example ask which trust-creating (or trust-reducing) effects come from specifically Protestant, Catholic, Orthodox (but also Jewish and Islamic) family structures or socially comprehensive milieus, which hypotheses can be formulated on connections with economic behaviour and which strategies are available for empirical checking of hypotheses. The category of "primal trust", which concerns the core of a person, is as important as it is empirically problematic, especially since psychology has given up the one-sided position of a creation of primal trust purely or primarily by a successful mother-child relationship.

On the role of trust in the Russian transformation process

What is valid, according to R. Rose, for Eastern Europeans on the whole, holds especially true for the Russians: they know the people they trust, and they trust the people they know.[35] In Russia, business deals, founding of companies, investment decisions or cooperation are not done within the framework of official and formal institutions or structures; rather, this is done with the help of friends, relatives, or colleagues. In the face of the often unstable norms and principles of the transformation period and of wide-spread corruption, this means that the factor "trust" has a special significance, which can be reduced to the formula: a lack of system trust is compensated by taking recourse to private relationships and networks, i.e., a reliance on traditional forms of (inter)personal trust. These informal business networks still play a significant role. By now, these networks can even be understood to be a stable and relatively closed system of relationships between business partners. This system is standardised by self-defined, informal control mechanisms (which are in a way becoming permanent and increasingly formal).

Several analyses examine the role of trust in the economic relations of Russian enterprises.[36] The surveys conducted show that not the law serves as a guarantee that a promise will be kept,

[34] Cf. Schmid, W., op. cit.. Further reading: Endreß, M.: Vertrauen und Vertrautheit – Phänomenologisch – antropologische Grundlegung, in: Hartmann, M.; Offe, C. (ed.):Vertrauen. Die Grundlage des sozialen Zusammenhalts, Frankfurt und New York 2001, p.161–204, here p.177.

[35] Rose, R.: Coping with Organizations: Networks of Russian social capital, Centre for the Study of Public Policy, 2000.

[36] See e.g.: Evdokimova-Dinello, Nataliya (2002): Kapital i rossiiskije bankiry, in: Sotsiologicheskie issledovaniya, 2, pp.75–86; Yurlov, Felix (2001): Sotsial'nyje izderzhki globalizatsii, in: Sotsiologicheskie issledovaniya,7, pp.13–22; Dushazky, Leonid (1998): Vsaimodeistvie predprinimatelei s usloviyami sredy, in: Sotsiologicheskie issledovaniya, 1, pp.68–72; Dushazky, Leonid (1999): Tsennostno-motivatsionnye dominanty rossiiskikh predprinimatelei, in:

but rather personal reputation and/or family relationships.[37] Russian companies do not trust state structures, but real persons. The fact that regulations established by contracts are kept is a guarantee that the reputation not only of the entrepreneur, but also of the enterprise will be consolidated.[38] The costs that arise in case of non-compliance are not only measurable in material terms; the loss of trust not only of current, but also of potential business partners is far more important.[39]

It is a special characteristic of the Russian economy that one cannot do without support of friends or relatives in the initial phases of entrepreneurial activity. These are people whom one trusts. However, when the enterprise grows, these networks of trust become too constraining; only later does trust in qualification of employees and quality of products arise. Long-term personal relationships with the business partners usually provide the basis for mutual trust. Such familiarity guarantees the binding force of mutual promises, lessens the risk of a breach of contract and increases the probability of further business.[40]

In spite of the generally low level of trust in present-day Russia there exist nonetheless some solid networks of trust between entrepreneurs. We can define three such networks: relatives, friends, and a special group of "Red Directors", former Soviet directors, who have kept their positions for the most part and continue to cultivate their old connections.[41]

There is however a principal difference between Russian networks and networks in other market economies. The common rules of the game, which form and influence networks and have a universal character, do not play any role in Russia. "In Russia, every network connection 'lives' according to its own specific terms, which are only accepted by its members. The universal norms, which have to be under control of the state, are lacking in the model of Russian capitalism."[42] The lack of commonly accepted rules influences the overall structure of the Russian market as well. The informal division of networks in "ours" (svoe) and "theirs" (chuzhoe) makes the solution of potential problems more difficult. Promises, privileges or reductions (e.g., discounts, cheap credits, etc.) are available only to members of one's "own" network.

On the one hand, this system has a stabilising effect both on the micro- and the macroeconomic plane. Traditional behaviour patterns and networks ensure the maintenance of a certain amount of economic activities and prevented the "free fall" of the Russian economy, often (wrongly) forecast in the West. However, these same mechanisms imply high transaction costs and prevent both an optimal allocation of productive resources as well as the development of dynamics of innovation. Only a conversion of entrepreneurial behaviour from personal to system trust might bring about progress. However, sustained improvement of the situation of trust in Russia apparently requires a lot more time than the purely institutional transformation of the system to a

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Sotsiologicheskie issledovaniya, 7, pp.91–94; Savkin, Vladimir (1999): Predprinimatel'skaya sreda v otsenke predprinimatelei, in: Sotsiologicheskie issledovaniya, 7, pp.95–98; Pachkovsky, Jury (2001): Predprinimatel'skoe povedenie:teoretiko-metodologicheskie aspekty, in: Sotsiologiya:teoriya, metody, marketing, 1, pp.57–63; Torbin, Alexander (2001): "Oblom" oblomovykh: Evolyutsiya menedzhmenta v Rossii, in: Ekonomika i organizatsiya promyshlennogo proizvodstva, 11, pp.26–45; Oleinik, Anton (1996): Stsenarii institutsional'nogo razvitija perekhodnogo obshchestva, in: Mirovaya ekonomika i mezhdunarodnye otnosheniya, 7, pp.19–24.

See e.g.: Oleinik, Anton (2001): "Biznes po ponyatiyam": ob institutsional'noi modeli rossiiskogo kapitalizma, in: Voprosy ekonomiki, 5, pp.4–26.

[38] See: Radaev,Vadim: Osnovnye vektory institutsional'nykh peremen v rossiiskoi ekonomike, in: Materalien der Internationalen Konferenz "Investitsionny klimat i perspektivy ekonomicheskogo rosta v rossii" (published on the Internet at: http://www.hse.ru/ic/materials/basic.htm 19.3.2002).

[39] See: Khlopin, A. (2001): Zakon v sotsial'nykh predstavleniyakh "novykh russkikh", ili gde prokhodit gran' prestupleniya?, in: Pro et Contra, 6 (published on the Internet at: http://pubs.carnegie.ru/p&c/Vol6-2001/3/default.asp?n=09ak.asp 19.3.2002).

[40] Shastitko, A. (2002): Mekhanism obespecheniya soblyudeniya pravil (ekonomichesky analiz), in: Voprosy ekonomiki, 1, pp.32–50, here: p.37.

[41] For an overview of the role of the "old guard of Red Directors" see: Ledeneva, Alena (1997): Neformal'naya sfera i blat: grazhdanskoe obshchestvo ili (post)sovetskaya korporativnost', in: Pro et Contra, 2 (published on the Internet at: http://pubs.carnegie.ru/p&c/Vol2-1997/4/07ledeneva.asp 19.3.2002).

[42] For a more detailed description see: Oleinik, Anton (2001): "Biznes po ponyatiyam": ob institutsional'noi modeli rossiiskogo kapitalizma, in: Voprosy ekonomiki, 5, pp.4–26, here: p.20.

market economy. Such a change is of far greater dimensions and is shaped by traditional and cultural factors.

For Russia, the hypothesis might be valid that the tendency to distrust the rather anonymous structures and mechanisms of state order and the inclination to rely on familiar personal networks has historical roots. For one, these roots are connected to the experiences of the Soviet era, which is remembered as a period of potential arbitrariness. For another, one must also refer to more distant Russian history, which was also characterised by a weak development of dependable and trustworthy formal institutions and by a relatively limited scope for individuality and bourgeois self-assurance. At the level of the intellectual superstructure this restricted individualisation (in quite different, even opposite ideological and religious contexts) can be found in communist ideology as well as in the teachings of the Orthodox Church. In both systems of thought the autonomous individual plays a relatively minor role as specific carrier and recipient of trust.

Translation from the German language by Matthias Neumann

David Smallbone / Fergus Lyon

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

[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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Gabi Dei Ottati

Some Thoughts on Entrepreneurial Strategies and Trust

Introduction

The increased complexity and uncertainty of the business environment (increased demands for enhanced quality and constant innovations) have made trust (interpersonal and interorganizational) more necessary. Fukuyama (1995, p.7) even claims that "a nation's ability to compete is conditioned by … the level of trust inherent in a society".
Trust, however, is an elusive concept that has many meanings that has been studied from different scientific perspectives, such as sociology, economics, philosophy.
In spite of the variety of approaches, trust is a meaningful concept to the parties in a social or economic relation *only if* at least one party is exposed to an element of behavioural risk, i.e., in Oliver Williamson's jargon, to opportunistic behaviour. Consequently, trust is the belief in the other party's trustworthiness that goes beyond control and enforcement. In other words, trust may be defined as the expectation that the partner will not exploit the vulnerability created by cooperation.
In this paper I will select from the by now rich body of literature on trust and economic relations only some concepts that seem relevant for our research project.

Different types of trust

As trust is a concept with different meanings, it is useful to distinguish between the various types of trust.
Following Mari Sako (1992), a first distinction is between trust in the other party competence (**competence trust**) and in the other party intentions (**intentions trust**). This distinction is relevant because when trust is broken the proper response varies according to the type of trust. With a breach in competence trust, one may respond by providing technical assistance. With breach in intentional trust, one may use "voice" (Hirschman, 1970), or improve incentives. In the case of intention trust, the vulnerability depends not on the abilities of the partners, but on their behaviour. In the latter case, it is useful to distinguish between contractual trust and goodwill trust.
Contractual trust refers to the expectation that promises made are kept.
Goodwill trust is the expectation of an open commitment not to exploit the other party's vulnerability even if the opportunity arises. Clearly, the notion of goodwill trust involves a willingness to go beyond contractual commitments.

Different types of behaviour

According to Max Weber's analysis (1922), human behaviour may have various orientations. Apart from affectual behaviour, which is determined by feelings, there are other three types of behavioural orientation: instrumentally-rational behaviour, value-rational behaviour, and traditional behaviour.
Instrumentally-rational behaviour is determined by the individual's calculation of the best means to attain a certain end, as supposed by mainstream economics.
By contrast, **value-rational** behaviour is determined by a commitment to a system of values, independently of the immediate results of the behaviour.
Traditional behaviour is determined by habit. In exchange relations institutionalised routines can be thought of as traditional behaviour.

Different sources of trust

Socially oriented trust as collective capital

As human behaviour is not located in a vacuum, but in a social context, sociologists (Max Weber, Talcott Parsons, but also Fukuyama) claim that trust is based on a common history and the sharing of a common set of values and norms. This notion of trust is the result of a value rational behaviour and it seems capable of explaining economic relations only in special contexts, particularly in an increasingly globalised economy. Lyons and Mehta (1997) introduce the notion of Socially Oriented Trust, which can be the result either of value-rational behaviour, or of traditional behaviour, i.e., of behaviour following an institutionalised routine or custom. The latter type of behaviour, unlike the former, is rather widespread in economic relations as well; moreover, it has the advantage that it can be promoted and sustained by appropriate institutions.
Indeed, socially oriented trust is similar to what I have termed 'trust as collective capital' (Dei Ottati, 1994), with reference to the custom of reciprocal co-operation which characterise economic relations in industrial districts. (For examples of institutionalised routines that promote co-operation among firms in industrial districts, see Brusco 1999, p. 20–26)

Reputation as personal capital

Since orientations of behaviour differ, the sources of trust differ as well. Next and often complementary to Socially Oriented Trust, especially in business relations, is trust based on the other party's reputation. Not by chance, many economists see trust as supported by instrumentally rational behaviour. (In particular Williamson 1993, see also Dasgupta 1988; Kreps 1990)
Lyons and Mehta (1997) refer to this notion of trust as Self-Interested Trust because its distinguishing feature is that behaviour is motivated by individual self-interest, as the expected future benefits of cooperative behaviour outweigh the immediate gain of an opportunistic behaviour. Therefore, the idea that it is possible to actually calculate future benefits of different courses of action is related to this notion of trust.
To posit self-interest as the *sole* basis of trust is clearly one-sided. It is also unrealistic because the future is intrinsically uncertain and trust begins exactly where rational prediction ends, due mainly to the pervasive effects of change.
In spite of that, particularly in economic transactions, elements of instrumental-rationality and calculations may be present even in trust relations. Therefore, I think it is useful to consider a mixture of the different behavioural orientations, changing according to context and situation. Especially in contexts in which exchange repetition can yield future gains, instrumentally rational behaviour may contribute to the building of a reputation for trustworthiness as personal capital (Dei Ottati, 1994). Eventually, this reputation may be a condition for the later development of goodwill trust.

Trust and the reproduction of industrial districts' dynamic efficiency

Among the processes enabling the reproduction of dynamic industrial districts there are at least two, which are crucial: 1) the division of labour and its integration and 2) the accumulation of contextual knowledge and its combination with the new codified knowledge normally produced outside the district (Becattini and Rullani, 1996). In both of the above mentioned processes trust plays a critical role.

Trust as collective capital favouring the flexible integration of the division of labour and the accumulation of contextual knowledge within the district

An industrial district is a local system characterised by the active presence and interaction of an economic subsystem (a cluster of small and medium-sized enterprises) with a social subsystem (a community of people). As far as the economic subsystem is concerned, the enterprises are usually small, because they are specialised in one or a few phases of the production process of

the main local industry. Consequently, a distinctive feature of the district organisation is a marked social division of labour.
As it is well known, the price mechanism is unable to effectively coordinate closely complementary activities, like those carried out by independent firms specialised in different stages of a single production process. As clarified by Richardson 1972, reciprocal co-operation can serve this purpose. The diffusion of a common culture and the sharing of business routines arising from the sedimentation of good practices sustain co-operation within the district. This, in turn, enables an effective integration of the division of labour among local firms, thanks to a peculiar form of transactions' governance, which combines elements of market (competition) with elements of culture (reciprocal co-operation): the 'community market' (Dei Ottati, 1991). Moreover, this form of integration, which derives from the embedding of economic relations in social life, has the advantage of favouring the learning process and the accumulation of contextual skills inside the district.

Trust as individual capital supporting the birth of new firms and continual innovation within industrial districts

I have just stated that trust as collective capital contributes to the integration both of the local division of labour and of contextual skills with new codified knowledge. However, is such a type of trust sufficient to fuel the birth of new specialised firms and the process of continual innovation within the industrial district?
The reduction of transaction costs due to the diffusion of a behavioural orientation that follow local routines is not enough to assure that ever new agents *will* (are prepared to take the risk) and *can* (have the money capital) start a business, or introduce an innovation.
The results of empirical studies carried out in several Italian industrial districts show that there are two resources which are decisive to start a business in the local system: a) production knowledge, and b) personal reputation of trustworthiness. The latter is usually acquired incrementally through repeated direct economic and social interaction between the same business partners (Dei Ottati 1994). Therefore, personal reputation of trustworthiness is the result of a mixture of motivations, and not *exclusively* of instrumentally-rational behaviour. Nonetheless, personal reputation of trustworthiness is important for future gains and it is often offered as collateral against the advance (cash or machinery) necessary to become self-employed or to innovate. Consequently, this personal reputation is like individual capital which, in the district environment, fuels the distinct but complementary processes of the division of labour and of continual innovation, which are the engines of the districts' dynamism.

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Urve Venesaar / Margit Venesaar

Remarks on Entrepreneurial Behaviour and Trust in Estonia

Based on social capital as a determinant of trust in a society, trust has been discussed in Estonia more at the level of society (cf. Putnam, 1993) and much less at the level of individuals and their networks (cf. Bourdieu, 1986). Various public opinion polls indicate that many people feel the impact of social problems, but few try to actively solve the problems. The reasons mentioned are economic difficulties (people's energy is spent on providing everyday subsistence for their family) and stabilisation of society after regaining independence; politics were left to professional politicians and active participation in politics by the people was not regarded necessary any more (Hansson, 2001). Declining political activity was accompanied by falling participation in voluntary associations and organisations (e.g. trade unions). Social trust in Estonia has diminished at both the vertical (Parliament and Government) and the horizontal (various social groups) level (*inter alia* because of the ownership reform: the problem of tenants and owners, etc.). After withdrawing from active social life, a large part of the population live and act in smaller informal social networks dominated by mutual trust. Consequently, the following interrelation applies: where formal institutions are weak, informal social capital may have particular importance (Fukuyama, 1995). However, distribution of social capital between different social groups in Estonia is rather unequal, which is caused *inter alia* by great changes in society (loss and/or change of job, financial and educational stratification, etc.) (Hansson, 2001).

A number of analyses have described social, economic and political environments in which trust is low (Zak & Knack, 2001; etc.). These environments have been estimated as politically unstable, socially heterogeneous and economically discriminatory. If we consider three measures of heterogeneity: Gini, Race and Ethnicity (where Gini and Race are significant, Ethnicity is not) (Alesina and La Ferrara, 2000), the environment in Estonia has become more heterogeneous on the basis of the Gini coefficient (0.203 in 1989 but 0.36–0.38 in recent years) (Mäe, 2000). This has been influenced by economic shocks, drastic changes in the labour market (the number of salaried workers decreased by 22% during 1992–1999, the unemployment rate is high – 13.8% in 2000), stratification in education, regional differences in economic and social development etc. Expenditures on social aid and unemployment benefits are very low in Estonia and so is the share of social benefits in the GDP (16–17% of GDP in recent years, compared with the EU average of 28.5%). Therefore, the process of transition in Estonia has incurred very high social development costs (rise in poverty, wealth and gender inequality, decline in life expectancy, etc). The above-described changes in the environment explain the extensive loss of trust in the system which in Estonia in the opinion of some authors has turned almost into a chronic social trust crisis (Raud, 1998).

A trustworthy environment has been characterised by the key words security and benevolence (Heidmets, 1998), i.e., people trust an environment that is secure, predictable and regular, and beneficial to people's wishes, needs and aspirations. This implies that a stable political situation, a favourable investment climate and real estate prices are increasingly linked to a trustworthy environment. Thus, we can say that by selling an apartment we also sell environment. Ulrich Beck prognosticates that the main article of sale and purchase in the 21st century will be risk and trust. Heidmets is of the opinion that these predictions must be taken seriously in modelling the future for Estonia. The need for trust only arises in a risky situation (Deutsch, 1958, Mayer et al, 1995 referred by Dyer, Chu 1997).

A good example of a stable policy and favourable investment climate may be given by analysing the features of Estonia's economic development policy where the main priorities have been stabilisation of national currency and both sustainable continued growth and yearly reductions of inflation, and encouragement of foreign direct investments (FDI). Efforts to create a trustworthy environment for FDI have included the drafting of laws on ownership reform, foreign investment (1991), privatisation, creation of special incentive programmes and adaptation of regulatory frameworks to meet internationally agreed standards. FDI-related laws have been com-

prehensively revised in order to create a transparent and non-discriminatory legal regime. Estonia is generally viewed as having very few restrictions on foreign investments and offering high levels of freedom and protection of property rights. The Foreign Investment Act of 1991 (repealed in July of 2000) defined procedures and legal regime for making foreign investments in Estonia, the basis for investment incentives, and the legal safeguards available. Foreign investors and their investments were granted „equal rights and obligations" unless prescribed otherwise in other legislation (notably in respect to the acquisition and use of land and other national resources). It guaranteed the unhindered transfer of profits, dividends and invested capital and provided fundamental protection and dispute settlement rights (such as the case of expropriation). These guarantees were secured by the provisions of some 23 bilateral treaties for the promotion and protection of investments, 23 bilateral taxation treaties and adherence to important international conventions. Special conditions were established for foreign investments in free zones under concessions. However, the Act allowed the Estonian government to "specify areas of activity" where establishment or investment could be prohibited or a foreign investment licence was required.

As a result, FDI inflows have reached relatively high levels: FDI stocks reached 44.5 billion Estonian kroons (EEK, 2,800 million Euro) by the end of the year 2000. FDI stock grew in per capita terms from 7,000 EEK (450 Euro) in 1996 to 32,600 EEK (2,050 Euro) by the end of 2000 and achieved one of the highest accumulated FDI levels per capita in Central and Eastern Europe (OECD, 2001). Studies of investors' motivations for choosing Estonia indicate that its potential market growth and the easy access it affords to neighbouring markets are its most attractive features. Restructuring, privatisation and liberalisation of investment conditions in foreign investors' interests have been the key features for Estonia's progress in transition to a market economy.

Trust is regarded as a big chance for Estonia in the 21st century. In the Open Community Forum (1998) M. Heidmets estimated trust as 1) the principal criterion; 2) more easily attainable in a small society and 3) at a low level in present-day Estonia (Heidmets, 1998). Many people perceive the living environment as being untrustworthy. However, as trust is also connected with attitudes and trends, then changes in these attitudes and trends would imply changes in trust. At the level of society, the "common core" (according to Heidmets, this includes "shared values and attitudes, accepted behavioural and interaction models in everyday life" (Heidmets 1998)) produces trust. This means the wish to participate in modelling one's living environment, e.g., cooperation in the form of aid or charity. In short, this is a mentality which places common interest on a par with private interest (Heidmets 1998). In developed countries we can see besides individualistic and self-centred values (personal welfare, career and self-realisation) a much higher regard for collective interests (as an attitude towards the common core and freedom to act in common interests) than in the Soviet period or in Estonia today. In the author's opinion, the Estonian situation, namely, that people further their private interests but are not very interested in furthering common goals of society, means that there is a need to change the attitude towards the "common core", i.e., the willingness to act in the common interest, which might help in raising the culture of behaviour (e.g., in road traffic) or solve political problems (e.g., integration of the non-ethnic population).

According to Alesina, trust may be a moral and cultural attitude influenced by individual characteristics such as the level and type of education received (Alesina and La Ferrara, 2000). Estonia is characterized by a high share of people with tertiary education – 23% of population aged 15–74 (Statistical, 2001). The share of people with primary or basic education in all age groups of working-age people in Estonia is more than twice as low as the European average. Estonian skilled labour has been the main resource that has helped to adjust to overall globalisation and economic opening. Though the share of young people who continue their studies in colleges and universities has increased considerably lately, a cause for worry in Estonia in recent years is the increase of young people without basic education (educational stratification) (UNDP, 2001). At the same time, the efficiency of education in the labour market has diminished, and Estonia has not been able to use one of the strongest features of its potential, a high

level of education (Terk, 1999). Considering the relatively short duration of the transition period so far it might be assumed that Estonia has the development potential to achieve harmony between the educational system and institutional relations of the labour market and in the development of trust created as a result.

Trust as initial capital of democracy is a deficient resource in all contemporary democracies. Trust is openness, readiness for participation and co-operation, goodwill to surmount difficulties and misunderstandings (Lauristin, 1999). Organisations however are not able to trust each other, trust bases on individuals (Dyer and Chu, 1997). In a democratic society where equal human rights are guaranteed to everybody, we can speak about trust between an individual and the state (Kovaljov, 1998). Therefore, trust really exists when people are responsible and ready to take responsibility. Issues of trust between citizens and the State have been discussed in the programmes of Estonian political parties (Moderates and Res publica, as published on the internet at http://www.moodukad.ee and http://www.respublica.ee, respectively).

Trust and reliability have been discussed as the bases of cooperation, which is one of the most important assets of society (Romanainen, 2001). If a person trusts us, we accept the silent demand not to let him/her down and use him/her (Lagerspetz, 1998). Thus, besides democratic political life, trust is the foundation of economic success (Fukuyama, 1995, Lauristin 1999, etc.) or, for example, adaptability to the world fashioned by information technology. It has been estimated that in transition economies trust (i.e., extended trust) is not positively related to growth, because trust is generally low in transition economies (Raiser et al, 2001). The main conflicts in countries in transition, including Estonia, arise from the fact that the natural development of their societies has been held up for 50 years, whereas they now have to cope with a rapidly developing global civilisation. In this situation it is inevitable that phenomena from different types of society intertwine, creating social conflicts. Their solution requires time for adjustments, development of new value judgements and attitudes, which can only happen gradually.

Economic benefits of interpersonal trust are widely recognised. When people trust each other, transaction costs in economic activities are reduced, large organisations function better, governments are more efficient and financial development is faster (Alesina and La Ferrara, 2000). This is confirmed as well by the principles of corporate ethics, according to which it is important to do everything as humanely as possible, hold mutual trust in honour and pursue social agreements which take into account both general and corporate benefits (Laanemäe 2000).

Martin Raiser (1999; see also Dyer and Chu (1997)) defines three types of institutional links between enterprises in transition countries. There are business networks built on ascribed trust (among kinship groups and family members, usually confined to the local economy), process-based (based on existing long-term relations or ties with customers, suppliers etc.) and extended trust (based on formal contracts, extended trust also in anonymous partners, integration into global production networks). In Raiser's opinion, firms with the latter type of trust have better a perspective for development and they are more open to innovations and thus, development. Intranational trust in general is also important here.

Trust has been empirically measured and used by many authors,[1] who have indicated that trust between people differs by country, and that nations have different attitudes towards honesty and accuracy. The results of the World Values Survey[2] show that in transition countries, indicators of social capital are significantly lower than in OECD countries (Raiser et al, 2001). Trust in public institutions is a key aspect of a functioning market economy and democracy. The results of WVS show that in transition countries trust in public institutions is *not* systematically lower than in the wealthier Western countries (Raiser et al, 2001). There are however notable exceptions concerning some key institutions: legal system, police, trade unions, commercial compa-

[1] World Values Survey (WVS) 1970-1992 and 1990-1995; General Social Survay (GSS) 1974-1994; New Democracy Barometer (NDB) (see Rose, Mishler, Haerpfer, 1997); Saar Poll Surveys in Estonia; Business Environment Survay WBES (see Hellman et al, 2000), Business Environment and Enterprise Perfomance Survey (BEEPS)

[2] The first collection of data on social capital in the transition countries of Central/Eastern Europe (incl. Estonia) and the Former Soviet Union.

nies and political parties. According to the World Values Survey, there was greater trust in the legal system, government and commercial companies in Estonia in 1995, but lower trust in police, parties and trade unions than in OECD countries. However, trust in most of these institutions increased in Estonia in 1990–1995.

People in transition countries value the family as highly as people in fully developed market economies do. However, people in transition countries seem to rely far less upon friends than people in OECD countries (Raiser et al, 2001). Changes in these relations are to a large degree connected with significant changes in the economy (e.g. people's departure from the labour market interrupts relations with former colleagues and friends, the circle of acquaintances narrows, the establishment of new relations on the other hand takes time).

The social and market research firm *Saar Poll* (2000) has conducted annual public opinion polls in Estonia since 1995 in order to research changes in people's attitudes in relation to social development tendencies. These polls indicate that people's trust in Prime Minister, Government and Parliament has gradually diminished with some temporary rises, trust in the Bank of Estonia (Eesti Pank) has risen in recent years but has fallen in comparison to 1998 (when 60% of the interviewees trusted the Bank of Estonia). Trust in the Defence Forces, Border Guard and Police has risen slightly. Trust in local governments has been stable (Table 1). Trust in the President has always been higher than trust in other institutions, which can be explained by the fact that the President's actual powers are small (more of a moral than a formal nature), expectations are smaller and consequently there are no disappointments, either (Lauristin, 1999).

Table 1. Trust in Estonian state institutions (in %, answered "trust completely" or "trust more or less").

Year	President	Government	Parliament	Local Government	Police	Eesti Pank
1995	66	53	49	46	30	44
2000	58	34	32	45	44	48

Source: Saar Poll (2000)

In the same questionnaire, 57% of the respondents were of the opinion that the Government has in general succeeded in the development of entrepreneurship during the last 10 years, i.e., since Estonia regained its independence, although 16% did not know what to answer to this question. The question which national programme would the respondents support most, produced answers by over two-thirds (68.5%) that the most supported programmes would be health care and medical assistance programmes; the second place was occupied by the new job creation programme (60%) and the third place by support to young families (46.5%). In the 14th place (out of a total of 27 on the list) was support to small business development (11.5% of the respondents). 25% of the respondents thought that small entrepreneurs can influence the drafting of laws. Answers to other questions related to the environment for entrepreneurship (e.g., limitation of interests of monopolistic enterprises; inviolability of property; elaboration of laws, etc.) indicated that a lot has changed but a lot remains to do to improve the external environment for the development of entrepreneurship.

The importance of process-based trust between firms in Estonia may be found in other studies. For example, the subject of the study "Internationalisation, Inter-firm linkages and SME Development in Central and Eastern Europe" (P95-2168-R) (within the framework of the Phare ACE Programme) was the main advantages furthering competitiveness of firms and their competitors (Smallbone et al, 1998). The firms of the food and clothing sector named established customer relationships among the three most important advantages, indicating the importance of these relationships. Owners of small firms who know each other can rely on trust (often based on verbal agreements), which makes them more efficient than large firms.

Factors that count in the changed entrepreneurship milieu are: personal contacts and network, availability, integration between production systems and institutions engaged in research and development activities (Raagmaa, 1999). According to the theory, winners are those who create

knowledge faster (Porter, 1990). Consequently, success depends on the creation of knowledge and on how fast petrified thinking, attitudes and views can be changed.

An issue of regional success is attitude towards new enterprises and self-development (diligence and fair competition). For instance, in the European regions which are the best examples of network economy (so-called new industrial areas, e.g., *Emilia-Romagna* in Italy, *Rhône-Alpes* in France and *Baden Württemberg* in Germany), trust and co-operation between public and private sector is evident everywhere (Raagmaa, 2000). Network relations are characterised by co-operation, mutuality, additional dependence, orientation to common objectives. Co-operation is motivated by equal benefits of partners.

Trust in enterprise depends on advertising and image (Kokk, 1998). Even more important is impeccable and professional servicing based on trust. At the time of the Estonian banks' trust crisis of 1992-93[3], client and client-oriented activity were close to zero. Banks seemed to operate only with each other. Lost trust means lost clients; clients are the main source of power for enterprises' operation. If there are no clients there is no future (Noormets, 1998). Noormets suggests 5 points for action: 1) define the position of organisation (public opinion about the firm); 2) environmental diagnosis (analysis of decisions, opportunities, risks, environmental impacts and other information); 3) innovations and more aggressive actions; 4) building of a communication model for the target group; 5) analysis of advantages and disadvantages of competitors *(benchmarking)* (Noormets, 1998).

The issue of trust in Estonian entrepreneurship environment has not been examined in detail. Taking the above overview into account, the issue of trust should be studied for all three types (as defined by M. Raiser: ascribed, process-based and extended trust). Furthermore, it is necessary to identify what the main factors are that determine trust/distrust between business partners at macro-, meso- or microlevels, and the strategies of enterprises they have used in different circumstances. Then, useful policy directions or regulations can be found to make business environment more favourable concerning the issues of trust.

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[3] By mid-1992, there were over 40 banks in Estonia. After the banking crisis of November 1992 the number of banks was reduced to 23 by early 1993. (Ardo Hansson, 1994)

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Friederike Welter

Trust, Institutions and Entrepreneurial Behaviour

Introduction

Our research project investigates entrepreneurial behaviour in different Western and Eastern European countries. The central hypothesis is that trust has a decisive impact on entrepreneurship. Trust determines ways into and forms of entrepreneurship as well as entrepreneurial behaviour. In this context, low levels of trust constrain market entry, enterprise growth and competition whilst encouraging unproductive forms of entrepreneurship. Empirical evidence shows that entrepreneurship under transition conditions takes a variety of different forms and enterprises use various strategies that partly reflect the external environment for private enterprise in these countries (Smallbone and Welter, 2001a). The types of entrepreneurship identified include the so-called 'nomenclatura' businesses, firms operating mainly within the formal economy, self-employment, part-time businesses and enterprises operating almost or entirely outside the formal sector. Although with the exception of the first mentioned all other types exist under mature market conditions, the specific context in which they have developed (particularly during the early stages of transformation) has implications for their specific characteristics and pattern of behaviour.

In this context, the paper, which should be considered a work in progress, discusses the theoretical concept we propose to use for our research project. Part 2 introduces the concept of formal and informal institutions developed by Douglass North whilst part 3 presents its implications for analysing entrepreneurship and entrepreneurial strategies. Part 4 discusses interactions between trust and formal institutions. Part 5 points out strengths and weaknesses of the institutional concept and indicates topics for further discussion.

The concept of formal and informal institutions

While most studies implicitly understand entrepreneurship and enterprise behaviour as a result of person-specific resources and capabilities, empirical evidence indicates that the dominant feature influencing the nature and pace of entrepreneurship is the external environment (Peng and Heath, 1996; Peng, 2000), which applies particularly to transition countries where market reforms have been slow and/or not properly implemented. Here, institutional theory, and especially the concept of formal and informal institutions developed by Douglass C. North, appears to be a suitable theoretical background to analyse entrepreneurship and enterprise strategies in the transition context (Hoskisson et al., 2000; Peng, 2000). This concept draws attention to external political, economic and societal influences on individual behaviour, discussing them in terms of formal and informal institutions.

North (1990, 1995) understands institutions as the incentive structure of a society, defining them more specifically as "the rules of the game in a society or, more formally (...) the humanly devised constraints that shape human interaction". Institutions assist in reducing uncertainty and risk for individual behaviour as well as the transaction costs connected with entrepreneurship. They "define what actors can do, what is expected from them, or they must do, and what is advantageous for them. In this way, they give stability and predictability to economic interaction." (Dallago, 2000: 305). Formal institutions include political and economy-related rules and organisations whilst informal institutions refer to codes of conduct, values and norms, i.e., those attitudes and mental perceptions (Denzau and North, 1994) which are embedded in a society. As North (1990) put it: "They [the informal institutions] come from socially transmitted information and are part of the heritage that we call culture."

Both informal and formal institutions are mutually dependent, especially if it comes to putting a new or changed institutional framework into action. Moreover, informal institutions also contribute to the enforcement of the formal framework. In the form of 'unwritten rules' they contain

that interpretation of formal rules which is accepted in the respective society and culture. Although legal sanctions such as penalties for unlawful behaviour play an important role in implementing new rules of the game, these means are far from being sufficient. Here, any civil society needs an additional implicit mechanism to sanction new institutions, which refers to trust as an important informal mechanism in shaping enterprise behaviour. 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 sanctions and penalties (Kahle, 1998). A consistent institutional framework therefore needs both personal and institutional trust in a society.

Williamson (1993) distinguishes between personal trust which he however limits to non-commercial relations, risk which characterises commercial transactions, and institutional trust which refers to the social, cultural, political and organizational embeddedness of economic transactions. Whereas personal trust can exist regardless of any formal institutions, institutional trust requires stability and predictability of the institutional context, i.e., formal institutions need to be legitimised through societal norms and values. Here, Williamson draws attention to the fact that "transactions that are viable in an institutional environment that provides strong safeguards may be nonviable in institutional environments that are weak (…)." (Williamson 1993).

In this context, North (1995) points out the path-dependent behaviour of informal institutions, which are deeply rooted in society. Whilst formal institutions may be easily modified and transformed informal institutions such as norms of behaviour and values are more persistent and change slowly. Mummert (1999) explains this as a result of societal sanctions for deviant individual behaviour. This could result in an incompatible institutional framework, which in turn fosters indifference or even institutional distrust in those cases where formal institutions perform unsatisfactorily or where individuals perceive their performance as inadequate.

Institutions, entrepreneurship and entrepreneurial behaviour

Applying North's concept to entrepreneurship, institutions are the 'formal' and 'informal' constraints on and enabling forces for enterprise behaviour. Features of entrepreneurial behaviour often reflect the unstable and hostile nature of the external environment and scarcity of key resources, particularly capital. In an unstable and weakly structured environment, informal networks often play a key role in helping entrepreneurs to mobilise resources, win orders and cope with the constraints imposed by highly bureaucratic structures and frequently unfriendly officials. An institutional framework which is beneficial for entrepreneurship consists of the "set of fundamental political, social, and legal ground rules that establishes the basis for production, exchange, and distribution" (Davis and North, 1971).

Examples of formal institutions include the political and economic constitution, the legal framework and the financial system. Fundamental rules such as private property rights are a major influence on the nature and extent of any entrepreneurial activity whilst the day-to-day economic and political decisions as well as non-written rules determine the actual scope for the behaviour of entrepreneurs and their actions. Culture on the other hand reflects the given informal institutions, although a clear-cut distinction between formal and informal institutions is difficult to achieve because of the interdependent relations mentioned above.

Institutional theory understands informal institutions as cultural norms and mores that in turn influence individual values and behaviour. Culture first of all influences the ways information is processed, thus shaping the patterns of informal institutions (Boyd and Richerson, 1994). Moreover, culture affects patterns of entrepreneurial behaviour. Cultural norms determine whether a society tolerates profit-making behaviour as a prerequisite for entrepreneurial actions. Patterns of consumer, saving and investment behaviour differ across societies. For example, South Asian 'producer' economies stress values such as economical behaviour or long-term orientation whilst European societies can be classified as 'consumer' economies (Weber, 1997). Culture thus has an effect on whether a society has a practice of saving for the future or a focus on "living and spending to enjoy the moment" (Morrison, 1998), which in turn determines the amount of personal savings available for a business. In addition, religious traditions might prescribe

specific roles for entrepreneurs thus shaping their standing in society. The image of an entrepreneur, which differs across countries, implicitly reflects these traditional values of a society, where Busenitz et al. (2000) speak of a 'normative dimension' which measures the degree to which a society admires entrepreneurial activities.

Informal institutions gain importance in those cases where formal constraints fail or are absent and/or where particular social groups are excluded from mainstream society. In an unstable environment with deficient formal institutions, informal networks and contacts often play a key role in helping entrepreneurs to mobilise resources, and to cope with the constraints imposed by highly bureaucratic structures (Ledeneva, 1998; Smallbone and Welter, 2001a). This indicates the importance of social capital in the form of personal trust, which is embedded in informal institutions, for entering entrepreneurship as well as for consequent business development and growth. Moreover, in transition economies the social context inherited from the former socialist period appears to affect both the attitudes and behaviour of entrepreneurs and the attitudes of society at large towards entrepreneurship, drawing attention to the constraining effect of path-dependency in the sense of legacies from the past on entrepreneurial behaviour. In addition, inadequate formal institutions in the transition process block the adaptation of informal rules inherited from centrally planned economies (Mummert, 1995, 1999), thereby re-enforcing these 'socialist' norms and explaining unproductive entrepreneurship as well as informal entrepreneurship.

With respect to enterprise behaviour in transition economies, imperfect formal and informal institutions thus result in strategies which may reflect a reasonable and rational entrepreneurial reaction to the given institutions from an individual entrepreneur's point of view, although it can be argued that they might constrain the contribution of SMEs to transformation and economic development (Welter, 2002, Welter and Smallbone, forthcoming). The inadequate legal frame results in 'evasion' strategies, such as (partly) shifting production to the informal sector. Inadequate financial systems and the overall macroeconomic situation favour strategies such as portfolio ownership and broad, unrelated diversification. Persistent informal rules from the socialist period, where social capital in the form of personal trust played an important role in securing resources, assist in explaining today's popularity of networking and the importance of personal contacts for entrepreneurship in an environment, where inadequate framework conditions do not encourage institutional trust to develop.

The interaction of trust with formal institutions

Analysing entrepreneurial behaviour in an institutional context, we may conclude that the specific structures of formal and informal institutions, the path-dependence of informal rules and incompatible formal and informal institutions assist in explaining certain forms of enterprise behaviour in West and East Europe. This leads to an important question with respect to the specific role of trust in an institution-based concept: *does trust complement formal institutions, or does it serve as a substitute for them?*

Research on trust in a transition context often emphasises the role of trust as a *substitute for the incomplete institutional framework*. For economies that are in the process of transformation from centrally planned to market based systems, formal institutions (such as banks) that are essential for the large scale and sustainable development of private sector businesses are either non-existent or inadequately focused on the needs of entrepreneurs. Here, Leipold (1999) identifies a 'syndrome of mistrust', which is based on experiences from the socialist period where individuals had strong mutual ties with family and friends, but where they mistrusted public institutions (Raiser et al., 2001). Thus, personal trust dominates while institutional trust is low or absent. Institutional distrust is also present during the transition process especially in the early stages or in those countries where economic, political and societal reforms are lagging behind (Raiser, 1999; Rose-Ackerman, 2001; Smallbone and Welter, 2001). Thus, personal trust substitutes for insufficient formal and informal institutions such as weakly specified legal regulations and inadequate law enforcement, all of which encourages the entrepreneurs' lack of institutional trust. In these circumstances, informal institutions and practices are said to

stitutional trust. In these circumstances, informal institutions and practices are said to substitute for some of the deficiencies in the formal market institutions.
On the other hand, trust is seen as *complementing the institutional framework* although Woodruff (2000) states that this view is "…at odds with the majority view in literature". As stipulated by transaction costs economics, trust is one of the mechanisms to coordinate economic relations[1]. Trust assists in lowering the transaction costs of commercial actions, which do not have to be (fully) based on formal legal contracts in those cases where the participants know each other either personally or by name, i.e., they value the reputation of their commercial partner against the possibility of him or her breaching these goodwill-based agreements. Moreover, trust also supports the enforcement of formal institutions. Whilst formal institutions such as legal regulations are normally enforced and enforceable only by the state, this always will be imperfect because of the opportunistic and only partly rational behaviour of human beings who often pursue their own interests. In this context, trust supplements formal institutions.
I suggest that we need to consider both ways in which trust interacts with the formal institutional framework in order to determine its impact on entrepreneurial behaviour. These relations, which apparently differ across societies and countries, can be best analysed considering a 'trust-continuum' where on the one end trust substitutes and on the other hand trust supplements formal institutions. Thus, we could discuss different trust levels within a society without necessarily simplifying the complex political, economic and cultural environments and classifying them as low-trust or high-trust milieus, although we need to take into account that human beings do not simply switch between different levels of trust (Hartmann, 2001). With respect to economic behaviour, we may hypothesize that in those cases where the formal institutional environment functions well trust mainly plays a complementary and second-best role for entrepreneurs whilst in environments with a distorted formal institutional framework trust is one of the foremost substitutes for some of the institutional deficiencies, thus explaining distinctive forms of entrepreneurship and entrepreneurial strategies.

Conclusions

A major strength of institutional theory is its focus on environmental factors in explaining entrepreneurship and entrepreneurial behaviour. This theory draws attention to the 'institutional' embeddedness of business behaviour, which includes both the formal legal and political framework and 'soft' factors such as codes of conducts, norms and values. Enterprise behaviour results from a dynamic interrelationship between internal (i.e. both organisational and personal characteristics) and external conditions. In situations where market conditions have been only partially implemented, the institutional context becomes a critical factor.
From a theoretical point of view there are also shortcomings to an institution-based view on entrepreneurship and enterprise strategies in transition economies. For example, institutional theory uses a comparative-static viewpoint to explain a process-oriented phenomenon such as enterprise behaviour, which evolves over time from simple reactions to the business environment to more complex and pro-active strategies (Welter, 2002). In institutional terms, enterprise behaviour is understood as a reaction to inadequate formal and informal institutions leaving little scope to explain emergent behaviour. The same criticism applies to changes in enterprise behaviour, which the institutional approach again interprets as a mechanistic response to changes in the institutional environment. However, North (1990) acknowledges a more complex relationship between individual behaviour and institutional change, where individuals can also influence the institutional environment. In addition, this approach also relies mainly on a neoclassical foundation of individual behaviour modelling individuals as a rational 'homo economicus'. Although institution theory concedes a context-based rationality, individual decisions are based on rational cost-benefit calculations (Nee and Strang 1998). In this regard, insti-

[1] However, Williamson (1993) challenged the role of trust in commercial relations. He referred to risk as an adequate term that describes what he termed 'calculative trust' whilst personal trust is mainly noncalculative.

tutional theory would need to be developed further to take into account cognitive foundations of entrepreneurial behaviour.

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Teemu Kautonen

Trust in the Context of Business Administration – a Note

Introduction

Trust is an integral concept in the field of business administration, particularly because it is one of the most important determinants of transaction costs. Transaction costs (see Williamson, 1985) may, depending on their size and the context, constitute a significant factor in the strategic decisions of a company. Building on this argument, this paper discusses some basic concepts from trust research in different disciplines that are relevant to the context of business administration. The paper should be considered work in progress.

Trust has been conceptualised and empirically studied by several disciplines including psychology, sociology, cultural anthropology, philosophy, political science, economics and business administration. The theories from the different disciplines, although specific to their respective fields, are often not contradictory, but rather complement one another. Therefore, the scope of this paper is not limited to conceptualisations originating solely in the field of business administration, but is, following the nature of trust research, interdisciplinary. Contributions from sociology, psychology and economics are particularly complementary to the trust research in business administration. Since the main emphasis of trust research in business administration is on marketing and management, those fields also contribute to the perspective of this study. The focus is on different aspects of cooperation between for-profit organisations. Issues such as trust between companies and consumers do not receive any specific attention, although many of the concepts introduced can be applied in such contexts as well.

The interdisciplinary elements are emphasised especially in the first three parts of this paper, which aim at conceptualising the dimensions and objects of trust as well as its main determinants. Answers are sought to questions such as “what is trust”, “which dimensions of trust are relevant to the business context”, “which parties and objects are involved in the trust process” and “which are the major factors that determine trust?” In other words, tools are provided for the analysis of the applications introduced in the next section, which examines trust in the context of business relationships. Relationships are a central category in modern marketing and strategic management research. They are also an issue in which trust is a fundamental concept.

Dimensions of trust

The common starting point

As it is easy to imagine, there is a myriad of definitions to a term such as “trust”, even within individual disciplines or schools of thought. However, despite the differences in details almost all definitions relevant to business administration seem to have common fundamentals.

In general terms, trust is involved when there is some kind of a relationship between an agent or a group of agents with another agent or group of agents. Every such relationship involves a certain level of ignorance or uncertainty, i.e. imperfect information about the behaviour of the other agent, because we are unable to monitor each other’s every move and thought. The agents have variable degrees of freedom to disappoint the expected behaviour, which implies that when we trust someone or regard someone as trustworthy, we in fact implicitly assess the probability that he will act in a manner that is beneficial or at least not detrimental to our interests. (Gambetta, 1988, 217–218)

Most conceptualisations of trust agree and are based on this fundament. However, from this common starting point onward the conceptualisations generally begin to take different courses. In the scope of this paper I aim at introducing broad categories under which most conceptualisations relevant to business administration seem to fit.

Confidence and trust

Let us start with a rather abstract (as opposed to practice oriented) conceptualisation proposed by Luhmann (1988, 97–98), who distinguishes between confidence and trust based on the dimensions perception and attribution. *Confidence*, according to Luhmann, refers to our everyday belief on things being as we are used to them being, e.g., we are confident that politicians will try to avoid war and that cars do not suddenly leave the street and try to hit us on our Sunday walk. If one of these expectations turns out to have been wrong, the disappointment will be attributed to an external factor. *Trust*, on the other hand, requires an individual choice of taking a risk and accepting its possible consequences, or not taking it and waiving the associated advantages. If a trust case does not turn out as expected, the disappointment will have an internal attribution and you may eventually regret your choice. People do not depend on trust relations as they do on confidence relations, yet trust, too, can be a part of our routine behaviour.

Marketing and management scholars have worked with related conceptualisations. For example, Ganesan & Hess (1997) suggest *credibility* as a dimension of trust defining it as being based upon "a focal partner's intention and ability to keep promises and deals with partner characteristics such as task specific competencies, reliability in the delivery of goods and services, and the predictability in terms of job related behaviours". Similar concepts have been proposed by Sako (1992) and Yamagishi & Yamagishi (1994), who refer to them as *competence trust* and, parallel to Luhmann, *confidence*, respectively.

The core idea in all of the concepts introduced above is the same as in Luhmann's confidence – the expectation of everyday things taking their usual course. The idea has simply been adapted to the business context. However, the other side of Luhmann's categorisation, trust, has no direct parallels but is elaborated further in the reviewed literature.

Trust – calculativeness or benevolence?

Lindenberg (2000, 28) distinguishes between two major traditions in literature on trust. One is the tradition that takes trust as calculated risk; the other is the psychological tradition that views trust and trustworthiness as "based on a presumed other-regard without calculativeness". The conceptualisations reviewed for this paper do not fit this categorisation perfectly, but the broad directions it suggests nevertheless serve as a basic orientation for the analysis.

Advocates of the calculated risk tradition are often those who have studied trust quantitatively, for example game theorists (see e.g. Dasgupta, 1988; Bolle, 1998; Glaeser *et al*., 2000), transaction cost economists (see e.g. Williamson, 1985, 1993) and some sociologists (see e.g., Coleman, 1990). According to Coleman (1990, 99) the decision whether to trust or not to trust is, analogically to placing a bet, based solely on the information on how much can be lost, how much can be gained and the chance of winning. Following the maximisation of utility under risk Coleman argues that a rational person should trust if the chance of winning relative to the chance of losing is greater than the amount that could be lost relative to the amount that could be won. The risk assessment is based on the trustor's knowledge of the trustee's disposition (his available options and their consequences), ability etc., and most importantly, whether the trustor believes the trustee will choose to act as expected given these conditions (Dasgupta, 1988, 50–51).

Another view to trust is based not only on hard, rational calculations, but involves a belief in the benevolence of human nature in general. Thus it is assumed that when a person trusts, he makes himself vulnerable to the trustee's behaviour with the expectation of not only lack of ill will, but also an element of goodwill from the trustee (Blois, 1998, 302). The trustee is expected to show genuine concern and care for the partner through behaviour that exceeds purely egocentric motives (Ganesan & Hess, 1997, 440). Therefore the trustor would not be very surprised if the trustee acted in a manner that benefits him even if it was not formally required of the trustee (Yamagishi & Yamagishi, 1994, 139). Besides calling this view on (or dimension of) trust simply "trust" (as e.g. Yamagishi & Yamagishi, 1994, do), it may also appear under the headings of *benevolence* (Ganesan & Hess, 1997) or *goodwill trust* (Sako, 1992).

Yamagishi & Yamagishi (1994, 132) introduce yet another interesting dimension of trust, *assurance*, which they define as "an expectation of benign behaviour for reasons other than goodwill of the partner", those reasons being based on the incentive structure surrounding the relationship. Suppose that a person has connections with the mafia and the trading partner knows this. This person can be sure that the trading partner will not try to cheat him in fear for his life. He is acting honestly, yes, but not because he is a benevolent person, but because it is in his best interest.

Obviously, calculativeness and benevolence are not mutually exclusive, although many authors tend to favour and emphasise one view more than the other. On the contrary, they are very much intertwined and together contribute to the assessment of the probability of the trustee acting beneficially or at least not detrimentally to our interests, which was the common starting point for the discussion on dimensions of trust. Benevolence – or the lack of it – strongly affects the calculation of (perceived) risk in the calculativeness view to trust. The more benevolent the trustee is perceived to be, the smaller is the (perceived) risk. Of course, risk can be affected not only by the benevolence of the partner, but also e.g. by the incentive structure surrounding the situation as exemplified by the assurance dimension above. In any case, the factors affecting the perceived risk are fundamental to the economic concept of trust. The less perceived risk there is, the less monitoring and coercion (discussed later in this paper) is needed and the less transaction costs incur. Depending on the situation, the transaction costs can be large and thus of vital importance in strategic business considerations such as whether or not to externalise a function.

All things considered, I would sum up the discussion on dimensions of trust from the business perspective by following the three (non-mutually exclusive) dimensions defined by Yamagishi & Yamagishi (1994): (1) confidence as the expectation of competence, (2) goodwill trust as the expectation of benign intent and goodwill and (3) assurance as the expectation of benign behaviour for reasons other than goodwill. These three dimensions provide a most interesting conceptual starting point for an operationalisation of trust in the business administration context.

Objects of trust

Besides knowing what trust is and in which forms it can appear, it is also relevant to know which parties are involved in the trust process. Whether the trust relationship is asymmetric or mutual or if it involves third parties or intermediaries are important considerations affecting the perceived risk of trusting. Coleman (1990) presents the objects of trust in a comprehensive way, of which the following is a summary.

It is not only the trustor who has to be considered when analysing a trust decision. The trustee has (in many cases) a choice between keeping and breaking trust – a decision that depends not only on his own short-term and long-term incentives, but also on effects possibly imposed on him by third parties. There are four basic types of trust relations (Coleman, 1990, 96, 177, 186):

1) *Asymmetric trust relations*: one actor is trustor and the other trustee.
2) *Mutual trust relations*: the two actors both trust and are trusted by each other.
3) *Trust relations involving an intermediary*: the same actor is a trustee to one and a trustor to another actor. For the different types of intermediaries see Coleman (1990, 181).
4) *Third-party trust relations*: when one party does not accept the other one's promise but will accept the promise of a third actor, this promise of the third actor can be used as an intermediary in a transaction between the first and second parties. An example of this is the modern monetary system in which the government acts as the third party.

As it is evident from the aforementioned categorisation, intermediaries or third parties (which are often used synonymously) can be persons, organisations (e.g. government, police, companies etc.) or institutions (e.g. legislation, norms and values, university diplomas etc.) Sanner (1997, 9) suggests that (human) intermediaries can be passive or active. An example of a passive human intermediary (in this context I would extend "human" to both persons and organisations) is the police force that prevents the extreme form of opportunism, crime, simply by its existence. An active human intermediary is, for instance, a third country acting as a peacemaker

between two countries in war. Understanding the variety of different trust relations between an even larger variety of actors, especially intermediaries or third parties, is fundamental for understanding the determinants of trust, which are the next topic of discussion.

Determinants of trust

As empirical studies show, numerous factors can influence trust and trustworthiness (see e.g. Alesina & La Ferrara, 2000; Zak & Knack, 1998). Although some of them have proven to be more important than the others, it makes little sense to describe narrow individual factors in an overview paper such as this. Therefore I have decided to concentrate on two concepts, "social capital" and "coercion and reputation", that provide a foundation for understanding more narrowly defined individual determinants of trust. It should be noted, however, that the discussion especially on social capital is very limited concentrating only on those concepts necessary for the purpose of this paper.

Social capital

It is indisputable that trust is embedded in a social context, which according to Fukuyama (1995, 26) can be anything between "the smallest and most basic social group", the family and "the largest of all groups", the nation. The theory of social capital makes the general assumption that the more people connect with each other, the higher the level of trust (Putnam, 1995, adapted in Claibourn & Martin, 2000, 268). The term "social capital" seems to have been independently invented at least six times during the twentieth century, each time referring to such social ties that make our lives more productive (Putnam, 2000, 19). This does not mean, however, that the perspectives on social capital were similar.

Raiser, Haerpfer, Nowotny & Wallace (2001, 2–3) divide social capital into two branches, each represented by one of the most prominent scholars dealing with the topic: Putnam (see e.g. 1995, 2000) and Coleman (see e.g. 1990). In Putnam's view, social capital is a cultural phenomenon consisting of the extent of civic mindedness, the existence of social norms promoting collective action and the degree of trust in public institutions in a society. Social networks enhance formal rule compliance, which is why this type of social capital is called *formal social capital* by Raiser et al. Furthermore, this type of social capital is accessible to everybody irrespective of personal characteristics. The concept of *informal social capital* builds on reciprocity in social and economic relationships. In other words, should social ties facilitate economic transactions between individuals, this may happen at the expense of excluding others, or as Coleman (1990, 302) himself adds, be even harmful to others. Raiser et al. use a business club as an example: it certainly benefits those with the financial and social status sufficient to become members, but it may simultaneously act as a protective guild excluding outsiders. Formal and informal capital can co-exist, yet they are not necessarily complementary to each other.

Besides providing a framework for the analysis of (individual) trust relationships, social capital is an important determinant of the overall level and type of trust in an economy. Following Raiser (1999), three types of trust can be distinguished in the context of economic transactions:

- *Trust among kinship groups and family members*. These kinds of trust relationships are dominant in subsistence economies, but also typical in small-scale crafts and trades.
- *Process-based trust.*[1] This kind of trust characterises relationships between individuals who have known each other for a long time, but who do not share the loyalty of a specific group. Typical examples of process-based trust are most business networks.

Extended trust.[2] When extended trust is dominant in an economy, agents enter into transactions with only limited information about the partner's specific attributes. In other words, the scope of trust extends beyond the number of people we know personally (Putnam, 2000, 136). Therefore

[1] Also known as *traditional sociability* (Fukuyama, 1995) and *thick trust* (Putnam, 2000).
[2] Also known as *spontaneous sociability* (Fukuyama, 1995) and *thin trust* (Putnam, 2000).

it is also called "generalised" trust. This type of trust is a key element in modern economic systems.

In the first two, informal social capital seems to be dominant, whereas in the third one it should be formal social capital. Social capital is an important factor influencing the perceived risk of placing trust discussed in the previous chapter. If a society is dominated by process-based trust and informal social capital, the perceived risk of placing trust in an unknown person or organisation is high, which results in high transaction costs. If, on the other hand, a society is characterised by extended trust, the perceived risk and the transaction costs are lower. Certainly the perceived risk can be low in a process-based trust oriented society as well, within an ingroup of people who have known each other for a long time, but chances for expanding the business within a narrow ingroup are limited. Moreover, one should not forget that such ingroups may also exist in an extended trust based society. They are simply not as exclusive as in a process-based trust dominated society.

Coercion and reputation

Trust is not a requirement for cooperation, but it is often seen as a lubricant that makes successful cooperation easier. Coercion has been and still widely is used as a means to ensure cooperation, yet it is not a real alternative to trust, because while it gives less cause for worry by enforcing a kind of "cooperation" in specific acts, it also makes treacherous actions more probable (Gambetta, 1988, 220–221). However, even if there is trust in cooperation, there some amount of coercion is also present, or at least its credible threat (Gambetta, 1988, 220). If there is more trust, less coercion is needed, and vice versa.

Based on the literature I decided to divide coercion into formal and informal categories. With formal coercion I refer to the formal coercive power practised by the state through its institutional framework including for instance legislation, law enforcement and the courts of law. In order for extended trust to emerge, it is essential that people believe in government institutions to provide impartial enforcement (Raiser, 1999, 5), for trust among persons and institutions is interconnected: if people do not trust the third-party institutions to provide credible enforcement, they are more likely to behave opportunistically (Dasgupta, 1988, 51). On the other hand, a further manifestation of the interconnectedness is provided by Raiser's (1999, 6) argument that extended trust is also needed to make third-party enforcement work efficiently. He reasons that the cost of uncovering information about the behaviour of economic agents is connected with huge costs and therefore it would be highly inefficient to rely on third-party enforcement alone to prevent opportunism.

Informal coercion consists of such mechanisms as guilt associated with moral norms, perceived sanctions in the future or in afterlife associated with religious beliefs, social sanctions such as ostracism, and loss of profits through reputational effects (Zak & Knack, 1998, 5). The most relevant of them in the business context seems to be reputation. Dasgupta (1988, 62) defines reputation as "the public's imputation of a probability distribution over the various types of person that the person in question can be in principle". According to Yamagishi & Yamagishi (1994, 138–139) reputation has two roles. Firstly, it conveys information about the cooperation partner thus reducing social uncertainty (and thus acting as an intermediary in the trust relationship – TK), and secondly, it works as a sanctioning mechanism against opportunistic behaviour, i.e. people often behave honestly because they are afraid of getting a bad reputation.

What then does a person or a commercial entity gain from having a good reputation? According to Coleman (1990, 108), two things. First, the trustee may expect to gain more from the relationship if it extends to multiple transactions instead of a single one. Second, depending on the dissemination of reputational information and its relevance to receiving further placements of trust from third parties, the trustee may gain other transactions, or at least does not lose any, because of having a good reputation. The dissemination of reputational information may occur either through formal channels, such as credit bureaus, or (more often) through informal ones, such as gossip (Zak & Knack, 1998, 5). The closer the community is, the more informal channels gain importance. For example among the merchant bankers in the City of London or the

diamond dealers in London or New York, verbal agreements suffice both because the reputation of trustworthiness is essential in these businesses and because that reputation is quickly communicated among those on whose actions the trustee's future business depends (Coleman, 1990, 109).

The role of trust in business relationships

Marketing and management researchers' interest in trust is focused especially on intraorganisational and interorganisational relationships (see Svensson, 2001), which form an integral part of many management and marketing theories. The growing interest in trust among management experts can be explained both by post-Taylorian management schemes, in which trust is essential (see Fukuyama, 1995, 223–230), as well as by new forms of organisation, including for instance different forms of strategic networks. Marketers have begun to take a great interest in the concept of trust with the increasing focus on the relationship marketing perspective, which emphasises "establishing, developing and maintaining successful relational exchanges" (Svensson, 2001, 431). The following presents a discussion on the role of trust in business relationships, which seem to form the main emphasis of trust research in marketing and management.

Governance of business relationships

A central issue in business relationships is governance. As has been already mentioned in this paper, trust is often seen as a lubricant in cooperation. Depending on the type of transaction or relationship different amounts of trust are needed. For example, in simple transactions such as buying a standardised product you do not need to trust the partner much because you know what you are buying and little supervision is required. Thus, according to the concepts described by Bradach and Eccles (1989) as applied by Lunnan and Reve (1995), the control mechanism is the price of the product. When the transaction becomes more complicated it may turn into a relationship, which needs different governance mechanisms. The aforementioned concept suggests authority and trust as alternative, yet not exclusive mechanisms of governance. Authority as a governance mechanism means that one party can get the desired product from the other through influence and behaviour control, whereas trust performs the same function allowing lower costs by assuming that one party can get the product from the other without having to fear opportunism. It is possible to mix these governance mechanisms, which is probably also the rule rather than the exception; the ingredients and the proportions depending on the context of the relationship (or transaction) in question. The following presents two interesting concepts that enlighten the relationship context by introducing a comparison of horizontal and vertical relationships and the effects of including third parties.

Horizontal vs. vertical relationships

Interorganisational relationships can be basically vertical (e.g. buyer – supplier) or horizontal (e.g. a co-marketing alliance between two firms that operate in the same industry with supplementary rather than complementary products). Rindfleisch (2000) found in his study of 106 American companies engaged in R&D activity that trust appears to be lower in horizontal relationships than in vertical relationships, which is particularly due to higher opportunism and lower interdependency. Opportunism is higher, Rindfleisch argues, because the firms are basically competitors and may use the relationship as a means to improve their market position at the expense of the other. Moreover, he adds that interdependency tends to be lower, because horizontally related firms rarely provide each with other important sources of needed inputs, such as firms in vertical relationships do. This would imply that whereas trust may be an effective governance mechanism in vertical relationships, authority and price might be more effective in horizontal ones.

Synchronised trust chain

A further interesting contribution, though not yet empirically tested, is the synchronised trust chain proposed by Svensson (2001). He bases his concept on a marketing channel, but the basic

idea is applicable also to other types of (vertical) business relations. He suggests that trust research has concentrated too much on dyadic relationships and has thus neglected the effects of third relationships. For instance, company A's trust scenario with company B may affect the ones between companies A and C and/or B and D. These various scenarios should preferably build a synchronised trust chain. Svensson uses the concepts of upstream (i.e. trustor) and downstream (i.e. trustee) relationships to illustrate the chain-likeness of his concept. An example of the chain-effect happened when consumers partly abandoned French wines in the late 1990s. It was not caused by the wine producers' behaviour, but by the behaviour and applied policies of the French government that indirectly affected the trust in the French wine producers (Svensson, 2001, 434). However, Svensson himself admits that the synchronised trust chain concept is narrow, because it concentrates only on vertical relationships. Thus he suggests that future research should aim at a synchronised trust system or synchronised trust network concept. Empirical research on such a concept would be highly interesting in particular with respect to the characteristics of trust in horizontal and vertical relationships as discussed previously. On the other hand, designing and implementing such a study would also be complicated.

Conclusion

The purpose of this paper was to introduce some basic concepts from trust research in different disciplines that have relevance to the analysis of trust as a phenomenon in the business administration context. The relevance of trust becomes manifest especially with the concept of transaction costs, which served as a common determinant of the cost saving nature of trust throughout the discussion.

It was concluded that the relevant conceptualisations of trust have a common starting point, which deals with the assumption of imperfect information about the other party in a relationship. The first level of elaboration was to divide trust research into two traditions. The first one sees trust as a pure risk calculation, whereas the other one involves a belief in human benevolence in general. Keeping this in mind three dimensions of trust were worked out, which were summarised following the classification by Yamagishi & Yamagishi (1994): (1) confidence as the expectation of competence, (2) goodwill trust as the expectation of benign intent and goodwill and (3) assurance as the expectation of benign behaviour for reasons other than goodwill. Furthermore, the different objects involved in four different types of trust relations were discussed: asymmetric trust relations, mutual trust relations, trust relations involving an intermediary and third-party trust relations. These were concluded to be fundamental for the understanding of the determinants of trust – the next topic of discussion.

Two broad concepts, social capital and coercion (including reputation), were chosen to provide a foundation for understanding the more narrowly defined individual determinants of trust. Social capital was discussed in formal and informal approaches with special reference to the three different types of trust that were introduced: trust among kinship groups and family members, process-based trust and extended trust. Coercion was divided into formal and informal categories. Formal coercion was defined as the formal coercive power practised by the state, whereas informal coercion was seen to consist above all of reputational effects.

Finally, the role of trust in business relationships was discussed as an important application of trust in business research. The discussion was based on the issue of governance, especially on the comparison and different combination possibilities of three governance mechanisms: price, authority and trust. Two further concepts were presented to provide examples of focal points in contemporary and future research. The first one was the comparison of horizontal and vertical relations. It has been empirically proven that trust tends to be lower in horizontal relations due to the nature of the relation being competitive rather than complementary as it often is in vertical relations. The second concept was the synchronised trust chain, which brings trust research from dyadic relationships into including third parties in a chain-like formation such as in a marketing channel. However, this is for the time being a concept, waiting to be studied empirically.

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List of Authors in Alphabetical Order

Hans-Hermann Höhmann	Research Centre for East European Studies at the University of Bremen hoehmann@osteuropa.uni-bremen.de and apo12@uni-koeln.de
Teemu Kautonen	Rhine-Westphalia Institute for Economic Research kautonen@rwi-essen.de
Bernhard Lageman	Rhine-Westphalia Institute for Economic Research lagemann@rwi-essen.de
Fergus Lyon	Centre for Enterprise and Economic Development Research (CEEDR), Middlesex University Business School f.lyon@mdx.ac.uk
Elena Malieva	Research Centre for East European Studies at the University of Bremen; PhD student, Free University, Berlin malieva@uni-bremen.de
Gabi Dei Ottati	University of Florence, Italy gabi.deiottati@cce.unifi.it
David Smallbone	Centre for Enterprise and Economic Development Research (CEEDR), Middlesex University Business School d.smallbone@mdx.ac.uk
Margit Venesaar	PhD student, Tallinn Pedagogical University
Urve Venesaar	Institute of Economics, Tallinn Technical University venesaar@tami.ee
Friederike Welter	Rhine-Westphalia Institute for Economic Research welter@rwi-essen.de

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