Understanding Power and Trust in Interfirm Relationships: A Dynamic Perspective

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Abstract

Trust and power are two key dimensions in business relationships and have been studied widely in the past decades, however, little attention has been given by researchers to understand the dynamics of trust and power as well as the underlying mechanisms in the process. In this paper, we take a dynamic perspective and propose a framework that depicts how trust and power evolve along with the development of business relationships. We show how the governance structure of a business relation, including trust and power as central elements, develops and changes over time through the experience and outcomes of the actions and interactions taking place in a relation that is also subject to external events and conditions and how this affects the learning and adaptation that result.

Key words: business relationships, trust, power, mechanisms, evolution

Introduction

The rapidly changing business environment is forcing business firms to seek more innovative and flexible means to address competitive challenges. Economists talk theories of pure and perfect competition, at the same time as more firms are attempting to build collaborative business relationships and networks for competitive success. This suggests the need for a corresponding cooperative theory. The management of cooperative projects requires strategies to share power, communication, openness, conflict resolution and trust. Among them, power and trust are two key dimensions affecting inter-firm relationships and their evolution.

Trust and power have been studied widely (e.g, Anderson and Weitz 1989; Arnulf, Dreyer and Grenness 2005; Dwyer, Schurr and Oh 1987; Emerson 1962; Gaski and Nevin 1985; Sicks, Berman and Jones 1999). Their dimensions and definitions have been examined (e.g, Child 1998; Gaski 1984), typologies have been proposed and measured (e.g, French and Raven 1959; Doney and Cannon 1997; Young 1993) and the precursors and outcomes of trust and power have been subject to theory and empirical analysis (e.g, Morgan and Hunt 1994). This research has made a significant contribution to our understanding but it has given only limited attention to the dynamics and development of trust and power and how they interact and co-evolve over time in business relations. The majority of models of trust and power are static and ignore feedback effects among these and other dimensions of relations. Yet, as observed by Ring and Van de Ven (1994), as the uncertainty, complexity, and duration of economic transactions within and between firms increase, it becomes increasingly important for scholars and managers to understand developmental processes; how governance structures emerge, evolve and dissolve over time.

The purpose of this paper is to present an analytical framework for understanding the dynamics and development of trust and power in business relationships and how they co-evolve with other dimensions of relationships. We argue that the nature and extent of trust and power are continually being shaped and restructured by the actions and interactions within and between firms and the interpretations of the parties involved. Trust and power, together with other dimensions of relations, affect the actions taken by firms in relations, the outcomes that result and how this in turn produces, reproduces or changes trust and power in a relation, which then sets the stage for further actions and interactions.

The structure of business relationships may be analysed in terms of the four underlying dimensions of actors, activities, resources and schemas, and the development and evolution of business relationship and network structures take place in terms of changes in actor bonds, activity links, resource ties and schema couplings within and between relations (Hakansson and Snehota 1995; Welch and Wilkinson 2003). A business relationship evolves as a product of an ongoing process of configuring and reconfiguring relationship structure, taking place through the outcomes and experience of the actions and interactions taking place within and between relations over time.

The paper is organized in the following way. Firstly the concepts of power and trust are briefly introduced, as well as existing theories of organization change. We then present a dynamic model of relationship development focusing on trust and power.

Trust

Virtually every commercial transaction includes an element of trust. Research on trust has drawn on a variety of theoretical perspectives from social psychology, sociology, economics and marketing, and each discipline has offered unique insights. Here we review briefly the definition and nature of trust, on which our conceptual model is grounded.

Trust is needed in an uncertain context where parties are interdependent, but trust only exists when one party can rely on another party to act in an expected way. Drawing on Rotter's (1967) classic view that trust is "a generalized expectancy held by an individual that the word of another…can be relied on" (p.651), Morgan and Hunt (1994) conceptualize trust as existing when one party is confident of its exchange partner's reliability and integrity. However, trust could be limited if a party

is confident of the other's dependability yet not willing to rely on that party. This ignored behavioral intention or "willingness" in Morgan and Hunt's concept is incorporated in Moorman, Deshpande and Zaltman's (1993) definition that trust is "a willingness to rely on an exchange partner in whom one has confidence"(p.82). Integrating these two definitions, we define trust as a party's belief in the reliability of an exchange partner and its readiness to behave accordingly.

There are various sources or types of trust identified in the literature (e.g, Sako 1992; Larsson et al. 1998). Here, we follow the distinction between two basic types - calculative and affective trust (Huemer 1998; Lewis and Weigert 1985; McAllister 1995; Wicks, et al. 1999; Williamson 1993). Calculative trust rests on a logical and rational calculation of likely outcomes of future collaboration compared to alternatives. Such trust is chiefly motivated by a value-adding collaboration with resource complementarities and reputation effects (Larsson, et al. 1998). Affective trust occurs because an emotional bond is created between people, enabling them to transcend rational predictions, to take a "leap of faith" that trust will be honored (Lewis and Weigert 1985). This could be pure trust with beliefs that the exchange partner will always perform positively and take care to avoid harming you. Calculative and affective dimensions of trust are interrelated and mutually relevant to interfirm relationships and therefore, they should be studied in conjunction.

Power

Power is defined conventionally as the ability to evoke a change in another's behavior, i.e., the capability to get others to do something they would not have done otherwise (Cartwright 1965; Dahl 1957; Emerson 1962). Power in business relationships is closely tied to the interdependence of partners in those relationships. A firm's power is directly related to the degree of dependence of other firms on it which is reflected in its ability to influence the behavior of others. The more others are dependent on a firm, the more power the firm has over them. Therefore, power is not an attribute of any firm but a property of the relationship (Emerson 1962). Though based on resources, power is a potential as perceived by others not simply an objective ability (Raven 1965).

Perceptions of power are based on a firm's beliefs about the resources of the other party, of which the most commonly used classification is French and Raven's (1959) five bases of power i.e. coercive, reward, legitimate, referent and expert (French and Raven 1959). Power is exercised in relations through the actions and interactions of the parties involved. Various types of tactics are used to influence the actions, intentions and beliefs of others and the experience and outcomes of using power affect the power actors have and are perceived to have and the way it is used.

Theories of interfirm relationship change

Business relations and networks are quasi-organizations (Hakansson and Snehota 1995) in which the emergence of cooperative relationships is a form of organizational change and innovation. The content of such relationships reflects the basic elements of social organizations including collective goals, functional differentiation and interdependency as well as integrated actions (Reve and Stern 1979).

Van de Ven and Poole (1995) have identified four generic types of theories of organizational change: life cycle, teleology, evolution and dialectics. In marketing, the main relationship-development theories are life-cycle theories, based on an organic metaphor in which the life of a relationship is divided into a sequence of stages through which relations are assumed to progress or die (Dwyer, et. al. 1987; Ford 1980). These are of limited use since they assume, implicitly, that relationship development is some rigid unfolding process, in which subsequent stages are determined from the start. Other models adopt a teleological approach in which it is implicitly assumed that the relationship is controlled by a firm that can manage it over time to achieve its purposes or that the most efficient structure autonomously emerges, as in transaction cost and production cost theories. Dialectic models focus on the process of change in terms of the interaction among competing groups but provide limited explanation of the underlying sources of change.

Here we adopt an evolutionary perspective. The evolutionary perspective comprises four generic processes: variation, selection, retention and diffusion (Aldrich 1999). Variation concerns the mechanisms by which new forms of relations emerge over time, due to chance factors or intentional design. Selection is the process by which internal or external forces support, develop or undermine new forms. Retention refers to the way selected forms are preserved or reproduced over time. Diffusion is the process by which new forms are adopted or duplicated by others in the relevant population. These processes are inter-related and together shape the pattern of evolution of business relationships.

Relationship development is a co-evolutionary process (Koza and Lewin 1998), involving coupled feedback loops among the structure, interaction processes occurring and the outcomes and experiences of those involved. Many paths of development are possible, depending on initial conditions, the history of interactions and the impact of external events.

A Model of Relationship Evolution

A business relationship is a living thing that is continually being and becoming. As firms learn and adapt to each other and to their environment, which includes other connected relations as well as more general environmental factors, the structure and nature of trust and power between these parties are shaped, evaluated and adjusted. This is a continuous and cyclical process which has feedback effects on the way firms act and interact in business relationships.

Figure 1 describes an interactive and iterative cycle of how trust and power evolve in business relationships. The prior history of business relationships that firms have experienced matters in shaping the initial conditions of how firms trust and depend on each other when relationships are established. These conditions develop and evolve over time throughout the actions and interactions taking place in a relation in the context of events and conditions arising from third party's actions including connected relations and general environmental circumstances. Firms co-evolve by learning and adapting to the experiences and outcomes of their actions and interactions in an environment over time. The outcomes of such interactions include perceptual changes in firms that revise the structure of trust and power in the relationship, which in turn have the feedback effects on the firms' future actions and interactions.

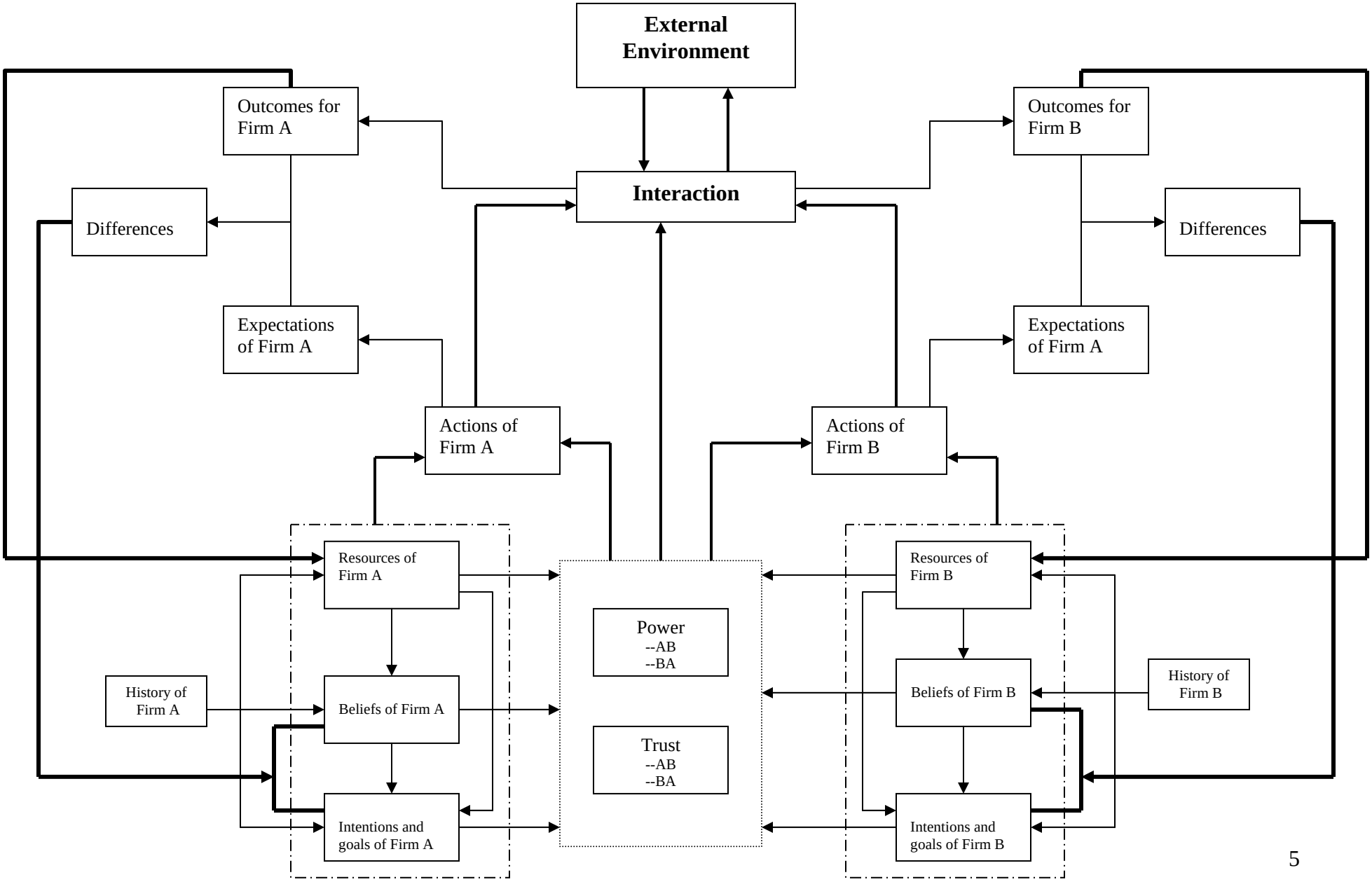
There is no means to predict exact developmental paths along which trust and power evolve, as many paths are possible, depending on initial conditions, the history of interactions and the impact of external events. As history unfolds, some events will turn out to be important turning points (Abbott 2001) or tipping points (Gladwell 2002) that redirect paths of evolution in critical ways.

If the patterns of actions and interactions occurring reproduce the relationship structure, including the structure of trust and power, the relation may be said to be balanced and in a stable mode of behaviours over time. A relationship is continually being tested and challenged by the ongoing interactions taking place and the experiences and outcomes for those involved. How stable it is will depend on the kinds of environmental disturbances it can deal with while maintaining essentially the same structure.

Initial conditions

The initial conditions of trust and power in a business relationship are largely affected by the effects of prior history of the parties involved, including carryover effects from previous relationship experiences, such as personal relationships and trust (Havila and Wilkinson 2002), and the position of the relationship in relevant business networks (Skyrms 2004), such as the connection to other relationships that provides access to external resources.

Figure 1: The Evolution of Trust and Power in Interfirm Relationships



Some research has shown that personal trust is a central prerequisite to start a business relationship and therefore, ought to be present from the beginning (e.g, Arnulf, et.al. 2005). But firms are also attracted by anticipated benefits in the relation such as an access to a new market and new technology. They make rational decisions of setting up business relationships based on their perceptions of themselves according to the resources they have, as well as perceptions of partner firms including their reputation, sizes and capability of realizing anticipated benefits in relationships. Prior histories play a role in affecting these perceptions and beliefs directly or indirectly through their influence on resources.

Resources provide bases of power in terms of how a firm's resources are needed by others and how alternative sources of the resources are controlled (Hallen, Johanson and Seyed-Mohamed 1991). Since the learning of tacit skills does not typically take place before the alliance is initiated (Iyer 2002), the availability of visible and measurable resources smooths the process of searching for, selecting and being selected by potential business partners. Such resources can be financial status, market experience and knowledge, research and development capabilities as well as customer base. A firm's market position can mirror the importance of the firm to its partners, based on the comparison with its competitors in terms of the value impact and complexity of its available resources (Santema 2005). Relationships offer firms unique access to external resources of their partners' and can be seen as valuable resources themselves. Network positions, which are the results of a firm's earlier activities in a network, characterize the firm's relations to other firms. These positions indicate potential resources that a firm is able to bring to the focal relationship and the possibility of extending the focal relationship.

Firms set various goals for relationships when they are initially established. They make initial decisions of what they expect and want to gain out of the relations. These intentions could be affected directly by former experiences of firms but are also subject to the resources firms possess and beliefs they hold of themselves and their partners.

Proposition 1: Prior histories lead to initial conditions of trust and power in interfirm relationships through their influences on firms' resources, beliefs of themselves and partners, as well as their intentions regarding relationships.

Ongoing relationship processes: production and reproduction through time

Nothing is given once and for all and there is always some space for change in business relationships (Johanson and Mattsson 1987). The initial conditions of trust and power influence how resources, actors and activities are tied at the beginning of a business relationship. Given these starting conditions, the path of relationship development depends on internal and external interactive processes. Internal processes comprise feedback mechanisms taking place within the relationship over time that support or not the development of cooperative norms. External interactive processes refer to interactions among connected relationships that reinforce or undermine focal relationship processes (Anderson, Hakansson and Johanson 1994). Internal and external processes are not isolated but connected and interactive in the sense that what happens in one relationship may influence the performance of other relationships in the network. In light of this, firms adjust their actions including their degree of trust and dependence on their partners in business relationships in accordance to their experiences in focal relationships as well as the environment of other connected relationships.

Proposition 2a: As a business relationship develops, the structure of trust and power is adjusted according to the experiences and outcomes in internal interactions and interactions with external conditions involving third parties in connected relationships.

Various exchanges take place in a business relationship, including product or service exchange, information exchange, financial exchange and social exchange (IMP Group 1997). Bonds of various kinds are developed in these exchange activities such as technical, planning, knowledge, socioeconomic and legal bonds (Johanson and Mattsson 1987). During the course, firms encounter role interactions (Ring and Van de Ven 1994) and personal interactions, where

processes of learning, adaptation and application take place.

Firms learn about each other over time in the relationship. Such mutual but not necessarily compatible and similar learning occurs about all aspects of the relation including the relevant environment of the relationship for each party, relationship tasks and how to perform them successfully, the process of cooperation, partners' skills, goals and motives (Doz 1996). Firms learn about differences as well as how to adapt to meet the needs of each other better.

Adaptation can be viewed as a significant feature in the dynamics of business relationships (Hallen, Johanson and Seyed-Mohamed 1991). It brings initial fit between the needs and capabilities of firms involved in a relationship but is also necessary in an ongoing relationship when firms are exposed to changing business conditions. The existing processes, routines and procedures that firms originally possess and operate may need to be selected and retained, or adapted and modified whenever necessary. Relationship norms are constructed through such mutual adaptation of participant firms and are reinforced or undermined through the firms' application of their resources and strategies.

Firms use their existing resources to achieve relationship benefits and apply in their relationship management what they have learned and adapted in the relationship. Firms may also use the relationship to build new relationships and develop others. The outcomes of such actions are uncertain as they are based not only on the actions of the firms but on the reactions of partner firms as well, and the interactions taking place. Through their actions and experiences, firms discover the differences between their expectations and exact outcomes of interactions, which lead to changes in firm's beliefs and their intentions or goals in regard to relationships. They adjust their expectations and understanding of partners. The actions taken next trigger new rounds of learning and adaptation through interactions.

Out of the processes of learning, adaptation, action and interaction, consequential events occur that generate changes in firms' perception of their partners, which subsequently give rise to changes in their trust and dependence on partners. These events could be minor ripples if the changes they have caused are more about amount and extent, or they could be turning points if the changes are about nature and direction (Abbott 2001). Firms may increase their affective trust on their partners when communication is sufficient (Anderson and Weitz 1989) or stop it when opportunistic behaviour of their partners' is caught (Morgan and Hunt 1994). More interdependence could be created when complementarities in and efficiency of the relationship are proved (Ring and Van de Ven 1994) but less if partners are inefficient learners and fail to fulfill obligations in relationships.

The revised conditions of trust and power in turn produce feedback effects on how firms interact with each other. For instance, with a different nature and amount of trust placed on their partners, firms may adjust their learning strategies and modify their goals, roles and responsibilities in the relationship.

Proposition 2b: Feedback loops exist between the revised structure of trust and power and the actions and interactions firms take and experience in business relationships.

The cycle described above between firms' interactions and their revised conditions of trust and power is interactive and iterative where the past of the relationship is encoded into the present through the structure shaped and reshaped based on the next moment of relationship (Abbott 2001). As a relationship matures, equilibrium might be established, where the governance structure of trust and power could be in balance. This does not mean that the processes of learning and adaptation have terminated but that the patterns and outcomes which these processes produce and reproduce are more regular and constant. Therefore, the equilibrium of trust and power does not imply a static state but rather, it is an ongoing balance produced in a dynamic process.

Proposition 2c: The processes of action and interaction, learning and adaptation are major

generative mechanisms that drive the evolution of trust and power in business relationships.

There is an ongoing dynamic process involving continual re-evaluation, re-adjustment and re-production of the relationship through time. This process is cumulative in the sense that relationships are constantly being established, maintained, developed and broken (Johanson and Mattsson 1987) to render short-term benefits and long-term survival and development of firms. When a relationship is in balance and becomes a long-term one, the stability in the relationship could be apparent, however, it may not be so if a network perspective is taken. As suggested by Gadde and Mattsson (1987), stability concerns an individual dyadic relationship being seen in a broader context of relationships. As relationships are connected in a network, what happens in one relationship may cause changes directly or indirectly in other relationships. Therefore, the connectedness among relationships in a network brings not just the sharing of resources but changes as well. What firms gain and lose out of these interactions sets new conditions for the next phase in the focal relationship and influences the conditions in other connected relationships.

Proposition 3a: The revised conditions of trust and power in a business relationship influence actions, learning and adaptation in connected relationships.

The history of a relationship matters in shaping its current conditions and context as well as future history of relationships. Path dependence plays a key role, not only in terms of starting conditions but in shaping the way future conditions and experiences are interpreted and adapted based on past experiences and understanding (North 2005).

A business relationship can end at any time as a result of temporally specific events affected by preceding and anticipated future events in a situational context (Tornroos 2004). But, even though trading may stop, the relationship energy may not be destroyed but conserved and ready to be exported to and reactivated in other relationships (Havila and Wilkinson 2002). The firm may have gained new resources out of the relationship or had its original resources augmented, changed or lost. Interpersonal relationships and trust could have been built in the ended relationship and connected relations strengthened or weakened. In sum, firms co-evolve with their relationships and are different from what they were when a relationship first began. This affects their attractiveness and trustworthiness as partners in future relationships.

Proposition 3b: When a business relationship terminates, new initial conditions of trust and power are set for future business relationships.

Conclusion

In this paper, we propose an analytical framework to understand the evolution of trust and power in interfirm relationships, and the evolution of relations more generally. The argument in this paper is that trust and power are dynamic features of business relationships and co-develop over time through the actions and interactions in interfirm relationships.

The evolution of trust and power undergoes a cyclical path of starting conditions and on-going reproduction. In these interactions, firms experience processes of learning, adaptation and action that produce actual and perceptual changes, which affect trust and power. The revised conditions of trust and power in turn influence learning, adaptation and action. Balance can be established when the patterns that ongoing processes reproduce the same relationship structure that endures minor variation without appreciable changes in overall direction (Abbott 2001).

Trust and power are not destroyed when a relationship terminates. The relationship aftermath is manifest in the new resource repertoires firms have in the end of the relationship and the personal and professional bonds developed. These affect a firm's opportunities to develop new relations and affect their power and how much they will be trusted in subsequent relations. In light of this, a relationship never dies completely but its energy is conserved that sets new initial conditions of trust and power for future relationships.

Our study contributes to the understanding of relationship dynamics by investigating the evolution of trust and power. The model provides the basis for further research in which we seek to understand and calibrate the types of feedback mechanisms at work. In particular we are working to develop systematic histories of relationship using narrative event history methods, which will then form the bases of dynamic simulation models. We welcome others to join in this research endeavour by contributing relationship histories.

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