

## Work-in-Progress Paper

### Trust as a Counterweight to Risks within the Development Process of Inter-Organisational Relations in Russia

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#### Abstract

Although the global financial crisis emerged in September 2008 has caused a dramatic fall in business activities of Finnish companies in Russia, the Russian market is still remaining attractive and building successful relationships with the local reliable partners became an increasingly important strategy for many of Finnish construction companies operating in Russia. Having relationships with Russian partners under the current conditions of uncertainty of Russian market environment, foreign companies are involuntarily exposed to certain risks. These risks can never be entirely eliminated, but to a large extent as literature suggests trust plays an important role in counterbalancing them. The research aims at deeper understanding the role of trust as a counterweight to risks perceived in different stages of inter-organisational relationships development between Finnish and Russian construction companies. This paper offers a conceptual model and propositions on the nexus between trust and risk and its affect on the inter-organisational relationship development. In the concluding part of the paper the tentative results of the empirical part of the study are introduced.

**Keywords:** *inter-organisational relationship, perceived risk, subjective trust, nexus between trust and risk*

#### Introduction

Finnish construction industry has always had special connections with Russia since the Soviet Union time. However, the significant growth of business activities of Finnish construction companies in Russia was a result of the radical political and economic reforms

there during last decades which have opened lots of opportunities for foreign business sectors. Although the global financial crisis emerged in September 2008 has caused a dramatic fall in business activities of Finnish companies in Russia, the Russian market is still remaining attractive for many construction companies which see it as a challenging opportunity. The challenge is to understand the current circumstances in the market and to predict its future development which will be only possible through close co-operation and determined work together with reliable local partners. As for construction companies, reliable relationships within business networks will also bring strong competitive advantages in the bidding process of future contracts.

Having the long-term reliable relationships with Russian partners became even more critical during the crisis time. Nevertheless, it is not the easy task. Even though Finnish construction companies have had business relationships with the Russian partners since the Soviet period and very well aware of their culture and behavior, building the successful relationships with them only seldom has been unproblematic and still continuously creates great challenges. Furthermore, despite the fact that the new Russia now embraces liberal free-market principles, the market institutions and infrastructure in Russia are still underdeveloped and development trends are difficult to predict. It means that foreign companies operating in the Russian market have to rely extensively on trust in forming relationships with local partners, while trust is often considered as a substitute for developed market institutions (Peng and Heath, 1996). In this research, trust refers to a belief that partner organisations will interact in the best interests of each other.

Developing relationships with Russian business partners under the conditions of uncertainty of current market environment, foreign companies are involuntarily exposed to certain risks. These are risks caused by disturbances inside the relationships between partners of business network, e.g. an exposure to potential loss or harm for a partner. Such risks can never be entirely eliminated, but to a large extent as literature suggests, trust plays an important role in counterbalancing them. Trust has been repeatedly stressed to be a strong foundation for the inter-organisational relationship development (e.g. Gustafsson et al., 2009; Doney and Cannon, 1997; Morgan and Hunt, 1994).

This highlights the need for a more comprehensive understanding of the role of trust as a mechanism to counterbalance relationship risks, and practically, how Finnish construction companies can approach the development of their relationships with Russian partners and cope with related risks. Thus, the study focuses on a nexus between trust and risk within the development process of inter-organisational relationships between actors of business networks. However, the discussions here on the inter-organisational relationships will not go beyond the dyadic level, i.e. beyond the Finnish general contractor's set of direct ties with Russian subcontractors operating in the Russian market.

### **The Purpose and Objectives**

The purpose of the paper is to present a work-in-progress research on the development of inter-organisational relationships between Russian and Finnish construction companies exploring the role of trust as a counterweight to the potential risks caused by disturbances inside the relationships between partners. The paper has the following specific objectives:

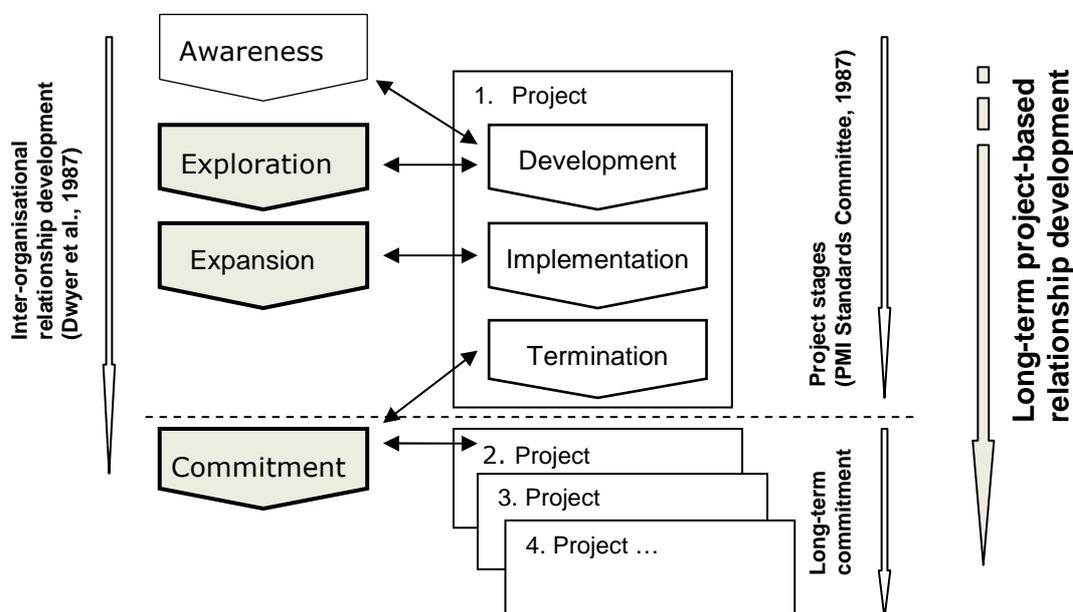
- first, to give a brief literature overview on the main research concepts,
- second, to propose a conceptual model demonstrating the role of trust as a counterweight to the risks in the development process of inter-organisational relationships, and
- third, to test the proposed model exploring the nexus between trust and risk.

## Theoretical Discussion

There has been increasing attention on inter-organisational co-operation in the literature since the 1960s, and a number of scientists have advocated that an organisation should seek continuing cooperative relationships with other organisations in order to cope with changes in technology, environmental uncertainty and other pressures (e.g. Van de Ven, 1976; Borman, 1994; Inkpen, 1996). Thus, the significance of long-term orientation in inter-organisational relationships has been widely acknowledged (e.g. , and the effective management of inter-organisational relationships is considered as being a key source of competitive advantage for modern organizations (Wilson, 1999).

In the literature, inter-organisational relationships are commonly referred to as ‘co-operation’ and ‘co-operative relationships’. There is a specific understanding of ‘co-operation’ such as meaning people working together or acting in conjunction with others, for their mutual benefits, on a voluntary basis, and which implies reciprocal sharing of rights and responsibilities (Robinson, et al., 2000). In this paper the term ‘inter-organisational relationship’ (IOR) is used to refer to voluntary co-operation between partner organisations within networks involving repeated transactions on the contract basis.

An inter-organisational relationship can generally be considered as evolving gradually over time through certain stages from establishment to end (Ford, 1980; Ring and Van de Ven, 1994; Dwyer et al., 1987). Dwyer et al. (1987) structuralized a relationship development into five main phases: 1. ‘Awareness’, 2. ‘Exploration’, 3. ‘Expansion’, 4. ‘Commitment’, and 5. ‘Dissolution’. The model was applied for the research purpose with the adaptation to inter-organisational relationships in the construction industry, where business activities have always been organized as projects. Therefore, the relationships between a general contractor and subcontractors are project-based. Projects as time-limited sequences of events are usually divided into three distinct stages: (1) development, (2) implementation and (3) termination (e.g. PMI Standards Committee, 1987). Thus, the main stages of Dwyer’s et al. relationship development model and project management are posed in reverse order to see a correspondence between stages and processes involved (see Figure 1). The Figure 1 depicts the model that reflects the development of inter-organisational relationships on the project basis.



## Figure 5 Project-based inter-organisational relationship development

A key distinction of this model relates to the *'commitment stage'* that refers to the continuity of relationship between partners. With regard to construction companies it means that a number of joint projects have successfully been completed with their partners or subcontractors, and both parties were willing to continue their relationships in the further projects.

However, inter-organisational relationships do not develop through all these stages in a pre-determined way. Some relationships may fail after an initial contact, others may turn out to be useless, or they may not have a possibility to develop either due to inability or unwillingness of the parties. In contrast, some relationships are long-lasting and deal with parties' varying aims and expectations at different times (Ford et al., 2004). A number of different conditions for the long-lasting relationships between co-operative partners has been identified by researchers, but *"virtually all scholars have agreed that one especially immediate antecedent is trust"* (Smith et al., 1995, 10).

Over the past four decades, the concept of trust has been a focus of many scientists in multiple disciplines, and a variety of trust definitions has been proposed. In relationship marketing literature, definitions of trust mainly concern a belief that relationship partners will interact in the best interests of each other (Wilson, 2000). In this respect, Anderson and Narus consider inter-organisational trust as *"a company's belief that the other one will carry out actions that will result in positive consequences for the company and furthermore it will not perform unexpected actions that may cause negative results"* (Anderson and Narus, 1990, 45). In regard to subjective trust, Das and Teng (2004) stated that it definitely refers to an individual's psychological state, and in the literature, trust is mostly cited as a perception about trustee in relation to trustor. Similarly Sitkin and Roth (1993, 368) defined subjective trust as *"a belief, attitude, or explanation concerning the likelihood that the actions or outcomes of another individual, group or organization will be acceptable or will serve the actor's interests"*. Trust is also a probabilistic belief, as it is the result of a holistic assessment of the past, present, as well as future interactions between partners. Therefore, in this research, trust refers to a probabilistic belief that partner organisations will interact in the best interests of actor under the conditions of uncertainty.

Much of the work on trust suggests that trust provides the conditions under which desirable outcomes such as positive attitudes, higher level of cooperation, and superior levels of performance are likely to occur (Dirks, 2006). Scholars from different business disciplines clam, that trust may lower transaction costs and enhance inter-organizational relationships (Doney, Cannon, & Mullen, 1998). The empirical research stated that trust has a positive impact on relationship performance (Zaheer et al., 1998). Morgan and Hunt (1994) showed that work relationships characterized by trust engender co-operation, reduce conflicts, and increase the commitment. The authors claim that trust as a key variable in relationship development encourages positive attitudes between partners. The basic level of trust operates as a prerequisite for inter-organizational co-operation, because it helps to generate and maintain interaction and social order (Bachmann et al., 2001; Inkpen and Curall, 2004; Luhmann, 1979; Reed, 2001). Where trust is absent relationship will deteriorate (Palmer, 2001).

Regarding this study it could be assumed, as a general contractor comes to believe its trust in co-operative partner as decreased, the contractor's orientation toward further stage of relationship with the partner will be changed and worsened. This leads to the following proposition:

Proposition 1: *The decrease in subjective trust level of a Finnish general contractor in its Russian subcontractor negatively affects on the contractor's willingness to co-operate with the subcontractor, while the increase in trust level will have a positive impact.*

In the literature trust is identified as an essential component of a relationship when uncertainty or risk is present (e.g. Mayer et al., 1995). Moreover, perceived risk decreases when trust is present (e.g. Ganesan, 1994; Lewis and Weigert, 1985). In the absence of trust, inter-organizational relationships would be pervaded with a high level of uncertainty, inducing managers to question continually motives and competences of their partners (Das and Teng, 2001; McEvily et al., 2003). Further, many theorists claim that trust is needed only under the conditions of uncertainty and risk (e.g. Boon and Holmes, 1991; Deutsch, 1960; Schlenker et al., 1973). A number of trust definitions include explicitly or implicitly the concept of risk (Das and Teng, 2004). Thus, the definition of Currall and Judge relates risk and trust concepts considering trust as *"an individual's behavior reliance on another person under a condition of risk"* (Currall and Judge, 1995, 151).

In practice, the term *'risk'* is generally considered by managers as a danger or a possibility of unwanted events not an opportunity for desired positive outcomes (March and Shapira, 1987). Hence, the traditional definitions of the risk have typically focused on the probability of risk occurrence and consequences or losses. Therefore, risk can be discussed objectively in terms of the factual dimensions such as a probability and consequences. Thus, as Lowrance (1976) shortly defined it, risk is a measure of the probability and severity of adverse effects.

Nevertheless, *'risk'* can also be seen subjectively in terms of the socio-cultural dimension which emphasises the difference of individuals' risk perceptions. It is often presumed that humans are irrational about risk because it involves the perception and calculation of probabilities. The subjective approach is the focus of social scientists' attention. They have rejected the idea of *'objective'* risk, arguing that risk is inherently subjective (Krimsky and Golding 1992; Slovic 1992) and defining risk as a social construct, meaning different things to different people, which cannot be measured independently of peoples' minds and cultures (Slovic and Gregory 1999).

Considering the sources of risk Miller (1992, 311) suggested that *'risk'* refers to the factors *"either external or internal to the firm that impact on the risk experienced by the firm"*. In this respect, Das and Teng (1996) differentiated and characterized two distinctive type of *'risk'* in terms of their sources. The first risk source concerns interactions between organisations and refers to *'relational risk'*. *'Relational risk'* is defined as the probability that partner will not satisfy the norms of co-operation. And, the second relates to the interactions between organisations and their environment and refers to *'performance risk'*. *'Performance risk'* is ascribable to the probability of failure in achievement of the intended strategies caused by partner incompetence or market uncertainties. (Das and Teng, 1996) In this study, *'perceived risk'* is composed of *'performance risk'* and *'relational risk'*.

According to Williamson (1983) opportunistic behavior is a typical source of relational risk. Shirking, distorting information, stealing the partner's skills, clients and personnel are the examples of the opportunistic behavior (Das and Teng, 1998). It seems that co-operative partners often justify their guileful and self-interested behaviour, due to the payoff from cheating could be greater than that from operating according to the agreement (Parkhe, 1993). High relational risk can even destroy co-operative efforts (Das, 2006). According to Das and Teng, (1996) co-operative relationship allow partners to share the total cost and risks involved e.g. in marketing, R&D, and production relationships. Thus, authors pointed out that performance risk can be shared by forming a co-operative relationship, while relational risk is emerged only within a relationship.

Thus, from the foregoing discussion it could be concluded, that trust will impact on the willingness to co-operate through its influence on perceived risk. In other words, perceived risk mediates the impact of trust on the willingness to co-operate. Hence, the following two propositions are emerged:

Proposition 2: *The more risks are perceived by a Finnish general contractor in the relationship with its Russian subcontractor, the larger the decline in subjective trust that contractor has in its subcontractor, and conversely.*

Proposition 3: *The more risks are perceived by a Finnish general contractor in the relationship with its Russian subcontractor, the less positive impact of contractor's subjective trust on the willingness to co-operate with the subcontractor, and conversely.*

It has been suggested by many scientists that trust can be viewed as an attribute of risk-taking behaviour. It enables a co-operative partner to be vulnerable to other taking risks from relationship. (Mayer et al., 1995) As Johnston-Georg and Swap (1982, 1306) suggested "*willingness to take risks may be one of the few characteristics common to all trust situations*".

Many researchers have agreed in views that behavioral trust is the manifestation of subjective trust, and subjective trust and behavioral outcomes of trust should be differentiated (e.g. Craswell, 1993; Das and Teng, 2004; Gambetta, 1988). Thus, behavioral trust is viewed as being vulnerable to, or relying on, another party (Michalos, 1990).

Das and Teng (2004, 95) distinguish three categories of trust: "*(1) trust as a perception (subjective trust), (2) as various antecedents to subjective trust (trust antecedents), and (3) as the actions resulting from subjective trust (behavioral trust)*". Authors make a parallel with two types of risks. In practice, it means that '*subjective trust*' and '*perceived risk*' are the opposite concepts of each other. Further, '*subjective trust*' can comprise two categories of trust: '*goodwill trust*' reflecting the '*relational risk*' among the partners, and '*competence trust*' reflecting the '*performance risk*'. '*Behavioral trust*' can be considered as risk taking. In this respect, the causal relationship between '*subjective trust*' and '*behavioral trust*' is similar to that of '*perceived risk*' and risk taking. The explanation for the relationship between '*subjective trust*', '*perceived risk*' and '*risk taking*' is that "*A perception of trust indicates a low level of risk, which then makes the subject more willing to undertake the risk and thus grant trust*" (Das and Teng (2004, 111). It means that trust encourages trustor to take risks. Thus, based on the discussion above, the final propositions are formulated:

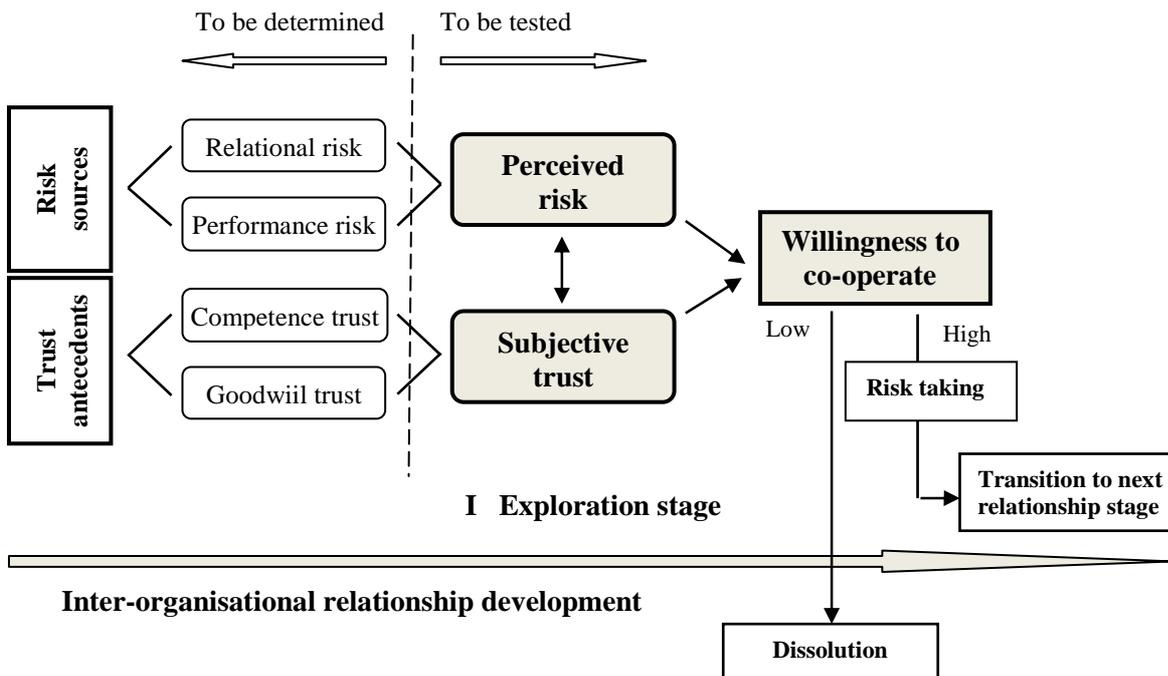
Proposition 4: *The higher the level of subjective trust that a Finnish general contractor experiences in its Russian subcontractor, the more risks contractor accepts in the relationship with its subcontractor, and conversely.*

Proposition 5: *The higher the level of trust that a Finnish general contractor experiences in its Russian subcontractor, the less sensitively contractor perceives risks in the relationship with its subcontractor, and conversely.*

### Proposed Conceptual Model

The conceptual model was constructed on the basis of literature review (see Figure 2). This model is a simplification of the causal relationships between the main concepts of the study, which provides a framework for the assessment of knowledge available and its compliance with empirically gained data. Figure 2 contains two areas for the empirical research: first depicts the concepts to be determined, which are beyond the scope of this paper, and second illustrates the concepts with proposed relationships to be tested. To explore the relationships between degrees of subjective trust, perceived risks and willingness to co-operate between the partners a set of propositions is deduced from the literature and inductive observations of a number of inter-organisational relationships over time.

Since inter-organisational relationships develop along different stages (see Figure 1), the levels of perceived risk in interactions and subjective trust between cooperative partners change across the stages of inter-organisational relationships. In practice, trust is required only when risk of losses exceeds benefits or gains. The greater this difference, the higher the trust level is required to sustain partners' relationship. The general argument is that the co-operation will continue from one stage to another as long as partner organisations are able to rely on trust in the presence of relationship risks, while trust plays a central role counterbalancing risks in the relationship between partners.



## **Figure 2** The proposed conceptual model

The model attempts to consider partially cultural and environmental factors incorporating concepts such as trust antecedents and risk sources occurring in the relationship between partners from different countries and cultures. It is assumed that the cultural national values are predictors of trust antecedents, and the environmental conditions are to a large extent responsible for risk sources. However, it ignores the potential effects of organisational characteristics and individual differences in the perceptions of risk and trust as well as risk and trust propensities.

### **Methodology and Data Collection Methods**

To achieve objectives of the study the methodology consists of a literature survey and qualitative analysis. Literature survey was conducted with the purpose to acquire the knowledge about recent research efforts regarding the topic to study and to develop the contractual model to be utilised in the further qualitative analysis.

The qualitative methodological approach is applied in the course of this study, while the use of qualitative methods is appropriate when the aim is to examine complex processes (Eisenhardt, 1989; Yin, 1994). The semi-structured face-to-face interviews are chosen as the primary source for data collection to provide a more qualitative insight into the research questions and ensure a high response rate and data reliability. The questionnaire with the closed and open-ended questions was applied to guide and focus the individual interviews with relatively large number of respondents from the Finnish companies operating in Russia. The questionnaire was dedicated to test the conceptual model and Propositions (1 – 5) exploring the nexus between trust and risk in inter-organisational relationships between Finnish case companies and their Russian partners.

The research setting for the phase three was the Finnish companies representing construction and related service industries with headquarters in Finland. The selected eight case companies operate in a very competitive business-to-business environment of the Russian market which is a major focus of the study. The studied period covers several years of the companies' activities in the market. Five companies are located in the St. Petersburg, and three – in Moscow. So far, interviews in five companies were conducted and analysed. The sample of respondents within each case company was from five to seven and based on the criterion of representativeness of different management levels: senior managers, middle managers, key personnel. The names of case companies are suppressed for confidentiality reasons.

The questionnaire for respondents from the case companies were written in the Finnish and Russian language. Interviews were conducted in the language most comfortable to participants, i.e. interviews with Finns were held in the Finnish language, whereas interviews with Russians were in the Russian language.

### **Findings and Discussion**

This study contributes to the body of knowledge in the areas of inter-organisational relationship development. There are only a few studies that offer an integrative view of

relational constructs of inter-organisational relationship development. However, the primary purpose of this study is not to provide a comprehensive model of all concepts related to the process of inter-organisational relationship development. Instead, it aims to expand the scope of the research on inter-organisational relationships by introducing a framework to address a specific question for considering the nexus between trust and risks in the process of relationship development and testing it empirically.

While the empirical research is not fully completed yet, the acquired data allow presenting only tentative results. Thus, the conceptual model (see Figure 2) was tested exploring empirically the nexus between trust and risk. In total, five propositions were tested against the data derived from interviews and found varying levels of support in the data. Strong support was found for the propositions 1, 2 and 3. More specifically from the perspective of general contractor, managers experiencing the higher level of trust in a subcontractor are more willing to co-operate, whereas managers perceiving more risks in the relationship with subcontractor are less likely to develop this relationship. Moderate support was found for the proposition 5. Finally, proposition 4 has got a weak support from the results. It was found that the higher level of trust has a positive but not-significant effect on accepting risks by Finnish general contractors in the relationships with their Russian subcontractors.

The study tested the strength of the trust construct in the presence of risks and confirmed the important role that trust plays in counterbalancing risks perceived in the inter-organisational relationships. The findings support the Smith's et al. (1995) argument conceptualized by many scholars that trust is immediate antecedent to the development of successful long-term relationship between co-operative partners. Although trust is viewed as a vital concept when there are significant risks involved in relationships (e.g. Das and Teng, 2001; McEvily et al., 2003), less attention is given to the effect of perceived risks on the relationship development. In this study, perceived risks are found as moderators in positive influence of trust on the '*willingness to co-operate*' in the inter-organisational relationship development (see Figure 2).

While interpreting the research results cautions should be made in making too broad of an interpretation due to several apparent limitations. First, the research questions have been studied from only one side of the dyadic relationships between partner organisations. The most significant reason for that was the lack of dyadic responses due to unwillingness of respondents from general contractors (Finnish case companies) to provide contact data of their subcontractors referring to ethical issues and business confidentiality. Therefore, it was not possible to see possible differences in perceptions between the informants across the dyads regarding the research issues. Second, while the study is focused only on one industry sector and one country, the problem of generalisation of research findings regarding other industries and geographical areas arises. Third, the descriptive character of the qualitative research methods place certain constraints on the findings too. Thus, the insights reached from the interviews with limited number of respondents within non-representative number of case companies cannot be generalized to the emerging theory and cannot validate the proposed conceptual model. The results should only be viewed as the attempt to deep understanding of the role of trust as a counterweight to risks involved in different stages of inter-organisational relationships in Russia.

This study may have essential implications for practitioners. It offers some insights into the managerial decision making process regarding the co-operative relationship development between partner organisations and the role of trust in this process. The proposed model demonstrates a significant part of this process. It can assist managers in

the choice of their partners for co-operation and the forms of governance of co-operative relationships with their counterparts. The final results of the study will contribute to a managerial dilemma of how Finnish construction companies can approach the development of relationships with Russian partners and cope with related risks.

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