

Relational Risk, Trust, and Control in International Business Collaboration¹

Torsten M. Kühlmann

University of Bayreuth, Bayreuth, Germany

Email: torsten.kuehlmann@uni-bayreuth.de

Nada Endrissat

Basel University, Basel, Switzerland

Email: nada.endrissat@unibas.ch

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Abstract

Trust and control have been recognized to be decisive factors for overcoming relational risks in cross-border business partnerships. However, there is a lack of studies that explore the concepts' embeddedness in different socio-cultural backgrounds. This paper seeks to fill this paucity by linking trust, control, and economic performance to the two socio-cultural contexts that are involved in Sino-German business co-operation. The overall results of our comparative study suggest that the socio-cultural background needs to be taken into consideration when examining the relationships between trust, control, and economic performance. Western models may not apply worldwide.

Keywords: relational risk, trust, control, international business collaboration

1. Introduction

The need as well as the opportunity for businesses to compete in multiple markets around the world has led to a spread of inter-organizational collaboration across national borders. An organization's ability to manage cross-border business collaboration such as research and development projects, distribution partnerships, licensing agreements and joint ventures has become an important source of competitive advantage on the global marketplace. The significance of managing international business co-operation is reflected in the extensive literature on this topic (for a review see Child & Faulkner, 1998; Doz & Hamel, 1998).

However, international business partnerships do not only represent a mean to reduce risks and to overcome restrictions, but constitute a source of risk themselves. A fact, that is reflected by the high failure rates of business partnerships (Das & Teng, 2000; Park & Ungson, 1997; Parkhe, 1993). One of the most fundamental risks in business partnerships is relational risk, i.e. the risk that the partner acts opportunistically and hence, no mutually

satisfactory co-operation can be attained (Das & Teng, 1996). This type of risk seems especially important in the context of international business partnerships since co-operating *internationally* – compared to co-operating *intranationally* - makes it more difficult, for example, to enforce written contracts due to national differences in the legal system, to detect opportunistic tendencies because of infrequent encounters, or to interpret the partner's culture-specific behavior. Thus, in order for business partnerships to work successfully, an effective risk-management strategy is important.

Principally, two alternatives are discussed in the literature: control and trust (e.g. Das & Teng, 1998, 2001; Faulkner, 2001; Knights, Noble, Vurdubakis, & Willmott, 2001; Nooteboom, 1996; Nooteboom et al., 1997; Reed, 2001; Williamson, 1985). It is argued that trust among the business partners is of paramount importance for the collaboration's success. As a consequence, numerous empirical studies have examined the process of mutual trust in international business co-operation (Aulakh, Kotabe & Sahay, 1996; Child & Möllering, 2003; Huff & Kelley, 2003; Inkpen & Currall, 1997; Sako & Helper, 1998).

Another success element is claimed to be the use of control mechanisms (Kumar & Khanna, 2000; Newburry & Zeira, 1999; Wang, Wee & Koh, 1998). Yet, even though both trust and control are central explanatory factors for collaboration success, the relationship between the two concepts is far from clear (Das & Teng, 1998).

Furthermore, cross-border partnerships usually involve different cultures. However, despite a magnitude of studies that have explored phenomena like trust and control in business partnerships, relatively few scholars have directly addressed the different national cultures and their link to the formation of trust as well as to the application of control mechanisms in cooperative relationships (Huff & Kelley, 2003).

This paper seeks to overcome the outlined deficiencies by addressing the impact of national cultures on trust and control, the relationship between trust and control, and the contribution of trust and control to the business success in the context of Sino-German business partnerships. The focus on Sino-German business co-operation was chosen because the two countries' contrasting values and norms promise new and context-sensitive insights. Compared to Germany, the Chinese business environment is known for its weak institutional support and guarantees. Therefore, business transactions in China are strongly dependent on trustful relations between business partners. On the other hand, it is difficult for foreigners to build up trust because Chinese do not easily extend trust outside their kinship and community based social networks (Child & Möllering, 2003). Ultimately, analysing trust and control in Sino-German business co-operation is also of practical relevance since Germany has become China's most important European trade partner and German foreign direct investments into China have accelerated in recent years (Deutsche Bank Research, 2004; Eurostat, 2004).

The remainder of the paper proceeds as follows. First we provide a literature review and clarify central concepts of our study. We then present our research hypotheses. The next two sections describe the research design and the empirical results of our study. The paper concludes by discussing our results and highlighting some of the implications of our findings for future research on trust and control in international business collaboration.

2. Literature review and hypotheses

2.1. Definition of terms

In business partnerships the partners often make co-operation specific investments, share valuable know-how, or refrain from competition with each other. These actions provoke vulnerability. Even though the partners agree to co-operate, behavioral uncertainty still exists (Parkhe, 1993). Das and Teng (1996) introduce an integrated risk perspective which includes

performance risk and relational risk. *Performance risk* is defined as the “possibility and the consequences that the objectives of inter-firm alliances are not successfully achieved, although all partners co-operate fully” (Das & Teng, 1996: 833). *Relational risk* “refers to the concern that firms may not work toward the mutual interests of the partners, and that they may not co-operate in a manner specified in the alliance arrangement or as expected by their partners” (1996: 831). Performance risk can be seen to inhere in every entrepreneurial activity whereas relational risk is unique to forms of co-operative partnerships (Das & Teng, 1999). Forms of the latter risk are often referred to as *opportunism*. The term opportunism can be defined as “a lack of candor or honesty in transactions, to include self-interest seeking with guile” (Williamson, 1975: 9). This definition incorporates behaviors such as “withholding or distorting information to mislead, distort, obfuscate, or otherwise confuse” (Williamson, 1985: 47).

The literature on *trust* reveals various conceptualizations and so far, there have been only few attempts to integrate the different perspectives (McKnight & Chervany, 2001; Rousseau, Sitkin, Burt & Camerer, 1998;). However, our review of the multidisciplinary literature on trust shows that most of the previous definitions have three assumptions in common: (1) Risk is a prerequisite for trust to arise. Risk is defined as the potential of negative outcomes for the trustor if the trustee does not prove trustworthy (Rousseau et al., 1998). Lewis and Weigert aim at the condition of risk when they state “...if one were omniscient, actions could be undertaken with complete certainty, leaving no need, or even possibility, for trust to develop” (1985: 970) (2) Trust is based on a set of beliefs and expectations the trustor holds about the trustee’s competence, benevolence, and behaviours (McKnight & Chervany, 2001). (3) Beliefs and expectations of the other party’s trustworthiness stimulate the trustor’s willingness to put its fate in the hand of the trustee and to take actions which make him vulnerable to the trustee (Mayer, Davis & Schoorman, 1995). Thus, incorporating these assumptions, we define trust as a

willingness to rely on another party under a condition of risk based on positive evaluations of the intention, competence and behaviour of the trustee (for similar definitions see Mayer et al., 1995; Rousseau et al., 1998).

The term control is widely used in management theory and practice. Its definition varies depending upon the perspective which has led to the fact that “control is referred to simultaneously as an organizational setup, a process of regulating behaviors, and an organizational outcome” (Das & Teng, 1998: 493). In the context of business co-operation the concept of control refers to the actions one partner develops in order to influence the other partner’s behaviours in a way that helps to attain the partnership’s goals (Inkpen & Currall, 1997). Control actions include a range of formal and informal (social) governance mechanisms. Formal controls are codified in rules and procedures. They involve regular and explicit information transfer. Informal controls utilize values and norms to foster a partner’s desirable behaviour. The latter are more uncertain and embedded in the social relations between the partners (Das & Teng, 1998).

The dichotomy *individualism vs. collectivism* represents a basic value dimension which Hofstede (1980) proposed for analysing variations among cultures. Individualism characterizes societies in which people look after themselves and their immediate family but neglect the interests of other groups or the society as a whole. In individualist countries (such as Germany) values and actions like initiative, autonomy, assertiveness, and self respect are highly valued. In collectivist societies, on the other hand, people prefer to act as members of a group rather than individuals. Extended and tight social networks exert control over their members through social pressure as well as through emotional dependence. People from collectivist societies (such as China) make a sharp distinction between the members of their own social networks (‘in-group’) and members from other groups (‘out-group’). Within the boundaries of the in-group they

emphasize cooperation, harmony and 'saving face'. However, it is argued that beyond the boundaries of the in-group, collectivists compete with and exploit people more extensively than individualists (Watkins & Liu, 1996).

2.2 Trust and control in individualist and collectivist cultures

So far, only very few scholars have linked trust in cross-borders business relationships directly to the prevalent societal cultures in general or the cultural dimension 'individualism vs. collectivism' in particular. The popular view holds that trust between business partners is high in collectivist societies and low in individualist societies (Dyer & Singh, 1998; Doney, Cannon & Mullen, 1998).

However, some authors have challenged this reasoning. For example, Fukuyama (1995) identified both collectivist and individualist societies that generally show a low level of trust (e.g. China, Korea, France) respectively a high level of trust (e.g. Germany, Japan, United States) in other people. In the case of China, several authors have confirmed the low level of trust prevalent in Chinese society (Child & Möllering, 2003; Kiong & Kee, 1998, Wang & Yamagishi, 1999). The tendency to distrust members of the out-groups might be increased by the weak institutional safeguards China has developed regarding business partners' capriciousness and opportunism.

As the neo-institutionalist view of trust (e.g. Lane & Bachmann, 1996) emphasizes, trusting relationships are promoted by effective and comprehensive rules and norms which deter from and sanction misbehaviour. Despite significant advances in the legal provisions, China has made little progress to put into effect the institutional bases for trust between (economic) actors, both Chinese and foreign. Thus, our first hypothesis is as follows:

Hypothesis 1. In Sino-German business co-operation Chinese managers show less trust in their foreign business partners than German managers in their Chinese partners.

A business collaboration might also be successful if effective control mechanisms are put in place (Geringer & Hebert, 1989; Newburry & Zeira, 1999). Due to the lack of a system of trustworthy institutions and legal protection outside the circles of family or guanxi networks, Chinese business partners have to resort to additional approaches to exercise control over the foreign partner. We therefore propose:

Hypotheses 2. In Sino-German business co-operation Chinese managers employ more control mechanisms than German managers.

Often, the two concepts of trust and control have been conceptualised as opposing alternatives in the sense that ‘if you control me, you don’t trust me, but if you trust me, you do not need to control me’. The presence of trust reduces the need for control, and vice versa. It could thus be argued that trust and control are substitutable (Aulakh et al., 1996; Inkpen & Currall, 1997; Parkhe, 1993; Ring & Van de Ven, 1994).

On the other hand some researchers claim that control mechanisms support the generation of mutual trust (e.g. Sitkin, 1995). Their argument is that exerting control enables to document and to evaluate trustful behaviours which consequently provides a basis for generating trust between the business partners. the relationship between the two concepts is substitutive, complementary, or supplementary. Yet, We therefore intend to empirically explore the relationship between control activities and trust-building.

In a review of the literature Das & Teng (1998) suggest that trust and control can exist simultaneously, that is, they operate independently from each other and contribute jointly to the co-operation’s success.

In sum, the relation between the two concepts is still not untangled. It may be conceptualized as either substitutive, complementary, or supplementary. However, since the few studies that empirically analysed the relationship between trust and control conclude that the deployment of controls leads to a decline of trust in the partner (Mohr, 2003) we propose an

inverse relationship between the level of trust and control in cross-cultural business co-operation.

Hypothesis 3. The less control mechanisms are applied the more trust a business partner has in the foreign business partner.

2.3 Trust, control, and business performance

Despite the increasing recognition of the role that trust plays for the success of cross-border business partnerships, very little empirical research has attempted to document the relationship between trust and performance. In accordance with a study of Child and Möllering (2003) who were able to confirm a positive relationship between trust and business success in the context of joint ventures and other forms of co-operation between Hong Kong based companies and partner firms in Mainland China, we propose:

Hypothesis 4. The more trust one partner in a Sino-German business co-operation has in his counterpart the better its economic performance.

A positive relationship between control and business success is particularly supported by agency theory and transaction cost theory (Dyer, 1997, Ramanathan, Seth & Thomas, 1997). Yet, empirical research has produced mixed results (Child & Faulkner, 1998; Geringer & Hebert, 1989). As the discrepant findings can be attributed to the lack of consistency across different investigations we propose:

Hypothesis 5. The more control mechanisms one partner deploys in a Sino-German business co-operation the better its economic performance.

3. Methods

3.1 Sample

To define the sample we used two approaches. First, we contacted the Delegation of German Industry & Commerce in China and asked for their support in identifying German small and

medium-sized enterprises (SMEs) which collaborated with Chinese partners. Second, we visited several international trade fairs in Germany in order to contact German and Chinese companies. These two approaches resulted in the identification of 81 German and 152 Chinese companies.

A questionnaire was mailed to the key-informant of each company who had a primary responsibility for managing the day-to-day relationship with the partner. The response rate for the German sample was 63 % and 26 % for the Chinese sample. Useable questionnaires were obtained from 51 German respondents and 40 Chinese respondents. The main industries covered by the sample are engineering (24%), automobile (19%), and electronics (22%). A majority of the companies has less than 250 employees. The most frequent forms of collaboration are the equity joint venture (58%), followed by distribution partnerships and contract production (each about 20%).

3.2 Measures

The questionnaire (see Appendix) included a broad range of items concerning trust and control in Sino-German business relationships. It was fully structured and the responses had to be given on a 5-point Likert-type scale ranging from (1) 'strongly disagree' to (5) 'strongly agree'. Based on the back-translation strategy we constructed a German and a Chinese version of the questionnaire. Items that measured the concept of *trust* were addressing the five components integrity, openness, competence, reliability, and loyalty. These components of trust were selected by surveying the literature (Butler, 1991; Schindler & Thomas, 1993; Cummings & Bromiley, 1996) and by analysing the answers of German and Chinese MBA-students given in an exploratory study concerning the meanings of trust/distrust which was conducted at our department. Overall, ten items were designed to measure organization-oriented trust. The trust scale is one-dimensional with Cronbach's alpha coefficients of .89 in the German sample and .81 in the Chinese sample, indicating high reliability.

Control was measured by using six statements about the use of specific formal as well as informal control mechanisms. The selection of control mechanisms was guided by the existing literature on control in business co-operation (Child & Faulkner, 1998; Geringer & Hebert, 1989). The items were combined into one scale that reflects the extent of controls one business partner deploys in the relationship (Cronbach's alpha is .84 in the German and .80 in the Chinese sample).

As the participating companies were not willing to provide 'hard' data about the *collaboration's success*, its performance was measured by a success rating. The respondents were asked to assess the co-operation's return on sales compared to the return on sales in their domestic business activities on a 5-point Likert scale.

4. Analysis and results

Table 1 reports the means, standard deviations and correlations of trust, control and business success both for the German and the Chinese sample.

Table 1.

Means, Standard Deviations, and Pearson Correlations by Samples^{a,b}

Chinese sample					
Items	Mean	s.d.	1	2	3
1. Trust scale	3.63	.47			
2. Control scale	3.18	.66	.34*		
3. Return on sales	2.53	.62	-.14	.02	-
German sample					
Items	Mean	s.d.	1	2	3
1. Trust scale	3.11	.84			
2. Control scale	3.19	.88	-.35*		
3. Return on sales	2.02	.87	.27	.29	-

^a Chinese sample N = 40

* p< .05 (two-tailed)

^b German sample N = 51

4.1 Trust, control, and cross-cultural differences

Hypothesis 1 predicts that German managers exhibit a higher level of trust in their Chinese partners than vice versa. Yet, as can be seen in Table 1, Chinese business partners report more trust in their German partners than German partners in their Chinese partners. The difference in the level of trust is statistically significant (see Table 2). Hypothesis 1 is therefore not corroborated.

Table 2.

Differences in Trust and Control across the Chinese and German Sample

Scales	Chinese sample		German sample		<i>t</i> -statistic
	Mean	s.d.	Mean	s.d.	
Trust	3.63	.47	3.11	.84	-3.68**
Control	3.18	.66	3.19	.88	.05

* $p < .05$ (two-tailed)

** $p < .01$ (two-tailed)

Hypothesis 2 proposes a higher extent of controls for the Chinese sample than for the German sample. But the average level of controls is about the same in both samples (see Table 2). Therefore, Hypothesis 2 is not supported.

Hypothesis 3 predicts an inverse relationship among trust and control. The correlations of both measures reported in Table 1 indicate a negative and statistically significant relationship between trust and control only for the German sample ($r = -.35$, $p < .05$). The Chinese sample reveals a positive correlation coefficient ($r = .34$, $p < .05$), suggesting that control fosters rather than impedes trust and vice versa.

4.2 Trust, control, and business performance

The calculation of a linear regression analysis with trust and control as predictors of the co-operation's success shows that both predictors significantly contribute to the economic success of the partnership from a German point of view (see Table 3). However, the results concerning the Chinese sample do not corroborate the theoretical predictions. From a Chinese perspective, trust and control do not appear as significant predictors for the partnership's economic success in Germany.

Table 3.

Results of Regression Analysis of Trust and Control on the Co-Operation's Return on Sales^a
(by Samples)

Independent variables	Chinese sample	German sample
Trust scale	-.15	.35 *
Control scale	.06	.36 *
R	.15	.45
R ²	.02	.20
Adjusted R ²	-.05	.16
F	.33	4.80*

^a standardized regression coefficients are reported

* $p < .05$ (two-tailed)

5. Discussion

5.1 Summary

The primary purpose of our study has been to empirically test whether the embeddedness of trustors and trustees in different socio-cultural contexts promote a specific pattern of trust and control in cross-border business co-operation. We were particularly interested in finding out whether managers from individualist cultures trust and control their foreign business partners more or less than managers from collectivist cultures. Contrary to Hypothesis 1 we found that business partners from the collectivist Chinese society show a higher propensity to trust foreign

business partners than individuals from the individualist German society. A possible explanation might be that the Chinese respondents took into account the reliable and impartial functioning of the German legal and economic institutions when assessing their level of trust in their German partners.

On the other hand, German partners seem to recognize the weak institutional foundations in the Chinese business environment and do not take the protection of these institutions in the commercial disputes for granted. Therefore, the risks involved in collaboration with Chinese companies prohibit 'too much' trusting. Thus, our results challenge the taken for granted assumption that Chinese business practices emphasize the traditional sources of trust embedded in strong social relations and neglect the importance of societal institutions as safeguards against opportunistic behaviours (Child & Möllering, 2003).

Furthermore, it seems inadequate to infer from a nation's alleged societal trust (Fukuyama, 1995) the degree of displayed trust toward a foreign business partner. The concept of high-trust and low-trust countries is therefore only appropriate when it refers to characterizing the relationships *within* a society.

Another interpretation of the unexpected higher level of Chinese managers' trust holds that Chinese businessmen do not start a business co-operation until they have developed a strong trusting relationship with the potential partners. To overcome the handicap of distrusting external partners, Chinese managers may have expanded the scope of their in-groups to include foreign partners. We suggest that future studies should examine whether collectivist business partners invest more time and effort to develop trusting relationships with outsiders before cross-border business transactions start than business partners from individualist societies.

Moreover, our prediction that the Chinese partners are applying more control mechanisms than German partners (Hypothesis 2) was not corroborated. The results suggest that the control

activities of German business partners compensate for their low trust level in the Chinese partners. At the same time, Chinese partners who trust their opposite seem to pursue control activities simultaneously.

These post hoc interpretations imply different relationships between trust and control in the two cultures under study. Indeed, the sample-specific correlations indicate that trust and control are associated in the predicted way of mutual exclusiveness only in the German sample, thus confirming Hypothesis 3. However, in the Chinese sample we found a positive correlation, indicating that trust and control supplement each other. It might be argued that for Chinese managers, control guarantees trust whereas for German managers, control impedes trust.

Finally, concerning the success of cross-cultural co-operation, the linear regressions of the variables 'trust' and 'control' on the measure 'return on sales' indicate that both predictors have a significant effect in the German sample but not in the Chinese sample. This finding might reflect the different economic contexts in which the partnerships are embedded. From the perspective of German business partners, trust and control play an important role for the economic performance in a highly dynamic and unreliable business environment like the Chinese. On the other hand, the Chinese business partners' experience shows that trust and control do not constitute significant factors for business success in the highly regulated and stable German business system.

5.2 Limitations and implications for future research

Due to limited resources and the small size of the participating companies, we interviewed only one key person from each company. Therefore the subjectivity of the answers could not be controlled for. Moreover, collecting data from just one person implies that the respondent has to provide information on both the independent as well as the dependent variables which might result in a common-method bias (e.g. Avolino, Yammarino, & Bass, 1991).

Although we can, based on the answers of our German respondents, agree with the arguments that trust and controls are prerequisites for business success our study lacks ‘hard’ data about the economic success. Therefore, further research is needed to explore the influence of trust and control on economic performance of cross-border-business partnerships.

Finally, we would like to comment self-critically on the research method we applied. The questionnaire approach might have reproduced a specific understanding of trust and control which corresponds with popular theorizing but not necessarily with the respondents’ point of view. Our approach is particularly questionable if the respondents live and work in socio-cultural contexts that are different from the researchers’. We therefore call for more qualitative, in-depth approaches which take these considerations into account.

6. Conclusion

The threat of relational risk is especially prominent in international business partnerships. Partnership failure and dissolution are often a consequence of relational problems like opportunistic behaviors. Our study attempted to shed light on the ways in which business partners are coping with it. In sum, our research results suggest that in order to understand the role of trust and control in cross-border business relationships it is not enough to study the relationship per se but rather seems necessary to also look at the socio-cultural contexts from which the partnering companies and individuals originate. Therefore, future research is encouraged to examine the interdependencies of trust, control and performance in cross-border business partnerships by incorporating socio-cultural differences that exist across countries.

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Appendix

Questionnaire Items

Items were rated on a scale ranging from 1, “strongly disagree” to 5, “strongly agree”.

Trust in the partner company

The partner openly addresses problems.

The partner delivers unsatisfying quality. (R)^a

The partner is honest in financial matters.

The partner remains faithful to his word.

The partner cancels agreements. (R)

The partner fails to attain mutually agreed upon goals. (R)

The partner withholds important information. (R)

The partner fulfils his contractual obligations.

The partner does not use opportunities to profit at our expenses.

The partner protects our interests before third parties.

Control mechanisms

We monitor the partner’s behaviour through third party information.

We monitor the products’ quality and quantity.

We fix high penalties in case contract conditions are not kept.

We want the partner to confirm oral agreements by written statements.

We write down specific procedures to ensure correct operations.

We sign detailed contracts with our partner.

Cooperation’s success

Our return on sales from the co-operation is higher than in other (domestic) business activities.

^a ‘R’ indicates reverse-coding.