

# The Contextual Factors that Affect the Development of Trust at the Initial Stages of International Joint Ventures

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## **Abstract**

*The importance of International Business (IB) Systems and in particular International Joint Ventures (IJVs) has increased in recent years. Great numbers of enterprises worldwide form International Strategic Alliances (ISAs) and IJVs in order to expand internationally and gain global competitiveness. One of the most important factors that affect the success of IJVs is the notion of trust between alliance partners, as evidenced by the growing volume of published research on the subject. The objective of this paper is to present a number of propositions on the contextual factors that have an impact on trust at the initial stages of the formation of an IJV and constitutes the basis for future research where we plan to examine the importance of trust in International Joint Ventures (IJVs) that include at least one Greek business partner.*

**Keywords:** trust, enterprises, international business (IB) systems, international strategic alliances (ISAs), international joint ventures (IJVs)

## **Introduction**

An issue that has recently received a great deal of scholarly attention is the importance of trust for the success of international business (IB) systems and in particular international joint ventures (IJVs). As economies become more globalized, more and more firms are participating in foreign markets. The use of strategic alliances and joint ventures is rapidly becoming popular with a growing number of multinational firms. In the last decades, IJVs have become a favoured form of international collaboration (Anvy and Anderson, 2008) and the establishment of IJVs has become a major strategy for firms entering international markets (Ding, 1997, Duan, 2007, Dunning, 1995, Li, 2003, Meschi and Riccio, 2008, Le and Jorma, 2009). According to Hitt (1996), "a joint venture is when an independent firm is created by at least two other firms". According to Geringer and Hebert (1989), "an international joint venture is an equity based, cross border alliance that is formed by two or more legally distinct organizations that are headquartered in different countries". Deresky provides another useful description of an international joint venture:

A wide array of partnerships between business companies whose headquarters are located in different countries, and who communicate for the execution of different stages or parts of

their activities, such as joined marketing, integrated production or joined development (Deresky, 2003).

A joint venture is considered international when at least one of the partner - firms originates from a country different than the one that the venture determines as a target market (Hajidimitriou, 2003). The many definitions of IJVs presented in the literature reflect the considerable academic interest engendered by the concept and its prevalence in the fields of management, economics and law (Ballon, 1978, Kogut, 1988). In an earlier paper (Hajidimitriou and Sklavounos, 2006) we referred to the theoretical background of the construct of trust which includes a variety of definitions, forms, dimensions, sources and international differences. Moreover, in a more recent paper (Hajidimitriou and Sklavounos, 2007) we examined the various mechanisms of trust creation and presented some contemporary and distinguished examples of trust creation from the relevant international literature. The purpose of this paper is to present a number of propositions on the contextual factors that have an impact on trust at the initial stages of an IJV. These propositions will be tested empirically as hypotheses at a later stage of our research.

### **Theoretical Background**

During the last three decades, the globalization of markets, the rapid shifts in technologies, and regulatory and institutional changes all over the world, has led to new opportunities for interfirm collaboration, across institutional and national borders. Research on strategic collaboration between firms has received increasing attention in the literature in recent years, reflecting the increasing frequency and importance of strategic alliances in business practice (Hajidimitriou and Sklavounos, 2008). Two main streams, in terms of focus, in this literature can be identified. One stream is mainly concerned with examining the underlying conditions favouring alliance formation (Harrigan, 1985, Contractor and Lorange, 1988, Hennart, 1988, Oliver, 1990, Williamson, 1991). The other stream is occupied with investigating alliance outcomes and the impact of alliances on the partner firms (Kogut, 1989, Blodgett, 1992, Dussage and Garette, 1995, Doz, 1996, Nielsen, 2001). Our research aims at combining elements from these two streams of literature in an attempt to shed light on the role of trust for the success of IJVs.

Conceptually and methodologically, trust is a complex subject area. As a result of this complexity, numerous definitions of trust have been proposed in the literature, each focusing on particular aspects of a relationship. According to Sabel (1993), "trust is the mutual confidence that no party to an exchange will exploit another's vulnerabilities". Mayer et al. provide another useful description of trust:

Trust is the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party (Mayer et al., 1995).

For any strategic alliance to be formed and function, a minimum of interfirm trust must exist. In fact, as argued by Arrow (1972), "virtually every commercial transaction conducted has within itself

an element of trust". This seems certainly true for any transaction conducted over a period of time and across organizational and national boundaries, where the level of complexity makes it virtually impossible to monitor in detail all aspects of exchange. As Butler (1991) points out, the development of trust is a complex process and numerous different conditions have been identified that are antecedents to trust. In addition, the process by which trust develops is highly uncertain and can vary depending on the context of the transaction, the characteristics of the transactors and their prior experiences (Dyer, 1996). Moreover, trust is not a commodity to be bought or sold in the marketplace, but rather must be developed over time based on a series of positive experiences between individuals (Kramer and Tyler, 1996). Thus, because of the uncertainty as to the factors and processes that create trust and the extended time period over which it develops, trust may be difficult for competitors to imitate and hence represent a considerable source of competitive advantage (Jennings et al., 2000).

The degree of trust is a critical determinant of alliance performance (Boersma et al., 2003, Robson et al., 2008, Nielsen and Gudergan, 2011). Partner trust increases cooperation, improves flexibility, lowers the cost of coordination and increases knowledge transfer (Nielsen and Nielsen, 2009, Schweitzer and Gudergan, 2011). The above arguments suggest that examining the processes that foster interfirm trust is a critical issue in international business systems research. In this paper we attempt to develop a conceptual framework with testable propositions of the factors that have an impact on trust in IJVs. These factors are separated into two categories based on the stage in the IJV formation in which they occur. In this paper, we will refer to those factors that occur before the formation of the IJV. In the future we aim at discussing the factors that occur after the IJV is formed and running and the impact of trust on performance of IJVs.

### **Pre - Alliance Formation Factors**

Pre - alliance formation factors refer to variables pertaining to the time before the alliance is formed and during the design and implementation stages of an alliance. In other words, they refer to the partner selection process. First of all, Reputation refers, to the knowledge held by individuals about the potential partner in terms of this partner's behaviour in prior network relationships in addition to more traditional attributes of reputation, such as innovativeness, quality of management, employee talent, financial soundness, use of corporate assets, social responsibility, quality of product / services etc. The concept of reputation is closely related to the concept of integrity, as presented by Mayer et al. (1995), since among the biggest concerns of firms entering into alliances is the predictability of their partner's behaviour. Among the biggest concerns of firms entering into alliances is the predictability of their partner's behaviour. In lack of prior experience with a particular partner, the next logical step is to rely on the reputation of that firm, which is a direct consequence of prior relational behaviour (Granovetter, 1985). Research suggests that most firms are embedded in a social network of prior alliances through which they are connected with one another either directly or indirectly (Kogut et al., 1993). Within a dense social network, reputational considerations play an important role in a firm's potential for future alliances, because these social affiliations determine the firm's perceived status and serve as a source of legitimacy. Hence, as argued by Granovetter (1985), "Social

relations, rather than institutionalized arrangements or generalized morality, are mainly responsible for the production of trust in economic life". This is especially true for firms entering new markets or industries or collaborating across organizational and national boundaries, where affiliation with a known firm might signal quality and trustworthiness and thereby serve as a foundation for a favourable evaluation by a potential partner.

The formation of strategic alliances and IJVs, as stated earlier, provides a way for gaining a competitive advantage. A favourable reputation can be a major factor in achieving a competitive advantage through differentiation and also contributes to a defensible position because of the time involved in its growth (Hall, 1992). While the development of trust between alliance partners is a slow process, it can be destroyed very easily (Fukuyama, 1995). A firm with a reputation of being honest, fair, and trustworthy gives one the first piece of evidence to take some initial risk (Barney and Hansen, 1994). Similarly, Saxton (1997) found reputation to be significantly positively related to alliance outcome in his study of dyads.

Alternatively, once a firm has acquired a reputation for not being trustworthy in collaborative relationships or in general, future partners will perceive this firm as a greater liability in terms of interfirm collaboration. According to Lu and Ma (2008), business groups are arguably more concerned than independent firms about the downside effect on their reputation associated with the dissolution of their IJVs. To maintain a favourable public image, groups may hesitate to terminate non - performing IJVs. Lu and Beamish (2006) also concluded that large firms are arguably more concerned than small and medium enterprises about the downside effect on their reputation associated with the dissolution of their IJVs. To maintain favourable public image, large firms may hesitate to terminate unprofitable subsidiaries. This is consistent with the empirical finding of Kollock (1994) that reputation and trust are correlated and that ongoing interaction can lead to an increase in trust. Reputation is also considered essential in many definitions of trust (Butler and Cantrell, 1984, Luhmann, 1988, Kramer and Tyler, 1996). Hence, we suggest that the historical trustworthiness of parties in previous interaction with others is important, and that it is the social context (e.g. networks) that makes reputational effects possible. Therefore, locating a partner with a good reputation seems to be an effective and logical starting point for building trust.

*Proposition 1: A favourable reputation is positively related to the development of trust in the context of IJVs*

The extent of transparency between the individuals structuring an international strategic alliance can certainly influence trust (Burt and Knez, 1996, Gabarro, 1978). According to Hamel (1991), transparency is the openness and willingness of the partner firm to share its embedded knowledge. In other words, openness refers to the extent to which individuals express ideas openly and freely. Open and honest communication at the outset of any relationship is important and in terms of forming a complex business relationship even more so. Formation of an alliance involves a search and identification process in order to find the right partner, where differences and complementarities need to be recognized and articulated. Different perspectives and expectations do not necessarily lead to conflict and subsequent poor performance, however, the probability of this occurring is, all other things being equal, higher when there is a lack of transparency between the parties involved (Jennings et al.,

2000). Having an awareness that alliance partners are different and being sensitive to these differences are important factors in building trust (Barber, 1983, Howarth, et al., 1995).

The empirical data of the research of Sazali et al.(2009) provide significant evidence that relationship characteristics, in terms of frequent and effective interactions, multiple individual exchanges, productive and adequacy of interaction, and intimacy of relationship, are more likely to contribute to an increase of a) relationship openness / transparency that reduces partner protectiveness, b) opportunity to learn, share and access to both IJV partners strategic knowledge and competencies, c) resource commitments in IJV, and d) mutual trust between IJV partners. The positive link between openness and trust is obvious from the above empirical results. Whereas openness can be argued to be beneficial at all times in interfirm relations, it is especially important in the pre - alliance formation stage because this is where the foundation (both formally through contracting and informally through social perceptions) for the relationship is laid. Hence, we suggest that openness between managers involved in the pre - alliance formation process can strongly influence the building of trust:

*Proposition 2: Transparency - Openness is positively related to the development of trust in the context of IJVs.*

In international business systems, cultural differences produce additional difficulties, which have been well documented in the literature (Mjoen and Tallman, 1997). Culture has been studied by an increasing number of writers on management, negotiation and marketing (Hall 1959, Hofstede 1980, Nes et al., 2007, Solberg, 2007). There are many researchers who explore the influence of cultural distance between partners on trust level (Brouthers and Bamossy, 2006, Lu, 2007, Makino et al., 2007, Mahmoudi et al., 2011). Culture is the homogeneity of characteristics that separates one human group from another (Hofstede, 1980, Asai and Lucca 1988, Clark, 1990). Some academic researches suggest that cultural distance has no significant moderator effect on trust structure (Zhang et al., 2003) while some assert that culture may hinder the ability to effectively standardize the process of relationship development strategies (Griffith et al., 2000, Kogut and Singh, 1988). Luo (2002) provides evidence that cultural distance is not a moderator affecting the influence of trust on performance but instead shapes the development of organizational trust.

Killing (1983) found that IJVs, where one partner is from a developing country and the other from a developed country, are more likely to lead to decision impasses due to divergent attitudes. Furthermore, Beamish (1985) showed that such international joint ventures have a higher rate of failure than those formed between two firms both originating in developed countries. In fact, as argued by Meschi (1997), most problems encountered in international joint ventures can be traced back to cultural factors. Lyles and Salk (1996) report that not only conflicts but also cultural misunderstandings rooted in cultural differences can minimize flows of information and learning. Hence, the partner's national or organizational culture has the potential to affect in depth all aspects of the collaboration, including the development of trust. Wai-Kit et al. (2007) in their research of investigating the antecedents of trust in Chinese IJVs, discovered that cultural distance, among other variables such as local reliance and experience of executives, is an important antecedent of trust which affects

performance of IJVs. Moreover, Nes et al. (2007) found that cultural distance impacts negatively on interfirm communication and trust.

Similarly, Mowery et al. (1996) found that distance and cultural differences were key obstacles to interfirm collaboration for U.S. firms engaged in international alliances compared to firms engaged in domestic alliances. Moreover, cultural asymmetry can sometimes lead to an unbalanced situation between partners in their attempt to decode, transfer, and interpret knowledge (Hamel, 1991). Thus, language, cultural heritage, and alignment play a key role in creating difficulties for identifying market opportunities and raises barriers to communication between partners. Moreover, trust in international joint ventures is closely related to norms and values because it involves an investment in a social relationship, which might potentially be damaging to economic performance. Hence, the extent to which partners have beliefs in common about what behaviours, goals, and policies are important or unimportant, appropriate or inappropriate will influence the level and speed of trust development (Dwyer et al., 1987). Luo (2002) also found that cultural distance impedes initial trust development and his finding corroborates the notion in the international strategic alliance literature that cultural barriers obstruct initial trust building (Doney et al., 1998, Inkpen and Currall, 1997, Parkhe, 1993). Reus and Rottig (2009) focus specifically on the roles of cultural distance, hierarchical control, partner conflict, and commitment in determining IJV performance. Their results indicate that cultural distance between partners of IJVs tends to increase the likelihood of conflict, which, in turn, adversely affects trust building and performance of IJVs. To sum up, misinterpretations due to cultural distance or the lack of cross - cultural understanding for a partner are likely to impair the development of trust in IJVs, suggesting that:

*Proposition 3: Cultural distance is negatively related to the development of trust in the context of IJVs.*

### **Conclusions and objectives for further research**

The purpose of this paper is to present a number of propositions on the contextual factors that have an impact on trust at the initial stages of an international joint venture. The first section is concerned with the conceptualization of trust and international joint ventures and their theoretical background with a variety of definitions. The main section contains the first stage of our theoretical framework and refers to the pre - alliance formation factors which are the variables that affect trust building during the design and implementation stages of an international joint venture. The first 3 propositions of our research are presented and discussed. We conclude that transparency - openness between managers involved in the pre - alliance formation process as well as a favourable reputation of a business partner are positively related to trust in the context of IJVs. On the other hand, we conclude that the cultural distance between IJV partners impedes initial trust development and therefore is negatively related to trust building in the context of IJVs.

As far as further research is concerned, we aim at discussing the factors that affect trust after the IJV is formed and running as well as the impact of trust on performance of international joint ventures. The propositions that we present will be tested empirically as hypotheses in the future. Our main research objective is to

empirically examine the concept of trust and its role in IJVs that include at least one Greek business partner. We plan to construct a conceptual model of trust with variables at 2 phases (during the design and implementation stages of an IJV and after the IJV is formed and running). We intend to investigate these issues by constructing an appropriate questionnaire which will be sent to managers of Greek companies that have formed IJVs in recent years. The results of the questionnaires will be statistically analysed using the appropriate statistical methods. The questionnaire survey will be followed by interviews with Greek managers involved in international joint ventures. Any possible findings would certainly constitute a valuable addition in the international literature about the complex concept of trust. This paper constitutes the basis for such future research and we believe that it contributes to the conceptualization of trust and constitutes a valuable addition that emphasizes even more the important role of trust in the context of international business.

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