



## **Small and medium-sized enterprise co-operation: The influence of trust on structure and performance**

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## ABSTRACT

THE OMISSION OF SOCIAL FACTORS HAS LEFT A SIGNIFICANT GAP IN THE PREDICTIVE AND EXPLANATORY POWER OF CO-OPERATION THEORY. AS A RESULT, EXISTING THEORY FAILS TO EXPLAIN THE STRUCTURE OF SOME CO-OPERATIVE AGREEMENTS. THE IDENTIFIED GAP IS PARTICULARLY EVIDENT IN THE CONTEXT OF SMALL AND MEDIUM-SIZED ENTERPRISES (SMES). AS A GUARD AGAINST OPPORTUNISM, LARGER ENTERPRISES RELY ON A HARD, FORMAL, DETERRENT-DOMINATED GOVERNANCE DESIGN. IF FIRMS CANNOT IMPLEMENT THE REQUIRED SAFEGUARDS THEN CO-OPERATION IS NOT RECOMMENDABLE. INSTEAD, MARKET-BASED TRANSACTIONS OR HIERARCHICAL STRUCTURES (INTEGRATION) SHOULD BE EMPLOYED. SMES, HOWEVER, OFTEN DO NOT HAVE THE RESOURCES TO PROTECT THEMSELVES ADEQUATELY AGAINST OPPORTUNISTIC ACTIONS OR MODERATE PROFIT EXPECTATIONS DO NOT JUSTIFY ELABORATE SAFEGUARDS. IT IS FOR THIS REASON THAT CO-OPERATION THEORY PREDICTS THE UTILIZATION OF MARKET STRUCTURES IN AN SME CONTEXT. BUT HOW CAN WE EXPLAIN THE PHENOMENON OF CO-OPERATING SMES? THE ANSWER MUST BE EITHER THAT FIRMS TAKE UNJUSTIFIABLE RISKS OR THAT FIRMS UTILIZE A DIFFERENT MECHANISM TO MAKE CO-OPERATION OPTIMAL.

THE PRESENT STUDY FOCUSES ON THE INADEQUATE EXPLANATIONS FOR SME CO-OPERATIVE AGREEMENTS AND INVESTIGATES THE ROLE OF TRUST IN THESE. A GENERAL MODEL OF CO-OPERATION STRUCTURING EXPLAINS THE IMPACT OF TRUST ON (1) THE ESTABLISHMENT OF SAFEGUARDS, (2) THE CHOICE OF TRANSACTION STRUCTURE, AND (3) THE PERFORMANCE OF THE CO-OPERATIVE RELATIONSHIP. THE STUDY ARGUES THAT FIRMS UTILIZE TRUST AS AN ALTERNATIVE TO SAFEGUARDS AND THAT TRUST-BASED RELATIONSHIPS ARE MORE SUCCESSFUL THAN DETERRENT-BASED AGREEMENTS. THE VALIDITY OF THE MODEL WAS TESTED WITH DATA FROM 191 SMES. FINDINGS GENERALLY SUPPORTED THE MODEL AND HYPOTHESES, SUGGESTING THAT TRUST CAN INITIATE CO-OPERATION AND POSITIVELY INFLUENCES PERFORMANCE.

THE STUDY HAS IMPLICATIONS FOR FIRMS AND SCHOLARS. TRUST IS MORE THAN A 'SECOND-BEST' ALTERNATIVE TO SAFEGUARDS. CO-OPERATIVE ARRANGEMENTS THAT ARE TRUST BASED PERFORM BETTER THAN DETERRENT-BASED RELATIONSHIPS. THIS RESULT IS ENCOURAGING AS IT SUGGESTS THAT WELL PERFORMING RELATIONSHIPS CAN BE DIFFERENTIATED FROM LOW PERFORMERS ON THE BASIS OF MUTUAL TRUST. MORE BROADLY, IT POINTS TO PROMISING RESEARCH ON THE IMPACT OF TRUST ON THE FORMATION, PERFORMANCE, AND DISSOLUTION OF ALLIANCES. NORMATIVELY, THE FINDINGS SUGGEST THAT *EX ANTE* MANAGERIAL APPRECIATION OF TRUST MAY INCREASE PERFORMANCE LEVELS. ON A PRACTICAL LEVEL, THIS MEANS THAT SMES SHOULD FOCUS THEIR ATTENTION ON TRUST-BUILDING PROCEDURES DURING THE DESIGN, IMPLEMENTATION AND EXECUTION STAGE OF AN ALLIANCE. FOR EXAMPLE ASSET-SPECIFIC INVESTMENTS, CLEAR COMMUNICATION CHANNELS, FEEDBACK PROCEDURES, AND SIGNALING SYSTEMS BETWEEN PARTNERS WILL INCREASE TRUST AND STRENGTHEN THE CO-OPERATION. THE SAYING 'IT IS GOOD TO TRUST BUT IT IS BETTER NOT TO TRUST' SHOULD THEREFORE NOT BE THE GUIDING PRINCIPLE OF MANAGERS WHO WISH TO CO-OPERATE.