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## THE DEVELOPMENT OF ORGANIZATIONAL TRUST IN THE CHINESE BUSINESS CONTEXT

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**WP 34/2000**

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## ABSTRACT

A consensus has been reached about the necessity for a dynamic theory of trust and its application to organizational processes. This paper contributes to the conceptual and empirical understanding of organizational trust. It reconciles managerial and sociological perspectives on trust development, yielding a pluralistic conceptual framework. It then applies and enriches the framework through the empirical analysis of the constitution and creation of trust in the modernizing Chinese business context as experienced by firms managing from across the border in Hong Kong.

Despite the ostensible cultural affinity between China and Hong Kong, it was found that managers in Hong Kong firms could not rely on traditional foundations for trusting in their China units. Moreover, the traditional means of coping with unreliable institutional provision, namely direct personal contact with government officials, was not effective in generating trust in local personnel. It was the contextual system itself rather than personal contacts with the people administering it that either facilitated or inhibited the development of trust in local staff. Institutional foundations in fact provided a sounder support for organizational trust. The more that manager perceived they could rely on the institutional system rather than having to depend on officials, the greater tended to be their trust in local staff. In addition, a trust-conscious management could actively generate trust in its cross-border units through policies that enhanced personal rapport with local staff and introduced an internal institutionalization of organizational practice. These initiatives appear to be valuable ways of developing trust within organizations, particularly in an environment such as that of contemporary

China, where both traditional and institutional foundations may not be readily available to foreign managers. The positive correlation of trust within organizational performance adds an incentive for managers to explore these initiatives.

### **BIOGRAPHICAL NOTE**

John Child holds the Chair of Commerce in the University of Birmingham. He is a Senior Research Associate at the Judge Institute of Management Studies and a Visiting Professor at the School of Business, University of Hong Kong. His interests are foreign investment and management in China, new organizational forms and organizational learning.

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## I. CONCEPTUAL INTRODUCTION

### *Perspectives on Trust Development*

The objective of this paper is a refined conceptual and empirical understanding of organizational trust. In this first part, we reconcile managerial and sociological perspectives on trust development, yielding a pluralistic conceptual framework. Subsequent parts of the paper will build on and enrich this through the empirical analysis of the constitution and creation of trust in the modernizing Chinese business context as experienced within Mainland China by firms managing from across the border in Hong Kong.

Trust research continues to lack coherence, but it seems fair to assume that a consensus has been reached regarding the necessity of a dynamic conceptualization of trust (as noted by the editors of various relevant collections, e.g. Smith *et al.* 1995, Tyler and Kramer 1996, Lane 1998, Rousseau *et al.* 1998). Trust evolves over time in personal, organizational and societal relationships. For heuristic and analytical purposes it has been useful and common to distinguish different types of trust in order to account for the dynamics. Within the management-oriented organization literature, the model presented by Lewicki and Bunker (1996) for work relationships, based on Shapiro *et al.* (1992) and applied to inter-organizational relations by the first author (Child 1998), is a representative example of the plausible view that early on in organizational relations trust tends to be very calculative and reliant on rewards and deterrence, then becomes more mutual and resilient as the deepening knowledge about the other fosters predictability and understanding; then finally – if all goes well – trust leads to an almost complete identification with the other so that desires and intentions are fully integrated and habitually accounted for. Typical management mechanisms that would characterize each phase are: contracts and controls for “calculus-based trust”; intensive communication and courtship for “knowledge-based trust”; proxy representation and social bonding for “identification-based trust”.

The more sociological and historical literature on the development of trust would argue that the Lewicki and Bunker model reflects the state of highly modernized societies in which it is fair to assume that most relationships within and between work organizations have to be built between potentially opportunistic strangers. Therefore recourse to institutional safeguards is needed in the beginning, mutual knowledge takes time to develop, and the other's values and intentions cannot be taken for granted as similar to one's own. By contrast, Zucker (1986) argues in her study of the American economic structure 1840-1920 that, traditionally, trust is first of all "process-based" and therefore reliant on rich information on prior exchanges with others. Thus it is difficult to transfer and resembles "identification-based trust" with regard to the kind of knowledge required. Zucker's second mode of trust is "characteristics-based trust" which is quite freely available and rests on the recognition of social similarity such as ethnicity. It becomes important when exchanges shall occur between parties who can have direct contact but who may not have prior experience with each other. This means that familiar, trustworthy characteristics need to be communicated: one needs to get to know the other (cf. "knowledge-based trust"). Finally, Zucker's "institutional-based trust" draws on extrinsic protection and legitimation in the same way that Lewicki and Bunker's "calculus-based trust" rests on deterrence (and rewards). This form of trust becomes crucial in highly modernized economies and societies where the parties in an exchange or a transactional relationship remain largely anonymous, possibly separated in time and space, but committed to the same institutional framework.

The "institutionalization" of trust bases observed by Zucker (1986) has been the underlying theme of many other sociological studies, see for example Misztal's (1996) comprehensive overview and Giddens' (1990, 1991, 1994a, 1994b) various contributions on the notion of trust in the transformation from traditional to modern and late-modern societies. Before analyzing the nature and foundations of trust further, we note that the sociological narrative

(Zucker; Giddens) and the management model (Lewicki and Bunker; Child) can be reconciled. They highlight seemingly opposing but practically complementary forces. In other words, the institutionalization of trust overall is met with a tendency to deinstitutionalize trust in ongoing relationships. Similarly, Giddens (1990) describes both “*disembedding*” and “*re-embedding*” mechanisms in his analysis of late modernity. The possibility of both becomes interesting when remembering Eisenstadt and Roniger’s (1984, pp. 294-301) view that trust can also serve to avoid or subvert institutions.

### ***Towards a Conceptual Framework for Trust***

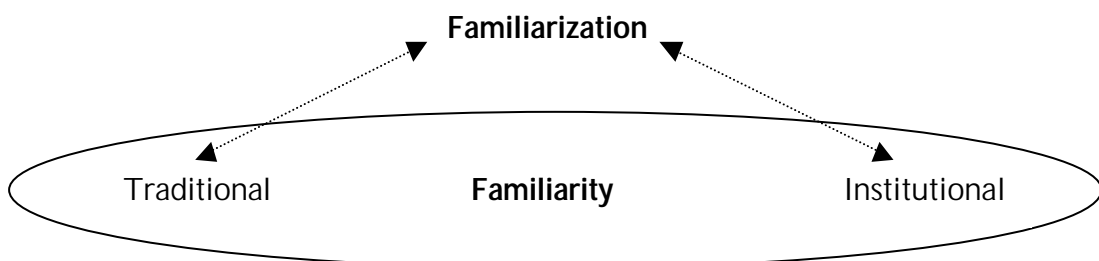
Discussing the dynamic bases of trust appeals to organization researchers, because in this area practical interventions – producing, organizing trust – appear most likely to be fruitful. Yet we must not neglect the peculiar *nature* of trust. The various foundations of trust, whether more or less calculative, more or less institutionalized, represent forms of *knowledge* (understanding) from which trust is supposed to spring. However, an equally defining characteristic of trust is the capacity of dealing with *ignorance*. Simmel identified this further element in trust, which he saw as being “both less and more than knowledge” (1990, p. 179), locating trust overall “between knowledge and ignorance” (1950, p. 318). Giddens’ definition of trust incorporates this explicitly when he states that trust is “made on the basis of a “leap into faith” which brackets ignorance or lack of information” (1991, p. 244; see also Möllering 2001). It is in this respect that the common claim that trust is inherently risky (Luhmann 1979) should be understood. Therefore, to speak of trust means to acknowledge the need for *suspension* (Möllering 2001), enabling an ultimately unfounded leap of faith over and above any kind of foundation for trust.

For the purposes of this paper we conceptualize as *familiarity* the diverse knowledge and understanding which serves as the foundation from which trust occurs most naturally. Primarily, the term familiarity concerns the extent to which people recognize their life-world including (but not restricted to)

other people. As Luhmann says: “Familiarity is an unavoidable fact of life ... [and] trust has to be achieved within a familiar world” (1988, p. 95). Familiarity *per se* connotes ontological continuity and security (see Luhmann 1979 and also Giddens 1984, 1990). However, the notion of familiarity also implies the *unfamiliar* as the opposite side of the distinction. From within the familiar world, though, the unfamiliar can be reintroduced into the familiar (Luhmann 1988, pp. 95-97). This activity of creating familiarity can also be called *familiarization*. Having borrowed from phenomenology here already, the principles of structuration theory (Giddens 1984) can be useful in further conceptualizing familiarity and familiarization as a duality: each is unthinkable without the other. Therefore, trust can also be achieved in relatively unfamiliar circumstances but will then either rest on weak foundations or involve the gradual building-up of such foundation. As a consequence, the leap of faith will be harder, but not impossible, in such unfamiliar contexts.

Figure 1 illustrates the duality of familiarity and familiarization as described above. It also introduces a continuum between *traditional familiarity* and *institutional familiarity*, which will be discussed shortly. The two bi-directional arrows in the exhibit add to the notion of duality the idea that, through familiarization, traditional familiarity may enable institutional familiarity and vice versa.

**Figure 1. The Duality of Familiarity and Familiarization**



The distinction between traditional and institutional familiarity takes this discussion back to the dynamics of trust development. Familiarity is a broad



concept and the continuum between tradition and institution should be seen as an analytical tool. More or less traditional and more or less institutional elements of familiarity – each placed either more to one side or the other of the continuum – are likely to co-exist, but their relative importance may be variable over time and across relationships. Take, for example, the concept of *competence*, which numerous authors have identified as a basis for trust (e.g. Barber 1983, Sako 1992). It represents *traditional* familiarity, if it is induced from prior observation. The example here is the nineteenth century carpenter who trusts the owner of a sawmill because they (and perhaps their ancestors before them) have always traded competently with each other. This contrasts with today's manufacturers who might insist that all their suppliers become ISO certified, ISO being an element of *institutional* familiarity from which competence can be deduced. Obviously, the historicity implied in this example may be misleading. Traditional familiarity as a foundation for trust has by no means become obsolete. It may still be seen as the more "natural" type of familiarity which, however, cannot always be available or sufficient.

**Table 1. Types of Familiarity, Trust and their Characteristics**

	<b>Traditional Familiarity</b>	<b>Institutional Familiarity</b>	<b>Familiarization</b>
Reference	Local	Global	Individual
Validity	Specific	Generic	Uncertain
Method	Inductive	Deductive	Experimental
Perceived Risk	Low	Low	High
Leap of Faith	Habitual	Habitual	Active
	↓	↓	↓
Heuristic Types	<b>Traditional Trust</b>	<b>Institutional Trust</b>	<b>Active Trust</b>

Table 1 sets out the distinction between traditional and institutional familiarity according to more general characteristics than the above example

on competence. We hope that this conceptual framework is fairly self-explanatory. *Reference* means the context in which familiarity is constituted. *Validity* concerns the spectrum of targets for which elements of familiarity may be trust-inducing. *Method* refers to the idea that different modes of logic exist whereby the paths from familiarity to trust can be described. Finally, but importantly, the last two characteristics concern the magnitude of the unaccounted *risk perceived* and the effort required for the *leap of faith* which, as argued above, are always a part of trust.

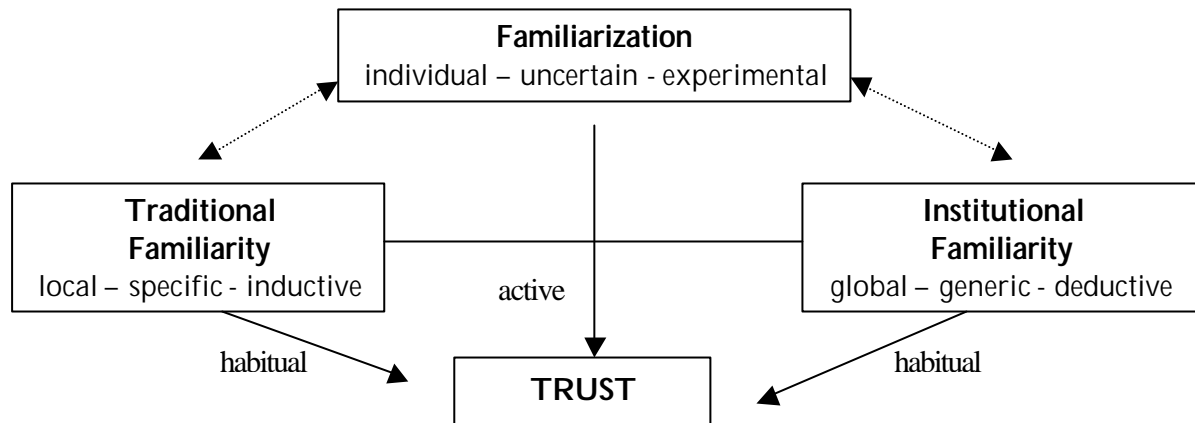
Corresponding to the two types of familiarity, we distinguish two types of trust: traditional trust and institutional trust. They differ fundamentally with regard to reference, validity and method, but share the characteristics of being achieved with a low perception of risk and a habitual leap of faith (see Giddens 1990, p. 90). When people can extrapolate from past experience or take the protection of institutions for granted, trust occurs at a low level of consciousness: the remaining risk and the leap of faith are hardly noticed. However, familiarity of either type may be problematic and, referring to Figure 1 again, this is when *familiarization* becomes crucial beyond its generally assumed duality with familiarity. Thus, according to the last column in Table 1, familiarization possesses altogether different characteristics compared to traditional and institutional familiarity. The point of *reference* is (the) individual; in how far the familiarity is created is *valid* for trust has to be uncertain; and the *method* is essentially experimental (although not random thanks to the duality with familiarity). Consequentially, trust that depends heavily on familiarization rather than familiarity involves a high perceived risk on the part of the trustor as well as a strong "operation of the will" (Luhmann 1979, p. 32), i.e. an active leap of faith. This conceptualization draws on and adopts the notion of *active trust* used explicitly by Giddens (1994b, pp. 186-187). Giddens sees active trust as typical for late modernity where highly globalized societies make both traditional and institutional familiarity increasingly unavailable unless people actively create them reflexively in their own (limited) social circles. We would expect that the resulting "traditions"

and “institutions” are thus rather micro-sopic compared to genealogical embeddedness and macro-mechanisms such as banking systems and state legislation.

In this paper, we use traditional, institutional and active trust as three equal and ahistorical heuristic types that describe different modes of reaching trust. This allows a pluralistic perspective on the dynamics of trust. In other words, trust phases can be described by the relative importance of the three modes. For instance, a subsidiary may initially be trusted mainly because of prior experience with the company and/or similar subsidiaries over many years; or mainly on institutional grounds because the subsidiary is bound by enforceable contracts; or it may be mainly active trust because the foundation for trust is the fact that short but intensive negotiations were conducted in apparent “good faith” and were fruitful. Over time, each type of trust may rise or decline in importance compared to others. The subsidiary may start behaving oddly; contracts may never be referred to; familiarization can become more passive.

Thus the three heuristic “paths to trust” used in this paper are designed to reflect broad economic and sociological themes by highlighting tradition, institutions and agency. At the same time, they reflect organizational concerns, sensitizing for a variety of modes of which the most managerial one, namely active trust, may not be the most attractive. Anyhow, to insist that all types of trust involve unaccounted risk and thus a leap of faith is to challenge overly control-focused concepts of trust. This raises questions as to how *trust-conscious management* (“managing with a leap of faith”) can be imagined. We will therefore elaborate on the notion of *active trust* and aim to contribute a better understanding of trust and management in organizational contexts that are characterized by a lack of familiarity. We have already introduced the conceptual tools we propose to use (Figure 1 and Table 1); these can be summarized as follows (Figure 2).

Figure 2. Conceptual Framework



## II. THE MODERNIZING CHINESE BUSINESS CONTEXT

Assuming and accepting for the time being that trust is generally desirable for organizational relations (see Gambetta 1988, Kern 1998 or Wicks *et al.* 1999 for a cautionary note in this regard), social scientists and managers alike will be interested in how it is achieved in practice. Our empirical focus in this article will be the context of managing business in Mainland China from Hong Kong. Previous studies (Child 1994, Fukuyama 1995, Child 1998) have already pointed towards distinct features of Chinese society with regard to trust and in the light of the transformation from the Maoist system.

It could be argued that trust in Chinese society today is still constituted predominantly through traditional familiarity – as it has been historically with the considerable importance of kinship relations and also the local community based on Confucian values. However, we cannot be satisfied with the simple conclusion that China is only at a relatively early stage of modernization and that familiar institutions which could provide the basis for more generalized trust are *not yet* in place. This would ignore the particular difficulties China has experienced with regard to the institutionalization of legal norms and the administrative system. Its low levels of institutional-based trust have their roots in the capriciousness of China's imperial and post-imperial rule, the

chaos and exploitation which accompanied periodic breakdowns of political and social order, and the lack of clear civil rights (including those of private property). As Fukuyama (1995, p. 87) notes:

“In traditional China, there were no established property rights. Through much of Chinese history, taxation was highly arbitrary; the state subcontracted tax collection to local officials or tax farmers, who were free to set the level of taxation at whatever the local population could endure. Peasants could also be drafted arbitrarily for military duty or to work on public works projects.”

Even today, despite continued legal reform since 1979 that has begun to evolve a distinct body of legal rules and institutions, evidence suggests that the law in China remains “a tool of state administration and always within close reach of the Chinese Communist Party” (Lubman 1995, p. 2). The impossibility for many Chinese organizations to reach trust-enabling familiarity with institutions and their representatives (“access points”, Giddens 1990) is due to almost pathological levels of inconsistency, arbitrariness and corruption on the part of officials. The problem has been recognized at the highest level: former premier Li Peng stated that the struggle against corruption “is a matter of life and death for the nation” (quoted by McDonald 1995, p. 175). In turn this explains the absence of strong institutional bases for trust *between organizations* in China. For example, the signing of a formal contract (ostensibly institutionally protected and enforceable) does not guarantee the end of uncertainty or even the conclusion of negotiation as the law is always open to interpretation, thus increasing the temptation to act opportunistically.

In this context, the Confucian injunction to place loyalty to one’s family (especially the father) above that to society is not so surprising – Confucius was himself writing at a time of great institutional instability. The

combination of low institutional trust with the emphasis that Confucianism placed on filial loyalty and kinship relations has led to the family, and to a lesser extent friends, becoming the primary locus of trust and protection against outside threat. Note, though, that the family as an institution cannot rely on comprehensive legal protection either. Relationships rather than rules are seen to offer assurance. Redding (1990, p. 66) describes the localized and specific nature of traditional trust in China, and how it develops inductively through direct experience:

“The key feature [of trust in Chinese society] would appear to be that you trust your family absolutely, your friends and acquaintances to the degree that mutual dependence has been established and face invested in them. With everybody else you make no assumptions about their goodwill ... To know your own motives well is, for the Chinese more than most, a warning about everybody else’s.”

Traditional, specific trust-based relationships in China fall into two categories, and the basis for the trust is somewhat different within each of these categories. The first comprises the extended family, and to a lesser degree relationships stemming from a common formative experience in hometown and school, all of which provide for group loyalty and shared identity. This trust is based upon blood and upbringing, and it often takes on fief-like qualities. The foundations of trust within these close social units are those of identification and affect. The Chinese family business, which culturally is the typical economic unit, exemplifies this form of trust-based governance of economic activity (Redding 1990).

As Redding goes on to note, connections between family and other groups with which there is shared social identity are necessary for their survival, or indeed prosperity. These connections become strongly bonded through special connections, and they provide the basis on which social networks develop.

Networks constitute the second category of traditional Chinese trust-based relationship. These networks can sometimes be quite extensive, taking on clan-like qualities (Boisot and Child 1996). Trust within Chinese networks is based on what the Chinese know as *guanxi*. Guanxi refers to the credit which a person or a group has with others, based on the giving of assistance or favours, or deriving from personal recommendations. It is significant within work units, and even more so for the development of inter-organizational relations in which the actors have no other foundation on which to establish trust in a society where institutional guarantees and protection are weak. There is a risk involved in offering the favours through which it is hoped to build up *guanxi*, and trust within Chinese networks therefore has an important basis in calculus. The main guarantee against lack of reciprocity lies in the strong social norms by which the acceptance of favours places an obligation upon the recipient.

China, according to this analysis, is a *modernizing*, but not yet modern, economy and society in which trust in business relations will continue for some time to be based on kinship and the special "institution" of *guanxi* (Traditional Trust), rather than on a comprehensive institutional system that individuals and organizations find familiar and reliable (Institutional Trust). To leave the analysis at this point, however, would be neither theoretically complete nor useful for organizational policy. For the conceptual understanding of trust offered above has been deterministic insofar as it claims that trust will be based habitually on the type of familiarity (traditional or institutional) that is readily available. Familiarity, however, is also continuously created and re-created, and this is of particular significance to the managers of organizations located within the Chinese environment.

Organizational managers have certain possibilities to foster trust in the Chinese and other environments. Familiarization, and the *active trust* that results, offer an alternative path to trust development. From this perspective, the relevant questions are: how can a Chinese organization enter into

relationships outside the circles of kinship and *guanxi* despite the lack of familiar, trustworthy institutions; and how can a foreign organization lacking *both* traditional and institutional familiarity build any trust in Chinese partners and staff at all?

### III. IMPLICATIONS FOR CROSS-BORDER MANAGEMENT

Unless we want to assume that the phenomenal levels of Foreign Direct Investment (FDI) into China have been reached without any concern for trust in the partners involved, the focus of our analysis has to shift to the notions of familiarization and active trust. As indicated in Figure 1 and Table 1, these concern the individual, uncertain and experimental ways in which foreign companies have sought to build trust in Chinese partners in a context where they cannot draw on traditional or institutional familiarity. At the same time, it should be noted that this active managerial alternative to the habitual types of familiarity-based trust involves a considerable leap of faith. Active trust is psychologically demanding. Because it depends heavily on individuals rather than socially-embedded traditional or institutional foundations, it is always liable to be rather tentative in nature and thus carries a high risk of failure.

Broadly speaking, “strategies” of familiarization can be distinguished with reference to the traditional-institutional dimension shown in Figure 1. One strategy could be targeted at getting to know local partners personally and establishing rapport, thereby producing traditional familiarity. Another strategy could aim to create institutional familiarity by, for example, explaining to potential partners the formal arrangements that have been chosen for other partnerships and which might form a template for the new relationship.

The first strategy is to establish personal rapport with local partners and staff in an endeavour to generate traditional familiarity. It attempts to absorb the



uncertainty generated by the low level of institutional trust in the Chinese context by giving primacy to establishing a system of personal relationships both within and outside the business venture. These relationships are expected to offer relevant information, advice and support from the external environment. It may take some time to develop such relationships, requiring as it does the development of both mutual cognition (knowledge and understanding) and normative identification as supports for trust between the parties.

Chinese criteria of cultural acceptability suggest that this approach could lay a basis for inter-unit trust between non-Mainland managers and local Chinese personnel. This judgment is consistent with the findings of research into joint ventures in other developing countries that have a low institutional support for trust (Beamish 1988). The factors likely to provide a foundation for building up trust based on personal goodwill include efforts to get to know local Chinese managers and staff on a personal basis, and a sufficiently long period of operation in China. In the case of Hong Kong companies, location of their Mainland units in the culturally more contiguous province of Guangdong may also be a positive factor in this regard. Nevertheless, in view of the defensive preservation of boundaries around clusters of relationship-based trust in China, the question remains whether out-group managers can effectively cross these boundaries and establish mutual personal trust on a sound and valid basis.

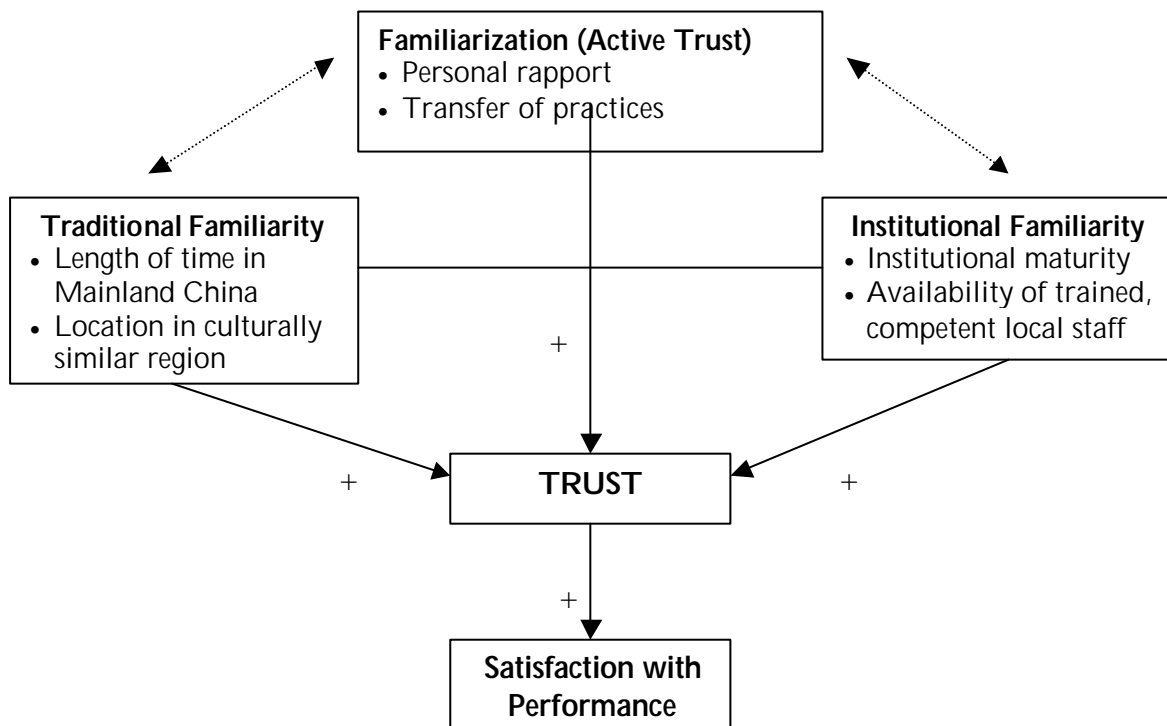
The alternative policy sees a company attempting to substitute its own "micro" institutionalization for the lack of contextual institutional trust, through importing its own familiar practices, rules and standards into its China operations. The transfer to China of standardized practices (accounting, quality, production, HRM, and so forth) is intended to generate some predictability in the conduct of local Chinese personnel. Equally, strong control over personnel selection should permit the recruitment of employees who, by virtue of features such as youth and rural background, are

“untainted” by Chinese organizational norms and who are therefore not so likely to resist the transferred practices. A foreign management may seek to support this policy through selecting people who possess attested qualifications and competencies. The steady development of China’s education and training systems is in this respect an important institutional development that is enhancing the availability of trained and competent local personnel (Child and Tse 2001). Subsequent to recruitment, appropriate training and reward systems are further micro institutional policies that enhance confidence in the ability and motivation of local staff, which in turn generates trust in them. This approach has been advocated quite strongly by western consultants (e.g. Meier *et al.* 1995).

Figure 3 draws together the main threads of the argument so far. It distinguishes between traditional and institutional foundations of trust. Traditional trust gives rise to an assurance about the intentions of other people based on the quality of relationships with them. Institutional trust provides some assurance about the validity of rules and standards in areas such as the certified training of personnel, and confidence in the prevailing system of legal protection. In the absence of sufficient trust of either type, as is usually the situation facing the managers of foreign-investing firms in China, we have noted the possibility that they may be able to generate confidence and trust in their local staff through what we have termed “active trust”. Applied to the organizational context, this process of familiarization amounts to the active “management” of trust. On the one hand, an active management policy can address the lack of traditional trust by giving priority to developing personal rapport with local staff, and where possible, to selecting people who are likely to be receptive to this approach. On the other hand, management can also endeavour to offset some of the deficiencies of institutional trust in the local environment by importing the practices and rules of its home company. Figure 3 also postulates that the ability to develop higher levels of trust in the staff of cross-border organizational affiliates located in China will enhance the performance of those units. This assumption is consistent with

academic thinking (e.g. Steensma and Lyles 2000), and it also underlies the importance that managers commonly attach to the generation of trust both within and between organizations (Lane and Bachmann 1998).

**Figure 3. A Model of Organizational Trust and Performance in the Chinese Environment**



#### IV. AN EMPIRICAL ILLUSTRATION OF THE ARGUMENT

The argument we have advanced is now examined and illustrated by reference to a recent study of 615 Hong Kong companies that are managing operations in Mainland China. For Hong Kong firms, the management of their units in Mainland China is effectively one of cross-border operations. Although Hong Kong was politically re-united with "Mainland" China in 1997, the border between them continues to be maintained as strictly as before. Moreover, Hong Kong and Mainland China constitute separate business environments.

Mainland China is still in transition from socialism and is a developing economy. Under the “one country, two systems” formula, Hong Kong and China’s regulatory and other institutional systems remain quite different, and their respective levels of economic development mean that resource availability, infrastructure and market efficiencies contrast significantly. While many Hong Kong citizens originate from adjoining Guangdong Province, which is also one of the Mainland’s most economically advanced regions, this Cantonese cultural and linguistic affinity does not extend to other provinces, many of which are also less economically developed as well. Thus from an economic and even sub-cultural perspective, Hong Kong and Mainland China can be regarded as separate territories with a degree of “foreignness” between them. To accord with common usage, even in Hong Kong, Mainland China will henceforth be referred to as China.

### ***Method***

#### *Sample*

The target population was identified as “ all firms operating in Hong Kong and managing at least some activities in Mainland China” . That includes firms who have employees in the Mainland or who have at least partial managerial responsibility for Mainland-located activities through joint ventures and other forms of co-operation. Companies whose activities are restricted to trading were not part of the target population. As the target firms are defined by their activities on the Mainland, they are not covered by Hong Kong’ relatively comprehensive statistical system. Hence, there is no available listing from which to sample firms and no census data on the characteristics of the population as a whole. The Hong Kong Trade Development Council (HKTDC) provides commercial information on Hong Kong firms having factories in China and was able to provide some figures for the sector breakdown of those companies. However, they covered a total of 23,082 firms in China, having 41,226 establishments, which compares with Chinese official estimates of more than 120,000 enterprises with investment from Hong Kong. Clearly, the HKTDC figures do not cover the whole population.

In the absence of a sampling frame containing the full population of target firms, and bearing in mind the need to secure co-operation for the data collection process, it was decided to use the membership lists of major business associations as the starting point for the survey. The Hong Kong General Chamber of Commerce (HKGCC) is the most prominent of these, but its membership distribution is skewed towards larger companies. It was therefore desirable to include more small companies in order to provide a more representative sample. That led to the addition of three other business associations to the sampling frame: the Chinese Manufacturers' Association of Hong Kong, the Chinese General Chamber of Commerce and the Hong Kong Small and Medium Business Association. In each case the membership lists were scanned for information on whether or not companies were managing activities in China in order to include only appropriate firms. Where that information was not available, companies were telephoned in order to check if they should be included.

On completion of the data collection process, a total of 615 companies had been surveyed, 430 of them in manufacturing and 185 in services. In terms of size distribution (where size is measured as the total number of employees in Hong Kong and Mainland China), 24% of responding companies had less than 100 employees, 37% had less than 200 employees and 36% were medium-sized (201-1000 employees). Large companies, with 1000 or more employees in Hong Kong and Mainland China combined, made up the remaining 26%. Given the lack of census data on firm size by total employment in Hong Kong and China, it is not possible to compare the characteristics of the sample in that respect with those of the population, in order to check for bias. However, for the manufacturing sector alone, it is possible to compare the distribution of sample firms by employment in Mainland China alone with figures provided by the HKTDC for its own much larger sample. The sample for the present study had a similar proportion of firms to the HKTDC profile with under 100 employees and also in the middle

range employing between 200 and 1000 people. However, the present sample had larger proportions of very small (under 50 employees) and large firms employing 1000 and over, compared to the HKTDC profile.

It is impossible to say with any accuracy how far the sample is biased compared with the target population as a whole. However, it is reasonable to assume that the HKTDC sample, the membership lists of the business associations, and the responding firms are all skewed towards the larger-sized firms in the manufacturing sector. In that case the manufacturing sub-sample for the survey has the same bias. It is likely that the same is true of the service sector, through no comparative figures are available. A possible overall bias towards larger firms needs to be kept in mind when interpreting the results. Nevertheless, the sample contains enough firms in each size category to provide reliable information on their status.

The sample covered all the major sectors of Hong Kong based business, and judging by comparison with HKTDC data, the sector distribution of the sample is reasonably representative. The great majority of the firms surveyed (61.8%) were unlisted companies owned and controlled by Hong Kong interests. Another 15% were wholly-owned subsidiaries of a foreign corporation, and 13% were joint-ventures. All of the other categories of ownership each accounted for less than 10% of the sample. Only 9% of respondents were listed on the Hong Kong Stock Exchange, and 8.6% were listed outside Hong Kong. Just 16 firms, making up 2.6% of the sample, were wholly-owned subsidiaries of Mainland Chinese companies.

The most popular form of business in Mainland China was the wholly-owned branch or subsidiary. This was used by almost 60% of the sampled firms, and more than half had a representative office. Of those companies with partnerships in China, more had equity joint-ventures (34%) than contractual joint-ventures (31.9%). About one-third of the respondents were engaged *inter alia* in arm's length selling and buying activities through their offices or

other facilities in China while roughly 19% of companies were selling through agents and distributors in China. Licensing and franchising were very much minority activities involving only approximately five and four percent respectively. No firm in the sample was solely engaged in buying or selling, licensing or franchising.

As might be expected, the respondents' Mainland operations were quite heavily concentrated in areas close to Hong Kong. About 32% of them had operations in adjoining Shenzhen while almost 60% had operations in other parts of Guangdong Province. A further 36% of the companies had operations in East China, comprising Shanghai, Jiangsu, Zhejiang, Anhui, Fujian, Jiangxi, and Shandong. About 25% were operations in North China: Beijing, Tianjin, Hebei, Shanxi, and Inner Mongolia. Only 6.5% of them had operations in the North East, consisting of Liaoning, Jilin, and Heilongjiang and only 11% were operating in the less developed regions covering Central and Western China, Guangxi and Hainan.

#### *Data Collection*

The starting point for this study was three "focus group" meetings where executives involved in Mainland China business were invited to discuss the factors that had affected their operations there and any changes which they might make if they were able to repeat their experiences with the benefit of hindsight. In the light of those discussions, and the insights provided by previous research, a draft questionnaire was developed in both English and Chinese. All statements in the questionnaire were in both English and Chinese, after a process of translation and back-translation to ensure conceptual equivalence of the alternative renditions (Brislin 1970). The draft questionnaire was then administered to a group of 15 executives. This led to a number of additional minor amendments, and the final version was further piloted with a separate group of five senior managers.

The final questionnaire was bilingual and had three sections. The first section was fully structured, using rating scales in order to provide numerical data on key variables. The second part of the questionnaire was open-ended and intended primarily to capture critical incidents relating to experience in China as well as the organization of cross-border responsibilities and reporting. The third part of the questionnaire was a fact-sheet requesting additional quantitative information on matters such as product range, various size indicators, the history of involvement in Mainland China, and a breakdown of employment there and in Hong Kong.

This amount of information could not be collected effectively through a postal survey, and some of it was too sensitive to do so. A team of research workers therefore spent seven months telephoning companies to make appointments and then visiting all respondents in order to administer the questionnaire. The target interviewee in each company was the executive responsible for its business in China, and each interview lasted for approximately 90 minutes. All of the relevant firms in the membership directories were contacted at least once and the process continued until the pool of willing interviewees became exhausted and the time available ran out. The response was generally good, in the sense that most firms contacted expressed a willingness to co-operate, but pressure of work and frequent travel to China meant that in a substantial number of cases arranging for an actual interview proved impossible within the time frame. Out of all the firms contacted, the final sample represents a positive response rate of approximately 22%.

### *Measures*

In order to characterize and measure *trust* a set of nine statements was given to respondents, using 1-7 'agree/disagree' scales. Five of these statements were designed to measure the quality of the relationships between Hong Kong managers and their Mainland staff, and four were designed to tap the extent to which the former had confidence in the latter. An exploratory factor analysis across these nine items identified one main factor which incorporated



all nine items and which was equivalent conceptually to *trust* in local personnel (Cronbach's  $\alpha = 0.89$ ).

Information was collected on two indicators of *traditional foundations for trust* between the Hong Kong companies and the people in their China units. These were the length of time the Hong Kong firm had directly invested in China (on the basis that traditional trust requires time to develop), and whether or not units were located in the culturally similar Guangdong Province.

The *foundations for institutional trust* in the China environment were assessed with reference to institutional maturity and the institutionalization of human resource competence in terms of availability of trained and competent local personnel. Two main aspects of institutional maturity were considered. The first concerns the extent to which China's legal system is perceived to be an effective system of support for transactions. This was assessed by a set of four items, for which  $\alpha = 0.86$ . The second (negative) indicator is the extent to which business success in China is seen to depend on personal connections (*guanxi*), and extent to which the actions of central and local government officials are seen as important but inconsistent. Exploratory factor analysis indicated that a single construct underlay the 13 items assessing these features, for which  $\alpha = 0.82$ . This factor may be called 'dependence on officials'.

The availability in China of training, and competent managers and employees was taken as an indicator of how far institutionalization of the country's education and training systems had progressed as a basis for having confidence in the availability of local human resources. For these three items,  $\alpha = 0.81$ . Questions were also asked about the extent to which managers and employees in the China units came from China rather than being recruited from outside. All the items used to indicate the basis for institutional trust employed 7-point scales.

The *active management of trust* was assessed both in terms of building traditional bases of trust and introducing within-company institutional trust. Indicators of the former were the frequency of personal contacts between company personnel in Hong Kong and those in the China unit(s), the frequency of contact with Mainland government officials, and the degree of emphasis on developing personal rapport with staff in China through careful pre-selection screening, building relationships, and shaping positive attitudes through training and social activities. The three personal rapport items were assessed on 7-point scales and when combined,  $\alpha = 0.66$ . The within-company institutionalization of home-based practices was assessed by the extent to which business practices are transferred to the organizational sub-unit. Respondents were asked through 7-point scales to assess the extent to which their firms' practices in six areas of management had been successfully transferred to China. Exploratory factor analysis identified a single factor, for which  $\alpha = 0.89$ .

### ***Results***

Table 2 reports the means, standard deviations and the correlation values for the variables in the study. It shows that the variables postulated to be predictors of trust are relatively independent of each other, with the highest shared variance between any of them being less than 10%. The correlations indicate that several variables are associated with trust, namely effectiveness of the legal system in China, the lack of dependence on officials, the availability of human resources and training, the recruitment of managers from China, policies to establish personal rapport with local Chinese staff, and the transfer of practices from Hong Kong.

**Table 2. Descriptive Statistics and Correlations**

	M	SD	1	2	3	4	5	6	7	8	9	10	11
1. Trust	4.46	0.92											
2. Years investment in China	9.70	10.61	.06										
3. Location in Guangdong	0.37	0.48	-.09	-.08									
4. Legal system effectiveness	3.04	1.01	.23**	.03	-.05								
5. Dependence on officials	65.32	8.82	-.27**	.07	.04	-.14*							
6. HR availability in China	4.03	0.97	.56**	.02	-.03	.19**	-.19**						
7. Managers from China	2.75	1.73	.24**	-.04	-.05	.07	-.21**	.20**					
8. Employees from China	5.05	1.17	.00	.01	.00	.02	-.02	-.06	-.18**				
9. Contact with China units	6.07	2.20	.01	.07	.07	-.18**	.03	-.01	.02	-.05			
10. Contact with officials	2.94	2.15	.08	.03	.10*	-.24**	.08	.05	.03	-.04	.28**		
11. Personal rapport	16.10	2.75	.26**	.06	.00	.01	.10	.12*	.13*	-.03	.06	.01	
12. Transfer of practices	4.57	1.12	.34**	.04	.02	.07	-.04	.21**	.14*	.04	.09	.13*	.30**

\*  $p < 0.05$     \*\*  $p < 0.01$     Decimal points omitted from correlation coefficients



Table 3 reports the results of a linear regression analysis (based on Figure 3) in which the independent variables are entered as potential predictors of trust. It should be borne in mind that the trust in question here is that of Hong Kong managers in the staff of their units in Mainland China. The highest correlation between any two predictor variables is  $r = 0.30$  which means that there are no substantial problems of multicollinearity. The combination of independent variables predicts 47% of the variance in trust ( $F=18.90$ ,  $p<.001$ ). The postulated traditional foundations for trust, length of time investing in China and location in Guangdong province, do not turn out to be predictors. By contrast, most of the institutional foundations are consistent predictors of trust. When the legal system in China is seen to provide an effective system of support for transactions, and when there is not a high level of dependence on local officials, trust in local personnel tends to be higher. The availability of competent managers and employees in China, and the ability to source managers locally also predict higher levels of trust.

**Table 3. Regression of Traditional and Institutional Familiarity and Active Trust Management on the Level of Trust in China Units**

Predictor	Beta Coefficient	Significance (p)
<i>Traditional familiarity:</i>		
Years of investment in China	.034	n.s.
Location in Guangdong Province	-.069	n.s.
<i>Institutional familiarity:</i>		
Legal system effectiveness	.121	-.017
Dependence on officials	-.163	.001
Human resource availability	.400	.000
Managers recruited from China	.174	.001
Employees recruited from China	.012	n.s.
<i>Active trust management (Familiarization):</i>		
Personal contact with China units	.019	n.s.
Personal contact with Mainland government officials	.080	n.s.
Developing personal rapport	.186	.000
Transferring practices to China	.195	.000

$R^2 = 0.47$ , Adjusted  $R^2 = 0.44$ ,  $F = 18.90$ ,  $p<0.001$

An active management of trust appears to produce results. Moves towards building trust on a traditional basis, through developing personal rapport with local Chinese staff, result in higher trust. More frequent personal contacts with China-based units of themselves do not, however, have an impact probably because such contacts may in some cases have a purpose inimical to trust building such as personal surveillance. Nor is frequency of contact with government officials a predictor. The institutionalization of company practices through transferring them to China units emerges as a very strong predictor of trust in local personnel. Taken together, the indicators of active trust predict 16% variance in trust.

We also suggested in Figure 3 that trust in cross-border units lays a good foundation for achieving a better performance from them. To assess performance, respondents were asked to provide a rating for three items concerning satisfaction with activities in China on 1-7 scales. The items making up the scale were taken from Venkatraman and Ramanujam (1986). The zero order correlation between trust and this performance measure is highly significant ( $r = 0.47, p < 0.001$ ). Data were also available from most participating companies on the growth of profits and sales from activities in China over the previous two years. Trust was also correlated with these indicators, though not so highly: with profit growth  $r = 0.18, p < 0.01$ , and with sales growth  $r = 0.15, p < 0.01$ .

## V. DISCUSSION

Findings from the survey suggest that, despite the ostensible cultural affinity between Hong Kong and Mainland China, reliance could not be placed on traditional foundations for trust. It was surprising to find that the time companies invested in China, or their location in Guangdong Province rather than elsewhere, had no apparent effect on the level of trust in local Mainland personnel. It is also noteworthy that the traditional means of coping with unreliable institutional provisions, namely direct personal contact with

government officials, was not effective in generating trust in local personnel. As expected Hong Kong managers tended to have more frequent contacts with government officials in cases where the legal system was unreliable, but it was the system itself rather than personal contacts with the people administering it that either facilitated or inhibited the development of trust in local staff. Institutional foundations in fact provided a sounder support for organizational trust. The more that managers perceived they could rely on the institutional system rather than having to depend on officials, the greater tended to be their trust in local staff. The exact reasons for this require further exploration, but it is likely that a reliable system provides norms and control for local staff to follow, whereas the intervention of officials could encourage come capriciousness in the attitudes and behaviour of local personnel.

This paper has developed the notion of active trust. It has made the concept more explicit and also demonstrated its efficacy in generating trust. Active trust is not a simple replacement for either traditional or institutional trust, and it is unlikely to prove so reliable a basis for trust as these two socially embedded foundations. Nevertheless, active trust is a valuable means of developing trust within organizations particularly in an environment such as that of contemporary China where both traditional and institutional foundations may not be readily available to foreign managers. Active trust is a phenomenon that can come within the purview of managerial action and to which managers can relate.

The reported experience of Hong Kong firms in China indicates that active measure to strengthen both traditional and institutional aspects of trust can be effective. Efforts to develop personal rapport with Mainland staff, who had also been carefully screened before selection, increased the trust that could be vested in them. The transfer of practices to Mainland units also increased trust in local staff. Our questioning about the development of personal rapport was originally intended as part of an exploration of control practices and this finding recalls the interdependence that trust has with control. On the one

hand, trust to some extent obviates the need for control; the leap of faith it requires can be regarded as a substitute for control in the belief that employees will be dependable and not let one down. On the other hand, while trust requires a suspension of belief (Möllering 2001) and hence implies risk, a policy of active trust is usually a more “controlled” risk than not investing in trust at all. The fostering of personal rapport with staff in cross-border units provides the basis for maintaining first-hand judgments on the behaviour and performance of those staff. The transfer of established company practices provides a micro-level institutionalization that further familiarizes organizational behaviour and underwrites the leap of faith.

There is a degree of uncertainty concerning the results of active trust, and the results are likely to be more modest than those arising from traditional and institutional trust. At the same time, an active trust policy offers managers the opportunity to build trust as a contribution towards better organizational performance employing measures that enhance control with trust rather than undermining it.

## **VI. CONCLUSION**

This exploratory paper has developed a framework for the understanding and prediction of organizational trust. This framework recognizes two foundations for trust that may be present in a society, both of which enable people to have confidence in the actions of others towards their interest on the basis of familiarity. Familiarity is the knowledge and understanding from which trust occurs most naturally. It derives in a traditional manner through first-hand contact that permits induction or from the role of institutional codification from which the behaviour and competencies of others may be deduced. The former, traditional trust, provides self-control over opportunism, whereas institutional trust provides for external controls. We further postulated that managers can pursue policies to generate active trust within organizational contexts that are characterized by a lack of familiarity. An examination of the



experience of Hong Kong firms with organizational units in China served to illustrate these distinctions, especially the contribution of active trust.

In conclusion, we claim that this paper contributes a meaningful notion of *trust-conscious management* relevant in the Chinese business context and beyond. Trust in business relations remains elusive, but our findings foster an appreciation of the main paths of trust creation. *Trust-conscious managers* will be sensitized to the importance of familiarity, traditional or institutional, and the extent to which it may be naturally available to them. At the same time, familiarization leading to active trust can be seen as another feasible path to trust, especially in unfamiliar circumstances. While we should acknowledge these alternatives, we must not be under the illusion that trust can ever be “manageable” to a degree where it becomes full-controlled or, indeed, risk-free – for then one could no longer speak of trust. There always remains a leap of faith to be made, which represents the ultimate skill in *trust-conscious management* rather than the skills of recognizing and actively creating familiarity. Further research in this area can build on the refined conceptual and empirical understanding that we have provided in this paper.

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