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Endogenous and Exogenous Determinants of Trust in Inter-Firm Relations: A Conceptual Analysis based on Institutional Economics

This paper investigates the factors that affect the availability and robustness of trust as a governance mechanism in inter-firm relations. By adopting a broad ‘embedded’ perspective, the analysis focuses both on the factors that affect trust within the inter-firm relation (endogenous determinants) and those that influence trust from the outside (exogenous determinants). So doing the discussion provides a comprehensive review of a broad perspective to the concept of embeddedness in the context of the role of trust in the governance of inter-firm relations, which has so far received limited attention in the literature.

From the point of view of the trustor, trust is analysed as reflected trustworthiness, which implies that trust involves two inter-related elements. Firstly, trust is based on information that the trustor has about the trustee’s characteristics and past behaviour as well as about the external environment in which the inter-firm relation is embedded. Secondly, it is based on the trustor’s assessment of the reasons why the trustee would behave in a trustworthy manner. These can be analysed in terms of material, social and emotional sanctions, which determine the consequences that the trustee would face for breaching trust. The sources of trust-related information and the aforementioned sanctions are located both within the inter-firm relation itself (endogenous determinants) as well as in the networks and the institutional environment in which it is embedded (exogenous determinants).

The endogenous determinants of trust consist of the length and depth of the relationship (accumulated experience that provides information about the partner’s past behaviour) and the significance of the benefit that the trustor thinks the trustee will expect from the relationship in the future (that is, the shadow of the future as reflected trustworthiness). Networks as a source of trust comprise three specific factors. One of these refers to the information about the trustee’s past behaviour that the trustor receives from third parties, that is, his network connections. The other two refer to the possibilities that the trustor can use his networks in a more active sense. One is the possibility to impair the trustee’s reputation by communicating opportunism to third parties who have an interest in sanctioning such opportunistic behaviour, and the other one refers to guarantor arrangements where a third party actively facilitates transactions and also suffers the consequences, should the trustor

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tee act opportunistically. The institutional environment is divided into two factors, both based on information that the trustor has about the surrounding environment: rules and regulations as well as norms and traditions, which are parallel to Douglass North's (1990) concepts of formal and informal institutions. ■