Social Capital and Venture Development in a Low-Trust Environment

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SOCIAL CAPITAL AND VENTURE DEVELOPMENT IN A LOW-TRUST ENVIRONMENT

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ABSTRACT

This study investigates the relevance of social capital for entrepreneur-actor relationships for operating ventures in the low-trust environment. The study reveals that social capital serve as an asset, access to opportunities, protection, or is a danger for ventures. Entrepreneurs apply selectivity and verification to decide whom to deal with.

ENTREPRENEURIAL SOCIAL CAPITAL IN A LOW-TRUST ENVIRONMENT

There is an agreement in the literature on the importance of understanding social capital within a particular context (Davidsson and Honig, 2003; Anderson et al., 2007; Jack et al., 2010). Entrepreneurs in the post-Soviet transition economies have to develop their ventures in the environment where trust in institutional and infrastructural integrity is low, and market possibilities are limited in the absence of a guarantee for third-party economic interaction (Aslund, 2002). This makes entrepreneurial ventures vulnerable to the pressures imposed by uncertain and hostile institutional norms (Manolova et al., 2009) and engenders generalized low expectations towards third-party reciprocity (Fukuama, 1995). Regardless of obstacles, entrepreneurs continue developing their businesses, and they concentrate relationships with major actors around themselves (Ivanova, 2004). If, as the literature leads us to believe, social capital is a key element of entrepreneurship, and trust represents the context on which social capital is built, it follows that sustainable entrepreneurial activity could be established only in a high-trust society, or social capital involvement to entrepreneurship would be different within low-trust contextual constrains.

In an effort to delineate the boundaries of a low-trust society, generally associated with transition economies (Radaev, 2004; Srader, 2004), we join Beugelsdijk, (2009) and Kwon and Arenious (2010) in the examination of individual-level relationships (micro level) within a national-level context (macro level). *At the micro level,* social capital is based on personal relationships between members of the network, enriched with shared values, personal attachments and mutual obligations (Nahapiet and Ghoshal, 1998; Adler and Kwon, 2002). These social relationships exist as assets in the private domain of individual actors, small organizational units or particular types of social networks. Social capital *at the macro level,* applies across different sectors of society and across business groups (Welter and Smallbone, 2006). It refers to formalized institutional norms and historically established networks, where institutional trust and the rule of law "shape social structure and enable norms to develop" (Grootaert and van Bastelaer, 2001: 8).

Environments where macro social capital and generalized trust and low, evoke a distinct differentiation between "us" and "them" (Schrader, 2004). Putnam's (2000) study of regions in southern Italy and Fukuyama's (1995) example of Chinese societies both show that the radius of trust there is small, and is limited mostly to the dyadic trust "between two parties who have direct knowledge of one another" (Leana and van Buren, 1999: 543). This distinction allows actors to cooperate based on habit and practice within their networks (Fukuyama, 1997), and reduces out-of-network exchanges or transactions (Bowey and Easton, 2007). While this does not necessarily translate into failure of entrepreneurial ventures, low trust does add obstacles to making effective use of market opportunities (Fukuyama, 1995; Putnam, 2000; Beugelsdijk, 2009). Entrepreneurs actively seek to design alternative governance structures and contractual arrangements (Manolova, et al., 2009), searching for a way of involving relationships into venture development.

METHOD

We selected Belarus of 1990s-2000s as a low-trust business environment based on two reasons. First, Belarus represents a gap (typical for emerging markets) between trust within personal networks and a trust at within the business environment (World Bank, 2003; Radaev, 2004; Schrader, 2004). Consider, for example, prepayment as a measure of trust. The EBRD found that demands for high prepayment can be seen as a measure of distrust in a customer and/or lack of confidence in the contract enforcement regime; and that post-Soviet Belarus of 1990s-2000s had one of the highest percent of annual sales made with prepayments (Raiser et al., 2004). The second reason refers to characteristics of the political, legal, and social environments for entrepreneurship in a state-controlled post-Soviet Belarus. Beginning in 1995, economic and political structures in Belarus have experienced re-establishment of a Soviet-style system of operations and espoused values, where "the individual had little reason to trust a system in which contracts were supplanted by central planning directives, laws were superseded by party decrees, and the party-state faced no institutional checks and balances" (Manolova et al., 2009: 108-109). Public relations actions undertaken by government bodies established an atmosphere of distrust to entrepreneurial behavior (Ozernoy, 2005; Istomina, 2005), fueling the perception that "war has been declared on the private sector" (Karbalevich, 2002: 19). Ozernoy (2005) believes that "while Belarus lacks the level of paranoia characteristic of Soviet rule, there is a culture of fear, enforced by a bureaucracy with far-reaching tentacles."

In 2008-2009, we conducted a series of case-studies on successful Belarusian ventures that were capable of managing stable operation in a low-trust environment. We applied a case study methodology because of the need to examine holistically the subject of entrepreneur-actor relationships within a real-life context, and because boundaries between phenomena and context were not always clear (Koschmann and Isbell, 2009). Case selection of 16 ventures thus was controlled for venture sustainable operation (15-20 years), the requirements of entrepreneurial ventures (vs. former-state-now-private organizations), private (vs. state-owned), and local Belarusian (vs. foreign or joint ventures) businesses. We conducted a first round of investigation, asked our informants whom they identified as actors for venture development and how they communicated with those actors. During the data analysis, we identified eight cases as featuring noticeably distinct patterns of entrepreneur-actor relationships. These eight cases were rich in details of with whom, how, and why the entrepreneurs developed relationships, and how they believed such relationships affected the ventures. We have found that the patterns were consistent among all the cases, while these eight cases represented them best.

We categorized the data in stages, as described in Jack et al. (2010). The study started with the main question of interest – how far social capital is relevant for entrepreneurial ventures operating in a low-trust environment of a state-controlled Belarus – and began by delineating core categories. Four core categories were revealed, representing a spectrum of respondents' experiences and beliefs on social capital role for venture development. Then, descriptive categories that clarified the core categories emerged. This included (a) the actors associated with each role of social capital for a venture development, (b) the mechanisms that entrepreneurs applied in identifying these actors, and (c) the entrepreneurial behavior in interacting with these actors. Finally, the coding differentiated among descriptors revealed analytical categories as patterns of entrepreneur-actor relationships that provided a holistic perspective on the issues under investigations.

FINDINGS AND DISCUSSIONS

We found that unlike entrepreneurs from developed economies, Belarusian entrepreneurs considered the "whom I know" only as the initial step in entrepreneur-actor relationships, while paying special attention to selectivity and verification of *whom and how to deal with*, applying the *whom can I trust* and *whom I should know* criteria. Categorization on the *whom I can/cannot trust* criterion did not bar actors from being involved to venture development; rather it defined acceptance towards insiders ("us") and caution towards outsiders ("them") of their inner circles. The entrepreneurs merged the *whom can I trust* criterion with the economically-driven *whom should I know* criterion, and they rationally evaluated anticipated benefits of entrepreneur-actor relationship for their ventures development. Such a combination of *whom can I trust* and *whom I should know* criteria seems to provide an explanation of how entrepreneurs distinguish the actors relationships with which are motivated with expected asset, opportunity, protection, or danger for venture development, and why they develop different entrepreneur-actors relationship scenarios while dealing with different actors.

Commitment in relationships with *whom I can trust* and *whom I should know*

Social capital seemed to be the method for explaining entrepreneurial relationships with trustful and salient actors because of its focus on social belongings (Anderson et al., 2007), personal attachment, shared values, and commitment between the parties (Leana and van Buren, 1999). Being trustful and salient for the venture, these actors secured the ventures' benefits "by virtue of membership in social networks or other social structures" (Portes, 1998: 6), contributed to ventures' access to resources, key competitive information, and potential customers and suppliers, as well as serving as venture asset, opportunity, and protection. Noticeably, in a low-trust environment, each dimension of social capital was stressed and emphasized – the ties had to be very strong, all the values were expected to be shared, disagreement can be associated with betrayal, and personal relationships became embedded into business relations, with families and spare time involved. As one of the respondents said, "This is like when you marry young and you have kids. You just live together and do your best to make it work."

Instrumental exchanges in relationships with those *whom I cannot trust* but *whom I should know*

Entrepreneurs applied trust-unrelated and emotionally distant instrumental exchanges in relationships with actors that did not belong to the "us" network, but were economically and politically salient for a venture. Any reciprocity was justified as being beneficial for both sides, e.g., the exchange of protection offered by state representatives in return for the bribes and pay-offs required of the entrepreneurs, or risky deals with untrusted clients in exchange on high and fast profit. Adler and Kwon (2001) label such interactions as being transaction-based, symmetrical, and explicit market relationships. Such relationships are based on the fundamental idea that "Certain outcomes … are more likely if firms/managers behave in certain ways" (Jawahar and McLaughlih, 2001: 399), referred to as an if-then causal mechanism for prescribing goal-directed actions (Widsor, 2002) with those "*who really counts*" (Freeman, 1984).

Avoidance of those *whom I should not know* regardless of *whom I can trust*

When entrepreneurs evaluated an actor as distrustful and low in salience or even as dangerous to be associated with (*whom I cannot trust* and *whom I should not know*), they preferred staying away from such relationships. If such relationships could not be totally avoided (for instance, with state officials from inspection, certification, or tax agencies), entrepreneurs maintained interactions that were minimally interactive, and they defined the most positive outcome of such relationships as the absence of harm. In this case, an actor became the subject of power rituals: entrepreneurs paid off state officials (Doern and Goss, 2011), and minimized their relationships with the actor in every possible way. The most painful for the respondents was reference to the actors that were trustful, but with whom cooperation would be economically or politically harmful for the venture (*whom I can trust*, but *whom I should not know*), so the entrepreneurs wanted to keep personal relationships, but keep them distant for the ventures to protect the latter. Examples of such references included partners who were perceived as related with political opposition to the ruling power or with relatives and friends that wanted to be involved in the venture operation, but did not fit the performance criteria.

Progression to trust and "trust but verify" based on continuing actor verification

Besides the definitive scenarios of cooperation, instrumental exchanges and avoidance, we identified two adjusted patterns of entrepreneur-actor relationships, where the entrepreneurs changed their evaluation of actors, and therefore adapted their behavior from the instrumental exchanges to the commitment-based social relationships (the progression to trust scenario), or from the commitment-based social relationships to the instrumental exchanges (the trust but verify scenario). In both adaptive patterns of entrepreneur-actor relationships, the entrepreneurs applied the mechanism of verification. This served as a second filter of *whom and how to deal with* and allowed entrepreneurs to adjust their behavior to the changing environment.

A process model of social capital involvement to venture operation

We conceptualize the findings of our study as interaction between micro- and macro-levels of social capital that defines intervening mechanisms between entrepreneurial relationships and outcomes of venture operation, and we offer a process model that demonstrates these mechanisms. The mechanisms of selectivity and verification serve as antecedents that promote or constrain entrepreneurial relationships with a particular actor: the selectivity here is a mediator between a network construction and the entrepreneurs' reliance on the trust-based and economically/politically justified criteria in actor selection; and verification here is a mediator between the nature of the relationships within these networks and the expected outcomes of the ventures' operations. This process was not linear, but cyclical and emotionally challenging, while beneficial for venture performance: balancing between the commitment-based relationships, economically justified transactions, avoidance of relationships, and continuing actor verification allows entrepreneurs to accumulate social capital as access to resources, decisions in venture favor, loyalty of salient stakeholders, or shelter from "special interest" from the forces unfriendly to the venture. The process of social capital accumulation and conversion to venture performance is shaped with the socio-cultural-political and institutional contexts of the low-trust environment, where socio-cultural-political factors frame distinguishing between 'us" and "them," and institutional factors set economically and politically framed "rules of the game" of actor salience.

CONTRIBUTION AND IMPLICATION

First, the study contributes to understanding of the complicated role of social capital in venture development in a low-trust environment. Our findings are in agreement with the widely accepted view that social capital serves as *assets* and opens *opportunities* that help ventures sustain and succeed. In such regard, the study contributes to the contextual testing of the value of social capital. Our study also reveals that social capital can provide a venture with *protection* from harm associated with criminal forces, political and administrative pressures, or competition for resources. The study also reveals that strong ties between entrepreneurs and politically disgraced people or association with "wrong" networks may be harmful or even *dangerous* for a venture. This reinforces the entrepreneurial instinct to avoid strengthening both bonding and bridging ties and preferring a lack of cooperation for the sake of venture security. Such a variety of social capital roles for entrepreneurial activity highlights the importance of alertness on the part of entrepreneurs. Navigation of the venture through potential assets, opportunities, protections, or dangers requires competency in evaluation actors' relevance for venture operation and careful consideration on whether entrepreneurs need social relationships with a particular actor, and how far relationships with each actor should be commitment-based, instrumental transaction-based, or even avoided.

Continuing reflection on the importance of awareness in entrepreneur-actor relationships, the study contributes with the identification of selectivity and verification as intervening mechanisms that link entrepreneur-actor relationships with venture performance. These mechanisms are based on *whom can I trust* vs. *whom I should know* criteria, and they serve as a two-level filter that help entrepreneurs apply the "*it depends*" approach in developing their networks of trust and avoid generalization of social capital as an overly positive or overly negative factor for ventures operation. The study contributes with the proposition that additional to *who I am, what I know* and *whom I know* means for entrepreneurship (Sarasvathy, 2008), awareness of *whom I can trust* vs. *whom should I know* should also be taken into account filtered with selectivity and verification.

Our study also contributes with understanding that entrepreneur-actor relationships must be sensitive to underlying economic and political structures, and even goes so far as to argue that such economic structures can actually dictate the dynamic of entrepreneur-actor relationships. Thus, entrepreneur-actor relationships must be congruent to the changes in political and economic realities and to actor relevance to the dynamic of venture operation. The study contributes with description of five scenarious of entrepreneur-actor relationships as mechanisms that help entrepreneurs navigate their ventures through changes in political and economic realities.

Finally, the study provides rich practical implications. Being framed around relevant for practitioners case selection criteria (ventures that were capable of operating sustainably in a low-trust environment), the study contributes to bridging the needs of practicing entrepreneurs with conceptually justified knowledge. We make a proposition that increasing the awareness of practitioners in the necessity and methods of actor evaluation negatively correlates with their overgeneralization of entrepreneurial activity in a low-trust environment and positively correlates with their capability to manage successful venture operation. This is especially relevant for foreign companies that consider entering transition economies, but do not have an experience of operation in the low-trust institutional context of undeveloped or unfair to entrepreneurship norms and socio-cultural-political context of definitive differentiation between “us” and “them.”

Limitations and Future Research

The study has some limitations and further research is needed to address these shortfalls. First, while we confirm that awareness, selectivity, and adaptability shape entrepreneurial relationship in a low-trust transition environment, the question of whether these same competencies are relevant for economies with established institutions and entrepreneurial support. Second, our work focused on one transition economy, namely post-Soviet Belarus; a range of other economies have emerged with different combinations of macro/micro levels of trust, wherein the nature of entrepreneur-actor relationships can and should be explored. Finally, our study also explores the entrepreneur-actor relationships in the context of how the macro-level of social capital shapes the micro-level of entrepreneurial relationships. However, in the process of developing relationships with market actors, entrepreneurs in turn affect the macro-level of trust in the environment. Thus, how entrepreneur-actor relationships alter trust throughout communities, regions, or societies, and how they affect institutional norms existing in the society may be good subjects for future research.

REFERENCES AVAILABLE FROM THE AUTHORS