

Process of Formation of Inter-Organizational Trust

—Case of Connection-Based Trust—

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【Abstract】This study examines the process of formation of mutual trust among organizations that share similar attributes or those that have had prior relationships. Previous studies have hypothesized that economic rationality must exist as a basis when two organizations establish a trust relationship. In reality, however, inter-organizational trust may accrue through business transactions among blood relations or because the leaders of the organizations are friends or have met at pan-industry social events. When organizations are somehow related in such a manner, the transaction is preceded by a type of trust regarding the people, capabilities, and technological capacity of the partner organization. We use the term “connection-based trust” and examine the problem presented above with reference to the case of a joint order-taking group that emerged out of an industrial district in Japan. Our results demonstrate that shared values and norms act as determinants in this process of formation. In addition, by drawing on the TPB proposed by Ajzen (1991), norms are found to influence the “intentions” determinant of inter-organizational trust.

1. INTRODUCTION

This study examines the process of formation of mutual trust among organizations that share similar attributes or those that have had prior relationships. Previous studies have hypothesized that economic rationality must exist as a basis when two organizations establish a trust relationship. In fact, however, the concept of economic rationality alone cannot explain the process of formation of inter-organizational trust. This study focuses on the case⁽¹⁾ of “connection-based trust,” which is formed among organizations that share similar attributes or those that have had prior relationships. Furthermore, it examines the influence of “norms” on the formation of trust.

Previous studies have already shown that norms influence the formation of inter-organizational trust. However, little is known about the specific role of norms in this process. Accordingly, this study reviews previous studies and analyzes a real-world case from Japan. Thereafter, it considers the influence of norms on the formation of connection-based trust. In addition, this study explains the process of formation of connection-based trust.

2. PREVIOUS STUDIES AND THE RESEARCH FRAMEWORK

2-1. Position of Inter-organizational Trust in the Research Landscape

In the management domain, the issue of inter-organizational trust emerged in the 1990s as special issues were compiled by journals, such as the *Academy of Management Review* (1998, Vol. 23) and *Organization Studies* (2001, Vol. 22). Early studies have adopted economic approaches, typified by the transaction cost approach. These studies have considered inter-organizational trust to be the most efficient mechanism for controlling transactions. These early studies have discussed the functions and effects of inter-organizational trust (e.g., economizing on transaction costs, constraining opportunistic behavior, and reducing uncertainty)⁽²⁾. The absence of an organization theory approach to trust research was identified as a problem (Arai, 2001; Wakabayashi, 2006), which stemmed from the simplification of inter-organizational trust, and its treatment was identified as a “cooperation issue.” Nevertheless, in recent years, the number of studies conducted from an organization theory perspective has rapidly increased.

Thus, while the importance of inter-organizational trust has been acknowledged, no consensus has been reached in organization theory regarding its role (Creed & Miles, 1996). Furthermore, the wider picture of trust research in the management domain, including both inter- and intra-organizational trust, indicates that the process by which “trust” is formed and maintained remains unclear. Therefore, explicating this process is an important task for trust research.

Trust research began in the psychology domain and has since been conducted in various academic fields, including sociology, economics, and management. As interest in trust expanded, the focus of research shifted from human “intentions,” or why people trust, to human “behavior,” which considers the kind of behavior that can gain the trust of others (Lewicki & Bunker, 1996). Accordingly, studies on inter-organizational trust have focused on independent behaviors displayed by organizations to answer the question of what kind of behavior can gain the trust of other organizations.

Inter-organizational trust can be viewed from three perspectives, depending on its relation with interpersonal trust.

First, an approach exists in which (1) organizations are personified and inter-organizational trust is equated with interpersonal trust. This approach was common in research conducted up until the 1990s. This was most likely due to the following two reasons: (i) research on inter-organizational trust was considered to be an application of interpersonal trust because trust research began in the psychology domain (where numerous studies on interpersonal relationships had already been conducted) and (ii) some scholars questioned whether it was actually possible to establish the organization as an object of trust⁽³⁾.

Next, an approach exists that focuses on (2) specific individuals within organizations and interpersonal trust among these individuals. This view considers the interpersonal relationships among the leaders or representatives through whom organizations are connected.

Finally, a view exists that (3) inter-organizational trust is distinct from interpersonal trust. An example of such an approach can be seen in the study by Zaheer et al. (1998), who viewed inter-organizational trust as a micro-macro link in which both inter-organizational relations and interpersonal relations are distinct yet interrelated.

If we are to adopt position (1) or (2), then we run the risk of neglecting issues concerning the organization. Therefore, to remain within the limited word count, this study adopts view (3) and restricts its focus to relations among organizations.

2-2. Definitions of Inter-organizational Trust

Inter-organizational trust has been defined in many different ways, most commonly in terms of “expectations.” For example, trust has been considered to be the expectation of a reduced risk of opportunistic behavior on the part of the exchange partner (Bradach & Eccles, 1989; Gulati, 1995); the expectation that the exchange partner behaves in a predictable and mutually acceptable manner (Sako, 1992); the expectation that the exchange partner will not engage in harmful behavior even when presented with chances or incentives to act opportunistically (Nooteboom, 2002); and the shared expectation for a stable cooperative relationship (Wakabayashi, 2006). Therefore, inter-organizational trust can be defined as “a kind of expectation toward the exchange partner.” Furthermore, these “expectations” can be said to relate to the “intentions” and “capabilities” of the partner organization (Sako, 1992; Yamagishi, 1998; Manabe & Nobeoka, 2003a).

Despite its conceptual diversity, it is possible to organize inter-organizational trust into three basic forms, namely, (1) trust grounded in self-interest; (2) trust grounded in knowledge, capabilities, and information; and (3) trust grounded in relations.

(1) can also be seen to constitute the minimum basis of trust needed for a transaction to succeed. Organizations generally prioritize their own interests above all else. Thus, there is always a possibility that they will behave opportunistically, which necessitates the use of contracts and sanctions among organizations for constraining such behavior. (2) is established during a transaction when an organization possesses some type of information regarding its exchange partner and can predict that it will complete the transaction considering its capabilities to do so. (3) can be further divided into two types. The first form of trust is formed when the organization has transacted with the exchange partner in the past and, over time, has come to learn what this partner desires, resulting in the emergence of shared values. The second form of trust exists when the organizations are somehow related prior to the transaction.

Various views also exist regarding the relation among these three types of trust, with some researchers maintaining that each exists independently of each other (Lewis & Weigert, 1985; Shapiro, 1987; Sheppard & Tuchinsky, 1996); some state that the three types influence or complement each other (Sako, 1992; MacAllister, 1995)⁽⁴⁾; and others maintain that trust develops in stages from one type to the next (Shapiro et al., 1992; Lewicki & Bunker, 1996; Lane & Bachmann, 1996; Mayer et al., 1995). However, this study adopts the view that various types of trust coexist (Manabe & Nobeoka, 2003a).

In view of the above, this study adopts the following definition of inter-organizational trust: “Mutual expectations established among exchange partners for maintaining certain cooperative behaviors and the capacity to respond to these expectations.”

2-3. Limitations of Previous Studies

Previous studies have two limitations.

First, the formation of business relations and inter-organizational trust has been assumed to occur simultaneously. Therefore, clarifying the basis of the formation of inter-organizational trust is essential.

Second, many existing theories are based on the premise that economic rationality, or self-seeking behavior, is the most essential condition for the formation of inter-organizational trust. This situation has likely emerged because the formation of trust has been assumed to begin at a point where the organizations involved have no transactional history or information regarding the exchange partner (Lewicki et al., 2006). In reality, however, inter-organizational trust may accrue through business transactions among blood relations or because the leaders of the organizations are friends or have met at pan-industry social events. When organizations are somehow related in such a

manner, the transaction is preceded by a type of trust regarding the people, capabilities, and technological capacity of the partner organization. For example, interpersonal trust may form through friendships among business leaders. It may also form if the organization has somehow discovered the partner's reputation or its outstanding technological capacity. Furthermore, an organization may speculate that its exchange partner is unlikely to transgress since both companies operate in the same area, and violating the trust relationship would run the risk of being ostracized by the business community. In such cases, self-seeking advances are not necessarily the only factor in the formation of inter-organizational trust. According to Manabe and Nobeoka (2003a), acquaintance or friendship relations or local or blood connections among organizational actors generate mutual trust relationships that transcend rational logic; as such, the existing framework of rational logic (economic motivation and the constraint of opportunistic behavior) is limited in its ability to explain such relationships.

3. CONNECTION - BASED TRUST

3-1. Inter-organizational Trust That Cannot Be Explained by Economic Rationality Alone

As discussed in previous studies, two types of inter-organizational trust exist. The formation of these types of inter-organizational trust cannot be explained by economic rationality alone.

The first is that trust forms when transactions occur among exchange partners belonging to a group of organizations with similar attributes (social class, region, nationality, race, etc.) or to a certain network or clan⁽⁶⁾. For example, Zucker (1986) classified inter-organizational trust on the basis of personal connections rooted in the family, community, religion, and ethnicity as "characteristic-based trust." Manabe and Nobeoka (2003a) used the term "relational trust" to describe trust accrued when the exchange partners belong to a certain network or clan. Furthermore, Nooteboom (2002) maintained that the concept of opportunism is limited in its capacity to explain inter-organizational trust. Instead, Nooteboom (2002) focused on "goodwill trust," arguing for the existence of a type of inter-organizational trust antecedent to economic relations based on the characteristics and reputation of the exchange partner, past experiences, blood relations, and friendship.

The second type of trust forms when an organization gathers more information regarding the exchange partner, as the transactional relationship becomes long-term and develops a certain degree of understanding of what its partner desires. Studies on this aspect of trust have been conducted from the perspectives of identity and identification (Shapiro, 1987; Lewicki & Bunker, 1996; Sheppard & Tuchinsky, 1996; Maguire et al., 2001).

The remainder of this discussion examines the type of inter-organizational trust that exists prior to a transaction, for which this paper uses the term "connection-based trust."

3-2. Role of Norms in the Formation of Inter-organizational Trust

The following research findings provide some useful hints in considering factors that affect the formation of connection-based trust.

In inter-organizational theory, the establishment of inter-organizational norms has been shown to function as an informal mechanism that helps organizations coordinate their cooperative activities (Pfeffer & Salancik, 1978; Yamakura, 1993). In this context, norms are defined as "the creation of joint expectations among actors under certain circumstances" (Yamakura, 1993). In other words, norms are established through the formation of joint expectations among actors. We previously defined inter-organizational trust as "a kind of expectation toward the exchange partner." If we

rephrase this definition, we can also say that inter-organizational trust is established through the formation of expectations. If this is true, then it implies that norms are involved in the formation of inter-organizational trust.

Moreover, Sako (1992) indicated that even though “shared normative values” may exist within groups of organizations with similar attributes, norms (“normative standards”) regarding open-ended commitment and reciprocity must exist before “goodwill trust” can form. In other words, inter-organizational trust does not form through “connections” alone. In addition, Wakabayashi (2006) argued that inter-organizational trust is only permitted when economic transactions are conducted against a background of shared norms and stable tacit understanding regarding obligations and rights. Following the assumption that norms influence the formation of inter-organizational trust, I now consider the significance of norms.

Concerning the question of what types of norms are necessary for the formation of trust among organizations, some researchers have identified aspects such as rules, standards, and systems (Zucker, 1986). Furthermore, other researchers have emphasized the role of shared sets of values within countries, industrial districts, and specific networks (Lane, 2001).

This study defines norms as “expected standards of conduct jointly established between or among organizations.”

4. CASE STUDY

4-1. Situation in Tsubame

This section examines the problem presented above with reference to the case of a joint order-taking group that emerged out of an industrial district. Although industrial districts appear in various forms, this section focuses on a long-standing local group with a typical division of labor. This approach should enable us to observe a group of organizations with similar historical, industrial, and regional attributes⁽⁶⁾. One group that fits the description is the joint order-taking group of the metal processing district that operates in the Tsubame area of Niigata Prefecture.

Although the district that operates in the Tsubame area of Niigata Prefecture dates back approximately 400 years, to the *wakugi* (Japanese nails) industry of the Edo period, local businesses have since undergone several transformations due to war and changes in the Japanese lifestyle. Tsubame is now renowned as one of Japan’s key composite metal processing regions; the same can be said of other industrial districts in Japan. However, the number of businesses is decreasing year by year; in terms of downsizing, it has now reached the point where more than 60% of companies employ fewer than three workers and 90% employ fewer than 20 workers. Consequently, many businesses have left the market due to economic recession and generational change. Tsubame now faces the threat of de-industrialization as, for example, local production plants are transferred overseas. One recent attempt to address this situation involved establishing a joint order-taking group to promote transactions within the area and stimulate local industry as a whole.

4-2. Coexistence of Competition and Cooperation

One characteristic of Tsubame’s business environment is the coexistence of competition and cooperation. The following quotations are taken from interviews with individuals from the Tsubame–Sanjo Regional Industries Promotion Center. These individuals have worked together with various businesses in Tsubame for more than 20 years, supporting local industry initiatives, assisting in the development of new technology and products, providing information, and facilitating exchange⁽⁷⁾. The quotations are as follows: “Most of Tsubame’s small businesses were founded by their

presidents. They started their own companies. They learned the techniques while working as apprentices at some of the older companies and then decided that they, too, wanted to be president and started out themselves. So there's a strong sense of rivalry"; "A lot of the companies are similar, so they're on bad terms. They hope that their competitors will leave the market"; "Since the core businesses have, to a certain degree, placed value in the cooperative structure, rather than dry, businesslike relations there's a sense that they're helping to bring up the smaller businesses. Even if they cannot do it this time, they will do their best to make it profitable next time round. The small local businesses are kind of interdependent"; "Most of the presidents want to get things done within the local area if possible. But, it's cheaper to go outside the Prefecture"; "They're fond of the area and they have connections. The personal relationships of trust among friends and people from the same junior chamber groups must play an important role."

These excerpts suggest that although there is a strong sense of rivalry among the Tsubame companies, there is also a desire to somehow improve the local situation and collaborate within the local area. Nevertheless, owners no longer leave their factories open with nothing to hide as they did in the past but keep their factory products under wraps and avoid disclosing client details.

Thus, transactional relationships among Tsubame companies are locally rooted and based on the "shared value" of wanting to improve the situation in the local area; however, simultaneously, local rivalries exist along with a sense of danger that work may be taken by rival traders. Accordingly, local businesses perform credit checks and avoid informal verbal agreements, even when transactions are conducted within the local market, to prevent work from being taken by rivals and technology from being leaked. Furthermore, when fellow traders collaborate on orders, there are rules governing the division of roles. An example of this can be found in the manual for transactions of the Migakiya Syndicate, a joint order-taking group of polishing businesses.

4-3. The "Migakiya Syndicate" Manual

With the Tsubame Chamber of Commerce and Industry as an initial point of contact for clients, as of April 1, 2011, the Migakiya Syndicate comprised 7 order management firms, 15 joint order-taking firms, 14 supporting firms, and 8 firms in the technical support section. The Tsubame Chamber of Commerce and Industry receives orders from clients based within or outside the local area and contacts the order management companies to determine whether they can accept the order. If one of the order management companies can handle the assignment, then that company is chosen as the prime contractor. Furthermore, it proceeds to organize a syndicate by selecting subcontractors with the necessary technical capabilities from among the joint order-taking firms. The syndicate then proceeds to complete the assignment and deliver the goods. Although the nature of these joint orders varies—from airplane wings to golf club polishing—each company has its own field of expertise determined by what and how it polishes, and tasks may need to be divided among several companies to complete even a single product. Furthermore, even if the number of orders exceeds the capacity of a single company—almost all of the order management and joint order-taking firms employ fewer than 10 workers, including some one-man shops—it is still possible to accept these orders by working as a syndicate. In the past, polishing work was considered to be a task for lone hands since it could be accomplished by a single tradesmen. However, Tsubame's polishing businesses must now cooperate with their fellow tradesmen to overcome the problems of industrial stagnation and a shortage of successors and "raise the bar" on their trade.

Considering this challenge, since its inception, the Migakiya Syndicate has been involved in the development of a joint order-taking manual. The manual states that the Syndicate "will not accept existing orders that would result in competition with polishing businesses in the local area" and "will share information about assignments among its members." Moreover, it defines a production system

as comprising business flows, contracts, and estimate templates. Furthermore, it clarifies the division of responsibility by prescribing solutions for problems that arise with clients or among members. Since polishing work is performed by hand, the manual also contains instructions to the effect that practical knowledge is shared among members and that quality and technology are standardized to prevent differences among contractors.

4-4. Analysis of the Case

The case presented above suggests that the transactional relationships that exist in Tsubame are characterized by (1) the fact that exchanges are conducted within a single local area and follow industrial practices unique to this local area, particularly the case of the Migakiya Syndicate, and (2) a shared objective among companies of improving local polishing technology and maintaining an active and dynamic polishing industry while dividing tasks among contractors. Moreover, due to the introduction of a manual, it is now possible to share information among members and avoid sources of distrust, such as the discount negotiations and dishonored checks that occurred under the verbal agreements that characterized the transactional relationships of the past. In addition—and this applies the Tsubame area as a whole—businesses tend to perform credit checks and issue official estimates, even when conducting transactions within the local area.

The Tsubame firms possess a shared value in that they wish to complete orders within the local area through collaboration. Simultaneously, however, there is a sense of rivalry since the companies are trading in the same market. Further, forming relationships of mutual trust through collaboration on the strength of shared values alone is difficult. As demonstrated by the Migakiya Syndicate joint order-taking manual, in cases where groups establish guidelines indicating the appropriate behavior for members, adherence to these guidelines amounts to a type of common understanding among individual members. This results in the elimination of uncertainty surrounding other members of the group and facilitates the formation of inter-organizational trust among members. Accordingly, the manual functions as a collection of jointly established expected standards of conduct, in other words, a set of professional norms observed by the group members. Therefore, the Migakiya Syndicate example suggests that inter-organizational trust is built on “shared values” and certain prescribed “norms.”

If we assume that these two aspects influence the formation of inter-organizational trust, then clarifying the manner in which these interact with intentions and capabilities is necessary, which previous studies have identified as determinants of inter-organizational trust. The next section identifies the process of formation of connection-based trust with reference to the theory of planned behavior, as applied in social psychology.

5. PROCESS OF FORMATION OF CONNECTION - BASED TRUST

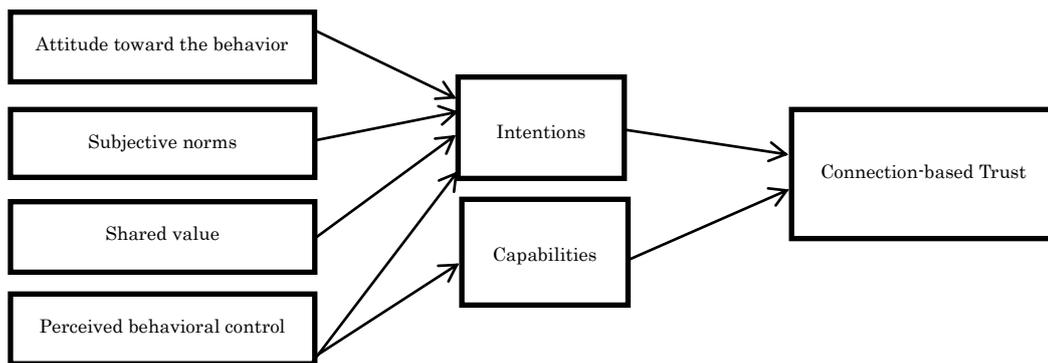
As mentioned above, inter-organizational trust has been shown to be determined by intentions and capabilities. This section employs Ajzen’s (1991) theory of planned behavior (TPB) as a framework for considering the manner in which expectations regarding intentions are formed.

The TPB was derived from Fishbein and Ajzen’s (1975) theory of reasoned action (TRA). The TRA posits that “intentions” to perform a behavior are the primary determinant of that behavior. It focuses on the processes by which humans employ reasoned judgment to discern the outcomes and values that are likely to result from certain behaviors. In other words, intentions are determined by (1) attitudes toward the behavior and (2) subjective norms. (1) Attitude toward the behavior refers to a person’s opinion on the type of outcomes produced by that behavior and his/her reasoned attitude

regarding the value of these outcomes. (2) A subjective norm is a perceived social norm concerning whether significant others close to the person view the behavior in question as desirable or imperative. The TPB includes perceived behavioral control as a third determinant of behavior. It proposes that intention to perform a certain behavior increases, causing the behavior to occur when these three factors combine to positive effect. Perceived behavioral control is an individual's belief about whether he/she is capable of performing the behavior. It is determined by the degree to which that person possesses the knowledge and resources required to perform the behavior.

When considered in relation to inter-organizational trust, attitude toward the behavior can be equated with the pursuit of self-interest. Moreover, the exchange partner would constitute a significant other involved in determining perceived social norms. In the case of connection-based trust, considering shared values to be a factor in the formation of trust is also necessary. Further, we must consider that inter-organizational trust is determined not only by intentions but also by capabilities. Then, we may assume that perceived behavioral control influences not only intentions but also capabilities. Figure 1 illustrates these determinants in the form of a process of formation for connection-based trust.

Figure 1 Process of Formation of Connection-based Trust



6. CONCLUSION

This study has examined the process of formation of mutual trust among organizations that share similar attributes or those that have had prior relationships.

The view that the nature and quality of inter-organizational trust vary across different national and regional contexts is not new. While it has been shown that the process of formation of inter-organizational trust is deeply and strongly connected to specific cultural and institutional environments (Bachmann, 2010), the factors involved in this process of formation have not been identified. With regard to this point, this study, by examining connection-based trust through a real-world case, has demonstrated that (as previous studies have suggested) shared values and norms act as determinants in this process of formation.

In addition, by drawing on the TPB, norms were found to influence the “intentions” determinant of inter-organizational trust. Therefore, the process of formation of connection-based trust could be identified. According to the TPB, perceived behavioral control is considered to influence intentions. However, this study has proposed that perceived behavioral control determines not only intentions but also capabilities.

Furthermore, in the case of connection-based trust, this study has shown that even if a relationship formed prior to a transaction motivates its initiation, this relationship does not constitute the direct cause of the formation of a trust relationship in transactions; the basis for the formation of transactional relationships and trust relationships are distinct.

The following three points can be identified in terms limitations of the study and future challenges.

This study has examined factors other than economic rationality in the formation of connection-based trust. However, this study, by no means, intends to discount economic rationality as a factor affecting the formation of connection-based trust. Rather, organizing the relationship between economic rationality and other factors external to it is necessary.

Moreover, this study has restricted its focus to relationships among organizations to remain within the limited word count. However, as mentioned above, there is also the view that inter-organizational trust is a micro–macro link in which both inter-organizational relations and interpersonal relations among the individuals belonging to organizations are mutually interrelated (Zaheer et al., 1998). On this point, the case study examined above revealed strong ties among individuals since businesses were connected through the local area and employed a small number of workers. This suggests that interpersonal connections play a certain role in, for example, the exchange of technical information when firms form syndicates and share practical knowledge. If this is true, then a consideration of interpersonal relations must be included in the discussion of inter-organizational trust.

In addition, regarding the formation of inter-organizational trust in industrial districts, studies have revealed that it is easier for businesses to construct relationships of mutual trust when there are more opportunities for contact as the business approaches to one another or higher levels of perceived value sharing (Inagaki, 2003). It is, therefore, natural to assume that frequency of communication also affects inter-organizational trust. This point must also be addressed in future research.

- (1) I would like to thank the Tsubame-Sanjo Regional Industries Promotion Center and Tsubame Chamber of Commerce and Industry for their generous support in this research project. However, the author assumes a full responsibility for all potential errors and omissions.
- (2) For example, Arrow (1972) argued that, in reality, almost every commercial transaction contains an element of trust. Moreover, inter-organizational trust has been regarded as the source of interfirm cooperation (Dyer & Chu, 2000), a control mechanism for governing economic translations (Bradach & Eccles, 1989), and an important adjustment mechanism. It has also been considered to be a necessary condition for achieving high performance and competitive edge in new business environments (Lane & Bachmann, 1996) and an important factor in determining the success of business partnerships (Child & Faulkner, 1998).
- (3) In the case of inter-organizational trust, researchers are divided into two camps, namely, those who believe that it is inherently possible to trust an organization (Hagen & Choe, 1998; Currall & Inkpen, 2002) and those who do not (McEvily & Zaheer, 2006). For the purposes of this paper, I will side with the former.
- (4) The argument that trust develops in phases delineated by a temporal breakpoint can also be observed, for example, in the study by Gulati (1995), and appears to be based on a non-linear differentiation model that holds that relationships with others gradually change over time.
- (5) See Manabe and Nobeoka (2003a) for a discussion of the type of trust that forms when partner organizations belong to a certain network or clan.
- (6) Previous studies on industrial agglomerations have also indicated that “the businesses constituting an industrial agglomeration do not simply engage in economic transactions but instead hold deeply connected mutual relations in the places where they live their daily lives” (Kishida, 2003) and that “when there are more opportunities for contact as the businesses draw nearer to one another or higher levels of perceived value sharing, it is easier for businesses to form trust relationships” (Inagaki, 2003).

(7) The interviews were conducted at the Tsubame–Sanjo Regional Industries Promotion Center on September 16, 2011.

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