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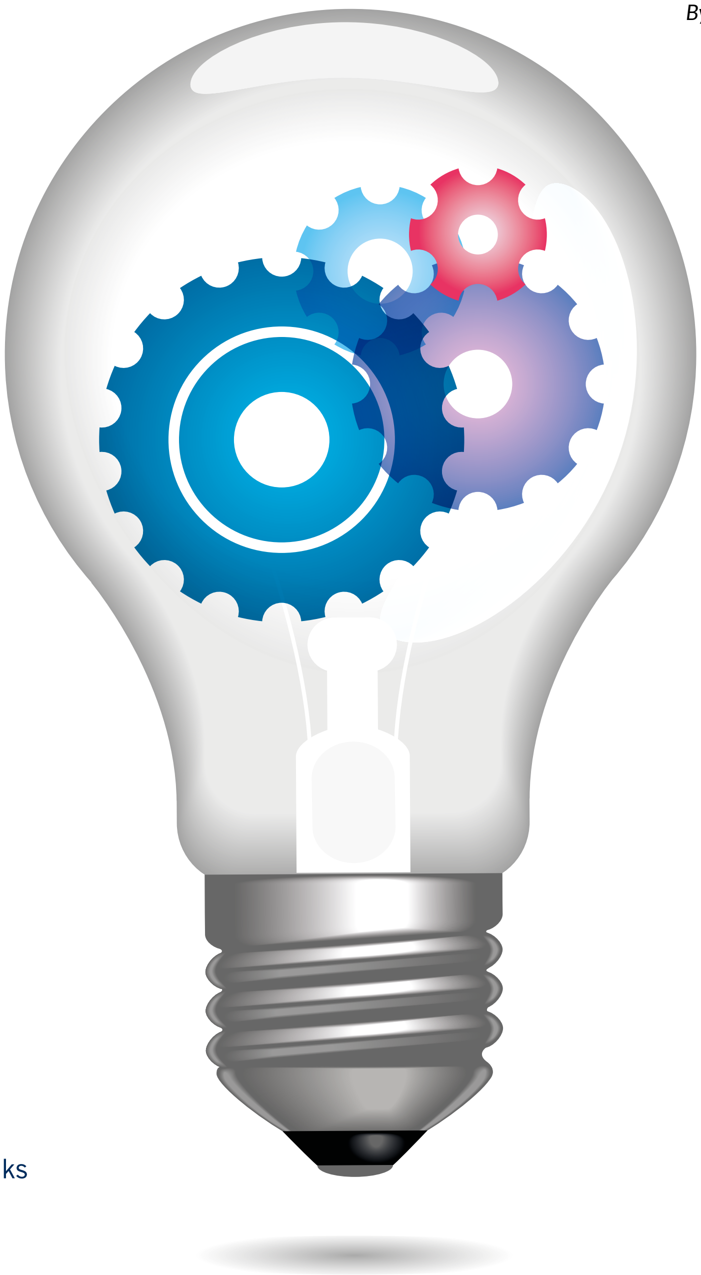

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Inter-organisational trust: is more always better?

By **Merieke Stevens**

Between friends and loved ones, more trust is mostly a good thing. But how about trust between business partners? Until recently, the dominant view has been that investments in trust generally result in positive returns. However, some of my research suggests that this may not actually be the case.

On the one hand, most scholars say there are important advantages to deep trust in the buyer-supplier relationship: reduced monitoring costs, superior information sharing routines, and lower transaction costs. On the other hand, too much trust can have negative consequences: diminished information gathering due to the perception that not much vigilance is needed; complacency; and burdensome obligations between the parties.

In a paper I recently published with John Paul MacDuffie, a professor of management at the Wharton School of the University of Pennsylvania in Philadelphia, and Susan Helper, a professor of economics at Case Western Reserve University in Cleveland, we looked at the experience of two Japanese automakers and concluded that the best business relationship should be neither too trusting nor too sceptical. But how do you strike the right balance?

To answer this question, we compared the experiences of Nissan Motor Co. in Japan following the establishment of the Renault–Nissan alliance during the period when the Nissan *keiretsu* (supply chain family) was dismantled, with that of Honda Motor Company in North America, early in the development of its North American supply base.

The Nissan insights were based on my own research, a series of face-to-face interviews I conducted in Japan and France with key actors over a 12-year period between 2000 and 2012. I also worked on the production line of a Tier 2 Nissan supplier for a few weeks. The suppliers interviewed (seven first-tier and two second-tier Nissan suppliers) were selected to ensure a diverse set of strong and weak *keiretsu* affiliations, different relationship durations, and primary product and production process. Most interviews were conducted in Japanese. My co-authors followed Honda's efforts to establish a supplier base in the USA, which involved several visits to Honda and seven of its suppliers between 1992 and 1994, with a follow-up in 2011.

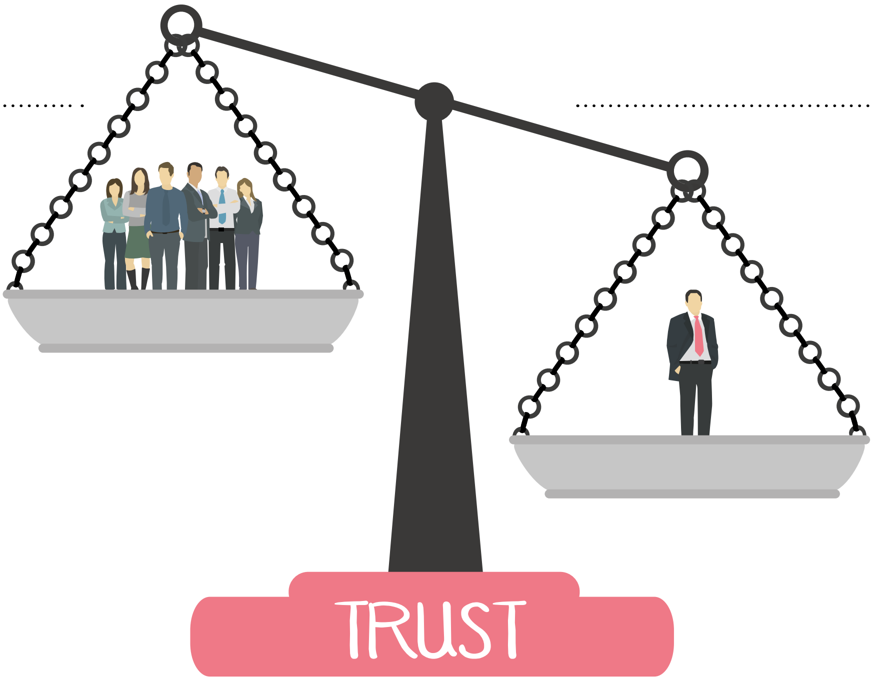
> *"Optimal inter-organisational trust is a balance of powerful and opposed forces…"*

Rude awakening

From the 1950s to the 1980s, the close relationships between Nissan and its suppliers had many benefits for Nissan. Suppliers would start preparations for a new contract before they were formally awarded it. They usually accepted last-minute requests for production schedule and delivery changes, overtime work, and even engineering changes, without demanding any additional compensation from Nissan.

Over time, however, these close relationships gradually devolved into a source of competitive disadvantage for Nissan, contributing to its financial losses in nine out of 10 years in the 1990s. Parts costs rose beyond the global average. Yet even when factory utilisation slipped to 50 per cent, the company maintained the same numbers of suppliers.

Some of the practices had grown clearly dysfunctional over time. In the purchasing department, for example, purchasers were in charge of a specific company, not a specific product group. As a purchaser, I might be sitting in a meeting and discussing where we source the radiators for a new model, and advocate my supplier simply because he was my supplier (who, not coincidentally, was also the supplier of various personal favours, such as golf trips or a future job after my retirement from Nissan).



"...the best business relationship should be neither too trusting nor too sceptical. But how do you strike the right balance?"

When Carlos Ghosn signed on as CEO, part of his remit was to restructure those cosy relationships. To signal a clean break from the past, he announced a dramatic restructuring of the supply base. Shares in all but four of the nearly 1,400 affiliated companies in Nissan's *keiretsu* were to be sold, and Nissan's supplier roster slashed from 1,145 to 600. The survivors would be required to reduce costs by 20 per cent within three years, without expecting any help from Nissan.

From Nissan's point of view, the cost cutting was a success. But it turned out that a purely transactional relationship also had its problems. Suppliers felt betrayed that Nissan "did not keep its promises" to share the company's restored prosperity, despite the fact that Ghosn had explicitly said Nissan was no longer making such promises.

In 2004, faced with their opposition, Ghosn began to back-pedal, publicly announcing the return to some of its previous *keiretsu* practices, such as a long-term orientation, equity holding, and technical assistance to suppliers. Even now, a decade later, the company still struggles to gain the right balance between too much and too little trust.

Honda's win

The example of Honda offers a very different story but a somewhat similar moral. Honda's start in the USA, first in manufacturing motorcycles (1978) and later cars (1982), was not auspicious. In Japan, the company had suffered from being overly committed to its suppliers in past recessions, and had an awareness of the potential dark side of trust. Honda sought to select self-reliant partners who could be responsive to its current and future needs. As a sign of good faith, they looked for a willingness to make investments in new technologies and new capabilities, without explicit contractual commitments from Honda.

Most suppliers did not have a clear sense of what kind of company Honda was, and in addition, their long experiences with the adversarial purchasing behaviour of American automakers had taught them to expect the worst. Suppliers saw ulterior motives in Honda's insistence on learning every detail about their production process and, especially, their costs. Nor did they like the idea of making a substantial investment without a contract.

Despite that rocky beginning, Honda still developed stable, trusting relations with small local suppliers within a decade of opening its first US auto assembly plant in 1982. It also appeared to have avoided the traps of complacency, blindness, and excess obligation. It did so by implementing its Honda Way philosophy and a supplier development initiative known as BP (the acronym has many referents, eg, "best practices", "best process", "best profits" and "best partner").

Now, as the business grew, Honda's managers began to add a set of larger suppliers to their supply chain, on similar terms as their smaller suppliers. The new suppliers were also sceptical of the proposition that they should make significant investments without a contract, but this time, Honda proposed starting with small contracts as a way to build trust gradually. In addition, the company was also generous with their technical advice.

Scepticism and trust

Our comparison of Nissan and Honda's experience led us to think that maybe companies should look at trust as an inverted U – beneficial within a certain range of behaviour, but potentially negative outside that band.

Instead of trying to achieve perfect trust, maybe the more productive approach would be to try to maintain an optimal level of trust instead – enough trust to enable the company and the supplier to work towards mutual goals, but not so much that the company never double-checks the supplier's prices and specifications.

A second lesson we drew from these cases is that it's important to give credit where credit is due. When Nissan did not recognise the role of suppliers in achieving its restructuring goals ahead of schedule, suppliers became bitter. By contrast, in Honda's early dealings with small US suppliers, executives praised the suppliers for being so responsive to its demands.

Finally, we learned something about ways to regain trust. This may be achieved either through a dramatic process of reorientation, as at Nissan, or by recalibration, as at Honda. Reorientation is often revolutionary, a clear break from past processes. Recalibration, by contrast, is perpetual but low-key – it consists of continuous, small changes that enable the relationship to stay near optimal trust. Sometimes the kind of reorientation that Nissan undertook is necessary, but it's much tougher on the company than ongoing recalibration. It's a bit like maintaining your weight – in the end, it's better to make a few minor adjustments every few weeks than to gain 20 kilos and go on a crash diet to lose it all at once.

Optimal inter-organisational trust is a balance of powerful and opposed forces: faith vs. scepticism, favouritism vs. impartiality, contentment vs. exigency, and loyalty vs. opportunism. The stories of Nissan and Honda suggest that the best way to avoid a ruptured relationship is essentially by continuous recalibration to prevent reaching the point where it needs to be repaired. ■

"...the best way to avoid a ruptured relationship is essentially by continuous recalibration..."

This article draws its inspiration from the paper *Reorienting and Recalibrating Inter-organizational Relationships: Strategies for Achieving Optimal Trust*, *Organization Studies*, written by Merieke Stevens, John Paul MacDuffie and Susan Helper and published in *Organization Studies*, Volume 36, Issue 9 (July 2015), p. 1237-1264. DOI: 10.1177/0170840615585337

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