

The Economics of Trust©

Dr. Kenneth A. Saban
Duquesne University
saban@duq.edu



Background

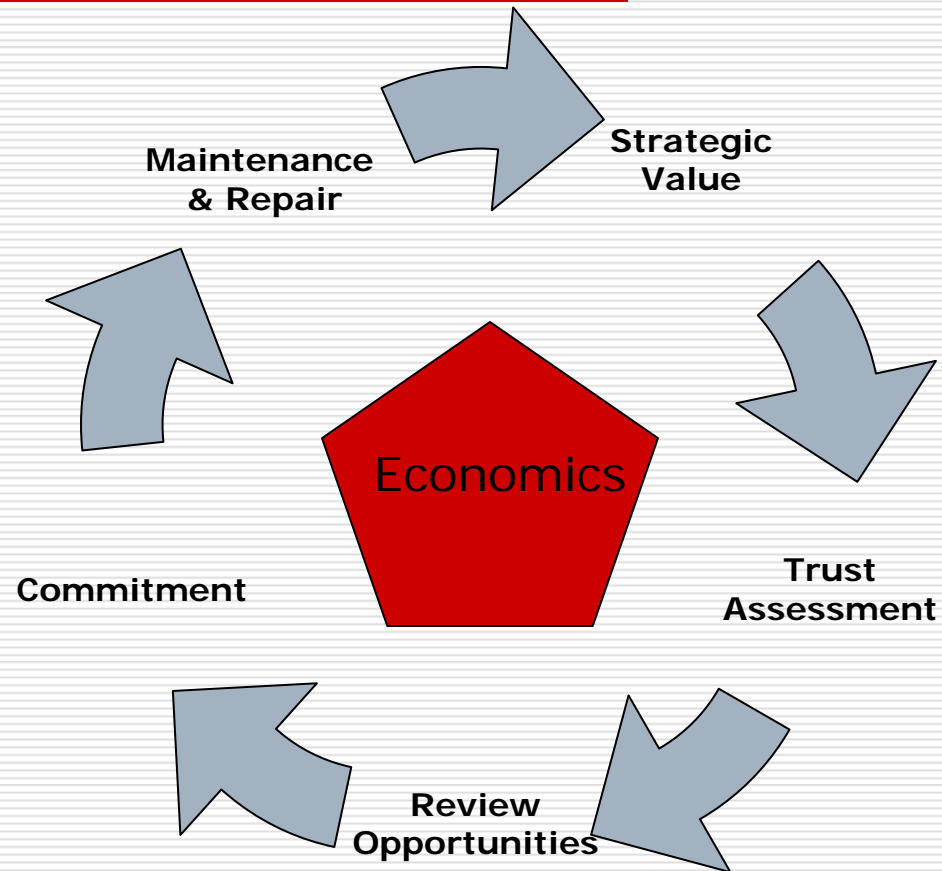
- The transition from a transitional to an extended supply chain requires a *collaborative* form of Supply Chain Management which...
 - employs a “win-win” vs. “lose-lose/win” conflict management philosophy,
 - facilitates change through “shared power” vs. “force-coercion”, and
 - is built upon **trust**.
- **Trust** has been shown to have many benefits, for example:
 - *Watson & Wyatt found that high-trust firms generated 286% higher returns than low-trust firms.*
 - *Russell Investment Group found that the “100 Best Fortune Companies to Work For” earned over 4 times better returns over a period of 7 years.*
 - *Warwick Business School found that outsourcing contracts – rooted in trust - generated 40% more profits for the manufacturer and supplier.*



According to Deloitte Consulting collaborative supply chains require...

1. Shared objectives and long-term strategic goals
 2. Joint investment of resources and knowledge sharing
 3. Alignment of people, processes and technologies
 4. Common performance metrics
 5. Mutual trust
-

Trust – It's a matter of "economics"





Trust metrics ©

Trust > Commitment >
Collaboration = Business
Performance

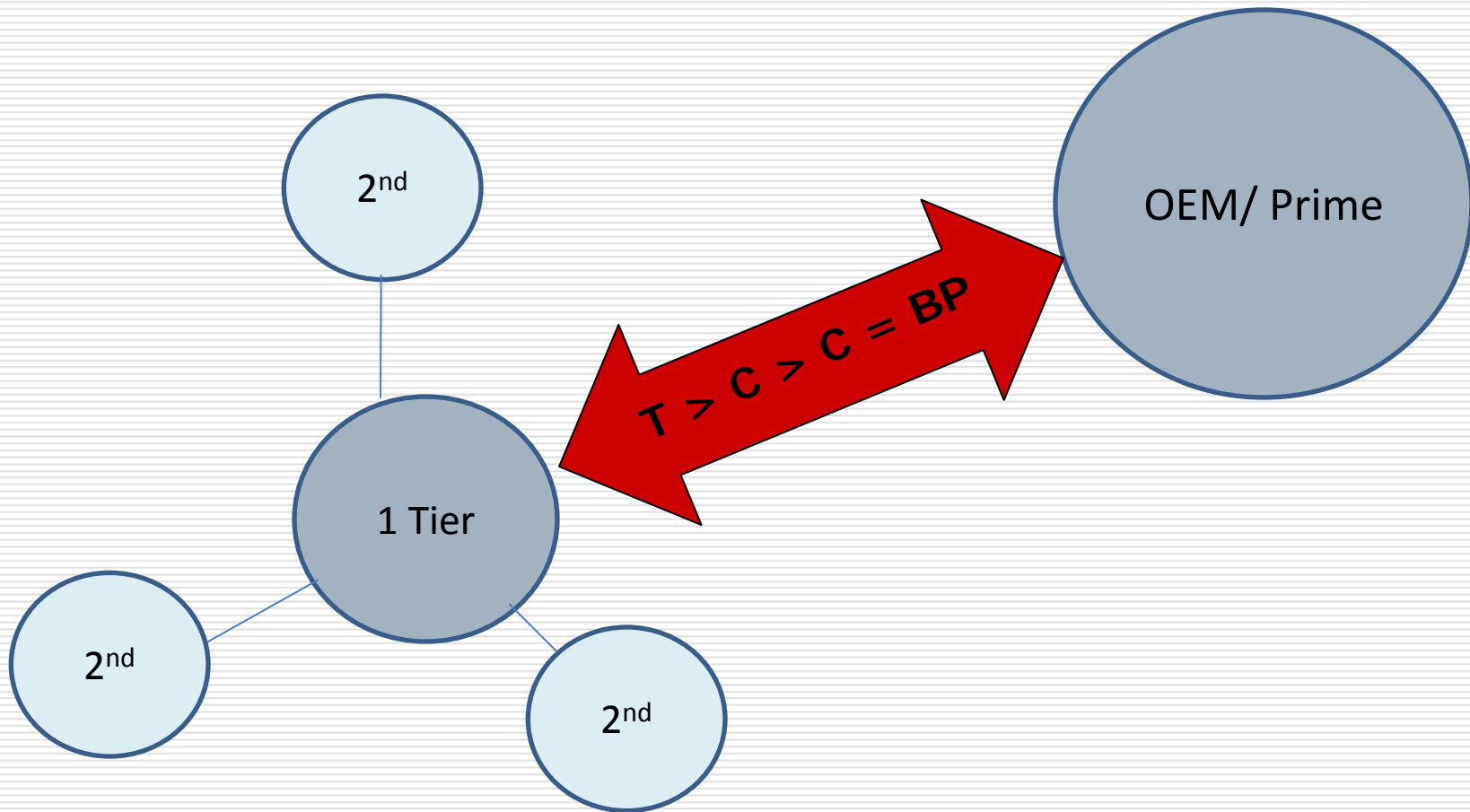
*“The more I trust you, the more
committed I am to collaborating with you
to achieve our mutual goals”*



What is Trust?

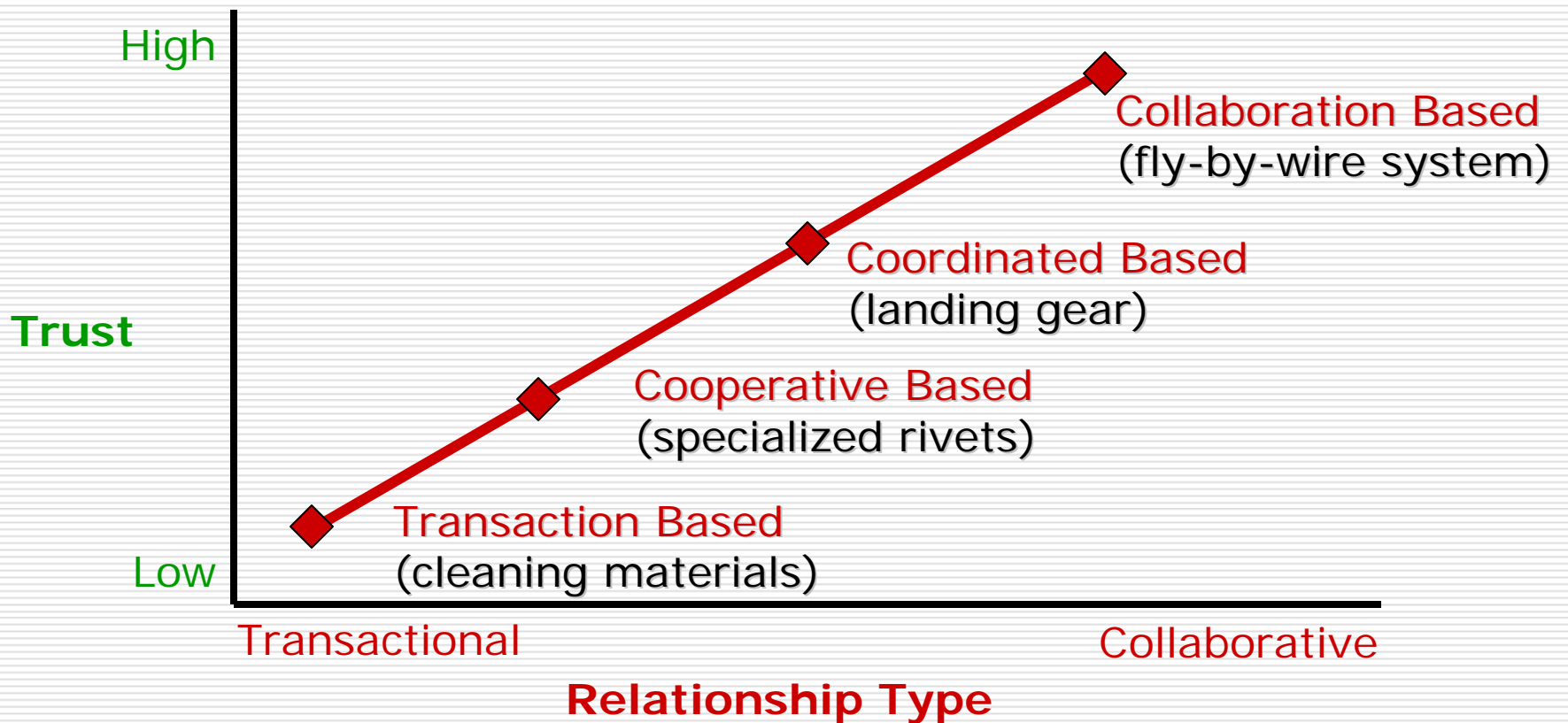
Trust is the belief that an actor: can be relied upon to fulfill their obligations; will behave in a predictable manner; and will not exploit a relationship when an opportunity presents itself.

Where does Trust reside?



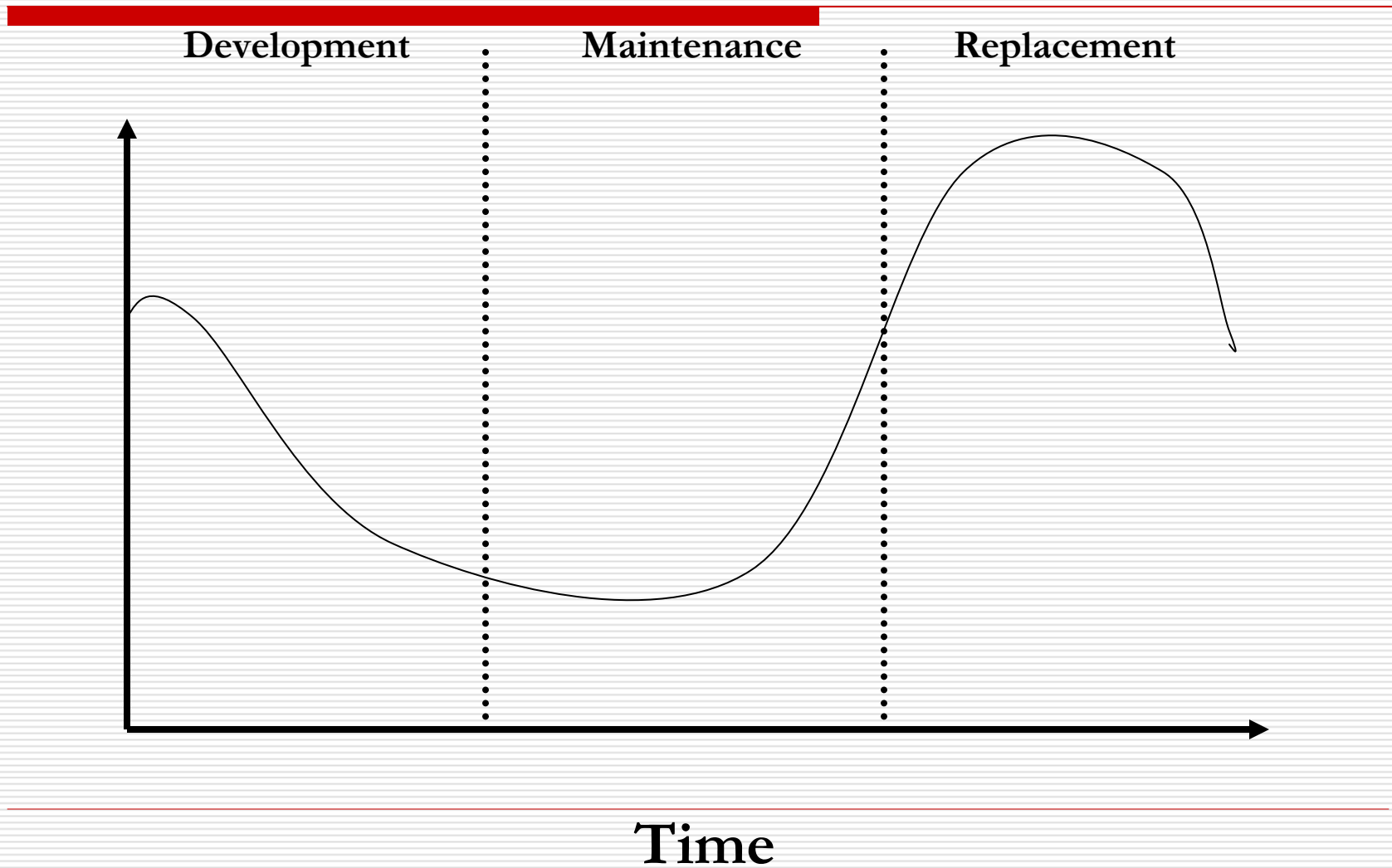


Does every supply chain arrangement require Trust?

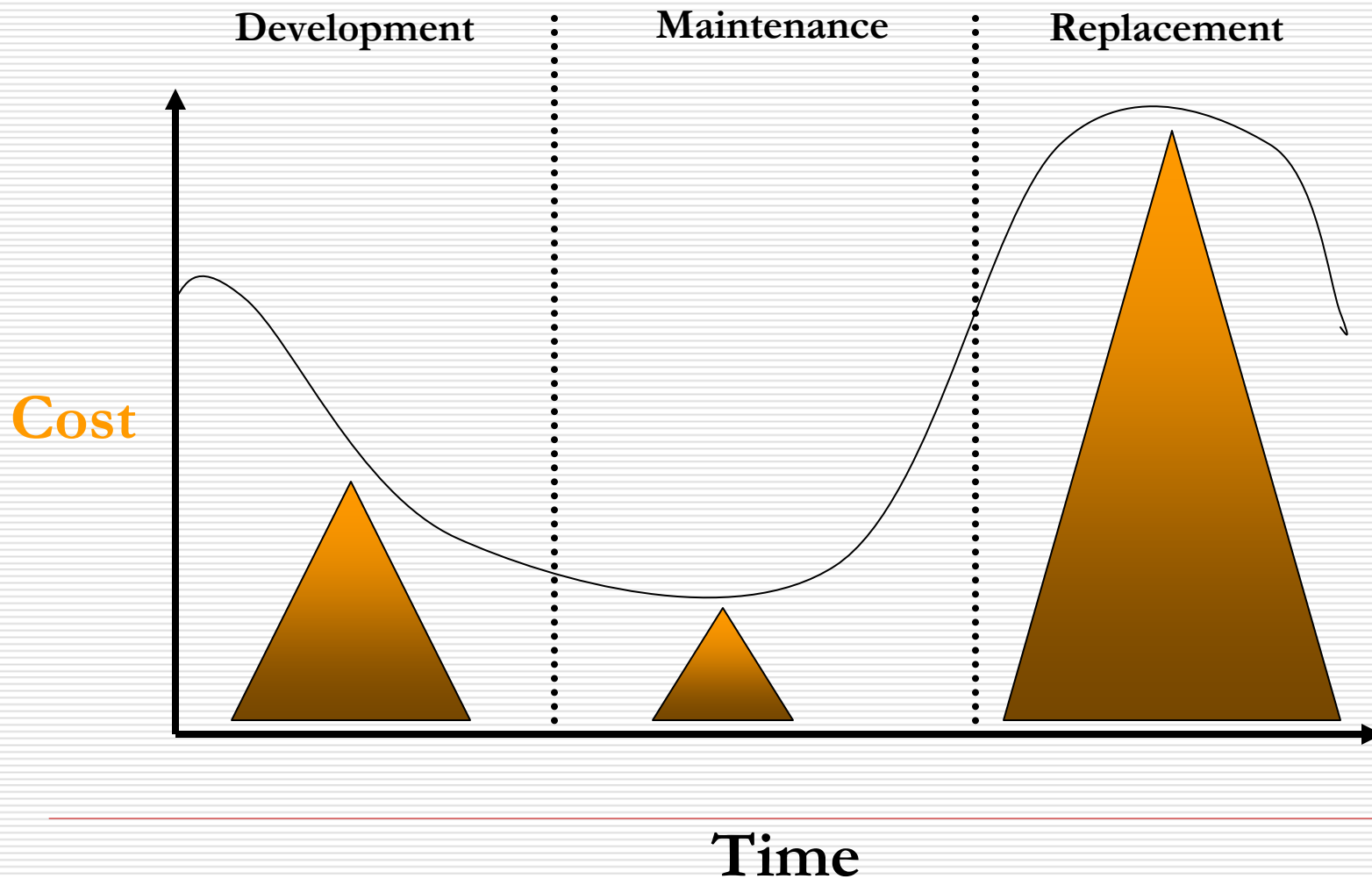




Is Trust a static condition?



What is the cost of Trust?

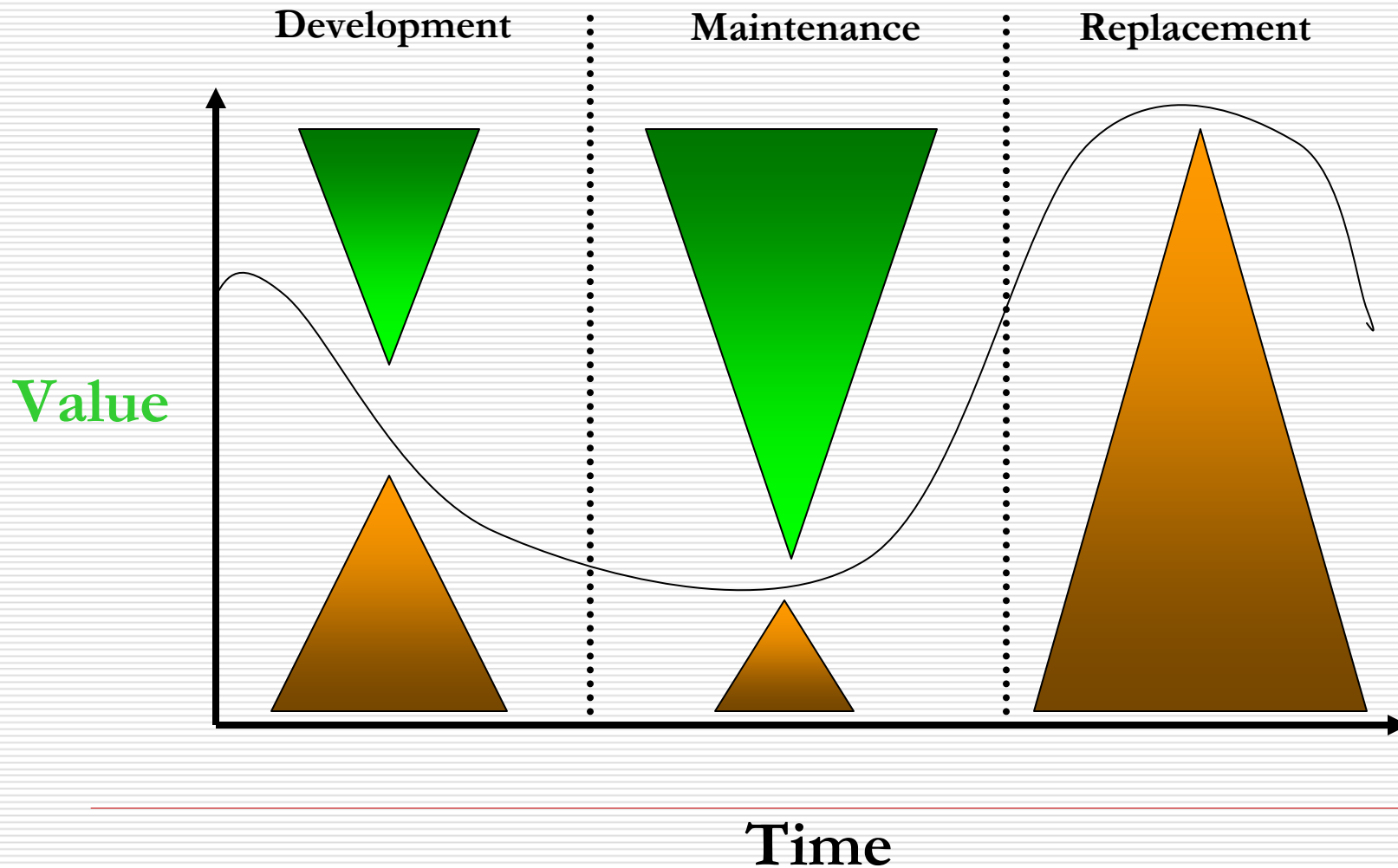




Why are replacement costs so high?

- ❑ Loss of Trust raises transaction costs (35-40% production costs) such as monitoring and enforcing contracts.
 - ❑ Holiday Inn hotels found that the loss of Trust in management not only impacted employee behavior, but also customer satisfaction (1/8 point improvement = 2.5% profitability improvement).
-

What is the value of Trust?





Trust Scorecard©

Value:	Study 1	Study 2	Study 3
- Innovation			
- Growth			
- Communi.			
- Commitment			
- Asset dist.			
Costs:			
- Search			
- Contracting			
- Monitoring			
- Enforcement			



Study 1

- Jeffrey Dyer's study of the auto industry (Big 3 vs. Toyota/Nissan):
 - High trust = low transaction costs (21% vs. 47% face-to-face interaction time).
 - High trust = low procurement costs (employee productivity).
 - High trust = high communication/innovation (3 to 1 level in confidential information sharing)
 - High trust = more dedicated assets.

Study 2

- Kumar's study of an auto parts manufacturer and its retailers.
 - Retailers that trusted the manufacturer:
 - Were 12% more committed to the relationship
 - Were 22% less likely to have developed alternative sources of supply
 - Generated 78% more sales
 - Were rated top-performing dealers

Study 3

- Lane and Bachmann study of first-tier component suppliers in the auto industry in Japan, USA and Europe.
 - High-trust suppliers controlled costs better in Japan.
 - High-trust suppliers defended their profit margins better in the USA.
 - High-trust suppliers were better at JIT delivery.
 - High-trust suppliers were better at joint continuous improvement.

Trust Scorecard©

Value:	Study 1	Study 2	Study 3
- Innovation	(+)		
- Growth		(+)	
- Communi.			(+)
- Commitment		(+)	
- Asset dist.	(+)		
Costs:			
- Search		(-)	
- Contracting	(-)		(-)
- Monitoring	(-)	(-)	(-)
- Enforcement			

Trust Metrics©

Trust > Commitment >
Collaboration = Improved
Interactions

“The more I trust you, the more committed I am to collaborating with you to achieve our mutual goals – which improves supply chain performance.”

How to realize the benefits of Trust?

- ❑ Recognize the strategic value of **Trust**.
 - ❑ Select the right **Trust** metrics for your network.
 - ❑ Develop a **Trust Scorecard**:
 - Scope of the assessment
 - Who will be involved
 - Need for confidentiality and an unbiased mediator
-

How to realize the benefits of Trust? (continued)

- Review the opportunities to improve **Trustworthiness** within/across your network.
- Make the appropriate commitments:
 - Prioritize tasks
 - Educate
 - Incent
- Develop a “maintenance & repair” program.
 - Monitor your **“Trust Economics.”**

Closing Thoughts

- The first step to achieve the level of **collaboration** and **trust** noted at the this conference, the industry needs to...
 - Make **Trust** a strategic imperative.
 - Conduct a series of pilots – with best-in-class manufacturers - to demonstrate the “**Economics of Trust.**”
 - Report on the “**Economics of Trust in the Aerospace and Defense Industry.**”
 - Launch a **Trust Training and Education** program for OEM/Prime Contractors as well as their suppliers.

All the information presented by Dr. Kenneth A. Saban is copyrighted. Written approval is required for any use of his presentation material.

Dr. Saban can be contacted at 412-396-5152 or saban@duq.edu.