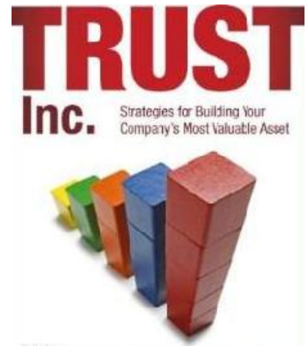
TRUSTED TO LEAD SERIES



Excerpted Chapter by
Robert Porter Lynch

Trust: The Economic Game Changer

How Trust can mean the difference between life and death in business

by Robert Porter Lynch,

WARREN COMPANY™

This chapter is included in
Trust Inc: Strategies for Building Your Company's Most Valuable Asset
now available via Amazon

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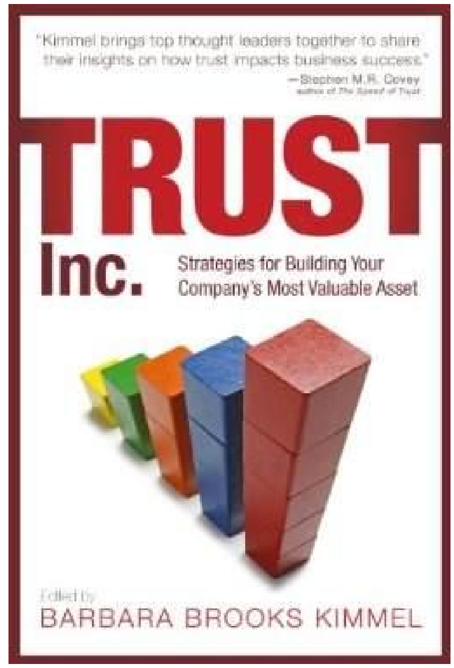

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This chapter is a short piece growing out of years of research that will be embraced in a chapter by the same title in my forthcoming book: ***Trusted to Lead***, by Robert Porter Lynch

Contents

SURVIVAL IS NOT A GIVEN

Success in any business venture, large or small, is not assured. Even the combination of a great strategy and a great product will not guarantee success. Nor will a company's size insure against failure. Startups and venerable giants alike can be struck down by a seemingly invisible disease: distrust.

Banks, airlines, and auto companies are just a few of the industries torn asunder by the distrust disease. Dishonest business practices ripped apart the banking and investment industry worldwide, causing trillions of dollars of economic damage. Every year large airlines file for bankruptcy and the common denominator is nearly always labor strife – a long history of labor-management distrust which causes highly inefficient delivery of services. Sports leagues like the National Hockey League and the National Basketball Association have been stricken by strikes that nearly threatened their very existence.

What's more, the disease of distrust tends to spread like an uncontrolled virus, soon becoming a plague that feeds on fear and greed.

U.S. AUTO INDUSTRY SUCCUMBS TO THE DISTRUST DISEASE

One industry that's dear to everyone is the auto industry – the world's most visible and best-studied business sector. In 2009, General Motors and Chrysler both filed for bankruptcy and Ford came darned close. Being "too big to fail," every taxpayer in the United States, through the action of the President, became an investor in GM and Chrysler via a bailout program (as taxpayers also did with the banks that failed).

What is less well known is that in the five year period leading up to the auto crisis, the "Big Three" U.S. automakers collectively had lost over $100 billion in the prior five years running up to the 2008 financial meltdown. The financial cataclysm did not cause their failure; it just put them over the precipice.

How could such large companies, staffed by highly educated management professionals, make such horrific mistakes? What really happened? What can we learn from this debacle?

How Distrust Became Deadly in Detroit

Today, most cars are assembled from components provided by outside suppliers. Typically 70-80% of an auto (such as seats, wheels, radios, and tires) is produced by suppliers, and the remaining (such as engines and transmissions) are made by the manufacturer, who then completes all the assembly.

Twenty five years ago, when the Japanese auto manufacturers -- Toyota, Honda, and then Nissan –– began building cars in the U.S., they tapped into the same supplier base used by the Big Three. The Japanese manufacturers on North American soil took a strategy with their supply chain to build trust: high levels of cooperation, respect, mutual sharing of ideas, continuous innovation, and a willingness to share in the cost savings those new ideas would bring. For example, if a supplier could redesign a group of parts to make them into only one part, thereby shortening assembly time, reducing complexity of inventory, and lowering potential warranty costs, the supplier would be rewarded by a 50/50 share in the savings.

Toyota used its vaunted "Lean" production model ("Kaizen" meaning continuous improvement) evolved to threaten Detroit's Big Three – Ford, GM, and Chrysler. At Honda, Senior VP of Procurement, Dave Nelson spoke of the insights Honda had about human behavior. He said the Golden Rule prevailed – treat people with dignity and respect, don't beat up on suppliers like lowly vendors, and never play the blame game when something goes wrong. I asked Nelson about innovation with his suppliers, and his remarks were quite insightful:

> *"When we receive a suggestion from our suppliers, we split the savings 50/50. However, if a supplier is not making their profit numbers, we give them a larger percentage of the savings (in the short term), sometimes up to 100%. It helps them out."* [1]

Having earlier spoken with GM suppliers who indicated that their relationships with GM were unprofitable, I asked Nelson about costs over the course of model run. He mapped the cost structure on a pad of paper using a target costing approach. (see Figure 1) He smiled and said that a product that cost $1.00 to manufacture had been reduced to $.58 by the end of the model run, which put over a billion dollars a year on the Honda's bottom line.

Not totally convinced that this was in the best interests of suppliers, I asked Nelson about supplier profitability over the product life cycle. He assured me everyone gained by this approach. Pressing farther, I challenged him. Honda, he affirmed, was committed to ensuring the sustainability of its supply base.

> "We regularly monitor the financial condition of our suppliers. I can assure you they are *more* profitable at the end of the product life cycle than at the beginning."[2]

Figure 1: Cost Reductions by Honda Suppliers

Toyota, for example, was not easy on their partners; they expected top quality and continuous improvement. But if a problem arose with a supplier, Toyota's presumption was: "we" have a problem, "we" must determine the cause, and "we" must mutually solve.[3] The Japanese manufacturers saw their suppliers as critical partners in the whole chain of value creation. Similarly they saw their employees in the same way; along with their newly emerging dealer-distributor-service network that interacted with the customer. Each member in the value-creation process was treated honorably as a cherished partner.

During the 1990s, Toyota and Honda gained ground fast, eating away at the Big Three's once monumental market-share. By building trust with their suppliers and treating them fairly, each grabbed a larger chunk of market share with higher quality, all the while keeping themselves and their suppliers profitable.

In stark contrast, Detroit's Big Three bludgeoned their key suppliers, using adversarial, short sighted tactics, to the detriment of all. Constant margin squeezing decimated the supply base. GM and Ford saved money in the short run, but at the at the expense of consumer value who received poor quality cars; and the suppliers were financially weakened - a flawed strategy.

Working with a wide variety of auto supply companies in the 1990s was very revealing. Most auto suppliers provided parts for General Motors, Ford, and Chrysler. Some were qualified as outsourcers for Honda or Toyota. For those that supplied both US and Japanese auto manufacturers, I would ask about their experiences. The worst buyer was, unquestionably GM, followed closely by Ford. Both were notorious for nickel and diming their suppliers, bullying behavior, and illegally canceling contracts or violating the proprietary material of their suppliers.

At one workshop I conducted in Detroit for CEOs of auto suppliers, I asked what kind of cars they drove themselves? Universally all the CEOs said their personal cars were Japanese. I asked "why?" They all agreed: "Because we know what goes into them!" One CEO meekly raised his hand and said "We have a token GM car which we only drive to meetings with GM for fear of retaliation."

Lack of Cooperation was Extremely Costly

GM's Procurement Czar, Ignatio Lopez' notorious negotiations techniques ran roughshod over every supplier in GM's supply base; he used ignominious and illegal tactics to pressure suppliers into price cutting that left them with the choice to either abandon GM or sell to GM below their costs of production. Lopez tore up legitimate contracts in the face of the supplier or illegally took supplier's proprietary drawings and give them to Chinese vendors for bids. One ploy that sorely irritated every supplier was to demand an immediate price cut of 20% or lose their contract. Suppliers were faced with producing at a loss, or shutting down large production lines, resulting in even bigger losses. Quality slipped, production lines often didn't have the parts ready for assembly, and GM's warranty costs consistently outpaced their profits.

Vendors weren't the only group to receive GM's wrath; its labor relations fared no better. At one GM plant in California there was a backlog of over 5,000 grievances, the result of a long-standing war between labor and management. Workers were boozed up or drugged up on the job. The absenteeism was often so high (frequently exceeding 30%) that the production line couldn't be started, which meant production halted. Workers regularly sabotaged cars on the assembly line, putting ball bearings or Coke bottles in the doors and frames so they would rattle around and annoy unsuspecting buyers.

Rancor and distrust was so thick you see, smell, and taste it. Self-esteem was destroyed, and adolescent revolt became everyday adult action.

Ford, not to be outdone, unilaterally changed contracts, reprogramming their computers to reduce the amount of any invoice by 5%. Adding insult to injury, Ford then obtained totally unrealistic bids from unqualified suppliers, which were used to pressure suppliers to succumb to unfavorable price reductions in order to keep their contracts.

Every part was examined to squeeze out more costs.

Here's a tragic example of price squeezing: The Explorer was one of Ford's most profitable vehicles, yielding $3-5,000 to the bottom line every time one was sold.

However, customers complained of the Explorer's harsh ride. Rather than spend money to reengineer the suspension's spring-tension levels to make the ride a little softer, Ford let pressure out of the tires. Firestone, the tire manufacturer, shot back that the lower tire pressures were below design specifications and would result in blowouts. Firestone recommended the addition of another nylon belt around the tire to enable it to run effectively at the lower pressures, reducing the failure rate by a factor of five.

Ford vetoed the idea – it was too costly. The addition of a nylon belt would add another 90 cents to each tire's cost, eating away at Ford's hefty profit margins.

The tires failed horribly. Ford was forced to replace all 13 million tires on its vehicles, at a total cost of about $3 billion. The recall and associated suits cost Firestone more than $570 million. But worse, more than 100 people died in crashes caused by failures of tires on Ford Explorers; law suits were filed around the world.

> "The whole thing just screamed greed," said La Rita Morales, part of a jury in California that earlier this year awarded an Explorer driver $23.4 million in damages. "I didn't believe in my heart that a company like Ford would put out a product with question marks over it."[4]

The debacle cost Ford billions of dollars in lost sales and law suits. All for a 90 cent belt. The tire manufacturer blamed Ford;, and Ford blamed the tires. The lawyers blamed everyone. Law suits dragged on for years.

The Warning: Distrust Costing US Automakers

Warning signals were everywhere during the years leading up to the 2008 meltdown and the impending "too big to fail" bankruptcies. An annual automotive benchmark study in 2004[5] sent emergency signals unequivocally:

- "U.S automakers' relations with their suppliers suggest more trouble if they don't change the way they deal with their U.S. suppliers …[who] are shifting their loyalties – and resources (capital and R&D expenditures, service and support) – to their Japanese customers at the expense of the domestic Big Three.
- "Supplier trust of Ford and GM has never been lower; conversely, trust for their Japanese counterparts has never been higher. Suppliers are increasing product quality at a greater rate for the Japanese.
- "US automakers have little regard for their suppliers, they communicate very poorly and they generally treat suppliers as adversaries rather than trusted partners. In all the other industries studied such as aerospace, electronics, and computers, no one treats their suppliers as poorly as the US automakers do.
- "US automakers continue hammering their suppliers for price reductions and multi-million dollar cash givebacks and suppliers are responding by giving them less support.
- "This shift in loyalty is not driven by cost reduction pressures on suppliers, but rather on how the US automakers work with their suppliers across a wide range of business practices.
- "The greater the trust between buyer and supplier, the more suppliers are willing share and invest in new technology, and provide higher quality goods and higher levels of service, which lead to greater competitive advantage and market share."

The disease of distrust in Detroit was virile. The author of this study, John Henke, presented this observation:

> "What is apparent is that the Japanese manufacturers are applying continuous improvement practices to their supplier working relations just as they have done to their manufacturing processes, and as a result they continue to win the cost-quality-technology race."

By 2008, things had gone from bad to worse for the Detroit Big Three, who had combined losses of over $100 billion for the prior five year period, while at the same time driving 500 suppliers a year out of business. Their flawed strategy of distrustful relationships took its toll not only on their businesses, but on the surrounding community.

Today, the effects on the City of Detroit's economy are horrible. The municipality is losing population at the highest rate in the U.S.; housing values are at the bottom. Detroit Mayor Kilpatrick, taking his cues from his Big Three counterparts, extorted money from city contractors, was convicted, and sentenced to jail. In 2009 the median home sale in Detroit was a sickly $6,000. Abandoned buildings litter the cityscape. The dreams and investments of thousands of city residents were crushed. By 2013 the City of Detroit was $14 billion in debt – bankrupt -- a "ward of the state."

Distrust Destroyed Detroit
by enabling innovation and productivity to flow away to other regions
where partners focused human energy to create value, not warfare.

This is the real message of trust and hope for our commercial future. Trust is not just good ethics; trust is about building the relationships that charge the human spirit with the collaborative energy to tackle new problems together; to build bold new futures synergistically; to join forces across the boundaries of supply chains to innovate; to safely know that the one will not be trapped by foolish win-lose gamesmanship; and to challenge the status quo with the assurance new ideas are welcome.

Trust's Hidden Advantage: Innovation

Lest one be lured into a false sense of hope brought about by the good feelings of trust, believing trust alone will assure business success, there is really much more. Trust, while highly desireable, is not the end or the goal; it's just the beginning of a larger process.

Toyota, Honda, and Nissan, unlike their U.S. rivals, understood that trust was the foundation of *collaborative innovation* – the hidden source of competitive advantage. By removing fear, doubt, suspicion, and manipulation from their business relationships, a much more powerful program of joint problem solving, removal of non-valued work (such a redundancy), reduction of waste, and acceleration of work flow could flourish. High trust is not the goal; it opens the pathways to real value creation, which then manifests in competitive advantage and profitability.

Trust enables everything to move faster, more effortlessly, and with less conflict. Mistrust causes everything to be more complicated, slower, and far more fragmented. Because virtually all innovation is a *collaborative* effort; and there can be no collaboration without trust.

Fortunately for the U.S. auto industry, the 2008 debacles shook the foundations of ill-conceived beliefs. New leadership has made some improvements to their supplier relationships, but so far nothing earth shattering that would make a compelling case for taking advantage of trust as an economic game changer.

How to Channel Trust into Collaborative Innovation

How important is trust? Our studies show, time and again, high trust organizations have at least a 25% competitive advantage over their low trust counterparts. Embedding a system of trust into your organization or alliance yields enormous rewards for all stakeholders. Trust unleashes latent human energy and enables it to be aligned on a common purpose. Leaders who want to support collaboration, be considered trustworthy, and trigger innovation should keep the "FARTHEST" principles in mind:

- ***Fairness*** *in all your dealings to be sure that everyone gets a fair shake. Successful innovation leaders are perceived as being even handed, good listeners, and balanced in their approach.*
- ***Accountabl****e for your actions. When you make a mistake, admit it and move on. Accountability is the external manifestation of internal integrity. Leaders without integrity are quickly dismissed as hypocrites.*
- ***Respec****t for others, especially those with differences in skillsets and points of view. Without respect for others, trust cannot be built. Giving respect often the first step in gaining trust. A sense of empathy, which is an even more powerful trust builder, can then emerge.*
- ***Truth*** *is an absolutely essential component of building the type of trust that triggers innovation. Remember, your emotions or perceptions are seldom real truths. Stick to the facts – things that are measurable or concrete. And be aware that a critical comment has about five times the impact as a positive comment; so balance your truths carefully.*
- ***Honorable purpose*** *must be the foundation of all your actions. If people perceive your purpose for innovating as strictly for selfish purposes, without a component impacting the 'greater good,' you will not be perceived as trustworthy. This frequently means sharing the rewards.*
- ***Ethics and excellence*** *in standards. Innovation is propelled by the idea of always getting better, improving continually, reaching for the highest level of performance. If anyone sloughs off, they must realign to the highest measures, otherwise others will be resentful or fall off in their performance.*
- ***Safety & security*** *are essential to all human beings. This includes ensuring that there is "No such thing as Failure, Only Learning." Be careful not to punish what might look like a failed attempt at creative solutions. And always avoid the Blame Game. Fear does not produce innovation. You will know when people feel safe – they will be laughing. Creativity is not all grinding labor; it's having fun and laughing a lot, spontaneously creating in the moment – that's magical. Research shows that laughter releases endorphins that trigger creativity.*
- ***Transparency & openness*** *enables seeing intentions, sharing data, and ex-changing ideas in a culture that supports challenging the status quo yielding new insights.*

The FARTHEST principles should be embedded into decision making, interpersonal relationships, and the fabric of organizational culture. These principles are essential to help diagnosing precisely broken trust and then rebuilding trust. Further, these principles must be taken holistically – together they generate trust – but independently, no single principle will generate trust alone. .

Conclusions and Insights

Trust and the Creation of Value

Trust enables a company to gain traction because it shifts the game of business from *transactionary exchange* to *value creation*, (and prevents value destruction) as illustrated in Figure 2: Power of Trust on Value Creation.

Toyota and Honda beat the Big Three by shifting their thinking about value derived from supplier relationships from traditional *Value Exchange* interactions to *Value Creation – the Game Changer* -- enabled by trust.

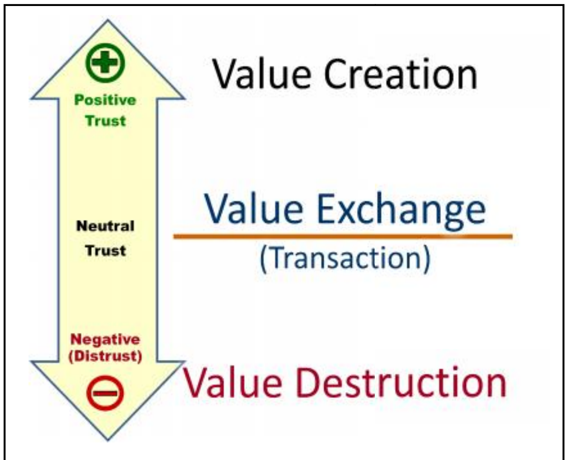

Figure 2: Power of Trust on Value Creation

Triumph of Small Numbers

How does trust change the financial game of business? Trust is the not the cause; it's the enabler. Gordon Bethune, the CEO who engineered the remarkable turnaround of perennially bankrupt Continental Airlines in the mid-1990s stated the phenomenon directly,

> "Trusting our employees didn't mean ignoring the business and letting it run itself, and it didn't mean that no matter what anybody did it was okay….
>
> "We want employees to use their judgment…."[6] "Multiply every little solution by more than 2000 flights a day, by millions of telephone calls to our reservation centers, by thousands of bags that might have missed a plane if someone didn't hustle, by thousands of gate agents taking thousands of decisions to keep passengers happy and planes moving. You can see the impact our new policy has…. "We want employees to make smart decisions, not blindly follow rules. Suddenly our employees are running a good airline."[7]

In a trust-enlivened atmosphere, employees are given greater power to use their innate ability to solve problems. All the little solutions begin to add up into a major profit:. The power and success of trust seldom occurs in the meteoric manifestation of one grandiose act or event, but in the subtle, almost invisible multiplication of thousands of small decisions, actions, and better results – the Triumph of Small Numbers[8] – adding a slight percentage here, a small advantage there, a minute shift in weight in another place -- accumulating, pulsing like a shock wave triggering an avalanche of competitive advantage.

We believe the factual, quantifiable data tells a compelling story about the reason why companies succeed and fail, and what constitutes effective leadership and leads to a powerful insight:

Bottom Line: Trust makes eminent financial sense, accelerating and amplifying the creation and sustainability of value. Trust enables a company to gain traction because it shifts the game of business from *transactionary exchange* to *value creation through innovation and rapid recovery from mistakes.*

The real advantage of trust? It is the deepest yearning of all humans; we were born with it, and it's our birthright to retain or regain it.

Many leadership situations require influencing without authority, which can only happen when those we wish to influence trust us. Trust produces highly effective people, high performance teams, useful ideas and innovations, and people who want to come to work because it is an energizing, co-creative experience.

Great Leaders do Three Things Well:

1. **Strategy:**
   Set an Inspirational Vision, then chart an Innovative Course
   that generates a Significant Advantage or Improvement
   over ordinary alternatives.

2. **Trust:**
   Create a Culture/System of Trust that Unleashes & Focuses Human Energy & Co-Creativity on Achieving the Strategic Vision.

3. **Operations:**
   Establish Excellent Organizational Processes, Measures, & Rewards that achieve #1 (strategy) and coherently reinforce #2 (trust).

****

The late Paul R. Lawrence of Harvard Business School saw the power of trust with deep insight:

Trust determines the course of history,
the destinies of nations, and the fate of people

End-note References

REFERENCES

[1] Interview, October 21, 1997 Pinehurst, NC.

[2] Another test of the power of Honda's quality control is represented by used car prices. A Cadillac, at the ten year point in its life will have lost a far greater % of its original value than a Honda. Typically the Honda depreciates at about half the rate of a Cadillac.

[3] GM, on the other hand was loathe to accept any responsibility for supplier difficulties, and would first place blame on suppliers, who may have been victims of poor planning or communications.

[4] Internal Ford Documents about Explorer Rollovers *By Peter Whoriskey,* Washington Post Staff Writer, May 8, 2010

[5] Planning Perspectives, Inc Report, Aug 2, 2004. Responses from 223 Tier 1 suppliers including 36 of the Top 50 and was based on 852 buying situations. Participating suppliers' combined sales represent 48% of the OEM's annual purchase of components.

[6] Bethune, Gordon; *From Worst to First, Behind the Scenes of Continental's Remarkable Comeback*, Wiley, 1998, p 134

[7] Bethune,Ibid, p 112

[8] Author's Note: The principle of the "triumph of small numbers" and its corollary "tyranny of small numbers" indicates when a small increase in a small number/percentage occurs, a large increase in another number will occur. This is particularly true regarding profitability when revenues increase and costs decrease (or vice versa) by small numbers.