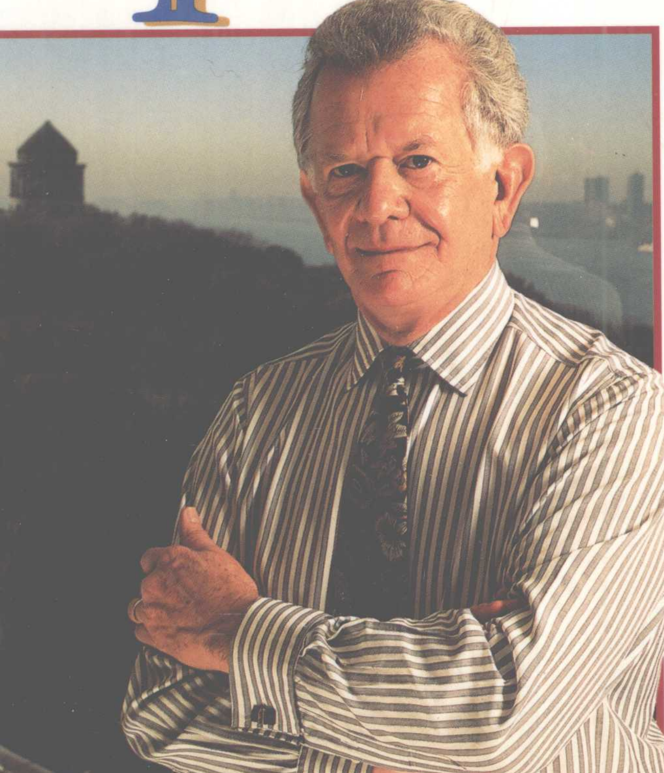
JOHN O. WHITNEY

THE TRUST FACTOR



LIBERATING PROFITS & RESTORING CORPORATE VITALITY

FOREWORD BY W. EDWARDS DEMING

The Trust Factor

Liberating Profits and Restoring Corporate Vitality

John O. Whitney

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This book is dedicated to three wise men: Olney A. Whitney, who taught me respect for learning; Professor Franklin J. Eikenberry, who taught me respect for the English language; and Dr. W. Edwards Deming, whose theory of profound knowledge changed the course of my professional life

Foreword

by W. Edwards Deming

We have reached the limits of the capability of our current philosophy and resulting methods of management. American Industry, our services, our government, and our education are today in an invisible prison. The walls of the prison are the basic assumptions that are made today about economics and human behavior. They are outmoded in the global economy of this day. We can emerge from this prison only through knowledge that is not a part of the present system. This knowledge may be described as Profound Knowledge. The result of adoption and application of Profound Knowledge is transformation of the individual. The individual, transformed, has a basis for his own life and decisions, and a basis for judgment and suggestions for other people's actions.

A key element of Profound Knowledge is the concept and application of the theory of a system. A system is a network of interdependent components that work together to accomplish the aim of the system. A business is a complex system. All of the components—research and development, sales, manufacturing, etc.—are interdependent and must work together to produce products and services that accomplish the aim of the system.

Optimization for accomplishment of the aim of a system requires cooperation between the components of the system. Left to themselves in the Western world, components become selfish, competitive, independent profit centers. An organization must accordingly be managed.

The cost of mistrust is one of the losses to business and to society in the Western world that can not be measured. There is the unmeasurable psychological cost of anxiety, and of layers of inspection to test conformance to agreement.

The most important losses can not be measured, yet these are the losses that for survival we must manage (a principle stated years ago by Lloyd S. Nelson).

Trust is mandatory for optimization of a system. Without trust, there can not be cooperation between people, teams, departments, divisions. Without trust, each component will protect its own immediate interests to its own long-term detriment, and to the detriment of the entire system. Transformation is required. This means adoption and integration of new principles.

Transformation begins with the individual. The job of a leader is to create an environment of trust so that everyone may confidently examine himself.

Professor Whitney brings home, in concrete fashion, the tremendous costs of the prevailing system of management. He helps us examine our current systems to see how lack of trust adversely affects today every aspect of our business. He helps us to look through the lens of Profound Knowledge so that we may begin to manage our organizations in a spirit of cooperation, win-win.

Mistrust is the basic reason for procedures drawn up in great detail, often 30 or 40 or more pages, for any agreement or transaction in business, whether it be simple or complex.

In contrast, two Japanese companies would draw up an agreement in one or two pages, with phrases such as "details to be worked out later, if need arise." It is understood without comment that the basis for working out the details later would be win-win, neither party to be a loser. We could learn a lot from Japan.

W. E. D.
May 1993

Preface

For the past 20 years, I have been involved with business turnarounds. Fourteen of those years, I was a CEO, COO, or chairman. The past seven years, I have been a professor of management, teaching the corporate turnarounds course at Columbia Business School. And, for the past three years, I have also served as director of the W. Edwards Deming Center for Quality Management at Columbia. One might naturally ask, "What do turnarounds, trust, and Dr. Deming have in common?" In a word, everything. A sustainable business turnaround is more than firing people, divesting companies, or practicing financial engineering. If the recovering company cannot soon stand toe-to-toe with world-class competitors, its agony will have been all for naught. Many of its competitors will have been influenced by the theories of Dr. Deming, who, as most people know, was an architect of history's most astonishing economic turnaround—Japan after World War II and until the late 1980s. Although Japan is having serious economic difficulties in the 1990s, few analysts believe these difficulties are the result of the operating management methods introduced by Dr. Deming.

As for trust, Kenneth Arrow, the Nobel laureate, has said that it is the lubricant of society.[1] In business turnarounds as well as leading-edge companies, trust is not only the lubricant that helps get things done, it is also the glue that holds the organization together.

Trust might seem to be an unusual organizational attribute. But it is well known to those who have led successful operational turnarounds. After the agonizing period of downsizing and divestiture is complete, the turnaround leader quickly assembles a group of people whom he or she trusts. The leader works with them to establish appropriate goals, then turns them loose with no red tape and a minimum of control. Furthermore, the leader sees to it that an aura of trust radiates from the core group through the entire organization. The troubled company cannot afford mistrust. It cannot afford to sap people's energies by requiring them to constantly outwit a tar pit bureaucracy. It cannot afford a towering organization structure and stove-pipe functions with the attendant excesses of inspection, supervision, checks, balances, reports, and controls. If it does not unburden itself of this baggage, it will provide full employment for the next decade's crop of turnaround specialists.

This warning is not idle speculation. It is the result of my study of hundreds of businesses, large and small, troubled and presently untroubled. My conclusions are based on the following premises:

If the function of business is to profitably design, build, and sell a product or service, then about half of its activities are unnecessary. Put another way: Costs are about double the optimum. Moreover, wasted activities and unnecessary complexity sap the creative energy and the motivation of the people doing the work, a cost that is not measurable. If these premises seem extreme, consider your answers to the following—either for your organization or for business in general.

1. Are administrative costs increasing faster than revenue growth?
2. Are selling and marketing costs increasing faster than revenue growth?
3. Is time-to-market competitive?
4. Are new products or services meeting or exceeding customer expectations?

5. Is the entire organization focused on the customer, or is it generally focused inward on relationships among its own members?

Current business performance suggests that answers to these questions would be unsatisfactory. Many business giants are in decline. Economies of scale and scope seem now to be diseconomies. Small organizations appear with great promise, soar for a while, then too many gradually decline or, worse, crash and burn. The premise holds true even for businesses that have downsized. If they have not removed unnecessary activities and unleashed the creative potential of the people who remain, these businesses find that they must downsize again and again—sometimes into oblivion.

Nothing is really new here. Disasters like these are reported daily in the business press. But if the problems are well known, the real causes apparently are not. Quite often the blame is laid on external forces: technological, regulatory, or environmental changes, and competitive activities. These are reasons, not excuses. External factors apply to everyone. Companies with low cost structures that retain the ability to move quickly with leading-edge products and services welcome change in the external environment. But for companies whose costs are too high and whose competitive edge is dulled and whose response is slow, change is frightening; existence for them is difficult, even in a benign environment.

My earlier assertion that 50 percent of our activities are wasted might be conservative. George Stalk and Tom Hout, the pundits of time-based management, report: "Most products and many services are actually receiving value for only .05 to 5 percent of the time that they are in the value delivery system of their companies."[2] Mike Hammer, the guru of reengineering, reported his now-legendary example of the 80 percent reduction in the accounts payable work force at Ford Motor Company.[3] Tim Fuller, who studies complexity in business organizations, reported work-sampling observations of an assembly operation in which 43 percent of the activities were real work. The rest was unnecessary complexity.[4] Tom Peters in *Liberation Management* reports on the famed Asea Brown Boveri firm, which believes the headquarters staff of most activities can be reduced by 90 percent in the first year. ABB runs a company which in 1991 had $28.9 billion in revenues, with only three layers of management. Peters reports similar results in the Titeflex Company.[5] My experience as a work-out consultant at the appliance division of General Electric confirms these observations. GE is probably the best-led large company in the world, but its administrative activities, effective as they are, still are too burdensome.

Many companies address administrative waste by applying techniques like process mapping, flow charting, town meetings, and thinking "outside the box." Others bulldoze waste and complexity out of the enterprise. All these streamlining activities are necessary and commendable. Some will endure because they are directly or indirectly addressing causes as well as symptoms. But others will have their brief moments in the sun, then fade away, because they have treated symptoms only. Processes that have been reengineered will be replaced by processes that look like the ones that have existed before the reengineering consultant arrived. Time and complexity will creep back into those processes and those systems. Managers and employees will burn out, become disillusioned, or leave the enterprise.

Mistrust is the cause that must be addressed if these process improvements are to endure. We do not usually trust the competence and motives of others. Sometimes we do not trust their integrity. We do not trust information—especially the financial and accounting reports. To protect ourselves, we build fortresses: extra measurements and controls, reviews, meetings, memos, and documentation. We break jobs into smaller pieces, then we add layers of supervision. We add inspectors. We tinker with incentive and reward systems. We centralize, then decentralize. We alternate between delegation, abdication, and micromanagement. When all else fails, we transfer or terminate management and employees. Defensive measures like these will not support enduring improvement.

Perhaps analytical business people are reluctant to address trust and mistrust because these concepts seem too soft. "Give us something hard and substantive, not something fuzzy like trust." Their reluctance is vindicated also by the realization that much mistrust is well placed. People are often incompetent. Their motives often clash with ours and with the firm's. Sometimes they lie, cheat, and steal. The financial information they provide is often late, wrong, or irrelevant.

Reluctance to address trust might be eased, however, if we were to acknowledge that trust in business is not like Portia's mercy, which "droppeth as the gentle rain from heaven." On the contrary, in order to trust we must first mistrust. Enduring trust must be earned—up, down, and across the organization. How it is earned, preserved, and used to reduce waste and eliminate unnecessary complexity, how it is used to improve the vitality of the firm and its products and services, is the subject of our enquiry.

John O. Whitney

Acknowledgments

My first meeting with Dr. W. Edwards Deming was a pivotal event in my professional life. That meeting in 1987 prompted a warm friendship and, for me, a continuing intellectual challenge. Many of the propositions I advance in this book will be familiar to those who have studied with Dr. Deming. They will understand my profound debt to him—in almost every chapter. But no one speaks for W. Edwards Deming. His voluminous writing and public statements speak for themselves. His recent book, *The New Economics for Industry, Government, Education,*[1] will set a standard for years to come. If the ideas here are credible, many of the plaudits go to him; if not, the blame to me.

The other two men to whom the book is dedicated also had a powerful influence on my life. My father was a school principal in southeastern Oklahoma during the depths of the Great Depression. School pay was so low that he moved to the oil fields, then on to oil company headquarters; but his love of learning never left him, and he held it high for me to see. Franklin Eikenberry was professor of English at Tulsa University. His specialty was the Shakespeare history plays, in which he was so steeped that his lectures seemed to be in perfect Elizabethan blank verse. Blank verse or not, Shakespeare's lessons in leadership sprang to life under Professor Eikenberry's tutelage. The good professor made another contribution. He once suggested that if I wished to truly appreciate the English language I should write a sonnet a day. I produced a semester of the world's worst sonnets but did learn to appreciate the English language.

Professor John O'Shaughnessy, the most literate man I know, challenged some of my incendiary assertions, causing me to offer a more balanced discussion which, in my view, made my case stronger and more believable. He also diverted the muzzle from my foot in several instances where I had an imperfect understanding of the antecedents of the theories I had cited. Moreover, he provided a comprehensive written critique, which profoundly influenced the finished manuscript.

Michael F. Young, Esq., of Willkie Farr & Gallagher, with whom I have worked and who I have come to respect as a brilliant lawyer and as a razor-sharp intellect, provided tough criticism and enthusiastic support. I shall always cherish two of his marginal notations: "Whitney, you don't know what you're talking about" and "I just hate this chapter." The offending section and chapter were tossed out. The book is better for the expurgations.

Robert Lear, former CEO, author, and Executive-in-Residence at Columbia, provided insight and support as he always does. His written critique was most helpful. Charles Clough, CEO of Nashua Corporation, reviewed and commented on the manuscript. Moreover, he and three of his senior managers with whom I have also worked—Joe Kershaw, Bob Geiger, and Frank Faticanti—have tested many of the ideas presented here.

Mark Graham, research assistant for the Deming Lecture Series that I offer at Columbia, provided detailed suggestions, most of which were incorporated in the final draft. Kenneth Craddock, senior teaching assistant for the Deming Lectures, commented on the manuscript and continually fed me with new material. Professor Murray Low commented on an early draft and made valuable suggestions about the book's organization. Professor Danny Miller at the Ecole des Hautes Etudes Commerciales in Montreal provided enthusiastic support as well as valuable advice that gave balance to some of my more controversial arguments. Professors Casey Ichniowski and Joel Brockner at Columbia Business School and Professor Donald Morrison at UCLA read portions of the manuscript and supported the central ideas in the book.

I have the honor of serving as pro bono advisor of some departments of the U.S. Navy and have received feedback on these ideas from them. Special thanks go to Admiral Jim Miller and Admiral Don Weatherston and their associates. Former Undersecretary of the Navy, The Honorable Daniel J. Howard, is probably the most knowledgable man in America on the subject of introducing quality management practices in large organizations. He offered valuable advice and support.

Three of the people who are closest to Dr. Deming, Drs. Barbara Lawton, Nida Backaitis, and Joyce Orsini, have contributed substantially to my understanding of Dr. Deming's theories. I owe much to Professor Peter Kolesar, who teaches a Columbia Business School course on the management of quality and who first introduced me to Dr. Deming. Professor Robert Howell, a colleague years ago at the Harvard Business School, now a professor at New York University and a preeminent figure in the new wave of management accounting, influenced many of my recommendations in the chapter on measurement.

Professor Jim Kuhn of Columbia might have started it all during a discussion of business ethics, when he remarked, "Think of what mistrust costs us." Professor Nathaniel Leff has shared with me his own work on trust but has also faithfully sent other material that contributed to the book's central arguments. Geoffrey Heal, professor and vice dean at Columbia Business School, put me on the trail of readings in transaction theory. Professors John Donaldson and Bill Lehr have also shared their insights. Professor E. Kirby Warren, with whom I have worked on assignments at General Electric, brought fine insight into how one preserves the good in organizations while excising the bad. He also made extensive and helpful comments on early chapters. Professor Kathy Harrigan's work on strategy for mature industries continues to provide important insights.

My humble thanks go to business leaders who have been subjected to these theories during their development over the past three years. Well over a thousand men and women at Columbia's executive seminars have shot arrows and thrown bouquets. Both were appreciated, but the arrows were more useful—they caused me to sharpen or change my thinking. Similarly, the hundreds of people at GE Appliances as well as

GE's corporate managers have contributed enormously to my insights, as have executives at TRW Space and Defense sector, Grand Metropolitan plc, The Nashua Corporation, GROWMARK Inc., W. R. Grace, Avon Products, Bristol-Myers Squibb, and dozens of others with whom I have had short encounters. My experience as a manager of business turnarounds has also honed my perceptions. I thank the heroes in these encounters and nod to the villians. I learned from both.

Betsy Brown, senior editor at McGraw-Hill, provided excellent, timely editorial guidance. Marcia Whitney, as always, kept me focused, and her incisive comments brought me from the ether back to reality. Marcia and I both express our enormous debt to Joy Glazener, who not only turned my foolscap into type but who offered insights as well as encouragement. Her contributions were enormous.

Special thanks go to David John Sainsbury, Chairman and CEO of J. Sainsbury plc, whose business leadership has been inspirational and whose faith in the Columbia Business School prompted his initial contribution to the Deming Center.

In considering the massive help and encouragement from my colleagues over the past three years, I probably should be reluctant to put my name on the book, but many of my constructs might be controversial enough that my colleagues will be happy to remain as advisors merely. Indebted as I am, I nevertheless shield them from unwarranted criticism by assuming full responsibility for the ideas and words that follow.

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