

# **The Impact of Trust and Dependency on Business Performance: A Study of SME Suppliers**

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### **Abstract**

The purpose of this study is to examine the extent to which trust and dependence are predictive of performance for small and medium sized vendors. Using a sample of 134 university vendors in the southwest region of the U.S., regression was used to test hypotheses related to both constructs while controlling for the organizational attributes of size, years working as a supplier to the buyer, and years working with the existing company. Results indicate that both trust and dependence are significant predictors of supplier performance for SMEs in the supply chain relationship.

### **Introduction**

Although small business owners often face challenges in their supply chain relationships, their size allows them to be well suited for logistical integration with a key number of suppliers (Gélinas & Bigras, 2004). Some advantages for effective supply chain practices in small firms include centralized decision making, organizational flexibility with limited layers of bureaucratic structure, and a focus on customer service and business growth. In addition, small business owners often search for greater access to resources and learning opportunities that make them more open to strategic relationships (Beekman & Robinson, 2004). Research has shown that long-term relationships with other organizations can increase the growth and survival for small businesses (Aldrich & Auster, 1986), while the absence of these types of relationships may contribute to higher failure rates (Baum, Calabrese, and Silverman, 2000).

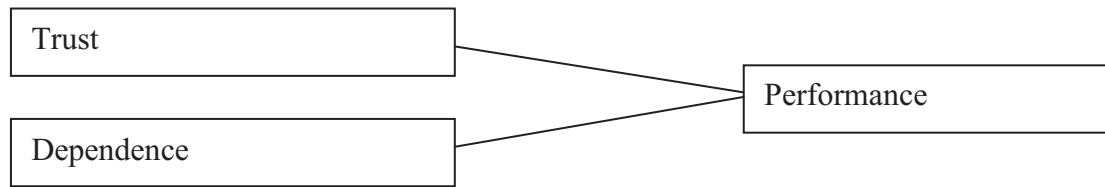
While the streamlined structure and customer service focus of most small businesses promote effective supply chain integration, there are also challenges that can limit the effectiveness of such relationships. Among these challenges are less access to information

technologies, limited long range planning capabilities, and a lack of efficiency and size to achieve economies of scale. Due to these limitations, G  linas and Bigras (2004) suggest that small businesses must be willing to invest in strategic relationships with key suppliers in order to achieve success in today's ultra competitive business environment.

If small businesses are to be successful in logistical integration they must rely on a strategic approach that allows them to be viable partners with larger firms. Much of the supply chain management literature has focused on models and practices that work best for large multinational firms. In situations where organizational size and resources can vary dramatically, small business owners must adopt practices that allow them to be viewed as legitimate business partners. The opportunities for successful partnership must be weighed against the unique challenges faced by small business in order to create working relationships that are mutually beneficial for all parties involved. Additional research is needed to better understand the supply chain management strategies and processes used by small businesses that result in success.

The purpose of this study is to examine organizational performance of small businesses and the role of trust and dependence in the supply chain management function. Our specific aim is to examine the relationship that trust and dependence have with the performance of small and medium-sized enterprise from a supplier's perspective. Prior research by Redondo & Fierro (2007) examined the relationship of trust and commitment in supply chain integration based on the buyer's role. Our study will expand on their findings and offer a different perspective from the role of small business supplier. A model of the relationships can be found in Figure 1.

Figure 1  
The Relationship of Trust and Dependence with Performance in SMEs



### Literature Review

#### Small Business

Supply chain management can serve as a critical function for small and medium-size enterprises, and there has been a call for more focus on its impact within the small business context (Gélinas & Bigras, 2004; Nelson & Ratliff, 2005; Morrissey & Pittaway, 2006; Redondo & Fierro, 2007). Past studies have shown that business size has a direct impact on the power dependency with the distribution channel (Gélinas & Bigras, 2004; Redondo & Fierro, 2007), and that larger companies are often able to control the relationship with smaller customers or suppliers (Mudambi, Schruender, & Mongar, 2004). As suggested by Gélinas & Bigras (2004), this can lead small businesses to have a subordinate relationship to larger companies.

Since small businesses can be vulnerable to the demands of larger companies, Saunders (1997) and Fuller and Lewis (2002) propose that small business owners identify organizations in which they can develop mutually beneficial relationships. Similarly, Beekman and Robinson (2004) urge small business owners to selectively identify businesses poised for growth and to focus on finding partners interested in long-term relationships. When size differences exist, smaller firms can focus on using business strategies that emphasize strategic relationships and customer service. If done correctly, small businesses can use supply chain management practices to develop a competitive advantage for sustainable growth (Ahuja 2000).

In addition to size differences, most large companies have a supply chain management function, whereas small businesses often lack a formal supply chain system (Quayle, 2000). In fact, supply chain management is generally not addressed in the business plan of most new ventures. This creates a situation where suppliers with limited resources are forced to provide substantial accommodations to larger organizations while also facing intense price pressure and customer service expectations (Kasouf & Celuch, 1997). Many small business owners, particularly micro businesses, tend to prefer a more informal managerial style and are responsible for collecting information and making final decisions (Matlay, 1999). As their businesses grow, they may adopt a more formal approach to supply chain management, but still the resources available to small ventures pale in comparison to the purchasing departments found in most large companies. As suggested by Morrissey and Pittaway (2006), once a business gets to a certain size, generally 26 to 50 employees, it will often identify a purchasing agent responsible for managing supplier relationships. Even then, however, there is limited information processing abilities and resources.

Research by Redondo & Fierro (2007) produced interesting findings when comparing the buyer relationships within micro businesses and small and medium-sized enterprises. Among their findings was that trust and commitment had a greater impact on the long-term orientation of supplier relationships. In addition, communication was found to be important for both types of small businesses. Other key components in relationship development included frequent inter-firm contact, firm flexibility, and a willingness to adapt to the changing external environment.

No matter the organizational size, supply chain management is an important area of research and practice in interorganizational relationships. Organizations are constantly searching for ways to lower costs, increase efficiency and productivity, and develop a competitive advantage through the supply chain function (Mentzer, DeWitt, Keebler, Min, Nix, & Smith, 2001). As such, researchers continue to examine variables that may impact organizational performance. In terms of relational variables, trust (Nooteboom, 2000; Johnston et al., 2004) and dependence (Pfeffer & Salancik, 1978) are two of the more important aspects of interorganizational relationships that can affect firm performance.

#### Trust

Trust, defined as the expectation that another party will perform as expected and treat you in a fair and reasonable manner, remains an area of continued interest in small business research. Within the scope of this definition, trust can be divided into two areas of focus, the cognitive and affective aspects. The cognitive aspect refers to the perception, by the actors, that expected performance has been achieved (Deutsch, 1958; McAllister, 1995). The affective aspect is explained as the intrinsic value, ascribed by the actors, of the genuine care or concern demonstrated within interactions (Lewis & Weigart, 1985; McAllister, 1995).

A widely examined relationship exists between trust and performance within organizations (McAllister, 1995). In interorganizational relationships, trust has been identified as one of the most “fragile and tenuous” components of relationship management, given the likelihood for conflict among collaborating parties (Handfield & Nichols, 1999: p. 10). Consequently, there is a sharp focus on how trust affects, not only performance, but also the relationship between actors from different organizations (Johnston et al., 2004).

Trust is an important aspect of interorganizational networks. Organizations that maintain trusting relationships with strategic partners cooperate efficiently and effectively to produce success, making trust an important predictor of behavior within organizations (Johnston, McCutcheon, Stuart, & Kerwood, 2004). Increased trust leads to concern for the relationship itself, and this emphasis on building and maintaining the relationship further influences performance and satisfaction among organizational members (Benton and Maloni, 2005) Strong connections, built upon trust, enable organizations to maximize synergy and more quickly respond to changes and solve interorganizational problems (Uzzi, 1997).

Prior research suggests that higher levels of trust will lead to greater performance in the supply chain management function. Within the small business context, it can be argued that smaller sized suppliers will place an even greater emphasis on trust to ensure customer service and satisfaction. Unlike larger companies with a significant customer base, small businesses are often more closely connected to their customers since they generally rely heavily on fewer clients. Thus, when trust on the part of the supplier is higher, the supplier will be more confident that the buyer will act in an expected manner. This will allow the supplier to be more secure in its ability to work with and perform as expected for the buyer.

Literary review also suggests that higher levels of trust in small business relationships are an effective predictor of improved performance. The willingness to participate in the assumption of risk to improve relationships is greater among organizations that realize higher levels of trust. Procedural justice theory lends credibility to this result. The foundation of which is that organizations, which perceive equity in a relationship, are more likely to achieve

desirable outcomes such as performance (Greenburg, 1990; Moorman, 1991; Gilliland & Chan, 2001).

The example of a supplier and a buyer can be used to illustrate the effect of trust within the confines of small business relationships. The development of trust in the relationship reduces the supplier's concern with respect to the uncertainty of the buyer's actions and/or tendencies to engage in opportunistic behavior (Williamson, 1975). This increased confidence on behalf of the supplier enhances their willingness to service the requirements of the buyer. Thus, the following hypothesis is given:

H1: Supplier trust is positively correlated with supplier performance in small to medium sized enterprises.

#### Dependence

Dependence, defined as the scale of investment one organization makes in its relationship with another organization (Emerson, 1962), also receives considerable attention as it relates to interorganizational relationships. This extent of dependence can be divided into four elements, which better explain the composition of the investment a firm makes in its relationships (Heide & John, 1988; Pfeffer & Salancik, 1978). First, the organization considers the outcomes produced from the relationship to be important. Second, those outcomes are considered more productive than those available from alternate relationships. Third, few alternate sources exist that could provide those outcomes making the loss of the relationship costly to the organization. Finally, few alternatives for exchange exist making replacement of the relationship difficult (Pfeffer & Salancik, 1978; Lusch & Brown, 1996).

When applying dependence theory to interorganizational relationships, Heide and John (1988) found that the organization that perceives greater dependence will utilize offsetting investments that will balance the dependent relationship. These investments can include



specialized processes, value-added product developments, or other complementary activities to provide greater overall value. When applied to the small business context, it can be suggested that higher dependence on the part of the supplier will lead to greater performance and customer satisfaction. Based on the four elements of dependency in organizational relationships, it is very likely that small businesses will have greater dependence in the distribution process, regardless of their role as the buyer or supplier. The good news is that this dependency can lead to a more focused strategic approach and higher performance standards.

Dependence theory, when applied to performance within interorganizational relationships, suggests that suppliers who perceive a higher level of dependence in their small business relationships will experience improved internal performance. Heide and John (1988), in applying dependence theory (Emerson, 1962; Beier & Stern, 1969) to vertical interorganizational relationships, found actors perceiving high levels of dependence in their relationships will balance this dependency through the development of alternate investments. This can manifest in a commitment to improving services, creating value added processes, expanding product offerings, or diversifying their business to improve confidence and efficacy. Thus, the following hypothesis is presented to explain the relationship between dependence and organizational efficacy.

- H2: A positive relationship exists, in small to medium enterprises, between the extent of a supplier's level of dependence and their subsequent level of performance.

### Methodology

Utilizing email, an electronic survey was administered to the approved vendors of a large university located in the southwestern United States. Given that most of the communication between the vendors and the university is through email, this approach was deemed appropriate. Survey respondents were the vendor's primary contact person with respect to the university. The survey completion rate was 31%, representing 156 completed surveys out of 498 administered. A total of 134 surveys were selected from the responses, under the criteria they represented an SME. After removing samples with a low response rate, the average firm in the sample employed 34 individuals.

### *Measures*

Given that both organizational and employee attributes can affect the relationship between a vendor and supplier, participants were asked to provide information including their organizational size, years of service to the university, and years the primary contact had worked with the vendor. Organizational size, according to Redondo and Fierro (2007) can impact relationships between vendors and suppliers. In this study, the average size of the organization was 34 employees. Years of service provides insight into the degree of institutionalization the vendor/supplier relationship exhibits. The duration of the relationship can affect the vendor's ability to meet customer demand (DiMaggio & Powell, 1983). On average, the vendors selected had worked with the university for 6.39 years. Length of service within the vendor's organization can help predict the employee's willingness to identify, accept, and embrace the firm's values and norms (Chao, O'Leary-Kelly, Wolf, Klein & Gardner, 1994). Primary vendor contacts, in this study, averaged 9.49 years of employment with the vendor firm.

Organizational trust was measured using Morgan and Hunt's (1994) six item scale examining the confidence of the vendor in the university as the buyer. This measure reflects the reliability of the buyer to the supplier in this vendor relationship. Trust (previous  $\alpha = .949$ ) is examined using a seven point Likert type scale with responses ranging from strongly disagree (1) to strongly agree (7). These items include "In our relationship with this buyer, our major buyer is always honest and truthful... our buyer can be counted on to do what is right...we have confidence in our buyer...we can count on them to have high integrity...we can count on them to be reliable...we can count on them to be trustworthy."

The level of organizational dependence is measured using an adapted scale by Lusch and Brown (1996) and items developed for this study. This study used three previous questions on dependence (previous  $\alpha = .881$ ) and two new items for a total of five items. Previous items included the statements "We are dependent on our major buyer," "Our major buyer would be difficult to replace," and "This buyer would be costly to lose as a buyer." The two new items included "Our business with this buyer is extremely important to our company" and "Continuing the working relationship with this buyer is much more valuable for our company than finding another buyer." These were measured using a seven point Likert type scale with responses ranging from strongly disagree (1) to strongly agree (7).

The performance measurement items were designed specifically for this study through thorough examination of the literature and based on the expectations that buyers have for their suppliers. These seven items assessed performance across six major performance areas as well as a general overall performance item. Scale items include on time delivery, full completion of work orders, corrective action on the part of the supplier, ensuring necessary

time and resources are committed to completing the job correctly, and utilizing approved products and procedures. These items were measured using a seven point Likert type scale ranging from strongly disagree (1) to strongly agree (7).

#### *Data and Scale Analysis*

Kline's (1997) recommended procedures for evaluating and preparing data were used. Surveys with missing data points and responses indicating a selection of standard scores were removed upon full analysis. Assessment of univariate normality was performed to examine variables for skewness and kurtosis. Results showed a normal distribution and the reliability of the scales were affirmed using Cronbach's alpha ( Nunnally & Bernstein, 1994; Henson, 2001). Coefficient alphas for the variables studied were well above Nunnally and Bernstein's suggested level of .70. Table 1 lists the reliability estimates obtained in this study.

Table 1. Factor Patterns / Structure Constructs

Variable Item #	Trust		Dependence		Performance	
	Factor	h <sup>2</sup>	Factor	h <sup>2</sup>	Factor	h <sup>2</sup>
1	0.931	,866	0.836	0.699	0.786	0.617
2	0.964	,929	0.902	0.814	0.791	0.626
3	0.966	,932	0.884	0.782	0.869	0.756
4	0.965	,930	0.825	0.681	0.834	0.696
5	0.958	,919	0.800	0.640	0.870	0.756
6	0.976	,953	N/A	N/A	0.771	0.595
7	N/A	N/A	N/A	N/A	0.860	0.740
Total Variance Explained	92.156		72.300		68.364	
Initial Eigenvalue	5.529		3.615		4.786	
Second Eigenvalue	0.181		0.707		0.604	
Cronbach's Alpha	$\alpha = 0.983$		$\alpha = 0.904$		$\alpha = 0.922$	

Item scores were evaluated to determine consistency with construct validity. A confirmatory factor analysis, per Ahire & Deveraj (2001), was performed using LISREL to explore the relationship between the latent variable and corresponding items. Principle component factor analysis was employed to analyze the latent constructs and identify the analysis pattern. One unique factor remained for each item when the K1 rule (Kaiser, 1960) was employed; therefore, only one latent construct exists per variable list (Hattie, 1985). Table 1, shown above, provides factor pattern/structure coefficients, communalities, eigenvalues, and Cronbach's alphas for the variables examined. LISREL was again employed to determine the relationships between the latent construct and individual items. Discriminate validity can be tested through examination of the fit indices. Table 2 provides the results of this testing, which indicates a strong fit between the variables and latent construct. As shown, scale reliabilities are significantly larger than correlation averages with remaining constructs. Examination also shows that interscale correlations do not correlate perfectly, and squared intercorrelations of the latent variable do not exceed the extracted variance. Overall means, standard deviations, Cronbach's alphas, and latent variable correlations are provided in Table 3.

Table 2: Construct Fit Indices

Construct	X <sup>2</sup>	d.f.	CFI	GFI
Trust	46.58	9	0.97	0.91
Dependence	64.50	5	0.9	0.85
Performance	37.69	14	0.98	0.93

Table 3: Means, Standard Deviations, Cronbach's Alphas, and Correlations

Construct	Means	S.D.	1	2	3
Trust	6.012	1.193	<b>0.983</b>		
Dependence	6.202	0.817	.465*	<b>0.904</b>	
Performance	4.178	1.536	.482*	0.499*	<b>0.922</b>

Note \* - Correlations are significant at the 0.01 level using a two-tailed test. Reliability coefficients are highlighted along the diagonal.

## Results

The purpose of this paper is to examine the relationship between performance and trust and dependence among small and medium-sized enterprises. Hypothesis one (H1) stated that there is a positive relationship between trust and performance in SMEs. Hypothesis two (H2) was similar in that it stated that there is a positive relationship between dependence and performance in SMEs. Utilizing regression to test these hypotheses, we first controlled for the attributes of organizational size, years working as a supplier to the buyer, and years working with the existing company. Second, we entered the independent variables trust and performance in the regression model.

The first model, consisting only of the control variables and performance resulted in an ANOVA with an F statistic of .182 that was not statistically significant ( $p > .05$ ). The second model that included these previous variables plus the constructs of interest, trust and dependence, resulted in an ANOVA with an F statistic of 13.435 that was significant at the  $p < .01$  level. Trust and dependence improved the fit of the control variable only model from an  $R^2$  of .004 to an  $R^2$  of .344 with an adjusted  $R^2$  of .319. The outcome of model 2 results in an  $\Delta R^2$  of .340 that is statistically significant at the  $p < .05$  level.

As can be seen in Table 4, the results of the regression analysis indicate that both trust and dependence are statistically related to performance in SMEs ( $p < .01$ ), thus supporting hypotheses one and two.

Table 4: Results of Simultaneous Regression Analysis for Prediction of Performance in SMEs

Variable	<i>B</i>	<i>SE B</i>	$\beta$	95% CI Lower	95% CI Upper	VIF
Step 1:						
# of Employees	.000	.001	.000	-.003	.003	1.044
Comp Years	.006	.010	.051	-.014	.025	1.062
Manager Years	.003	.009	.031	-.014	.020	1.087
Step 2:						
# of Employees	.001	.001	.055	-.001	.003	1.054
Company Years	-.010	.008	-.089	-.027	.007	1.130
Manager Years	.005	.007	.048	-.010	.019	1.092
Trust	.222	.053	.336*	.116	.328	1.278
Dependence	.188	.043	.366*	.104	.272	1.334

Note.  $R^2$  for first model = .004       $R^2$  for second model = .344       $\Delta R^2 = .340$

\* $p < .01$     N = 134    Two-tailed tests.

### Discussion and Practical Implications

As suggested by Hong and Jeong (2006), although large companies may exert more influence on the supply chain process, smaller firms are more flexible and often use this function as a specialized niche strategy. Our results seem to support this conclusion and indicate that trust and dependence are important in determining supplier performance for SMEs. These findings are also consistent with prior research by Hoffmann and Schlosser (2001) and Redondo and Fierro (2007) which indicated trust, commitment, and reciprocity play a critical role in relationship development and business performance. This is not surprising as SMEs generally have fewer resources and rely more heavily on personalized relationships with customers. Large companies often have a more extensive customer base and are not dependent on any one customer. Conversely, SMEs are generally more focused on a smaller

number of customers, and place a great deal of value on developing long-term, mutually beneficial relationships (Gélinas & Bigras, 2004; Hong & Jeong, 2006).

Research has shown that the supply chain management can be affected by numerous variables, regardless of organizational size and resources. Beekman and Robinson (2004) suggest that SMEs focus on developing strategic relationships to ensure sustainability and growth, and our results indicate that trust and dependence are significant factors in determining the performance of SME suppliers. These findings offer important practical implications and avenues for future research.

Often the owner-manager of a small business is more likely to use social factors to build trust and manage relationships (Morrissey & Pittaway, 2006) rather than rely on more formalized technologies or processes. SMEs will generally rely on trust, collaboration, and communication to reinforce commitment level and customer satisfaction (Redondo & Fierro, 2007). Since smaller suppliers often do not need as much information to establish business relationships, it is likely that their decision making processes will be more informal and personalized (Matlay, 1999). Multinational companies with dedicated purchasing departments invest a great deal of resources to develop formalized processes that gather large amounts of information to make strategic supply chain decisions. While these technologies can lead to greater efficiency and economies of scale, perhaps the more informal approach of small businesses is better suited for customer service and interorganizational trust. If this is indeed the case, then large companies can learn something about relationship development from SMEs.



All organizations, regardless of size, must be flexible and adaptable in their business relationships. While large companies expend significant resources to efficiently manage the supply chain function, these systems tend to focus more heavily on complex information processing rather than individualized customer service. This can be a very effective practice, as it allows for rational and efficient decision making based on detailed data analysis. In addition, larger companies often use the supply chain function as a means to accomplish multiple performance objectives, while SMEs are more focused on fewer performance outcomes (Hong & Jeong, 2006). SMEs can learn from their larger counterparts and continue to refine their own supply chain management process. The survival and growth of smaller firms is often dedicated by their ability to use their resources to effectively negotiate through the supply chain.

While the supply chain practices of SMEs are much less sophisticated and based more on personalized connections rather than superior technologies (Devins, Gold, Johnson, & Holden, 2005; Morrissey & Pittaway, 2006), they, too, can be quite effective in developing strategic relationships and improving innovation (Hong & Jeong, 2006). As such, large companies might consider adopting some of the more personalized and innovative practices of SMEs to strengthen the dependence and trust in their supply chain relationships. Even though a reliance on data-driven decision making is efficient, a balance of information processing and human interaction may lead to better performance given the constraints of the current economic conditions. As suggested by Bordonaba-Juste and Cambra-Fierro (2009), no matter the firm size, the purchasing process is managed best when suppliers and buyers are able to develop a strategic fit in regards to business approach, aptitude, and shared values.

### **Future Research**

Researchers must continue to examine additional variables that impact supply chain management practices and performance. While our study focused more on relational factors, other studies should examine operational variables, perhaps in conjunction with relation variables. Also, since the communication process is so vital in relationship development it needs additional examination as it relates to the growth and development of supply chain practices in SMEs. The supply chain function can lead to a strategic advantage for both large and small businesses; hence we need to have a more thorough understanding of the best practices that promote successful buyer-supplier relationships.

### **Conclusion**

In conclusion, research has shown that performance within the supply chain has many influences. This study has taken steps to examine two of these influences, trust and dependence, within the context of SMEs. What we found is that both trust and dependence are important influences for performance within the buyer/supplier relationship. Suppliers have the ability to build relationships with buyers, and this relationship, when examined within SMEs, can lead to greater performance on the part of the supplier. Suppliers should continue to build on these capabilities as well as others in order to continue to see greater performance levels that can benefit all within the collaborative arrangement.

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