# TRUST IN RELATIONAL CONTRACTING AND AS A CORE COMPETENCY

*Nuno Gil, Hedley Smyth and Jeffrey Pinto*

# INTRODUCTION

# In recent years, a considerable interest in and literature regarding relational contracting and trust have emerged in the project management field. Though there are distinct and important differences in the nature of these two phenomena, their central premises underscore an important movement in re-evaluating inter-organizational relationships (partnering, for example) that are so prevalent in modern project ventures. The motivations for undertaking such partnerships are varied and not within the milieu of this chapter (see Chapter X by Bresnen); nevertheless, as the nature of relational contracting continues to be explored by a wide variety of project organizations, it is necessary to better understand some of the dynamics of inter-firm collaboration and its corollary focus, particularly trust as a governance mechanism and within project partnering arrangements.

A large and growing literature has pointed to the importance of trust as a critical component of project stakeholder management and a facilitator of successful project outcomes (cf., Kadefors, 2004). Trust here is defined as a conviction that other parties will behave in line with a reasonable range of expectations derived from organizational market reputation and a sense of the individuals whom are representing the other parties (Smyth et al. 2010). This adds some nuance to Rousseau et al.’s (1998 p.395) definition of trust as the willingness to be vulnerable, i.e., “the psychological state comprising the intention to accept vulnerability based upon positive expectation of the intentions or behaviors of another”. (Distrust results when actual behaviour falls outside a reasonable range of expectations). Underlying the research and theorizing that have emerged on these two concepts – relational contracting and trust – is the notion that the management of inter-firm relationships in projects can recognize the value in relationship-building, eschewing the traditional contractual relationships which seek to identify and formalize the full spectrum of contracted services and obligations so as to act as a safety net in the face of distrust. This is not to argue that contracts are inherently wrong, though they may occasionally contribute to project process inefficiencies through too-strict codification. A clear advantage of promoting trust and positive relationship development in project partnerships lies in its desirability as an alternative to the transaction costs of monitoring and controlling, thereby making working relationships more efficient (see Chapter X by Clegg et al. )

 There is a critical challenge with this perspective, however, as it seeks to re-orient the historical, western, inter-organizational business paradigm away from the standard, contract-laden obligatory relationships toward one that is, arguably, more positively-focused, yet naïve. Essentially, the challenge is: how can we better understand the nature of contractual relationships and trust in project partnerships? In a business context, practitioners will be wary of any calls for dispensing with contract rigor as a means to promote trust. But the existence of a contract should also not rule out opportunity for two parties engaged in a contractual relationship to develop mutual trust. Hypothetically, each party can continuously assess how the other behaves relative to the contract. Evidence of trustworthiness that may surface over project time can then provide a basis to build expectations about the other party’s behavior which can be played against the unfolding reality in an iterative fashion.

 This chapter addresses these issues in theory and practice. It seeks to first establish a better understanding of relational contracting through the examination of a recent large-scale project: the design and construction of Terminal Five (T5) at Heathrow Airport in London, which was promoted as a global exemplar for industry. Each first-tier consultant and contractor in this project entered into a unique contractual relationship with the private developer and project client, British Airports Authority (BAA). The case will show that, first, writing a contract that is genuinely relational (as framed by the theory) is not trivial; second, implementing a relational contract is not conflict-free, involving instead mutual adaptation and adjustment by all parties involved; and third, relational contracting as a one-size-fits-all strategy can be interpreted as an overkill for the case of simple transactions that are also part of a complex project. This seems to detrimentally affect the perceived effectiveness of the contract, which in turn can undermine the sustainability of a relational contracting strategy over a capital programme time.

We then build on these insights to elaborate on trust in stakeholder relationships. We argue that trust can emerge, not simply as a happy coincidence of the project or as a function of an adopted relational contract, but as a core organization competency (in terms of its sources, mechanisms of development, and methods for promotion) when managed correctly, that is, when firms muster appropriate knowledge, skills and behaviours to build inter-firm trust. To build the argument, we draw on conceptual differences between a traditional view of self-interested trust as opposed to socially-orientated trust – the latter an outward focus which can proceed by managing the risk of misplaced trust through self-reflection and relationship assessment. Specifically, we argue there is opportunity for organizations involved in joint ventures to move beyond Rousseau et al.’s (1998) “calculus-based trust” (predicated on self-interest or economic incentives) to behavior that genuinely promotes positive and long-lasting relationship of business value.

# On Relational Contracting, Inter-Firm Collaboration, and Mutual Trust

### Contract theory

Contract theory builds upon the assumption in Western legal philosophy that formal contracts are essential to mediate the relationship between firms. Contracts concern cooperative social behavior where parties are willing and able to work with others (Macneil 1980). They represent obligations to perform specified actions in the future. The more potential hazards the parties involved associate to those actions, the more they deem contracts necessary (Macneil 1987). The theory also acknowledges that contracts are formulated both by the parties engaged in an economic exchange, as well as by society and law. All contracts have relational elements since all economic exchanges happen in a relational context (Macneil 2001), therefore an element of trust is foundational to fair exchange (Smyth et al, 2010; Gustafsson et al, 2010).

At one end of the spectrum are the discrete, complete classical contracts (Macneil 1987). They are expected to detail the job roles and responsibilities, specify procedures for monitoring performance and penalties for nonconformance, and determine outcomes or outputs to be delivered (Poppo and Zenger 2002). Theory argues they suit short-term transactions involving limited personal interaction. Conceptually, complete contracts require minimal or foundational trust and invoke high confidence levels, where confidence is considered a probability statement (Smyth 2008).

 At the other end are the ‘relational’ or ‘intertwined’ contracts in the sense that personal relations become heavily intertwined with the economic exchange (Macneil 1987; cf. Eccles 1981). The conceptualization of relational contracts draws on social systems and tenets that are thought to induce collaboration, for example the employer-employee contract or agreements between subsidiaries in a vertically integrated company (Wiliamson 1985). Relational contracting is therefore akin to a domestic market (cf. Campbell 1995). It presumes that the parties are willing to discard adversarial forms of contracting for others that nurture cooperative, long-term relationships, and mutual dependence; it is also conceived as emphasizing governance by trust over price and authority. In this way, relational contracts, whether informally agreed as forms of intent through partnering or in written form through supply chain alliances, are designed to induce trust. Indeed, theory argues relational contracts suit long-term repeated transactions allowing adjustments over time. Technically, relational contracts build upon the notion of a contract as a flexible framework for yielding rules, involving open-ended and sometimes vague provisions, some of which may be of dubious enforceability (Llewellyn 1931). Conceptually, not only is trust an important factor of governance in relational contracts, but there is also greater reliance upon trust due to incompleteness.

 Large engineering projects are a context particularly fit to explore how relational contracts work, and the extent to which they induce inter-firm collaborative work and trust. In these projects, many of the contracts between the client and the different suppliers have to be necessarily incomplete because the project requirements are characterized by uncertainty and ambiguity, exacerbated by long project timescales. Further, the fragmentation of the supply chain is prone to cause problems in information flow and decision-making, miscommunication between design and construction parties, and difficulties in planning and control (Stinchombe and Heimer 1985). Next, we examine the particular motivations underpinning the use of a relational contract in the T5 project, the extent to which the T5 agreement sought to embody this notion, and how it played out at implementation.

## The case of the T5 agreement: a quasi-realization of a relational contract?

At the genesis of the T5 project, the £4.2bn (2005 prices) expansion of Heathrow Airport was an experiment to emulate Japanese-style partnerships in large engineering projects, traceable to the internationally influential *Rethinking Construction*, the study commissioned by the UK government and coordinated by Sir John Egan, CEO of BAA at the time and a former auto-manufacturing executive. It exhorted clients to replace competitive tendering of the suppliers with long-term partnerships, sustained through trust, performance measurement and incentives for continuous improvement. The recommendations built upon studies about collaborative relationships between Toyota and its suppliers. These argued mutual trust was an outcome of the reliability demonstrated over repeated market interactions and of the shared knowledge that the parties need one another (Womack et al. 1990). The recommendations were also influenced by studies on Western corporations such as Chrysler suggesting these practices were transferable and not culture-bound (Liker et al. 1996).

This section of the chapter builds on in-depth fieldwork conducted between 2004 and 2007, funded by a research council – see Gil (2009) for details. Our analysis focuses on a salient proposition tested in the T5 project – that the T5 agreement could enable cooperative behavior between BAA and the first-tier suppliers (architectural practices, engineering consultants, contractors, and manufacturers). The contract was putatively framed as relational by BAA, and assumed as such in recent discussions (Gil 2009). After submitting the outline planning application in 1993, BAA was granted planning consent in 2001. Schematic design and implementation (i.e., detailed design, manufacturing, construction) started right after, and T5 opened in March 2008. This accomplished the first milestone of a broader capital programme for Heathrow airport, which included opening a second satellite in T5 around 2012, and replacing the terminals 1 and 2 with a new terminal around 2015.

Two notions were at the core of BAA strategy for the capital programme: one, improve the efficiency of the suppliers; and two, create value for the customers. But to accomplish these goals in the T5 project was not trivial because some premises informing its conceptual design were no longer valid when schematic design started in 2002. BAA also understood that the airline and airport industries were volatile businesses, and the main T5 customers and users (e.g., British Airways, BAA retail, Home Office) were likely to request business-critical changes as the project unfolded:

“The idea of building £4bn worth of infrastructure over 4 or 5 years and not having to rework and go around the loop a couple of times is nonsensical. Therefore, we’ve to manage change and minimize it in the best way. We won’t be able to get it right the first time. Change is a fact of life.” (T5 Project Lawyer)

BAA was not alone in believing that high client-supplier collaboration and flexibility to respond to change could only be enabled through a relational form of contract. Standard forms of contract had started to emerge encouraging clients to adopt a relational approach. The New Engineering and Construction contract, for example, was first published in 1993, introducing the notions of ‘trust’, ‘working together’, and ‘cooperation in planning’. And in 1995, BP received an “Innovation in Industry” award for its reportedly relational contracting strategy at the Andrew facilities alliance project (Knott 1996). Still, comprehensive studies were lacking as to whether these contracts could lead to superior outcomes in large engineering projects.

### The T5 agreement contractual terms and conditions

BAA deemed that a relational contracting strategy was fundamental for encouraging the T5 suppliers to achieve “exceptional performance. Hence, the T5 agreement ─ the “absolute bedrock of getting the relationships right” in BAA terms ─ aimed at creating incentives for “positive problem-solving behaviors that would not allow things to go wrong in the first place”. Its ethos was about creating an environment where “attitudes and roles bedeviled with concern about exposure to risk, unbalanced focus on capital cost, lowest costs, and layers of practices that inhibit change are unacceptable” (T5 Handbook). This was explained by the T5 lawyer:

“We cannot load suppliers with risk, drive prices down, and complain this is costing us more than we thought. It’s fundamentally dishonest and economically illiterate. Our approach is: we can drive prices down by removing inherent waste and allowing suppliers to have a decent return just like us.”

The T5 agreement called for integrated teams to focus upon cause rather than mitigate problems (BAA T5 fact sheet, cited in Potts, 2008) and for suppliers to reduce production costs while remaining flexible to accommodate design changes. The principle for remunerating the suppliers was reimbursable cost of time and materials plus an agreed profit margin. The T5 contract manager explained the rationale:

“The fact that we’re paying people by the hour allows us to be pretty flexible in using resources, and changing and moving things quickly around (…). We’ll give suppliers a level of profit for the tasks we can see ahead of us, but suppliers won’t be taking any of the risks of inefficiency or overspend. Suppliers may not make their best returns here, but they aren’t making any loses.”

The T5 suppliers were expected to demonstrate to BAA that the costs had been properly incurred. BAA reserved unfettered rights to carry out reviews to audit supplier accounts, staff and labor payrolls, purchase ledger systems, volume discounts, retrospective rebates, early payment discounts, and cash flow statements. Three contractual details were, however, built in the T5 commercial policy to effect the profit mark up made by the suppliers (Gil 2008):

*1. Ring-fenced Profit*

The commercial policy spelled out that the T5 suppliers’ profit was ring-fenced as an agreed lump sum against an agreed estimate of resources for a defined scope of work. Suppliers could increase their profit margin percentage by delivering their work at a cost less than the estimate. Conversely, the profit margin could shrink if the estimate of resources was too optimistic relative to the actual work needed to deliver the defined scope of work.

*2. Incentive Plan*

BAA agreed to share benefits of ‘exceptional performance’ with the suppliers. The benefits were calculated as the difference between the baseline target cost and the actual cost of work. Target costs were agreed with the suppliers involved in the T5 design and implementation. The targets were meant to reflect benchmarks, yardsticks and norms free of allowances and contingencies for inherent construction risks.

*3. Compensating for Change*

BAA set two main categories for design change requests, one of which impacted the profit margin of the supplier. Changes that BAA described as ‘design evolution’ meant that, in the view of the T5 agreement, they did not alter the design scope. Thus, BAA did not amend the ring-fenced profit in response to design evolution – while suppliers were reimbursed for the actual costs incurred with work stemming from design evolution, their profit margin was reduced. Conversely, BAA considered as ‘exceptional’ all the events and issues changing the project scope. In these circumstances, BAA would amend the ring-fenced profit not to affect the supplier’s aim: profit margin. Conversations between BAA and the suppliers preceded the categorization of an event as design evolution or scope change.

**Analysis**

While the BAA administrators insisted that “there was no better deal on the market” than the T5 agreement, the fieldwork repeatedly uncovered tensions associated with the implementation of the strategy. The findings revealed that occasional inadequate management of these tensions could hinder supplier cooperation, in essence defeating the purpose of the contract. BAA respondents tended to frame the difficulties as a cultural issue: “our biggest challenge is educating and working with suppliers and getting them to see the vision,” argued a project director. And indeed, studies of efforts to align the systems and cultures of the buyers and suppliers for facilitating coordination and generating relational rents highlight the long time and commitment involved whenever total cultural and organizational changes are required (Dyer and Nobeoka 2000). But, the fieldwork also revealed two important challenges in implementing effectively the T5 agreement.

First, some terms and conditions as they were worded in the commercial policy that integrated the T5 agreement moved the contract away from a relational contracting ethos towards a more classical contracting regime. The mechanisms to ring-fence the profit and to set target costs, for example, were largely a reconfiguration of price governance. They required suppliers to trust both on their own ability to estimate costs, as well as on BAA willingness to agree to realistic targets. Any emergent confidence relied upon accuracy and fairness of the benchmarks, yardsticks and norms in that context. And the mechanism to compensate for change required suppliers to trust BAA would behave in a reasonable way when negotiating at the borderline between design evolution and change of scope; and that market power would not be used to impose unreasonable outcomes. Similarly, BAA required suppliers to behave reasonably and realistically in negotiations, thus not being opportunistic or adversarial. Thus, it seems more accurate to position the T5 agreement relative to theory in economics and law as somewhat of a hybrid: it was unarguably relational in intent and objectives, but it integrated in the commercial policy terms and conditions that were characteristic of (neo-)classical contracts.

And second, the actual way through which BAA implemented the T5 agreement, including both its relational ethos and its commercial policy, affected the capability of the contract to encourage inter-firm cooperative work: “It’s very easy to write the words, to sell the concept, but how to actually make it work is really tough,” alerted a project director. An in-depth analysis unearthed five critical factors that affected its effectiveness at implementation (Gil 2009). We next summarize those:

1. *Suppliers are Keen to Reap Reputation Benefits*

Reputation is an integral part of a relational contract. Reputation partly embodies trust derived from past behaviour and performance. Interestingly, the findings of the study reveal that the capability of the T5 agreement to encourage cooperative work was limited whenever the suppliers were indifferent as to whether they wished to reap reputational benefits from project participation or not. Some T5 suppliers were strategically interested in establishing a presence in the world of airport projects. For this group, a good reputation was important. Others wanted to grow their domestic business. The participation in the T5 project could be a springboard for success, and a good reputation was equally important. But, for other firms, the T5 project work represented a small fraction of their annual turnover with limited strategic importance. For these suppliers, reputation was not reliant on the performance on the T5 project, suggesting perhaps that relationship reputation “travels a short distance”. Trust and confidence generally were not therefore important for the wider market.

1. *Suppliers have Flexibility in their Production Processes*

A core motivation underpinning the adoption of a relational contract is encouraging project suppliers to be flexible to accommodate client-driven requests to change the design or the construction sequences. The findings suggest, however, that the effectiveness of the T5 agreement in this regard was limited by the degree of flexibility in the production processes of the suppliers. The engineering design and architectural consultants were inherently flexible to accommodate change. And commercial tensions rarely emerged whenever BAA requested them to do so (Gil 2009). Conversely, some suppliers of manufactured components disliked the notion of design evolution. Unlike the autonomy exhibited by the site teams of consultants relative to the head offices, the site teams for some manufacturers needed to coordinate their plans with the production schedules for their factories. Because the factories invariably served a number of projects at any time, the site managers were under pressure to commit to specific production slots months in advance to optimize the utilization of the fixed assets. The supplier staff believed it would be hard to recoup the full cost of disrupting production due to a change request since it would be difficult to distinguish the costs attributable to the client intervention from normal costs associated with production.

The fieldwork also suggested that the resistance to change exhibited by a few suppliers was partly due to the way BAA ring-fenced the profit. Hence, late changes reduced the chances for suppliers to make the originally agreed profit margin unless BAA adjusted the maximum lump sum to compensate for the additional work. But BAA did not to do so unless it considered that the change altered the scope, given that the contract assumed that suppliers were flexible to accommodate change associated with design evolution.

Over time, BAA realized that the T5 agreement would not automatically eliminate commercial tensions with the suppliers. Confidence in the T5 agreement meeting expectations in this respect waned. Some adversarial behaviour surfaced. BAA staff needed to understand how to interpret and manage emergent issues, whilst suppliers’ staff needed to stay attuned to the relational principles when searching and negotiating solutions for adverse situations. Although trust and confidence played an important part, price emerged as important and influenced the inter-firm relationships.

1. *Client and Suppliers Choose the Right People for the Jobs*

The findings revealed that the limited financial risk borne by the T5 suppliers did not suffice to temper the ambitions of some suppliers’ staff for making higher returns. Evidence suggests that this misalignment of expectations could drive two responses deleterious to working cooperatively. Occasionally, the supplier administrators agreed to the T5 deal but found it hard to assign to the project the most competent managers, being unimpressed by what BAA termed ‘decent profit’. Rather, the latter preferred to work for fixed-price projects gained through competitive bidding offering greater rewards for leveraging their skills in getting the work done efficiently. Alternatively, suppliers could assign competent individuals to the project but they could fail to grasp the ethos of the T5 agreement if they had been accustomed to working in adversarial environments. In both cases ‘behaving opportunistically with guile’ reverted to price-based negotiations with the consequence of eroding trust and confidence beyond the contested issues and tasks.

Relational contracting conceptually tries to induce trust. The findings show this does not occur automatically. It is left to individuals to take responsibility, but not all individuals fit a cooperative environment. Clients and suppliers both need to ensure staff fit a relational culture. They should replace staff that cannot acquire the mindset required. It would also be naive to expect induction workshops on relational contracts to quickly change behaviors, especially as we argue later, if inter-firm trust is not embedded as a core competency in the firm.

1. *Client Learns to Contract in Response to Supplier Feedback*

Writing a contract is an incremental and local process, seldom very far-sighted, that occurs over a long period of time (Mayer and Argyres 2004). This requires organizations to align the knowledge of the different groups (with respect to the different types of contract terms) with the writing of the different types of contractual provisions. As a result, project clients are unlikely to get the commercial details right at the first attempt. Rather, ex-post capabilities to interpret and adapt the contract are crucial to the project over time. The value of learning was conspicuous, for example, in the process that BAA and the suppliers went through to implement the principle of rewarding suppliers performing exceptionally well*.* The idea was to allow the suppliers to reap monetary rewards when they executed the work at a cost below the target cost. But the extent to which this incentive actually worked depended as to whether it met two major concerns of the suppliers. The first pertained to whether BAA planned to distribute the incentives shortly after the date when the suppliers had completed their work; and the second pertained to whether the suppliers perceived the cost targets to be realistic. Through trial and error, BAA and the suppliers jointly reworked the incentive scheme until they had figured out a mutually acceptable scheme. This involved both trust and confidence between parties, and appeared to have been effective.

1. *Client Aligns Practices to Control and Improve Performance with Supplier Capabilities*

BAA decided to use the T5 agreement regardless of the size of the first-tier suppliers, but the implementation of some details turned out challenging with the smallest first-tier suppliers. Project participation was unarguably important for these firms ─ “these projects don’t come along every day!” explained one director. Yet, small suppliers seldom had adequate organizational structures and procedures in place for addressing the demand for detailed performance reports and cost data. In T5, the construction director termed the set of practices institutionalized for “never letting suppliers feel entirely comfortable in a reimbursable environment” as ‘vigilant trust’. He deemed it necessary to scrutinize how suppliers were planning the work and incurring costs, as well as continuously exploring ways to meet targets and improve performance. Yet, the smaller firms were often unable to meet the expectations of BAA in this regard. BAA also found it difficult, at the project onset, to persuade some consultants to cooperate with the demands for information because the latter seemed less attuned to a culture of monitoring performance and continuous improvement than contractors. The lack of cooperation frustrated BAA, which was incurring expenses in employing staff to monitor costs and ensure best value for money. Small firms found the transaction costs too demanding and some consultants found the accountability challenging to professional conduct.

# Discussion on the T5 agreement: intent and practice

This study yields three main insights. First, the findings suggest the contract was not as relational as BAA and many others commentators assumed, using an employer-employee contract as the archetypal comparator. Trust and confidence were present, but some elements were reconfigurations of price and power drivers. Still, this quasi-relational contract strategy used in the T5 agreement enabled cooperative behavior between project client and suppliers. Specifically, the T5 agreement provided BAA flexibility and transparency in using resources to accommodate volatility in project requirements. This, in turn, enabled many project-based production practices aimed at improving process reliability (Gil 2009), suggesting an almost symbiotic relationship between the contract and project management practice. Overall, the implementation of the T5 agreement was effective whenever client and supplier staff fitted a relational environment, and managed to interpret the contract sensibly.

Second, high-levels of inter-firm collaboration were not enough to dissuade BAA from monitoring and controlling the performance of suppliers, what BAA termed ‘vigilant trust’. This is not unusual as social safeguards, such as trust, reputation, and continuity, help to manage under uncertainty, but they can be insufficient to dissuade opportunistic behaviour when there is high ambiguity about available courses of action, variables, and cause-effect relationships (Carson et al. 2006). Ambiguity increases the possibility of opportunism with reduced risks of being uncovered, especially at the level of the individual. Implementing ‘vigilant trust’ is not trivial, however. At T5, mutual trust and confidence were stifled due to failure to adjust the practices associated with vigilant trust to the capabilities of smaller suppliers and to the professional codes of conduct of some consultants. Arguably, this is when higher trust levels could be most beneficial. Yet, they may be beyond the bounds of a quasi-relational contract such as the T5 agreement and, we conjecture, of relational contracting more generally.

Third, the findings suggest that by positioning the implementation of the T5 agreement at one extreme – one size fits to all first-tier suppliers – BAA undermined the sustainability of this quasi-relational contracting strategy over the capital programme. With credit to the T5 agreement, T5 opened on time and reportedly on budget on 27th March 2008 as announced years in advance. But the successes of design and construction were not attributed to the contract by some top management. Many argued instead that the inclusive application of the agreement had failed to create enough commercial tension with the suppliers, thereby occasioning a ‘lazy’ budget and programme for the T5 project, as well as complacency from some suppliers. We conjecture this perception was factored in BAA’s announcement in January 2008 that it would put out to competitive tender forthcoming capital projects.

Of course, it remains indeterminate whether BAA would drop its relational contracting strategy had the world economy not entered in recession in 2008 – right after BAA was bought in a highly leveraged bid. The new top management team may have seen opportunity to get better deals through competitive tendering since the order books of the suppliers suddenly became less full, that is, commercial conditions shifted firmly to a buyers’ market. And, hypothetically, BAA may succeed in freezing project designs early on so as to require less flexibility from suppliers. We are mindful, however, that airport projects serve the volatile and fast-moving airline industry, which makes some late change requests inevitable. This, in turn, makes it likely that wasteful tensions, lack of collaboration, and increased inter-firm distrust will surface if BAA insists in using fixed-price contract in future capital projects.

Interestingly, BAA’s decision is not unique. BP, for example, also abandoned a similar relational contracting strategy after it employed it in the Andrew project. In both cases, a decision to use a relational contract across-the-board seems to have triggered two responses: one arguing this strategy is instrumental to deliver complex engineering projects on time, on budget, and another arguing it is an expensive way to achieve these objectives. It merits further exploring how fixed-price and reimbursable contracts can be effectively combined in a complex project so as to align better these alternative commercial regimes with the nature of the different transactions that are part of the project and the characteristics of the corresponding suppliers’ markets.

From a trust perspective, whilst the T5 agreement was conceptually inducing trusting behaviour from suppliers, the primary objectives for BAA appeared to be the generation of confidence, especially around price-based governance. This concurs with the criticism that ‘calculative trust’ from transaction cost theory (Williamson 1993; cf. Luhmann 1988) is closer to the concept of confidence derived from probabilities rather than the sense or conviction embodied in the concept of trust (Edkins and Smyth 2006; Smyth 2008; 2009; Gustafsson et al. 2010). It also sets the ground for a broader discussion of the role of trust as a core competency.

**Trust as a Core Competency**

The empirical findings from T5 have shown the limitations of trust generation through the implementation of a governing agreement, a putative relational contract. They appear to confirm the conceptual distinction of trust as a conviction derived from reputation and behavioural evidence and confidence as a probability statement, indicating that the practice of relational contracting can be closer to confidence creation than trust generation. The findings also imply that trust required for relational contracting can be supported from organizationally generated trust. This poses a challenge: firms either revert to adversarial ways or opt to explore trust as a core competency. This section takes the latter path, recognizing that this may be a strategy pursued by few firms, yet one that theoretically can lead to superior performance.

In order to develop trust at a deeper level, trust needs to be encouraged through the culture of a firm, its systems and procedures. In this way, trust becomes a core competency embedded and spread in the firm (e.g., Prahalad and Hamel 1990) which can be mobilized across projects for value and co-value creation (Prahalad and Ramaswamy 2004) either from the corporate centre or through programme management (Smyth 2008; 2009). This seems also to be the logical path for project clients and suppliers claiming they are serious about non-adversarial relations. From a supplier perspective in particular, financial evidence from over 300 projects suggests that suppliers and projects can become a client asset (Smyth et al. 2010) and a source of both repeat business and increased profitability (Gustafsson et al. 2010).

**The sources of trust**

The focus for trust is twofold within the project business environment – individuals and organizational. Individuals and organizations have dispositions to trust. Personal history and the choices made about how to interpret past events effect willingness to trust or defensiveness towards others. This is largely psychological and is tied into our sense of security and identity. Organizational history gives rise to a culture, systems and procedures that create path dependencies along two lines:

1. The capacity to mobilize trust within the organization and then into the market
2. The reputation individuals and organizations have in the market for trustworthiness, which is partly a reflection of history that informs the other party about trustworthiness.

Trust is nurtured (Baier, 1994) thus strategies and tactics served by cultures, systems and procedures that facilitate nurture create trust. Organizations that nurture trust will probably attract staff with the disposition to trust through self-selection to apply and selection by the firm. Where there are personal and organizational dispositions to trust, then parties reach back into the personal and organizational history to inform the present circumstances. The further back they reach, the further they will tend to form expectations of being able to trust others into the future. Thus, the source of the propensity to trust is based upon past experience and organizational capability, which is perceived by others in the market as reputation or goodwill – part of the social capital of the firm or project organization (Gustafsson et al. 2010).

This potential formation of trust is depicted in the first stage of the sequence shown in Figure 1, covering personal, corporate and project disposition to trust from the supplier standpoint. The client looks upon this disposition and makes a highly intuitive assessment of their collective trustworthiness. The intuitive assessment will also draw upon cognition of project track record and corporate reputation where there is some evidence in these early stages of the project lifecycle.

*Insert Figure 1 about here*

**Corporate investment in trust development**

The organizational and personal dispositions can be harnessed and developed as social capital within the firm. This is a resource to be drawn upon in the management of projects from the business development phase towards and into the execution stages.

The business development team is active trying to sell the project services and learning about the explicit and implicit strategic and tactical needs for the project and behind the project. This is carried out in part through desk research, but primarily through relationship building. Having a relationship building strategy begins to create trusting relationships, requiring systems of cross-functional coordination and either personnel continuity or handing on the baton of understanding to contract directors and project managers and their team (and ideally throughout the supply chain) (e.g. Gummesson 2001; Smyth and Fitch 2009). Supplier program management provides one basis for developing a trust based relationship strategy (Smyth 2009), so that client expectations are mediated by trust to build confidence in the market (Edkins and Smyth 2006) (especially through repeat transactions that characterize projects as well as through repeat business). This is developed in the supplier decision-making unit, where systems, procedures and behaviour guidance are needed to develop internally added value generation and consistent delivery in the market. The strength of internal trust, derived from the culture and systems and particularly from the configuration of actors, informs the potential to be trusted in the market, although success at realizing the potential has been mixed in practice (e.g. Edkins and Smyth 2006; cf. Smyth and Olayinka, 2010).

One of the weaknesses within many project businesses is the lack of continuity of personnel between project stages, the frequent disjuncture between business development and the project management on the one hand and the bidding processes on the other (cf. Baiden et al, 2006; Smyth, 2000). This may not lead to distrust in the market but it stifles the nurturing of internal trust. Trust development as a core competency can arise through additional forms of investment, for example through soft management skills such as emotional intelligence or developing social obligations to foster trust by treating people with dignity and respect (Sako 1992; Swan et al. 2001; Smyth 2008). How project firms develop trust is part of service differentiation and can yield competitive advantage if it meets the needs of the clients.

Bechky (2006), for example, draws attention to the importance of prescribed roles to structuring project relations and to enthusiastic thanking and polite admonishing, plus role-orientated joking as a means to bring stability to relationships and task conduct in filmmaking. In construction, joking has traditionally been used to iteratively negotiate the informal hierarchy, and then used to apportion blame “ahead of time” (Smyth 2000) – an arena of behaviour that requires addressing in some project environments. Swift trust can also be applied (Meyerson et al. 1996) to encourage attitudes and behaviours that encourage trust through conscious, hence cognitive actions to generate fertile conditions.

These investments need to be maintained and reinforced regularly. Such investments tend to move the organizational and project culture away from exchange norms and some way towards communal norms (Clark 1978), that is, from cultural values primarily based upon equity to those that place some emphasis upon equality (Kurtzberg and Medvec 1999). This engenders an organizational culture with egalitarian tendencies of enhanced knowledge sharing, resultant problem-solving and innovation that is more conducive to trust (cf. Douglas 1999; Auch and Smyth forthcoming) and adding value – potentially a richer environment of value creation and perhaps value appreciation internally and externally. It places the supplier and client as part of the same team, which is in line with concepts of co-created value (Pralahad and Ramaswamy 2004) rather than project teams in opposition.

In essence, these types of measures require investments in systems, procedures and behavioural guidance both from project suppliers and clients. Hence, for trust to be an assured factor, proactive management at the front-end follows from corporate investment. Evidence from practice shows mixed success to date and thus the analytical ‘jury’ is still out on this test for firms moving towards less adversarial and more trusting management. Corporate investment and management to encourage moving from self-interested trust, the classic win-win situation of mutual interest, towards an outward focus of socially orientated trust (Lyons and Mehta 1997), i.e., towards considering the interests of the other party, have proved the most difficult to implement (e.g., Edkins and Smyth 2006; Smyth and Edkins 2007).

**Mobilising socially-orientated trust in the management of projects**

The front-end stages are important for setting the behavioural and relationship scene for the specific project management stages, shown in the final sequence in Figure 1. The corporate investment provides the means to develop trust at the front-end, to be subsequently carried over to the execution stages of the project, providing there is continuity and consistency of services. Personnel continuity is important, sometimes provided through key account management and through a relay team approach with effective handovers (McDonald et al. 1997; Kempeners and van der Hart 1999; Smyth, 2000).

In the execution stages therefore, the overall corporate, programme level and front-end processes directly support and contextually help nurture trust. Individual responsibility plays a role, but not the dominant one where the organization is proactively managing the development of trust. The key project management issues hence become managing events, particularly critical events and combinations of critical events that unexpectedly are configured as “moments of truth” that determine where the project goes and how the relationships are viewed (e.g. Storbacka et al. 1994; Pryke and Smyth 2006 regarding projects). These are depicted in Figure 1 where the way in which events are managed can have positive or negative effects. Clearly trusting behaviour is not the only issue, competence and other matters being important. Yet the foundational nature of trust in relationships and the fact that all service value and some technical value is directly or indirectly delivered through relationships (Pryke and Smyth 2006) renders trust as a critical issue. Where critical events are handled positively, including managing events in trustworthy ways, then the value of the relationship grows and the project becomes a growing asset for the client. Conversely, where events are managed negatively, the relationship value declines and the project moves towards becoming a liability as transaction and other costs increase.

**CONCLUSION**

# The development of trust, as a core competency for a project organization, is a process that involves a strong degree of cultural change, consistent reinforcement, personnel stability and longevity, and, indeed, a long-term focus. Earlier in this chapter, we observed that the quasi-relational contracting employed in T5 may be thought in many ways to represent “confidence creation” perhaps more than “trust creation.” Yet, the critical point to observe is that trust, as an operating philosophy, rarely emerges *ex nihilo* into an organization’s set of standard practices. And this seems to be true whether the focus is self-interested trust seeking win-win situations, or socially-orientated trust with a greater outward focus. Mutual trust often evolves iteratively through stages, edging up levels as organizations gain confidence in the behaviors and motivations of their partners as well as recognize the positive results for their joint project ventures and act accordingly.

There are a number of fruitful avenues for future research that are suggested in the study of relational contracting and trust, for example:

* How does a relational contract should be realized in capital projects, in regards to the exact wording of its commercial terms and conditions? And how should clients and suppliers go about to implement a relational contract so as to behave congruent with the intended ethos, and sustain the strategy over time?
* Research into the direct relationship between transaction costs and the development and promotion of trust: transaction cost analysis theory strongly suggests that economic self-interest should be apparent in inter-organizational relationships; however, as trust expands, we would expect that the costs associated with maintaining the relationship with a partner would drop commensurately. Future research could evaluate the inverse relationship predicted between theory and trust.
* Trust is often viewed as an antecedent variable in the nature of relationship development between firms; yet, because trust is usually viewed as a psychological state, it would be interesting to identify some of the contextual issues that influence the development of trust: what variables motivate the emergence of trust itself?
* The direct linkage between trust and relational contracting needs further explication. Does relational contracting require mutual trust? Encourage mutual trust?
* To what extent can trust be developed and managed in the firm as a valuable asset to be taken into the project market to the benefit of all parties?
* We posit that developing inter-firm trust as a core competence can help project-based firms achieve superior performance. This proposition warrants rigorous empirical testing.

The explicit nature of the inter-relationship of these constructs is an important avenue for future research and theory-building. Taken together, the issues of relational contracting and organizational trust represent an important element in project collaboration and learning. Joint ventures and stakeholder partnerships in projects will continue to be a critical feature in many ventures into the future. The better we can understand and formulate policies for effective management of inter-firm relationships, the greater the likelihood will be for developing win-win and other socially-orientated opportunities for project-based firms.

**REFERENCES**

Auch, F. and Smyth, H.J. (2010). “Cultural divergence in project firms,” *International Journal of Managing Projects in Business*, forthcoming.

BAA T5 fact sheet (1996) *The Key Stages of Terminal 5*, [www.baa.com/t5](http://www.baa.com/t5) - accessed

July 1996.

 Baiden, B.K., Price, A.D.F., Dainty, A.R.J. (2006). “The extent of team integration within construction projects,” *International Journal of Project Management*, 24, 13-23.

Baier, A.C. (1994). *Moral Prejudices: essays on ethics*. Harvard Business Press, Cambridge.

Bechky, B.A. (2006). “Gaffers, gofers, and grips: role-based coordination in temporary organizations,” *Organization Science*, 17 (1) 3-21.

Bennett, J. and Jayes, S. (1995). *Trusting the Team,* Reading Construction Forum, Centre for Strategic Studies in Construction, University of Reading, Reading.

Campbell, N. (1995). *An Interaction Approach to Organisation Buying Behaviour: relationship marketing for competitive advantage*, Butterworth-Heinemann, Oxford.

Carson, S.J., Madhok, A., and Wu, T. (2006). “Uncertainty, Opportunism, and Governance: The Efffects of Volatility and Ambiguity on Formal and Relational Contracting”, Academy of Management Journal, 49 (5) 1058-1077.

Clark, M.S. (1978). “Reactions to a request for a benefit in communal and exchange relationships,” *Dissertation Abstracts International*, 38, (10-B), 5089-5090.

Douglas, M. (1999). “Four cultures: the evolution of parsimonious model,” *GeoJournal*, 47, 411–415.

Dyer, J.H. and Nobeoka, K. (2000). “Creating and Managing a High-Performance Knowledge-Sharing Network: The Toyota Case”, Strategic Management Journal, 21, 345-367.

Eccles, R.G. (1981). “The Quasifirm in the Construction Industry”, Journal of Economic Behavior & Organization, 2, 335-357.

Edkins, A.J. and Smyth, H.J. (2006). “Contractual management in PPP projects: evaluation of legal versus relational contracting for service delivery, *ASCE Journal of Professional Issues in Engineering Education and Practice*, 132 (1) 82-93.

Daft, R.L. and Lengel, R.H. (1986). “Information richness: a new approach to managerial behaviour and organization design,” *Research in Organizational Behavior*, Staw, B.M. and Cummings, L.L. (eds.), JAI, Greenwich, 91-233.

Gil, N. (2009). Developing Project Client-Supplier Cooperative Relationships: How much to Expect from Relational Contracts? California Management Review, Winter, 144-169.

Gil, N. (2008). BAA: The T5 Project Agreement (A), ECCH Ref. 308-308-1.

Gummesson E, (2001). *Total Relationship Marketing*, Butterworth-Heinemann, Oxford

Gustafsson, M., Smyth, H.J., Ganskau, E. and Arhippainen, T.(2010). “Managing trust: bridging strategic and operational issues for project business,” *International Journal of Managing Projects in Business*, forthcoming.

Kadefors, A. (2004). “Trust in project relationships – inside the black box,” *International Journal of Project Management*, 22, 175-182.

Kempeners, M. and van der Hart, H.W. (1999). “Designing account management organizations,” *Journal of Business and Industrial Marketing*, 14 (4) 310-327.

Knott, T. (1996). No Business as Usual. An Extraordinary North Sea Result. The British Petroleum Company, plc.

Kurtzberg, T. and Medvec, V.H. (1999). “Can we negotiate and still be friends?” *Negotiation Journal*, 15 (4) 355-362.

Liker, J.K., Kamath, R.R., Wasti, S.N., and Nagamachi, M. (1996). “Supplier Involvement in Automotive Component Design: are there Really Large US Japan differences?” *Research Policy*, 25, 59-89.

Llewellyn, K.N. (1931). “What Price Contract? An Essay in Perspective”, *Yale Law J.*, 40, 704-751.

Luhmann, N. (1988). “Familiarity, confidence, trust: problems and alternatives”, in Gambetta, D. (ed.). *Trust: making and breaking cooperative relations*, Basil Blackwell, Oxford.

Lyons, B. and Mehta, J. (1997). “Contracts, opportunism and trust: self-interest and social orientation,” *Cambridge Journal of Economics*,21, 239-257.

Macneil, I.R. (1980). The New Social Contract: An Inquiry into Modern Contractual Relations, Yale University Press, New Haven, CT.

Macneil, I.R. (1987). “Barriers to the Idea of Relational Contracts”, in Nicklish, F. (ed.). 31-44, *The Complex Long-term Contract*, Heidelberg, Germany, C.F. Muller Juristischer Verlag.

Macneil, I. (2001). *The Relational Theory of Contract: Selected Works of Ian Macneil.* Ed. David Campbell. Sweet & Maxwell.

Mayer, K.J. and Argyres, N.S. (2004). “Learning to contract: evidence from the personal computer industry,” *Organization Science*, 15 (4) 394-410.

McDonald, M., Millman, T. and Rogers, B. (1997). “Key account management: theory, practice and challenges,” *Journal of Marketing Management*, 13, 737-757.

Meyerson, D., Weick, K.E. and Kramer, R.M. (1996). “Swift trust and temporary groups,” *Trust in Organizations: frontiers of theory and research*, Kramer, R.M. and Tyler, T.R. (eds.), Sage, Thousand Oaks.

Poppo, L. and Zenger, T. (2002). “Do Formal Contracts and Relational Governance Function as Substitutes or Complements?” *Strategic Management Journal*, 23, 707-725

Potts, K. (2008). “Change in the Quantity Surveying Profession Heathrow Terminal 5 case study”, in Smyth, H.J. and Pryke, S.D. (eds.), *Collaborative Relationships in Construction: Developing Frameworks and Networks*, Wiley-Blackwell, Oxford, 42-58.

Prahalad, C.K. and Hamel, G. (1990). “The core competence of the corporation,” *Harvard Business Review,* May-June, 79-91.

Prahalad, C.K. and Ramaswamy, V. (2004). “Co-creating experiences: the next practice in value creation,” *Journal of Interactive Marketing*, 18 (3) 5-14.

Pryke, S.D. and Smyth, H.J. (2006). “Scoping a relationship approach to the management of projects,” *Management of Complex Projects: a relationship approach*, Blackwell, Oxford, pp. 21-46.

Reichheld, F.F. (1996). *The Loyalty Effect*, Harvard Business School Press, Boston.

Rousseau, D.M., Sitkin, B., Burt, R.S., and Camerer, C. (1998). “Not so different after all: a cross-discipline view of trust,” *Academy of Management Review*, 23, 393-404.

Sako, M. (1992). *Prices, Quality and Trust: inter-firm relations in Britain and Japan*. Cambridge *University Press, New York.*

Schön, D.A. (1983). *The Reflective Practitioner: how professionals think in action*, Basic Books.

Skitmore, M. and Smyth, H.J. (2007). “Pricing Construction Work: a marketing viewpoint,” *Construction Management and Economics*, 25, 619-630.

Smyth, H.J. (2000). *Marketing and Selling Construction Services*, Blackwell Science, Oxford.

Smyth, H.J. (2005). “Trust in the design team,” *Architectural Engineering and Design Management*, 1 (3) 193-205.

Smyth, H.J. (2008). “Developing trust”, in Smyth, H.J. and Pryke, S.D. (eds.), *Collaborative Relationships in Construction: Developing Frameworks and Networks*, Wiley-Blackwell, Oxford, 129-160.

Smyth, H.J. (2009). “Trust and the moral economy,” Keynote |paper, *Trust in and across Organizations*, Arctic Workshop 2009, Finnish Doctoral Program in Industrial Engineering and Management, 12-13 November, Helsinki University of Technology, Espoo.

Smyth, H.J. and Edkins, A.J. (2007). “Relationship management in the management of PFI/PPP projects in the UK,” *International Journal of Project Management*, 25 (3), 232-240.

Smyth, H.J. and Fitch, T. (2009). “Application of relationship marketing and management: a large contractor case study,” *Construction Management and Economics*, 27 (3) 399-410.

Smyth, H.J. and Olayinka, R. (2010) Construction Industry Performance Improvement Programmes: the UK case of Demonstration Projects in the “Continuous Improvement” programme, *Construction Management and Economics*, forthcoming.

Smyth, H.J. and Thompson, N.J. (2005). “Managing conditions of trust within a framework of trust,” *Journal of Construction Procurement*, 11 (1) 4-18.

Smyth, H.J., Gustafsson, M. and Ganskau, E. (2010). “The value of trust in project business”, *International Journal of Project Management*, Special Edition for EURAM, forthcoming.

Stinchcombe, A.L. and Heimer, C.A. (1985). *Organization Theory and Project Management*, Norwegian University Press.

Storbacka, K., Strandvik, T. and Grönroos, C. (1994). “Managing customer relationships for profit: the dynamics of relationship quality,” *International Journal of Service Industry Management*, 5 (5) 21-38.

Swan, W., Wood, G. and McDermott, P. (2001). *Trust in Construction: achieving cultural change*, <http://www.scpm.salford.ac.uk/trust/publications.htm>.

Williamson, O.E. (1985). *The Economic Institutions of Capitalism*, Free Press, New York.

Williamson, O.E. (1993). “Calculativeness, trust, and economic organization,” *Journal of Law and Economics*, 36, April, 453-486.

Womack, J.P., Jones, D.T., and Roos, D. (1990). *The Machine that Changed the World*, Harper Perennial, New York.

**Figure 1. Trust Formation in the Project Business**