

# **ANALYZING TRUST LEVEL IN B2B RELATIONSHIPS VIA PAYMENT METHODS**

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## Abstract

This paper introduces a work-in-progress research that aims to analyze trust level in Hungarian B2B relationships from a special perspective; from the payment methods point of view. The purpose of this research was provided by the fact, that in international comparison the Hungarian economy can be described by very high cash-usage. The Magyar Nemzeti Bank, the central bank of Hungary (hereinafter MNB) made a research to explore the reasons of this increased cash demand and found out that one of the major motivations of the high cash usage is the lack of trust in B2B relationship. This result was strange and unexpected a little bit, that's why MNB started a new research in 2012 in order to deeply analyze it.

The paper will start with a short literature review about the nature and role of trust in business relationships and after it the research motivation and method will be introduced. The third part of the paper presents the results of the qualitative research phase and finally the outlook for further steps will be analyzed.

Key words: trust, interorganizational relationships, payment methods

Work-in-progress paper

The research introduced by this paper has definitely exploratory scope: to analyze whether trust can affect the applied payment method (especially cash-usage) in buyer-supplier relationships? As it was mentioned, MNB initiated a research to analyze this question. In this paper – after a short literature review – the results of the interviews will be presented that can provide a “status report” about typical relational norms and payment methods in Hungarian B2B relationships.

## LITERATURE REVIEW

Summarizing the statements of several previous publications about trust we can state that trust is a necessary (but not sufficient) building element of relationships and/or networks (Arrow, 1974; Luhmann, 1995; Blomquist-Seppanen, 2003; Ford et al., 2008). Trust can be considered as a multiplicative factor in the operation of business relationships: in the presence of trust there are more frequent transactions and long term relationships among business actors. However in lack of trust the term of relationships is much shorter and there are less frequent and intensive transactions (Akerlof – Schiller, 2009; Barney – Hansen, 1994). In line with Blomquist and Seppanen (2003), in this paper trust is defined as “actors’ expectation on the capability, goodwill, and self-reference visible in mutually beneficial behaviour enabling cooperation under risk.” (p.8.) For business relationships, it means that the mentioned four dimensions are required for the existence and development of trust. In line with this Creed and Miles (1996) stated that ability and dependability are the two basic sources of trust. They consider that “trust may concern a partner’s ability to perform according to agreements (capability trust), or his intentions to do so (goodwill trust)” (p. 990). The goodwill dimension determines the first steps in the trust-building process, because it expresses the basic intentions about the party’s trustworthiness. The capability dimension of trust can be divided into three major components: technological capability, business capability and the capability to cooperate. These three capabilities have different focuses and all of them are required for trust-building. As Blomqvist and Seppanen (2003) found out self-reference and behaviour are also important dimensions of trust-building under turbulent business circumstances. Under self-reference they understood a solid base for open communication, learning, and knowledge creation. In their interpretation a „self-referential organization is aware of its identity, capabilities, and values, and can also build on its strengths, and balance its weaknesses by generating the needed capabilities internally or externally.” (p.9.) Based on these elements above, the behavioural dimension can be considered as a manifestation of trust. In practice those signs, signals, formal and informal behavioural patterns, those summarize and determine each party’s decision about the other’s trustworthiness.

Risk is also a crucial factor in trust building. Many author stated that trust and risk are strongly connected to each other, because if an organisation trusts in another one, that means that it will be vulnerable to the actions of the another party (Das and Teng, 2004; Mayer et al., 1995; Barney and Hansen, 1994).

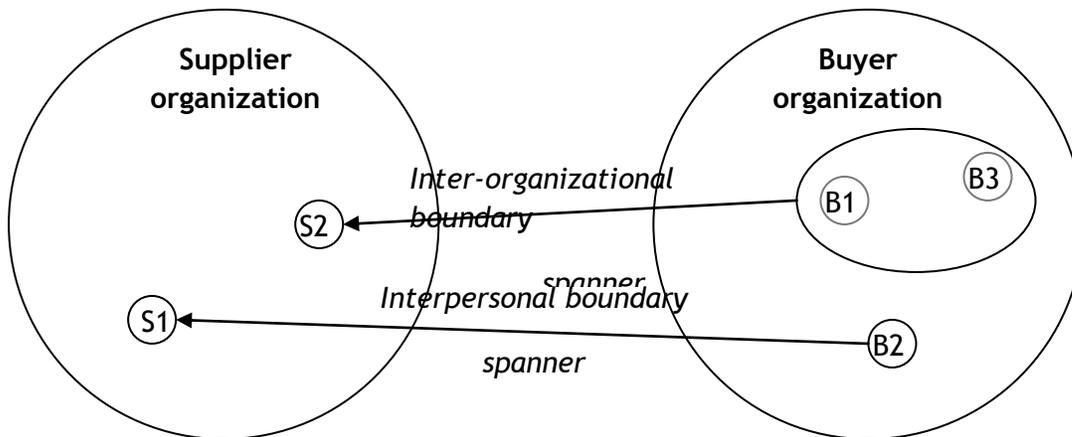
According to Barney and Hansen (1994), this vulnerability derives from three sources:

- There is adverse selection vulnerability; it takes time and is costly to find and choose the appropriate business partner and evaluate its available resources.
- There is moral hazard vulnerability; it takes time and is costly to evaluate the quality of the methods and assets offered by the partner.

- There is hold-up vulnerability; there are many transaction-specific investments to be executed in advance.

In organizational relationships trust building process is also determined by interpersonal and individual elements. Several authors emphasize that interorganizational and interpersonal trust have basically the same sources, because organizations are created by persons, so interorganizational trust should contain interpersonal elements (Dibben 2000; Zaheer et al. 1998; Barney and Hansen 1994). Interorganizational and interpersonal trust mutually influence and modify each other. The employees of an organization are influenced by the company’s mission, culture and processes, while organizational decisions are affected by the employees’ emotions, knowledge and experiences. But in this field Zaheer et al. (1998) stated that interpersonal and interorganizational trust are different constructs. They define interpersonal trust as “the extent of a boundary-spanning agent’s trust in her counterpart in the partner organization” (1998, 142). They further define interorganizational trust as “the extent of trust placed in the partner organization by the members of a focal organization”. They state that only individuals and groups can trust, but the object of the trust may be an individual, team, organization or even a cluster as well. According to them, interpersonal and interorganizational trust is created parallel in business relationships. It is illustrated in Figure 1.

Figure 1. Interpersonal and interorganizational trust



Source: Zaheer et al. (1998 p.142.)

Trust plays important role in the development of *organizational competitiveness* as well. It supports reducing transactional costs (Barney and Hanssen, 1994) and develops the organizations’ dynamic capabilities, especially those ones, which development requires strong cooperation and stable relationship’s environment (Barney, 1999; Blomqvist-Seppanen, 2003). As Metcalfe and James (2000) stressed, firms can develop their capabilities by interacting with their buyers, suppliers, and other parties and these interactions can be the source of long-term competitive advantage. Trust is also an enhanced component in interorganizational learning process, because it facilitates the partners to share information and experience with each other (Miles et al., 2000).

## RESEARCH PURPOSE AND METHOD

As it was mentioned in the abstract, the purpose of this research is quite unusual. Cash usage of the Hungarian economy is very high and even growing compared to international peers. Moreover, only about one-third of this demand can be identified as transactional one, the rest two-third cannot be connected to formal payment transactions (Sisak, 2011). Couple of researches from the MNB has shown that one of the main reasons for this phenomenon - besides the demand of the hidden economy - could be the lack of trust<sup>1</sup> in B2B relationships (Odorán-Sisak, 2008; Bódi-Schubert, 2010). The latter result was strange and unexpected at first sight, so it forced MNB to analyze it more deeply.

This research – initiated by the previous one - focuses on (I) analyzing the general trust level among Hungarian business actors and (II) exploring the connection between trust level and applied payment method in B2B transactions.

Our research is divided into two major phases. In the first section, semi-structured interviews (14 pieces) were made with top-managers (CEO, owner-manager, Supply Chain Manager, Key Account Manager) and banking experts about their view on the importance and actual existence of trust, payment methods and customs in B2B relationships. A round-table discussion was also organized to analyze the results of the interview and to get new impulses. Table 1. below introduces the sample of the interviews. The results of these interviews will be presented in the next part of the paper.

Table 1. Sample of the interviews

Selected sector	Number of interviews
FMCG	6
Banking	3
Transportation and Logistic	3
Automotive	2

The second phase of the research is currently under preparation and expected to be materialized during spring 2013. In this round a questionnaire will be sent out to Hungarian companies (expected sampling size of around 400 companies) to analyze the applied payment methods in their short term and long term business relationships. Their general opinion about trust and the reasons/motivations of their applied payment terms (both on the buyer and the supplier side) will be also requested among the list of questions. The results of the questionnaire are planned to analyze during summer this year.

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<sup>1</sup> The less business partners trust in each other, the more cash they demand to their interactions.

## RESEARCH FINDINGS

This chapter of the paper introduces the major outcome of the interviews and discussion with appropriate businessmen. During the interviews we asked the selected managers (I) to describe and evaluate the relational norms in their company's supplier-buyer relationships: what is the typical behavior in these relationships, what kind of business patterns are followed and identify the problem of that (if the latter exists); (II) interpret the meaning and role of trust in B2B relationship and evaluate the current trust level in their company's supplier-buyer relationships; (III) make suggestions how the actual situation could be improved. The key message of these interviews are as follows.

- No clear and common understanding about the meaning of trust

One of the most important conclusions of the qualitative research phase is that interviewees understand the meaning of trust on several different ways. At first we requested a general reading from the interviewees about the relational norms and actual behavior of business actors. All of our interviewees talked about lack of trust in business interactions, when described the current situation. After saying that, we asked them to define the meaning of trust and the phrase "lack of trust". In their interpretation some of them applied trust and reliability as synonyms, some of them understood much more creditability and dependability under trust. They described the meaning of trust as follows: "the partner does not take unexpected actions", "the partner does not break the agreements", "and the partner keeps its promises". In general, we can state that interviewees understand the meaning and role of trust on a wide spectrum and associated a positive, cooperative, reliable and "fair" (non-opportunistic) behavioral mood with the phenomenon.

During our interviews we asked the businessmen to describe the phenomenon "lack of trust", and explain why they feel this. They define an uncertain relationship (sometimes general business environment), in which they might expect that their partner will not act on correctly and will not meet the points of bilateral agreements or even break the rules of the cooperation, as agreed previously. Our feeling was during the interviews that this kind of business risk (see next point as well) has been continuously increased in the recent years, and now it has reached a certain critical level, that is difficult to be properly handled. So our understanding about lack of trust is more of a general term expressing the changes of the business environment and typical relational norms.

Summarizing the above, in most of the interviewees' confirmed that the meaning of trust is the goodwill dimension of the phenomenon. The capability and self-reference dimensions were not mentioned. In addition actors consider that trust has a high importance in relationship management and nowadays its role changing and broadening.

- Uncertain environment: problems with the companies' financing and liquidity management, application of deferred payments

The economic crises and – parallel to that – the actual slowdown of the Hungarian economy caused serious financial problems in all sectors. Circumstances of the macro-economic environment has significantly weakened: sales opportunities (both export and home market)

failed, lending activity of the banking sector decreased, the exchange rate risk increased and thus all companies have to face with financial and liquidity challenges. Those companies, who were not able to finance their operation from the available internal and external sources started to delay in the payment towards suppliers.

This practice has become more and more popular and nowadays many business actors in buyer position apply deferred payments<sup>2</sup>, i.e. they do not meet the payment deadline and/or do not pay for the given goods or services at all. In practice it means that suppliers are financing their buyers' operation. This phenomenon generates high level of outstanding on the supplier side and sometimes jeopardizes the smooth operation of these companies. The practice of deferred payments is getting more frequent and derives from two sources: opportunistic behavior of the actors (the buyer gets more liquidity if it applies deferred payments) and real financing problems in the partner's operation, generated by the consequences of the economic crises. This problem exists in several sectors of the Hungarian economy from the construction to the agriculture and food industry. The spread of this norm-breaking behavior generated a general uncertainty among business actors. The interviewees frequently mentioned that business environment is highly unpredictable, and they can never know who they could trust, and who will break the previous agreement.

All of our interviewees concerned that the phenomenon of deferred payment is very harmful and makes the operation of business relationships unbalanced, tough and conflicting. They frequently mentioned that this behavior makes the business environment even more uncertain, because "it is always feared that the partner will not keep its promise and your company can easily get into trouble and in extreme cases can go bankrupt as well". As one of the interviewed manager said: "deferred payment generates a "bad balance": companies, who were affected by deferred payments, will not trust in their partners anymore and will apply advanced payments or on-the-spot cash payments. This practice is getting even more frequent and results that no one will believe in that the partners will keep their previous agreements and pay in time. In this environment several transactions fails or does not come into existence because of lack of trust and suppliers often request high amount of cash-advance as a pre-requisite to certain deals." This high uncertainty and the negative experiences of many suppliers' generated different kinds of "defensive mechanisms" (e.g. advanced payments, wide application of cash payments and/or strict payment terms) appeared in the field of payments. As the interviewees said this defensive behavior of the suppliers requires increased cash-usage, because sometimes even high transactional amounts are paid in cash.

The above description about the current situation definitely confirms the multiplicative role of trust – introduced in the literature review – and underlines the importance of goodwill and behavioral dimensions of trust. According to the mentioned problems all of the interviewees agreed that the current situation is not sustainable and trust (including the respect of the norms of "fair" cooperation) among business actors is needed to be rebuilt.

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<sup>2</sup> Before the crises, the general business practice in B2B contracts in Hungary was the application of 30 days as payment deadline after the billing. In this paper under deferred payment we mean the one-sided elongation of the agreed and applied payment deadline or - in extreme cases - denial of the payment from the buyer's side.

- Interpersonal trust

During the interviews the businessmen were asked about trustworthiness and the sources of trust as well. Many of them answered that they can trust only in those persons, who they know for many years and have only positive experience during the cooperation with them. In many cases the interviewees said that their trust is based on personal relationship that is independent from organizations. Moreover, some of them stated that they decide on new deals based on reputation, personal experience and knowledge, and they manage the partner's business performance and/or the evaluation of credit rating companies as secondary points.

But on the contrary to the above mentioned opinion, some interviewed manager said that personal relationships are important, but cannot be considered as superior point. These interviewees considered that the business performance of the partner is more important than the personal feelings and applied more or less sophisticated models to evaluate their customers' credibility. In practice it means that all B2B relationships (including long term ones) of these companies have been reconsidered based on business figures and credit limit has been set up for customers. They decide on transactions and the sustainability of the relationship based on this credit limit classification in case of new and existing customers as well. One manager of this "group" said that: "It's ok, that personal relationship is important and can help a lot in smooth management of the business. But I think that all customer relationships should be managed on a complex way, and the financial figures and development potentials are also important. Nowadays everything changes and you cannot rely on your past experience to hundred percent; the current situation can always make surprises." The evaluation of the business partners' (financial) performance is usually applied by medium-sized and large enterprises, who have adequate capabilities to manage their liquidity and liabilities. This practice is not typical in case of small-sized companies, because their operation is much less sophisticated and mostly the interpersonal relationships can be considered as the main source of trust in their relationships.

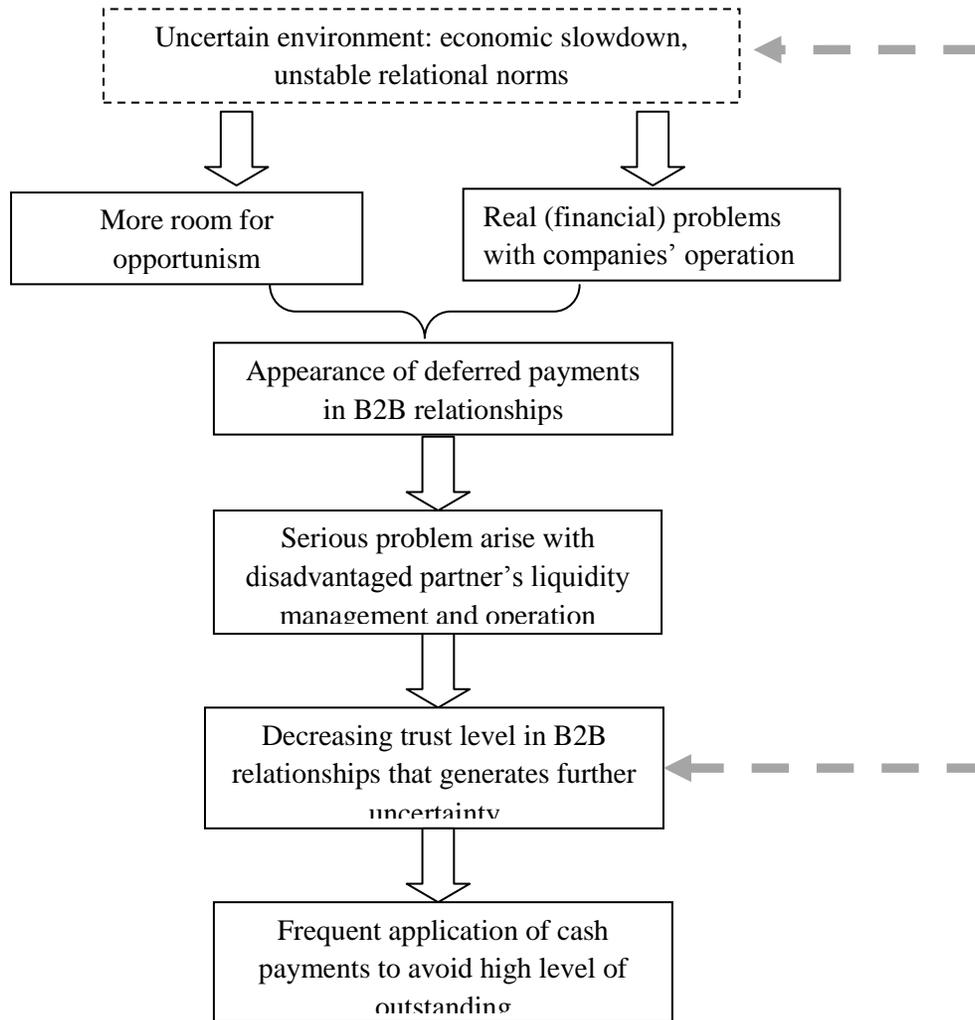
Summarizing the findings of this point we can state that the personal relationship elements (that can be connected to goodwill dimension of trust) plays significant role in creation and sustenance of trust. But in the current turbulent times even more companies apply some kind of customer rating model. It shows that, capability dimension of trust is getting more important, especially in case of medium-sized and large enterprises. Besides the interpersonal relationships, the increasing interest of capability dimension can be a potential source of trust building as well.

## SUMMARIZING THE DISCOVERED PROBLEMS

Figure 2. below summarizes the identified problems in B2B relationships concerning lack of trust and other behavioral issues driven by deferred payments. At first we can state that the increasing uncertainties of the business environment generated more room for opportunism and caused real financing and liquidity problems in many cases. These two main reasons demanded the appearance and spread of deferred payments in buyer-supplier relationships and generated serious problems with the suppliers' liquidity that jeopardized their smooth operation. The practice of these (sometimes extremely) deferred payments resulted that trust – especially goodwill and behavioral dimensions of trust – was broken among business actors; and in many cases only interpersonal relationships are the driver of trust. The phenomenon of lack of trust

significantly affects B2B payments, and causes the general usage of cash payments in B2B transactions.

Figure 2. Identified problems and their consequences



## CONCLUSIONS AND FURTHER RESEARCH DIRECTIONS

The research finding has pointed out that the economic crises generated changes on the field of relational norms, the potential sources and number of relational risk increased, and concerning this, several business actors feel that it can less trust in its partners than before. Although the interviewees understood the meaning of trust on a very wide range and sometimes described the increased uncertainty of the business environment with the term “lack of trust”. It was also an interesting research finding that there might be a connection between trust level and applied payment method in B2B relationships. The appearance of the deferred payments phenomenon - generated by mostly the issues of the economic crises – caused serious problem in B2B relationships, mostly on the supplier’s side. The deferred payments caused high level outstanding at the suppliers’, who started to prefer cash payments in order to get their liabilities without any delay. This problem exists in almost every sector of the economy and typical in case of small-sized supplier companies.

The introduced results raise several further questions, so in the quantitative round (expected sampling size is at least 400 companies) of this research the following dimensions will be analyzed:

- The degree of this “lack of trust” phenomenon: the responding companies should evaluate on a 5 Likert-scale, how they trust in their business partners in generally and how they feel, how their partners trust in them. This answer could provide a little bit clearer picture about the general trust level among business actors. (Supposing that this evaluation can be applicable in each concrete relationship.)
- The degree and threat of deferred payments: in the questionnaire the respondents should evaluate their own payment behavior in buyer and supplier role as well. According to this they should provide the amount and average due date of their suppliers’ debt and their buyers’ claim. In order to have clear view about the deferred payment’s problem, it should be analyzed whether these two components are in balance or not. It will be also analyzed whether this problem is more typical in each sector or depends on the company size?
- The trend of cash-usage in the last three years will be also asked among the questions. The analyses of cash-usage of the responding companies can also ensure more proper information about the effect of deferred payments on cash demand. But it should be noted that in many cases the cash-usage is connected to hidden economy transactions as well, so there is a chance that these answers will be not honest from the responders’ side and will not valuable for us.
- The general application of customer rating models (created by independent rating agencies or own models) will be also asked in the questionnaire, because this competence dimension of trust can be a proper potential source to overstep on the current situation and develop trust among business actors.

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