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Will our customers bail us out?

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HBR CASE STUDY AND COMMENTARY

Will Our Customers Bail Us Out?

How much should Clarinda's president divulge to customers about the company's difficulties?

Four commentators offer expert advice.

by David Silverman

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The Clarinda Company is struggling and may go under. Asking customers for help could aid the effort to keep the company afloat—or torpedo it.

HBR Case Study

Will Our Customers Bail Us Out?

by David Silverman

"What will I find if I open the trunk?" the cop asked.

"Textbooks," I said.

"What are you, encyclopedia salesmen?"

"No, we typeset books."

"You," he said, pointing at Rich in the driver's seat. "Out of the car."

I watched the cop frisk my chief financial officer and then escort him back to the highway patrol car—leaving me alone. He looked hardly half my age and had all the sunglass-wearing bluster of a recent academy graduate.

Leaving the cruiser's multicolored roof lights oscillating at top speed, he aimed the door-mounted searchlight at me to obscure what he was doing to Rich, who was now sitting in the cop car's passenger seat, arms folded. But since it was still early afternoon, all his intimidation was washed out in the burning Iowa sun glaring off the mud-gray, yet-to-be-sown cornfields on both sides of the road.

Not that anyone else was there to see us across the barren field, and not that it would have mattered if we'd been watched by the local farmers. I was already beaten down as far as I could go. A small part of me wanted to get out, walk back to the black-and-white, and say to the cop, "Don't you know what we've been through? Don't you know what my employees just went through?" But I didn't. Being pulled over on the side of an empty two-lane highway for some imagined traffic infraction on the worst day of my career left me with little energy to fight.

My briefcase didn't contain drug paraphernalia, as the deputy hoped, but the documents that had begun to define my life as president of the Clarinda Company. There was the list of employees we'd fired earlier that day. Forty in Clarinda and Atlantic, Iowa; a few more in Baltimore, St. Paul, Syracuse—though none in Manila. All in all, 20% of the workforce.

There was also the letter from Dan's lawyer. Dan—my former business partner, our ex-CEO, and my mentor—was threatening to sue me for firing him a month ago. Did his new lawyer know that Dan was a drunk? That I'd found him slumped over his desk one morning with

Unlike the typical HBR Case, which uses a fictional narrative to present a common managerial dilemma and concrete solutions from experts, this Case is based on real events. The names of some people and companies have been changed.

vodka sloshing in his "World's Greatest Dad" mug? Did Dan explain to the lawyer how I had hauled him bodily from the Holiday Inn at the BWI Airport to the emergency room at the University of Maryland Medical Center in hopes of reviving the man who had been my best friend for eight years?

The letter demanded we rehire Dan, which was almost amusing in the midst of the massive layoffs. It was thanks to Dan's dream of "benevolent capitalism" that we had continued to hire in the U.S., despite the industry trend to ship work to Bangalore. The only thing keeping the company afloat now was our decades-old sales relationships with Pearson, Harcourt, Thomson, and a handful of other major publishers. That and our own offshore operation in Manila—and even there our labor rate of $6,000 a year was more than triple the costs of our Indian competitors.

I was only 35, and my career and life had gone from dreams of wealth and IPOs to desperation-driven layoffs and days filled with new fears and setbacks. Two years earlier, Dan and I had bought the Clarinda Company out of default and embarked on a turnaround effort. In our first year, we'd increased sales by 30% and made the first profit the company had seen in a decade. In our second year, we'd stalled. And now Dan was gone, I was left behind in my role as president, and we were in what Rich called a "flat spin—the kind that planes and companies rarely recover from."

Thanks to the day's firings, we had bought some time to plot our next maneuver, but what would it be? It would be nice to save the company and my own career, but as I watched Rich in the rearview mirror shake his head to the police officer's questions, I wanted out. Just out. Out of the car. Out of the company. Out of Iowa. Just walk away, somewhere, anywhere. And if doing that wouldn't have put me $2 million in debt myself—thanks to the personally guaranteed loans we'd taken out to buy Clarinda—and, worse, left my ailing father with the chance of losing his house, I might have done just that.

The deputy returned with Rich walking alongside. He waved me out of the car, and with all three of us standing there behind the rented Buick, he directed me to open the trunk. Accompanied by the quiet buzz of bees and grasshoppers, I reached into the cavernous interior—Buicks have great trunk space—and retrieved the contraband, which bore the sinister label *Precalculus for Beginners*.

I Need to Get Out

"He said we passed a truck going uphill. Did you see a truck?" Rich asked, shaking his head. "I wasn't planning on ever coming back to Iowa, but this seals it."

"I'm sorry," I said.

"It wasn't your fault, David. He saw the Virginia license plates and got all excited after sitting by that empty field all day."

"No, not about that," I said. "About getting you wrapped up in this. You should never have come to work for Clarinda."

"Oh, that," he said as he opened a pair of Ray-Bans with one hand. "You mean the part where I was going to help you and Dan go buy companies and instead helped you fire his drunk ass?"

I'd known Rich since high school. For over 20 years, he'd been my good friend, and now I'd derailed his career, bringing him in just as Dan went bad to deal with yet another flop, hard on the heels of the dot-com implosion that had been his last job. All his fancy MBA, CPA, and Ernst & Young–trained skills going to waste in my desperate little company.

"I'm joking," he said, his eyes behind the dark shades now, unreadable. "Come on, so what now?"

"Now?"

"Do we try to keep the company going or get you out of this?"

I flipped the pages of the ridiculously colorful and enthusiastic textbook in my lap. Perhaps the cop was right—maybe smoking it would yield some kind of positive result.

"In or out?" Rich asked.

"Out," I said. "I need to get out."

"OK, so first we've got to figure out what to do about your personally guaranteed loans." He slowed abruptly, overcompensating as the speedometer barely edged past 55. "What do you think about selling the company?"

"I'll have to tell the customers. Red Bones is probably already hearing about the layoff."

"He's the guy at Pearson, right?"

"Yes, Clarence R. D. Bones, aka 'Red,' aka the guy with the thin lips who's our biggest customer."

"The guy who said Clarinda was his second-favorite typesetter?"

"That's the one."

David Silverman (dsagman@yahoo.com) is the author of *Typo: The Last American Typesetter or How I Made and Lost 4 Million Dollars* (Soft Skull Press, 2007), which recounts his efforts to revive a struggling typesetting company—an experience that serves as the basis for this Case. He is currently a business-continuity-planning consultant and is working on Jamseed, an internet start-up that helps musicians find funding for their music.

Red's $3 million was a third of our business since we'd lost Reed Elsevier just a few weeks before. The Elsevier letter had read: "We are selecting three U.S. vendors and sending the rest to our new partners in India. Your firm was number four." I don't know how many number fours there were, but it didn't matter; we had gone from $12 million in revenues to $9 million instantly. We were counting on $3 million of it from Jackie Dee at TPC. After that, we had a million pretty much guaranteed from IPC Print, and the remaining two mil was spread among a handful of publishers—McGraw-Hill, Oxford University, Thomson. There was no question that each of our customers controlled a large percentage of our business and that their buying decisions for the upcoming academic year would either allow us to survive or put us out of business—and me into bankruptcy.

"Didn't you say you'd called Red already?" Rich asked.

"He wasn't there. Neither was Jackie Dee. I didn't think this was the kind of thing to leave in a voice message, so I just hung up." I rolled down the window and put my hand in the warm air as we merged onto Interstate 80. "Somehow when they need me, I'm always supposed to be right there, but when I need them—"

"What are you going to tell them?"

"The truth, I suppose. With Dan gone, I need their help."

"I mean what are you going to tell them about the layoff and Dan? Are you going to tell them he was drinking?"

"What else can I do? You know me. I always have to tell everybody everything."

"Maybe you should talk to my attorney, Jack, first."

"And what's that going to do?"

"I'm just saying, it couldn't hurt to talk to him," Rich said and hit the pedal hard as we passed the You Are Now Leaving Iowa sign.

And Why Are You Calling Customers?

In the hotel room in Omaha, I called Rich's lawyer friend. As the phone rang softly in my ear, I folded the corner of the bedspread down. Since we'd fallen on hard times, I was forgoing the modest luxury of the Embassy Suites, and now the red paisley coverlet in the $40-dollar-a-night room was giving me every indication that it would glow like a Grateful Dead poster under black light. When he answered, I explained our situation. An old coworker of Rich's, Jack was a former corporate attorney turned business consultant. With his white beard and silver hair, he often referred to himself as the "Chief Adult in the Room."

"And why are you calling the customers, David?" Jack asked.

I wasn't sure what he meant. Of course I had to call the customers, didn't I?

"Let's take a step back," he said. "What's making you feel that you've got to do this?"

I explained that McSwenson, our Pearson sales rep, had probably already called two or three of the buyers there, if not Red Bones, the production VP, himself. McSwenson had been selling to the Columbus, Ohio, division of Pearson Education for nearly 20 years. With his sallow cheeks and his shiny jet-black hair—it had Kiwi written all over it—he'd won the nickname "the Cadaver" from Dan. He refused to call on any other customers but, at the same time, he was blocking our new salesperson, Beth, from seeking business in other parts of the Pearson empire. He would call after her visits to people in the New Jersey headquarters and remind them that he was "their official account manager." He had, as Dan described it, "pissed a circle around 'his' client."

"And what do you think this ingrate is telling them?"

"I don't know," I said. "Certainly that we've had to let a lot of people go, probably that Dan was a drunk, and that he will take care of them like he always has."

"OK, so they have this information, which they will know is coming from him, not you, and they'll be expecting a call from you to explain?"

"Yes, I mean, of course. Right? Wouldn't you, as a customer?"

"I might, but I'm not that close to it," Jack said. "All I can do is remind you that any information that's currently out there is rumor. Once you say something, it becomes real."

His attorney background gave Jack such a different perspective from mine. For the past two years, I'd been reacting as rapidly as possible to the customers' every concern, real or imagined. At one point, a customer had left me a harsh voice mail about a project. I called back immediately to apologize—only to discover later that his misdialed call had been intended for our competitors in Dubuque.

"There's also our editorial-services division in St. Paul," I said. "The editors there are essentially outsourced employees for Pearson; they'll be calling the customer, too."

"So you're saying that the customer is deep in your underwear."

"And TPC. Steve and Jo from our Atlantic plant must have called down to their contacts in San Antonio as I was on my way to getting pulled over by the highway patrol."

"I understand you've got to deal with that. What I'm suggesting is that you have options. What you do next is much more complicated for you than it is for an employee who doesn't have as much at stake. Far bigger companies than yours carefully assess what they release and how they state it—and there's a reason why it's usually 'No comment.' All you can be sure of is that your customers will react to what you say, so why take unnecessary risks?"

"Say nothing?" I shot back. "Let them wonder what I'm thinking, what I'm going to do next—have more layoffs or rebound?"

Any information out there is rumor. Once you say something, it's real.

"You could tell them that everything's fine, and leave it at that."

"But if I don't address the elephant in the room when I talk to them, they might defect to our competitors."

"And if you confirm for them all this wonderful inside information about Dan's drinking, about the loss of business to overseas vendors, about the layoff you just had?"

"Well," I said, and laid my coat down as a protective barrier on the brown, stained pillow, "I guess they might defect to our competitors."

That's All We've Got?

At dinner, Rich ordered a Johnnie Walker Black, ice, and nothing else.

"You're not going to start, are you?" I asked.

"As your friend, and unlike Dan, I'll be sure to tell you in advance if I'm going to screw you." He twisted his wrist in a knifing motion.

"In the back?"

"Only in the front. So you can see it," he said and laughed.

I laughed, too, thinking how no one laughs at success, only failure.

"Seriously, tell me," he continued. "Is Clarinda what you want?"

"You mean do I want to build a typesetting empire by getting Clarinda back on track and buying up other typesetters and then going public like Dan and I had planned?"

Rich put down his drink and motioned to the bartender for a glass of water by pointing at mine. I watched the guy deftly fill a glass with ice, press the button on the soda gun, and deposit the drink neatly on the hammered-copper bar with one hand, scooping up his tips with the other in one motion.

"No." I said. "It was Dan's dream, and I was along for the ride. Without him, there's no dream. Without him, this is just a job."

"Thank God," Rich said.

"You're surprised?"

"Look, I'm here to help you. If you think we can make a go of it, I'll do it. If you want out, I'll get you out." He clapped his hands. "So tell me about those companies that got bought."

"Lincoln and ABC sold to Bookers, the Indian firm."

"How much did they sell for?"

"One times sales."

"And how did they come up with the revenue number?"

"They would have had to guess; nobody gets contracts that guarantee actual work."

"Is that all we have?" Rich asked. "Only guesses for next year?"

"Well, we've got one contract with TPC, although it doesn't promise any specific job, and we've got a rough list of books we're getting from Pearson. There's also the journal work with IPC. That's pretty much the same every month, so we can put all those down as regular and repeatable."

"What's to stop Bookers from just taking our work?"

"Our fine salespeople, apparently."

"You're kidding."

"No, really. The buyers like dealing with the people they know."

"And that's all we've got?" Rich bent his red cocktail straw into a tight knot.

"That's all we've got."

"So maybe you do need to call them. If we're going to sell this company, we need to point to a book of business."

"And tell them what? That I'm going to sell, and I need them to support me by letting me promise their work to our unknown buyer?"

Rich finished his whiskey and waved for another for both of us. "Yeah, something like that."

Tell 'Em Everything

Lying on the bed, fully clothed, I drifted into a fitful sleep.

"What's up, kiddo?"

"Dan?" He looked like he had when we first met in Baltimore all those years ago. The same houndstooth jacket, yellow tie, brown slacks—the old-school exec who had befriended me with kindness, long before he'd given up.

"Of course, my boy, who did you think would be haunting your dreams?"

"I'd prefer someone else."

"Would you like to hear me say that I'm sorry? That I never intended to let the drinking get out of hand? That I thought we would be able to make it?"

"Yes."

"Then I'm sorry, kiddo. But you've got bigger problems. You're the one who's going to have to call the customers. And be sure to tell 'em everything. They need to know that it's the price cuts they're demanding that's making us—I mean you—send work to our Filipino friends." Dan's ethereal image lit a transparent Benson & Hedges.

"So you want me to say that the layoff's our fault because we're not sending work overseas faster?"

He flicked imaginary ashes on my suitcase. "Well my boy, Red's going to expect you to fall on your sword, and you need his help."

"For what?"

"You need a promise of business from Red whether you're trying to sell our lovely Clarinda to one of those evil competitors or not. You need his business to keep afloat. Heck, my boy, you need to be asking for more work to fill up the gap left by losing Elsevier. And you need Red to let you fire the Cadaver."

"Fire McSwenson?" All the recent layoffs, and I have to fire more people?

"Of course, kiddo, like your new friend Rich has been telling you. McSwenson's the most expensive employee. Haven't you figured out that McSwenson's commission eats up almost all the profit on the Pearson account? And remind me, what new accounts has he brought in, now that he's working for you and not me?"

I felt my head slip off the coat and directly onto the mildewed pillow—powerless to correct the situation.

"And for you to fire the Cadaver," Dan's poltergeist continued, "you're going to have to get Red's permission. They've been close chums for decades now, but maybe Red's ready to toss over his old friend just like you tossed me aside. You didn't have such a hard time firing your old friend for taking a few sips of vodka. Maybe Red's as much of a turncoat as you."

I pushed myself awake. The display of the alarm clock glowed 3:00 AM. I felt more at sea than ever—even my dreams were beating me up.

What Would I Say?

What was I going to do? I needed the customers' help for so many things. How could I combine asking for a guarantee of existing work with the firing of expensive and largely useless sales people whom the customers had, in some cases, invited to their homes and, at the same time, without any irony ask for more work? Dan had misled me so often. What reason did I have to believe his ghoul? For years the customers had told me that he knew the business better than anyone. But which Dan was I listening to? My old friend in a dinner jacket or the drunk?

Rich was very knowledgeable about operations and finance, but he admitted he wasn't the best at sales. And Jack, he was the most reasonable, but the furthest from the details.

On my way to the airport, I checked my voice mail. I had two messages. One was from Red Bones: "Why didn't you tell me you were going to have a layoff?" The second was from Jackie Dee requesting that I "come to San Antonio early next week, say, Monday."

As I sat down in the narrow seat and folded my tray table into the upright and locked position, I knew that, unless my plane circled forever on the approach to LaGuardia, I had to make those calls. What I didn't know was what I would say.

Want to know what actually happened to the real-life Clarinda Company? Go to bailusout.case.hbr.org.

How much should Clarinda's president divulge to customers about the company's difficulties? • Four commentators offer expert advice.

See **Case Commentary**

Case Commentary

by Jim Marsh

How much should Clarinda's president divulge to customers about the company's difficulties?

Based on my own recent experience, I'd urge Clarinda's president to be very open with his customers about the company's situation. When I assumed my current position at Cable & Wireless in April 2006, we were in a similar, if somewhat less serious, situation. Our part of the company had some significant problems: Not only were our customers getting patchy service, but the business itself was cash negative. The previous senior management team had chosen to hold information about financial problems close to the chest, so neither customers nor most of our own employees were aware of the challenges we faced.

We made an explicit decision to be open about these problems with both customers and colleagues. But—and this is crucial—that openness was accompanied by a road map, complete with specific milestones, which laid out the transformation journey we planned to take, one on which we wanted customers and colleagues to join us.

The decision to be transparent was absolutely the right one for us. Clarinda should move in that direction.

Our executive chairman and I took our message on the road, personally delivering it to each of our major customers around the world. This was critical, I believe, because customers don't buy from and into companies—they buy into individuals. It was important that they see us face-to-face, look us in the eye, and trust us as individuals—individuals who'd be able to deliver the changes we were promising. I gave all key customers my home phone number and told them to call me anytime, 24/7, if they had a problem.

We also assigned a senior executive to be the sponsor for each of our top 100 customers, offering to meet with them each quarter. Not every customer wanted that kind of frequent contact, but the open channel helped build trusting relationships.

We found that customers appreciated this openness—"refreshing" was the term they most often used—and that if you're honest and straight with them, they'll be understanding of your situation. One of the key things we got out of our face-to-face meetings was that, even if customers had lost faith in us because of our past actions, they really wanted us to be successful. Mind you, we weren't asking them to do us any favors. All we were asking for was another chance to prove ourselves.

That said, there's always a question of *how* open you should be with customers. Should David, Clarinda's president, divulge to customers his desire to sell the company, for instance? In our case, some people were quite nervous about the idea of divulging the underlying financial performance of our part of Cable & Wireless. But I argued for complete transparency—even down to the incentives offered to members of the senior executive team—because we were asking these people to trust us. We were under no obligation to divulge the unconsolidated results from our business. But our willingness to do so not only showed customers the magnitude of the problems we were facing but also generated a lot of emotional buy-in from them.

I think our honesty had a lot to do with the success of our transformation effort. More than two years into it, we're hitting our milestones on schedule, we've helped boost the company's share price, and customers have stuck with us. The decision to be transparent was absolutely the right one. Clarinda should move in that direction.

Jim Marsh is the CEO of the Europe, Asia, & U.S. business of the London-based telecommunications company Cable & Wireless.

Case Commentary

by Rick Rickertsen

How much should Clarinda's president divulge to customers about the company's difficulties?

David's guiding principle in talking with Clarinda's customers should be to disclose nothing beyond what he has to. He'll have to discuss the layoffs, of course, which will soon be industry knowledge, if they aren't already. He'll need to apologize to Red Bones, the Pearson buyer, for not telling him about the cuts earlier and explain that they resulted from the loss of the Reed Elsevier business. Otherwise, all is steady, and serving Pearson remains Clarinda's most important goal.

David should not talk about Dan's drinking problem—that has lawsuit written all over it—simply explaining, if asked, that Dan was let go as part of the cost cutting. And David should not mention his desire to sell the company or, worse, show his despair by asking for unusual favors or long-term deals.

David should buck up and try to whip the business into shape so it's actually appealing to a buyer.

In rare cases, you might go to customers with your plan to sell the business. For example, you might seek their input on potential buyers that they would find attractive because of, say, a reputation for efficient operations or fair dealings with customers. After all, customers may know your competitors—who would be potential buyers—better than you do because of their own relationships with them. Or you might get the word out that the company's up for sale in order to flush out a buyer or two and even start a bidding war.

But this is a risky strategy, given that customer reactions to a sale are typically negative. In general, you don't want to talk about a sale until a deal is almost done—usually just days before the purchase agreement is signed, after most of the details of the agreement have been hammered out. At that point, you can break the news to customers with a well-crafted case for how they'll benefit from the sale—"The buyer can invest additional capital that will fuel growth," "The buyer's overseas operations will reduce operating costs," and the like—after which the buyer can talk to them as part of the due-diligence process. Furthermore, telling customers could allow competitors to get wind of the sale and give them the opportunity to put a negative spin on the news: "Between you and me, the new owners are jackals; the company will now be overleveraged; customer service will suffer; and, by the way, the sky is falling." Rivals will often portray the sale as a sign of desperation.

There's something that's even more important here, though, than deciding what to tell the customers. David has to figure out what to do about the business. My advice here: Buck up, get back on the horse, and try to whip the business into shape so it's actually appealing to a buyer.

Yes, things aren't going all that well: You're in a declining business, facing cheap overseas competition; you just lost a customer representing one quarter of your business; and you're on the hook for $2 million in personally guaranteed debt. But there are some bright spots. You have close relationships with a roster of prestigious customers, such as Pearson. A competitor was just sold for one times sales, which implicitly values Clarinda at $9 million. Perhaps most promising of all, there are foreign buyers with strong currencies out there doing deals.

Don't panic! Don't be weak with customers. Redouble efforts to provide terrific customer service. Seek new customers who will reduce Clarinda's reliance on the handful that dominate the company's current order book. That will make the company much more attractive to acquirers. Even if a buyer does come forward, you'll probably be running the business for another year. You've had an awful few weeks, and your knee-jerk, I-want-out reaction is understandable. But it would be a mistake to completely lose perspective and hold a fire sale in this dark hour.

Rick Rickertsen (rick@pinecreekpartners.com) is a principal at the private equity firm Pine Creek Partners and the author of the book *Sell Your Business Your Way: Getting Out, Getting Rich, and Getting on with Your Life* (Amacom, 2006).

Case Commentary

by Richard Charkin

How much should Clarinda's president divulge to customers about the company's difficulties?

It would be a mistake for David, our protagonist here, to tell customers the whole truth about Clarinda's problems and his plans to look for a buyer. It would also be a mistake to lie to customers; in a tight industry like this, people would quickly find out. He should do something that falls between the two extremes.

The advice of his former partner, Dan, is about as helpful as the nightmare in which Dan offers his recommendation. To open up completely to customers and essentially ask for their mercy would precipitate disaster. As Jack, the lawyer, points out, David is under no obligation to confirm what customers may be hearing from salespeople. And however loyal those customers may be, their first loyalty is to their own companies and bosses. If I were a Clarinda customer—and at Macmillan I was in a position to be just that—and had a sense that the business was about to go bust, I'd be heading for the door rather than making promises to prop the company up.

Even if David got some commitments from customers, that wouldn't mean much to a potential buyer.

Keep in mind, too, that even if David successfully appealed to customers' loyalty and got some informal commitments to continue purchasing from Clarinda, that wouldn't mean much to a potential buyer. If, during the due-diligence process, a Clarinda customer offered a glowing assessment of the typesetting company, a buyer would simply assume that something else was going on—that the customer had been nobbled by Clarinda to say nice things about the company.

David's determination to sell the company really is the only sensible move, given the departure of Dan, who seems to have been the driving force behind Clarinda's industry consolidation strategy. To do so, David has to provide customers with a vision of the company's future. What he doesn't have to say is that a new owner may be the one to realize this vision.

The pitch would go something like this: "Despite the layoffs, Clarinda continues with its aggressive growth plans. Besides domestic acquisitions, the company is seeking partners in India to complement the Philippines operations. It needs refinancing to realize those ambitions." (Technically, a sale of the business is a form of refinancing.) "Would you, the customer, be interested in taking a stake in Clarinda?" (What better way, after all, to secure their commitment?) "Even if you're not, certainly you realize that the offer is an indication of the confidence we have in our partnership." (And this confidence will, with any luck, be reciprocated.) Or something like that.

Finding a buyer for Clarinda, with or without a guarantee of continued business from its customers, isn't out of the question. Typesetting businesses in India, including subsidiaries of publishing companies such as Macmillan, have in fact acquired typesetting businesses in the United States. Even though the typesetting can be done much more cheaply in India, the businesses are attractive because of their sales teams and their direct contacts with U.S. customers.

However, the value of salespeople and their contacts isn't limitless. If McSwenson, the Cadaver, is raking in commissions roughly equal to what he's bringing into the company in profits, he should be fired—and David shouldn't hesitate to be straight about it with Red Bones, the Pearson executive. Red and the Cadaver may be "close chums," but Red's closest chum is his own boss at Pearson. And if McSwenson is making exorbitant commissions, Pearson, as well as Clarinda, ultimately foots the bill. That can be the subject of an honest conversation.

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Case Commentary

by Kimberly D. Elsbach

How much should Clarinda's president divulge to customers about the company's difficulties?

Throughout his time at Clarinda, David has wrestled with the ethics of honesty in the business world. Despite becoming somewhat jaded by his experiences—after all, people haven't always been honest with him—he is still strongly inclined to do what he sees as the right thing. The implicit benefit of such altruism: By being completely truthful with customers, he will gain their trust and therefore their backing.

But David is making the common mistake of confusing two different kinds of trust. What he needs to secure from his customers is something called *competency-based trust*. This is the confidence that someone is capable and able to deliver the goods—in this case, that Clarinda has the competence to meet its obligations to its customers.

David seems to be blurring in his mind competency-based trust with interpersonal trust.

David seems to be blurring this in his mind with something called *interpersonal trust*. This is the confidence that someone will support you when times get tough and that you will reciprocate—in this case, that Clarinda and its executives will treat customers with decency and, in turn, be rewarded with further business.

Interpersonal trust has a place in business, but research shows that it can't be developed overnight. McSwenson, the Clarinda sales rep, has built it up with Red Bones, the Pearson production VP, over a 20-year period. To try to do it in a couple of phone calls or a single meeting will seem disingenuous.

Competency-based trust can be established more quickly. David doesn't have to lie, but he has to be strategic about what he says and how he says it. My own research shows that three things are essential to establishing this kind of trust: David's message must be simple; it must reflect that he has a clear understanding of the situation; and it must exhibit rational decision making.

Thus, in talking about Clarinda's situation with customers, David should not go into laborious detail about the economics of the typesetting industry. But he should acknowledge the recent loss of a big customer and other business challenges—especially those that customers would have heard about through the grapevine. And he has to convince customers that he is taking rational steps, such as the layoff of relatively expensive U.S. staff, to meet these challenges.

He might say something like this: "We are redeploying our workforce, with a larger number working overseas, but we are keeping critical people in the United States who are important to our knowledge base—people who know our customers and have a firm grasp of U.S. textbook requirements."

To engender competency-based trust, David certainly doesn't need to get into a discussion of difficult matters that might, over time, contribute to interpersonal trust but in the short term will only make people uncomfortable. For example, he doesn't need to raise the issue of Dan's drinking, which is no longer relevant to Clarinda's ability to meet customer needs. He also doesn't have to talk about his desire to sell the company, which has more to do with his personal financial situation than with the organization's and its employees' capabilities—which is what will ultimately be important not only to customers but to potential buyers, as well.

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