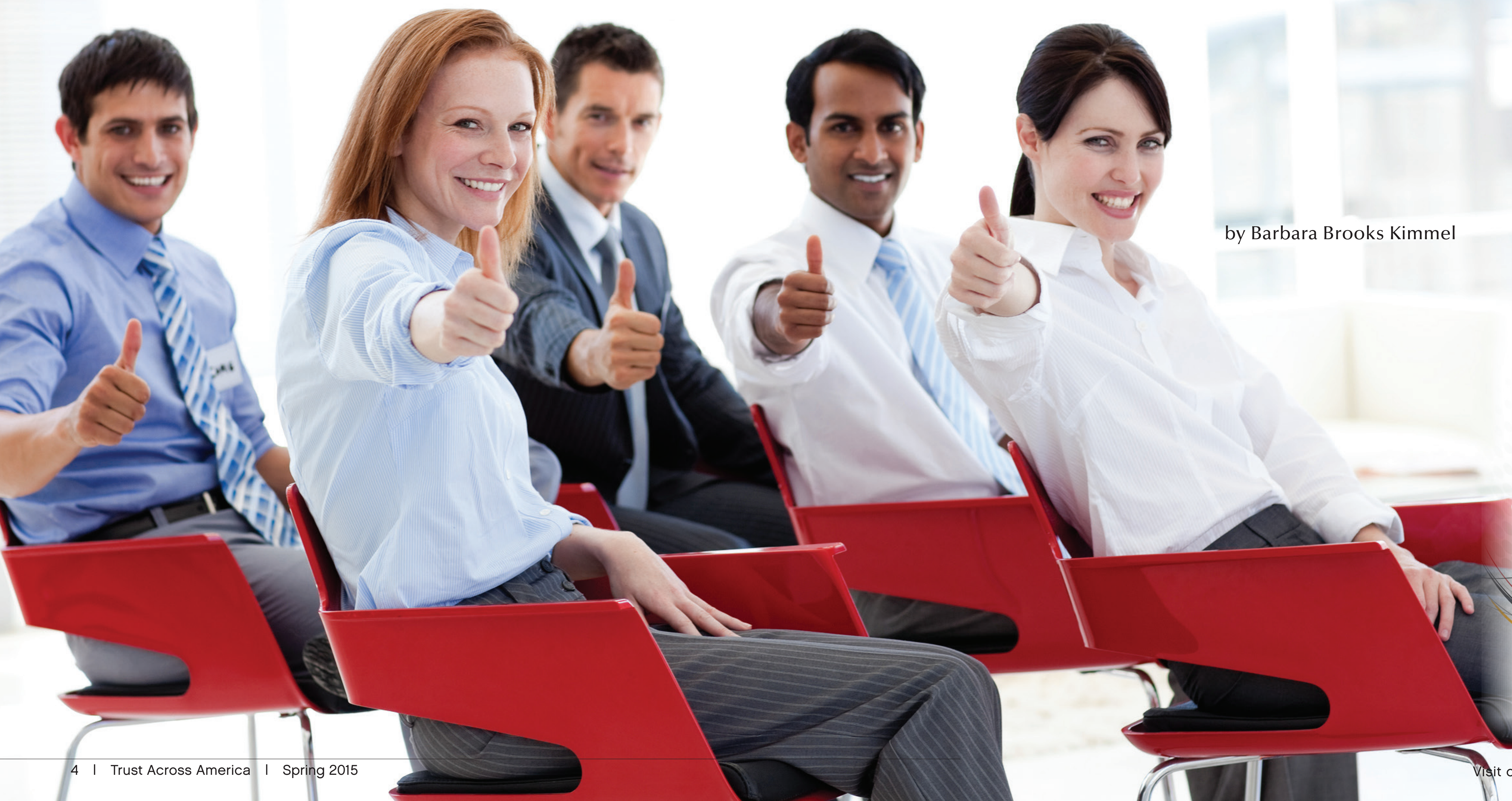
"Return on Trust"

The Business Case



by Barbara Brooks Kimmel

In the short-term "low trust" businesses can be very profitable. Corporate executives who "legally" cheat, steal, lie, avoiding paying taxes, and stay just on the "right side" of compliance may produce the profits that both their Board and shareholders crave, but these "business as usual" trust violations are not conducive to long-term business success. But just how is that success built? By embracing trust as both a business "imperative" and long-term strategy. This translates to practicing "trust" on a daily basis by treating your customers and suppliers "right", by having superior products, great service, high performing teams, low employee turnover, and a high degree of innovation.

A person "like yourself" is now trusted nearly two times as much as a CEO or government official.

Ben Boyd, Edelman

Employees learn to trust when leaders provide adequate information about decisions they're making

Andy Atkins,
Interaction Associates

What Does Low Trust Cost an Organization?

The Hard Costs of Low Trust

- A study by Murphy, Shrieves and Tibbs called "Determinants of the Stock Price Reaction to Allegations of Corporate Misconduct" finds that "allegations of misconduct are accompanied by statistically significant control-firm adjusted declines in reported earnings, increases in stock return variability, and a decline in concordance among analysts' earnings estimates."

  Murphy, Deborah L., Ronald E. Shrieves, and Samuel L. Tibbs, "Understanding the Penalties Associated with Corporate Misconduct: An Empirical Examination of Earnings and Risk," Journal of Financial and Quantitative Analysis, February 2009, Vol. 44, No. 1, pp. 55-83.

- In a 2008 study by Karpoff, Lee and Martin called "The Cost to Firm's of Cooking the Books," the authors find "The penalties imposed on firms through the legal system average only $23.5 million per firm. The penalties imposed by the market, in contrast, are huge."

- Less than one-third of US workers were engaged in their jobs in 2014, with millenials the least engaged. (Gallup) and this is costing the US economy $450-550 billion a year, which is over 15% of payroll costs. (Gallup, 2013)

- The Washington Post reported that "the federal government imposed an estimated $216 billion in regulatory costs on the economy (in 2012), nearly double its previous record."

- The cost of the tort litigation system alone in the United States is over $250 billion. – or 2% of GDP (Forbes, January 2012)

- The six biggest U.S. banks, led by JP Morgan Chase & Co. and Bank of America Corp. have piled up $103 billion in legal costs since the financial crisis (Bloomberg, August 2013)

- According to The Economist Intelligence Unit (2010), 84% of senior leaders say disengaged employees are considered one of the biggest threats facing their business. However, only 12% of them reported doing anything about this problem.

- Recently, the New York Times reported that the daily cost to house, feed and guard a single prison inmate in New York City is $459.54. In the sharpest of contrasts to the cement-block walls of a cold jail cell, the Ritz Carlton Hotel is the paragon of luxury. World-class service, beautiful design, 600 thread-count sheets. And yet, the average cost for a night at the Ritz — $323, according to its public filings — is 30% less than the cost of a night in city jail. (Josh Linkner, Detroit Free Press, November 9, 2014)

- The PR firm Edelman finds in their 2015 "Trust Barometer" that

  For the first time, nearly two-thirds of the 27 nations surveyed fell on the "distrustful" end of Edelman's index, gauging respondents' trust in government, business, media and non-governmental organisations. Among the informed public segment of the 33,000-person survey — a group of 700 wealthy, well-educated, well-informed individuals — 57 per cent said they trusted business, down from 59 per cent last year. (Financial Times, January 20, 2015)

The trust gap not only negatively impacts a company's revenue, market share, brand reputation, employee engagement and turnover, stock price, and bottom line profitability, but every facet of society.

What happens when trust increases?

The Low Cost of Hard Trust

Building a trustworthy business will improve a company's profitability and organizational sustainability. A growing body of evidence shows increasing correlation between trustworthiness and superior financial performance. Over the past decade, a series of qualitative and quantitative studies have built a strong case for senior business leaders to place building trust among stakeholders high on their priority list. While none of these studies are perfect, over the next decade their results will be increasingly difficult to ignore.

- In this brand-new research from Interaction Associates

It is demonstrated that companies that enjoy high levels of trust among their employees are two and a half times more likely than those that don't to enjoy superior revenue growth. High-trust businesses significantly outperform all other organizations in achieving a wide variety of business goals, including customer loyalty and retention; competitive market position; values-driven behavior and actions; predictable business and financial results; and profit growth.

- and more from the Chartered Management Institute follow this link.

When people trust an organization, they are more likely to exhibit supportive behavior.

Linda Locke,
Reputare Consulting

As we look more closely at the morality of managers through the lens of MoralDNA, we see that being good and doing things right is mostly about our empathy, our reason and our values. It is much less about the achievement of narrow financial targets, or our robotic compliance with rules and regulations. And yet governments, businesses, public services and charities still persist in a focus on quantitative targets and bureaucratic red-tape that drive dysfunctional and unethical workplace cultures. This has to change.

- A 2013 study by Guiso, Sapienza and Zingales called "The Value of Corporate Culture" finds that proclaimed values appear irrelevant. Yet, when employees perceive top managers as trustworthy and ethical, firm's performance is stronger.
- In a Harvard Business School working paper from July 2013 called The Impact of Corporate Sustainability on Organizational Processes and Performance, Robert G. Eccles, Ioannis Ioannou, and George Serafeim provide evidence that High Sustainability companies (those integrating both environmental and social issues) significantly outperform their counterparts over the long-term, both in terms of stock market as well as accounting performance.
- Forbes and GMI Ratings have produced the "Most Trustworthy Companies" list for the past several years. They examine over 8,000 firms traded on U.S. stock exchanges using forensic accounting measures, a more limited definition of trustworthy companies than Trust Across America's FACTS Framework but still somewhat revealing. The conclusions they draw are:

  "… the cost of capital of the most trustworthy companies is lower …"

  "… outperform their peers over the long run …"

  "… their risk of negative events is minimized …"

It doesn't take an index to tell us public trust is dangerously compromised.

Davia Temin,
Temin and Company

From Deutsche Bank:

- 100% concurrence on Lower Cost of Capital ("… academic studies agree that companies with high ratings for CSR (corporate social responsibility) and ESG (environment, social responsibility, governance) factors have a lower cost of capital in terms of debt (loans and bonds) and equity.")
- 89% concurrence on Superior Market Performance ("… studies indicate companies with high ratings for ESG factors outperform market-based indices")
- 85% concurrence on Greater Performance on Accounting –Based Standards ("… studies reveal these types of company's consistently outperform their rivals on accounting-based criteria.")
- From Global Alliance for Banking on Values, (see more on the GABV in the first issue of our magazine,) which compared values-based and sustainable banks to their big-bank rivals and found:

  7% higher Return on Equity for values-based banks (7.1% ROE compared to 6.6% for big banks).

  51% higher Return On Assets for sustainable banks (.50% average ROA for sustainable banks compared to big bank earning 0.33%)
- Another study has just been released measuring "Return on Character" and correlating it with profitability.

These studies are bolstered by analyses from dozens of other respected sources including the American Association of Individual Investors, the Dutch University of Maastricht, Erasmus University, and Harvard Business Review.

Business leaders may continue to challenge the "return on trust" but the evidence is mounting. There is not only a business case but also a financial case for trust. Trust works not only in business, but in all organizations regardless of their industry, size or location.

Form a Culture-Guiding Coalition.

Bob Vanourek,
Triple Crown Leadership

Improved Profitability

This growing body of evidence shows increasing correlation between trustworthiness and superior financial performance.

Companies exhibiting high levels of trustworthiness have a competitive advantage. Who are they and how do they build trust?