MARKETS

The Erosion of Trust & How to Repair It

Managing Trust Proactively

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When Matthias Müller addressed his first shareholder meeting as Chief Executive of Volkswagen, he began with an apology. Speaking to thousands of small shareholders and representatives of large institutional investors in Hanover's vast 'Deutsche Messe' exhibition hall, Müller acknowledged that VW was facing the biggest crisis in its history. The debacle centered on the company's use of so-called 'defeat devices' to cheat emissions tests. The diesel vehicles in question were sold in the United States and around the world. Trust in VW had, he admitted, been betrayed.

"It is all the more painful – for you, for us, and for me personally – that rules were broken and ethical boundaries transgressed by the software manipulations on diesel engines," he told the shareholder meeting in June 2016. "This behavior contradicts everything Volkswagen stands for. It has damaged our most valuable asset: the trust people place in our Company and our products. On behalf of the Volkswagen Group – and everyone who works here – I would like to apologize to you, our shareholders, that the trust you, too, placed in Volkswagen has been disappointed."

The crisis at VW, likely to cost the German automotive powerhouse more than $15 billion in penalties in the US alone, followed its admission that secret software had been installed in diesel vehicles to mislead regulators over the test results of cars that emitted up to 40 times the legally allowable levels of pollution. It also undermined general trust in the automotive industry, with investigations being launched in Germany, the UK, France, South Korea and numerous other countries as consumer confidence in engine-test results took a battering.

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A Year of Eroding Trust

The turmoil at Volkswagen coincided with a year of eroding trust in institutions, companies, public agencies and individual leaders in multiple sectors. Institutional trust has long been a precious and rare commodity. But it has arguably never been more precarious. Trust has sunk to a new low – ranging from voter distrust in both US presidential candidates, through to the drug allegations against Russian Olympic competitors, generalized fears over security, widening societal splits between rich and poor, and systemic suspicion on the part of consumers about industries as diverse as banking, retailing, news media and social networks.

Mark Thompson, the Chief Executive of the New York Times Company, blames the era of distrust on a failure in political discourse. Promoting his new book - What's Gone Wrong with the Language of Politics – Thompson recently told one interviewer: "We live in the most challenging times of our lives. There's global terrorism; growing nationalism; widespread distrust of mainstream politicians, which is encouraging many voters to turn to populist alternatives, both on the left and right — Donald Trump and Bernie Sanders in America and Nigel Farage and Jeremy Corbyn in Britain; rising religious fanaticism; deep divisions in society between the rich and the poor; and climate change shocks. The world needs explaining and fixing as never before. But the people we need to explain it and fix it, notably politicians, have forgotten how to talk to each other and to the public. If they don't remember how, we're all screwed."

The inability to create and maintain trust in an institution – whether a political party or a corporation – is emerging as one of the biggest risks to stakeholder engagement. If ordinary voters, consumers or shareholders don't believe in the strategy and promises of the institution in whom they are voting or investing, then overall confidence is undermined.

Without trust, electoral mandates are weakened in politics. In business, purchasing decisions are deferred and consumers go elsewhere. Faced with such as challenge, institutions tend to react in one of two ways: they either become even more radical and grandiose in their promises and claims – the Trump doctrine – or they become much more risk adverse, and defer decisions to avoid any further erosion of confidence: the primary danger for business.

Why is this important? After all, politicians come and go. America has survived truly dreadful Presidents. Britain has spent far longer outside the European Union over the course of its history than inside it. Both the United States and Europe have absorbed millions of migrants before. Debt crises can be overcome. Consumers who once reviled certain brands – think Audi or even Apple – can be persuaded back.

Trust, nevertheless, carries greater visceral power than almost any other sentiment when it comes to personal, political or corporate behaviour. The basic concept was explained in a paper for the journal, European Societies, by academics Jan Delhey and Kenneth Newton. They wrote that trust, "… contributes to economic growth and efficiency in market economics, to the provision of public goods, to social integration, co-operation and harmony, to personal life satisfaction, to democratic stability and development, and even to good health and longevity. Trust is also at the centre of a cluster of other concepts that are no less important for social science theory than for practical daily life, including life satisfaction and happiness, optimism, well-being, health, economic prosperity, education, welfare, participation, community, civil society, and democracy."

The absence of trust can be corrosive. Politicians or business leaders who cannot assume a basic level of trust on the part of their voters, consumers or shareholders tend to become more risk averse. Sir Martin Sorrell, WPP's CEO, traces the breakdown in trust – and the consequent aversion to risk – to the financial meltdown of 2008, when the US sub-prime mortgage crisis almost brought down the global banking system.

Importance of Calculated Risk

Writing in his 2015 Annual Report, Sorrell told shareholders: "If political leaders are wary of risk-taking, the appetite for it in the corporate world is smaller still. Since the collapse of Lehman Brothers in 2008 and the economic crisis and recession that followed, boardrooms have become ultra-conservative in their decision-making. In a world of zero-based budgeting, activist investors and ubiquitous disruption by tech start-ups, there is little encouragement to be bold.

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"This is a regrettable, if understandable, fact of contemporary corporate life. It is both a reflection of our low-inflation, low-pricing power, low-growth world, and one of the reasons it is proving so hard to break out of it. Calculated risks are necessary for the long-term health of a business, because without them innovation, development and renewal are impossible."

There are, arguably, five basic factors behind the breakdown in trust that has intensified in the second decade of the 21st century.

First, weakening confidence in the political class. In the political world, voters are rightly disenchanted with decisions that were taken and accepted largely on trust – and that subsequently had disastrous longer-term ramifications. American Government policy in the Middle East, from Iraq to Syria (and compounded by the botched British and French intervention in Libya), has spawned a security vacuum and societal breakdown that proved a fertile recruiting ground for radical Islamic terrorism. That in turn created a migration crisis that has shaken the European Union. Britain, long a grumpy outlier of European federalism, has voted to exit the 28-member bloc. Far right parties are on the rise in Germany and France. Former Soviet satellite states like Hungary, once behind the Iron Curtain, have erected their own walls against refugees from terror. In too many countries, domestic growth has been sluggish. Secure jobs are in short supply. Many ordinary voters feel disenfranchised. Put simply, people mistrust the politicians they elect.

Mistrust in politics has been replicated in a second area of distrust: confidence in business conduct. Around the world, there has been a surge in highly publicized corporate wrong-doing, whether insider trading or rate-fixing in banking, procurement corruption or design flaws in products. In the UK, two retail tycoons – Sir Philip Green, the former owner of department-store chain BHS, and Mike Ashley, owner and controller of Sports Direct – cast a shadow over corporate conduct generally because of their apparent disregard for the rights of pensioners or shop-floor workers.

Simon Walker, the out-going director general of the Institute of Directors, recently insisted that these controversial retailers do not reflect the conduct of the vast majority of business people. But, writing in The Times, Walker added: “Characters such as Ashley and Green have a strong grip on the public imagination and their behaviour is sometimes taken to be representative… There is no time for hand-wringing. Large chunks of the public have decided that most companies are run by crooks and it is up to us to show that business not only creates wealth and jobs but it can also act with integrity.”

Falling levels of trust in business reflect a third factor that is exacerbating the problem: attack-dog journalism. In an age of falling circulation, weak advertising revenue and cut-throat competition, some news organisations are migrating to blatantly polemical news with scant regard for facts. This phenomena, perfected over generations by British tabloid newspapers, has been amplified in a digital environment where anyone can become a reporter or commentator with a blog and no editorial credentials. This is making it harder for companies to react to hostile or factually incorrect stories on issues ranging from remuneration to product recalls.

It is harder still to deal with a fourth issue contributing to the trust deficit: the deliberate and sometimes state-sponsored use of misinformation. The Russian Government is a prime mover in 'dezinformatsiya' – or disinformation – whether it is leaked emails about the US Democratic National Committee or the health records of US athletes. Anders Lindberg, a Swedish journalist and lawyer who has been following the dezinformatsiya trend, told The New York Times: "What the Russians are doing is building narratives; they are not building facts. The underlying narrative is, 'Don't trust anyone'."

Digital Content Overload

The spread of misinformation, often reported with glee and without fact-checking in a social media environment, is compounded by the fifth and probably the most systemic factor behind the erosion of trust: the explosive impact of instantly-shared digital content. Of the three billion users of the internet, two thirds are relying on smartphones for content consumption that they can comment on, mash up, repurpose and send who knows where. The sheer volume of information swirling around in the online world frequently undermines the veracity of the news or analysis that is being shared.

At the same time as online consumption is going up, the number of social network providers and e-commerce platforms is going down. The entrepreneurs behind the worldwide web never imagined that, on its 25th anniversary, network power would reside largely in the hands of a corporate oligarchy comprising a dozen or so companies. This concentration of power, while entirely legitimate in corporate terms, does not necessarily enhance the freedom of choice when it comes to where and how to communicate or transact in an online environment.

Those three billion consumers who are getting their information and levels of trust from a networked world are also increasingly polarized from the world's unconnected population of more than four billion. The offline population is concentrated mainly in under-developed and primarily rural economies. In these places, if you can't trust your government to provide health, basic utilities, education or security, a broadband connection is unlikely to enhance your trust in institutions.

Faced with the five primary drivers of mistrust – in political competence; corporate misconduct; attack-dog journalism; state-sponsored misinformation; and the polarizing nature of digital communications – institutions need to become far more alert to managing trust proactively.

Surfacing Potential Problems

Given rising levels of distrust in the political and business world, institutional leaders and their staff need to adopt a risk-management approach to basic issues of trust. They need to imagine a worst-case scenario and plan against it. More than that, they need to adopt strategies and action to avoid trust being damaged in the first place.

This anticipatory form of reputation management has a name: the "premortem." It was coined by Gary Klein, a senior scientist at MacroCognition, the US research firm, where he focuses on the power of intuition to inform good decision-making.

In a recent article for McKinsey Quarterly, he said: "The premortem technique is a sneaky way to get people to do contrarian, devil's advocate thinking without encountering resistance. If a project goes poorly, there will be a lessons-learned session that looks at what went wrong and why the project failed — like a medical postmortem. Why don't we do that up front? Before a project starts, we should say, "We're looking in a crystal ball, and this project has failed; it's a fiasco. Now, everybody, take two minutes and write down all the reasons why you think the project failed."

"The logic is that instead of showing people that you are smart because you can come up with a good plan, you show you're smart by thinking of insightful reasons why this project might go south. If you make it part of your corporate culture, then you create an interesting competition: "I want to come up with some possible problem that other people haven't even thought of." The whole dynamic changes from trying to avoid anything that might disrupt harmony to trying to surface potential problems."

The premortem is another way of encouraging institutions to get better at planning. If they prized trust more and considered ways by which to best preserve it before embarking on a certain course of action, then perhaps they would not face such a loss of credit when things go wrong.

Trust is clearly a precious commodity. But just how precious trust is does not become clear until you lose it.

That is a sentiment well understood by Mattias Müller, the VW chief executive battling to save his company's reputation. Concluding his remarks to this year's shareholder meeting in Hanover, he acknowledged how hard the company had to work to regain trust and to avoid making the same mistakes in the future.

"Despite the progress that has been made, we still have a long way to go before all aspects of the diesel issue have been comprehensively processed," he said. "We are addressing this task with diligence, sincerity and determination. And we will not rest until we have uncovered the whole truth about how the situation came about. Above all, we will draw the right conclusions for the future."