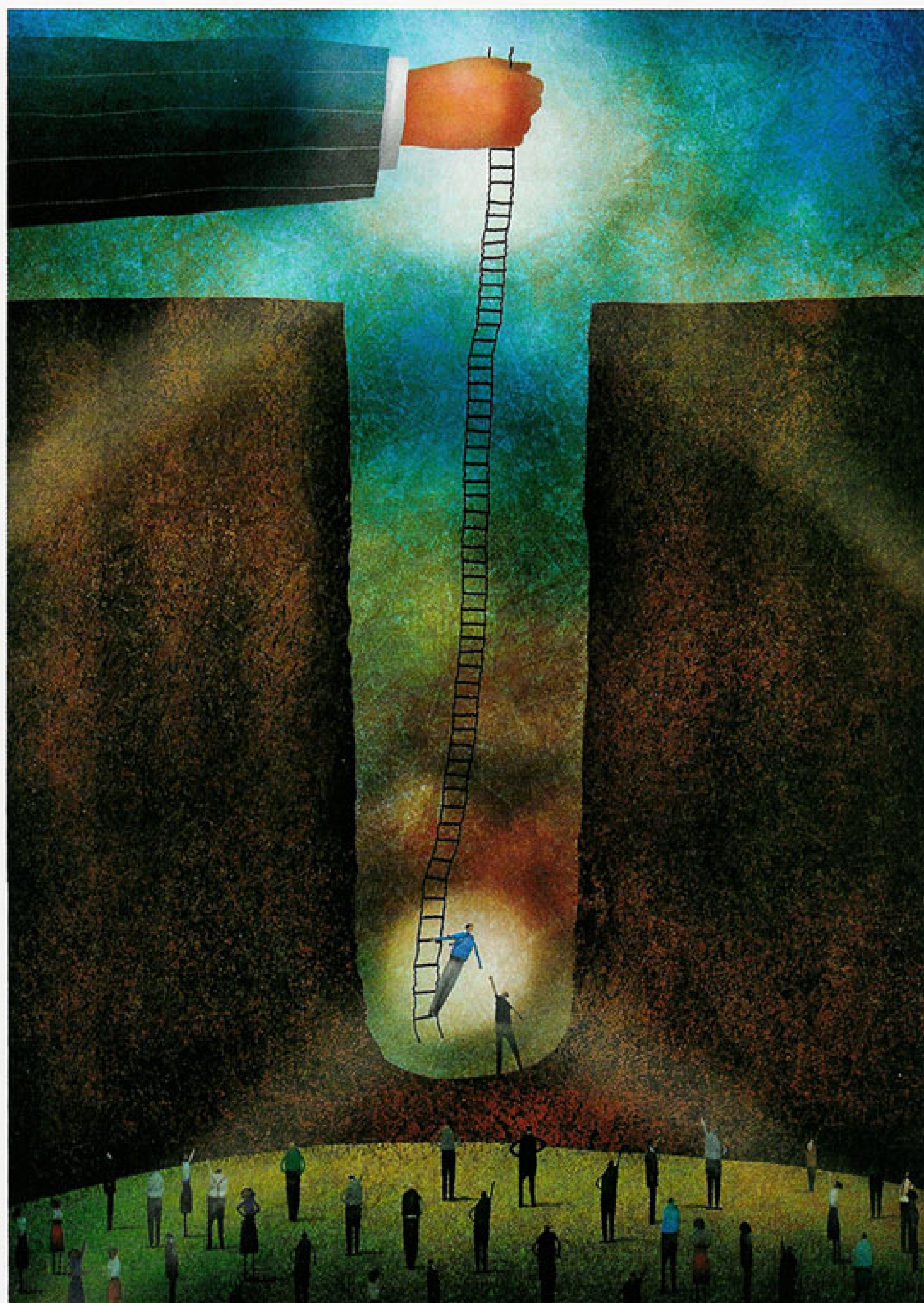
THE BUSINESS CASE FOR TRUST

We've always known trust matters; now we know share price depends on it.

BY STEPHEN M. R. COVEY



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Almost everywhere we turn, trust is on the decline. We find low trust in our society at large, in our institutions and in our companies. Research shows that only 51 percent of employees trust senior management, and only 28 percent believe CEOs are a credible source of information. This compels us to ask two questions. First, is there a measurable cost to low trust? Second, is there a tangible benefit to high trust?

Few argue with the notion of trust. Everybody is in favor of it and nobody is against it. But at the end of the day, many CEOs don't really believe that internal organizational trust is directly connected to their company's bottom line. Instead, they believe that trust is merely a soft, nice-to-have, "social virtue."

An increasing number of CEOs, however, are convinced that this so-called "soft" trust factor is, in reality, a "hard-edged economic driver." From an abundance of research, consider just four studies:

1. A 2002 study by Watson Wyatt surveying 12,750 workers across all industries showed that high-trust organizations had a total return to shareholders (stock price plus dividends) that was 286 percent higher than low-trust organizations.

2. A 2005 study by Russell Investment Group showed that *Fortune* mag-

azine's "100 Best Companies to Work For" (in which trust comprises 60 percent of the criteria and is the "primary defining characteristic") earned over four times the returns of the broader market over the prior seven years.

3. FranklinCovey's Execution Quotient (xQ) tool consistently shows a strong correlation between organizational execution and trust. In a 2006 FranklinCovey study done with the Coca-Cola Retailing Research Council, top executing grocery stores had significantly higher trust levels than lower executing stores.

4. A 10-year study of hundreds of outsourcing contracts done by Warwick Business School in the U.K. demonstrated that outsourcing contracts that are managed on trust, rather than on stringent service level agreements, lead to benefits for both parties—as much as an additional 40 percent of the total value of a contract.

What are the economics of trust that make these returns possible? Trust always affects two measurable outcomes—speed and cost. When trust goes down, speed goes down and cost goes up. This creates a trust tax. When trust goes up, speed goes up and cost goes down. This creates a trust dividend. It's that simple, that predictable.

For example, Sarbanes-Oxley was passed in response to Enron, WorldCom and other corporate scandals. While Sarbanes-Oxley has helped maintain trust in public markets, this has come at a substantial price. All executives subject to Sarbanes-Oxley rules know the amount of time it takes to comply with its regulations, as well as the added cost of doing so. A recent study pegged the costs of implementing Section 404 alone at $35 billion—exceeding the original SEC estimate by 28 times. Compliance regulations have become a prosthesis for a lack of trust—and a slow moving and costly prosthesis at that. Clearly, Sarbanes-Oxley demonstrates the relationship between low trust, low speed and high cost.

On the other hand, consider the example of Berkshire Hathaway CEO Warren Buffett in acquiring McLane Distribution—a $23 billion company—from Wal-Mart. A deal of this size involving public companies would typically take several months to complete and cost several million dollars in due diligence. But because both parties operated with high trust, this deal was made with one two-hour meeting and a handshake. In less than a month, it was completed. Buffett wrote in his annual report: "We did no 'due diligence.' We knew everything would be exactly as Wal-Mart said it would be—and it was." Imagine—less than one month and no due diligence costs. High trust, high speed, low cost.

Once we understand the hard, measurable economics of trust, it's like putting on a new pair of glasses. Everywhere we look, we can see quantifiable impact. If we have a low-trust organization, we're paying a tax. While these taxes may not conveniently show up on the income statement as "trust taxes," they're still there, disguised as other problems. Once we know where and what to look for, we see low-trust organizational taxes everywhere, including the following:

Redundancy. Redundancy is unnecessary duplication. A costly redundancy tax is often paid in excessive organizational hierarchy, layers of management and overlapping structures designed to ensure control.

Bureaucracy. Bureaucracy includes complex and cumbersome rules, regulations, policies, procedures and processes. It's reflected in excessive paperwork, red tape, controls and approval layers. One estimate put the cost of complying with federal rules and regulations in the U.S. alone at $1.1 trillion—more than 10 percent of the GDP.

Politics. Office politics divide a culture against itself, generating behaviors such as withholding information, infighting, operating with hidden agendas, spinning, manipulating and holding meetings after meetings. These behaviors result in all kinds of wasted time, talent, energy and money. In addition, they poison company cultures, derail strategies and sabotage initiatives, relationships and careers.

Disengagement. Disengagement occurs when people put in enough effort to avoid getting fired but don't contribute their talent, creativity, energy or passion. Gallup's research puts a price tag of $250 billion to $300 billion a year on the cost of disengagement. A primary reason for disengagement is that people feel they aren't trusted. Gallup shows that 96 percent of engaged employees—but only 46 percent of actively disengaged employees—trust management. We have to wonder which came first, the chicken (distrust) or the egg (disengagement)? It's a self-perpetuating cycle that gradually grinds the organization to a crippled pace.

Turnover. Employee turnover represents a huge cost, and in low-trust companies, turnover is in excess of the industry standard—particularly of the people you least want to lose. Performers like to be trusted, and when they're not, many will seek employment in places where they are.

Churn. Churn is turnover among customers, suppliers, distributors and

investors. It results when low-trust interactions within the company are perpetuated in relationships with external stakeholders. Studies indicate that the cost of acquiring a new customer versus keeping an existing one alone can result in an increase of as much as 500 percent.

Fraud. Fraud is flat out dishonesty, sabotage, obstruction, deception and disruption—and the cost is enormous. A 2004 study estimated that the average U.S. company lost 6 percent of its annual revenue to some sort of fraudulent activity. In Enron's case, the fraud tax was ultimately 100 percent, sinking the company.

Just as the taxes created by low trust are significant, so the dividends of high trust are also incredibly high. Consider the speed with which Warren Buffett completed the McLane acquisition. Consider the studies cited earlier. When trust is high, the dividend we receive is a performance multiplier, elevating and improving every dimension of the organization.

Specific dividends include the following:

- **Increased value** (Watson Wyatt shows an increase of 286 percent.)
- **Accelerated growth** (Customers buy more, refer more and stay longer with companies they trust.)
- **Enhanced innovation** (High creativity and sustained innovation thrive in a culture of high trust.)
- **Improved collaboration** (In low-trust cultures, collaboration is mere coordination or, at best, cooperation.)
- **Stronger partnering** (The Warwick Business School study shows a 40 percent dividend.)
- **Better execution** (The Franklin-Covey study shows every measure is substantially higher.)
- **Heightened loyalty** (All stakeholders—employees, customers, suppliers, distributors and investors—stay longer with high-trust companies.)

When you add up all the dividends of high trust—and you put those on top of the fact that high trust decreases or eliminates all the taxes as well—is there any doubt that there is a significant, direct, measurable and indisputable connection between high trust, high speed, low cost and increased value?

Only 28% of employees believe CEOs are a credible source of information.

So what's the role of the CEO with respect to trust? I suggest it's threefold:

First, recognize the business case for trust—be an advocate instead of an obstacle.

Second, see leadership as "getting results in a way that inspires trust." In other words, personally model trust through character, competence and demonstrated behavior.

Third, align organizational systems and structures around trust. In the words of Campbell Soup CEO Doug Conant, "The first thing for any leader is to inspire trust."

Bottom line, nothing is as fast as the speed of trust. Nothing is as profitable as the economics of trust. It's truly the one thing that changes everything. ▲

Stephen M. R. Covey is the CEO of CoveyLink and the author of the new book, *The Speed of Trust: The One Thing That Changes Everything.*

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