Trust Matters
A vital element for global business
Trust:

A form of reliance on the integrity of someone or something. Two parties, looking into the future, have the expectation of a particular outcome on the one side as a result of a particular behaviour on the other.
INTRODUCTION

“If once you forfeit the confidence of your fellow citizens, you can never regain their confidence and esteem. It is true you may fool all of the people some of the time; you can even fool some of the people all of the time; but you can’t fool all of the people all of the time.” - Abraham Lincoln, 1865.

Why does trust matter? Without trust at all levels - person to person, person to company, person to Government/institutions, company to Government/institutions and vice versa - interactions, commerce, investment, legislation, enforcement, would all come to a grinding halt. Within borders and across borders.

In business, trust is the glue that binds employees to employers, customers to companies - and companies to their suppliers, regulators, Government and partners. Yet several years on from the financial crisis and ensuing recession, efforts to rebuild trust are still ongoing. Companies and regulators alike are seeking to restore trust, in industries, products and services and regulation.

Clients, customers, employees and stakeholders around the world now demand greater transparency and ethical behaviour from the businesses they engage with. Growth is no longer sufficient, what is wanted is “good growth”. Boards are increasingly finding that trust is on their agenda as a key business enabler – and that not only means trust in the business itself, but also in its leadership, its stakeholders and its network of suppliers. Corporate structures and processes are essential, but are not enough - they must be overlaid with an ethos and values that have at their heart integrity, transparency and a respect for the rule of law. Sound corporate governance is key.

Gain trust and the benefits will be substantial. Research shows that improving trust in an organisation and its leadership leads to a stronger reputation, higher revenues, greater customer advocacy and increased employee retention. A company with higher trust levels is also likely to come out of a future crisis much more quickly than one with a lower level of trust.

Conversely, businesses that fail to keep the trust of their clients and stakeholders will struggle to prosper over the long term – and risk losing their licence to operate. For leaders, it is the tightrope that must be walked to balance the interests of all stakeholders. Trust needs to be seen as a key asset that organisations not only understand, but also properly manage and grow in order to succeed in today’s complex operating and globally connected environment.

To explore these issues in more detail, Baker & McKenzie’s new report Trust Matters curates some of the latest research surrounding the issue of trust in business globally and highlights the main areas that organisations need to address in this regard. In particular, we have focused on data and insights in six key areas: trust in business, trust in leaders, managing trust in the digital age, building a trusted supply chain, trust in transactions and trust in the rule of law.

We hope that you find Trust Matters an insightful and useful publication. We would of course welcome the chance to discuss any of these issues with you in more detail.

Baker & McKenzie (2014)
Trust is a key indicator of the health of a business and its future prospects for growth. Having high trust levels leads to an enhanced reputation, increasing revenues and shareholder returns, greater customer engagement and more loyal employees.

4 out of 5 respondents now see performance and value creation as the greatest benefits of an ethical culture, surpassing compliance for the first time.  

59% of the British public says that they believe British businesses generally ‘behave fairly’ or ‘very’ ethically, the joint highest response rate recorded during the past decade.  

65% of people worldwide believe corruption in business has increased in the last two years.

The technology industry continues to lead as the most trusted sector. After changes in sourcing and management and a stronger focus on higher quality products, automotive, food & beverage and consumer packaged goods are showing strong trust rebounds over 2009. Media companies and banks continue to trail, seeing little movement since 2009 and, with additional incidents this year, are facing continued public and regulatory reprimand over ethics, business practices and malfeasance.

In 2014, trust levels in business and government were analysed across 27 markets around the world to gauge whether trust had increased or decreased in these regions over the past year:

The top three drivers for building trust, when looking at business performance:

- Being Ethical 60%
- Listening to customers 59%
- Being good to your employees 58%

4 Family-owned and small & medium-sized business outperformed big business in all regions except Asia, where publicly-traded and big business companies are trusted more.
Many companies are clearly facing an uphill battle to win public trust, often for reasons that have little to do with their actual behaviour. It may appear unfair that companies of a certain size or industry sector are less trusted than others, yet the fact that they are aware of this perception means that these companies can at least act on it.

Indeed, many successful companies, from the fast food sector to the financial services market, have made a virtue of confounding stereotypes regarding how their sector operates - winning industry accolades, investor confidence and market share as a result.

Of course, the process of enhancing or rebuilding trust is likely to involve several different strands of activity, depending on whether the aim of the exercise to improve trust among employees, customers or the wider public. But, as both the Business Ethics Briefing and the Edelman Trust Barometer research indicate, such exercises can ultimately pay dividends. It is possible for almost any type of company to become a highly trusted enterprise, no matter where in the world it operates or what sector it operates in.

The World Economic Forum estimates that corruption adds up to 10% of the total cost of doing business globally and up to 25% of the cost of procurement contracts in developing countries.
TRUST IN LEADERSHIP

Trust in business leaders is worryingly low. There is still a lot of work to be done if customers, employees, regulators and other stakeholders are to regain their trust in the C-suite and entrust them to make the right decisions. For leaders themselves, an ever tighter regulatory framework combined with the competing demands of customers, employees, shareholders and other stakeholders means a clear and focused strategy for building and retaining trust is vital for success.

- Trust in CEOs stands at just 39 per cent. According to the Edelman Trust Barometer: “People trust businesses to innovate, unite and deliver across borders in a way that government can’t, [but] that trust comes with the expectation and responsibility to maintain it.”

- The 2014 Global CEO Survey from PwC found that half of UK business leaders are ‘somewhat’ or ‘extremely’ concerned that a lack of trust in business poses a threat to the growth prospects of their organisations.

- Academics and experts remain the most trusted source of information about companies, followed closely by technical experts, which has increased significantly since 2009. CEOs and government leaders remain at the bottom of the list, with extremely low trust levels on key metrics.

- More than one in three employees (34 per cent) reported their level of trust in senior managers is weak. Worryingly, company leaders seem to be out of touch with how their staff feel, with senior managers more likely to report strong trust between employees and senior management (40 per cent) than non-managerial workers (27 per cent).

It is concerning to note that even though trust in business stands at 56 per cent, the credibility of CEOs stands at just 39 per cent, according to the 2014 Edelman Trust Barometer. Clearly, action is needed here. From the top down, senior leadership teams must not only commit to behaving in an honest and transparent manner – but must be prepared to demonstrate this commitment every day. After all, the process of building trust between a company’s leadership team and its workforce will only be possible if employees truly believe that actions will follow words. A series of empty promises will only serve to erode trust even further.

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According to a 2013 survey conducted by the Hay Group\(^5\), among the top 20 companies for leadership, trust is built via engagement and empowerment, a focus on global issues and a commitment to diverse hiring strategies:

- **73% of the top 20** reported giving everyone at every level of the organisation the opportunity to develop and practice the capabilities needed to lead others, compared to only 47% of all other companies.
- **79% of the top 20** companies require an appreciation of global issues as a key job requirement compared to just 46% of all other companies.
- **The top 20 companies** are more likely to recruit minorities, with 71% of them engaging fully with this statement compared to 34% of all other companies.
- **84% of the leaders** in the top 20 companies are culturally savvy and have the skills to work effectively with diverse teams compared to 64% in all other companies.
- **59% of the top 20** companies have women in positions of senior management compared to 40% of all other companies.\(^4\)

Views on trust and leadership are complicated by the pace of change in our world, societies, and businesses. Yvonne Sell of the Hay Group has identified six megatrends that will have the most impact on the nature of leadership within organisations:

- globalisation
- climate change
- talent war
- individualisation
- rise of digital natives
- technology fuelled innovation

All of these areas will be treated as a risk to trust for many, but if leaders can embrace these inevitable changes, adopt new attitudes and build a new set of competencies, then these megatrends can be used to create trust, not erode it further.

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4 Employee Outlook: Focus on the current state of trust in leaders, CIPD, 2013, http://www.cipd.co.uk/hr-resources/survey-reports/employee-outlook-focus-trust-leaders.aspx
TRUST IN THE DIGITAL AGE

The explosive growth of social and digital media has transformed the issue of trust for both businesses and consumers alike. Is the email from your bank real? Do citizens trust the public sector not to lose their data and not pass it on where it shouldn’t go? Is that negative review of your business really a disgruntled customer – or is it a competitor trying to steal your customers? A single ill-conceived tweet can break a business. So what can companies do to survive and thrive in this new world?

A lack of trust has the potential to pull the ecosystem apart. ¹

Traditional media (65%) and search engines (63%) remain the most trustworthy sources of information, with social media trust levels at 45%. Online media is the most trusted source of information for people to turn to for information about businesses. ²

Many supply chain professionals see social media as a rich supply for demand data. In particular relevance to trust, nearly four out of 10 supply chain executives (39%) believe that in the future social media will give visibility to social / environmental / labour practices (compared with 26% now) and 17% believe it provides advance warnings of disruptions to the supply chain (with 39% believing it will in the future). ³

of users – a small majority – agree that the internet is a safe place to express their opinions.

71% of users say they are careful about what they do or say online.

18% of users totally agree it is acceptable for anyone to use personal data that they make public.

Two-thirds believe that organisations, companies and agencies ask for too much personal information online.

Roughly 2 in 3 users thought people who go online put their privacy at risk.

There are high levels of distrust of internet infrastructure companies...

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<thead>
<tr>
<th>Service Provider</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Internet Service Providers</td>
<td>45.4%</td>
</tr>
<tr>
<td>Mobile phone companies</td>
<td>43.7%</td>
</tr>
<tr>
<td>Search engines</td>
<td>39.6%</td>
</tr>
<tr>
<td>Social networking companies</td>
<td>37.4%</td>
</tr>
<tr>
<td>Online marketers or advertisers</td>
<td>29%</td>
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- 78% of Europeans think it is hard to trust companies when it comes to the way they use consumer personal data.
- 70% agree that there are few or no trusted ways to find out about personal data management and protection online.
- 78% feel that service providers hold too much information about their behaviour and preferences.
- Two-thirds believe that the organisation benefits most from gathering information about customer purchasing behaviour or history. In the UK, this figure is the highest at 71%.
- Two-thirds believe that organisations hold too much information about consumer behaviour and preferences.
- On a European level, just 6% think that the consumer is the ‘winner’ from the data exchange while one in six (16%) believes that there is an equal benefit for consumers and organisations alike.

One option for companies operating in the digital sphere that are facing widespread consumer cynicism, is to increase their engagement with customers regarding their use of clients’ personal data. As a first step, companies can consider reviewing whether their existing data collection processes are excessive, and, if so, reduce the data collection process.

Once this review process has taken place, companies can explain to their customers - at the point of collection - why certain data must be collected and also how it is used. Finally, companies can put procedures in place which allow customers easily to amend, update and delete data that they no longer wish to share.

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TRUST IN THE SUPPLY CHAIN

World-class supply chains are built on trust. Companies need to ensure that their strategic global partners can be trusted to deliver the quality and best practice that they expect. Weaknesses in the supply chain can often be exploited, potentially causing irreparable damage to the corporate brand.

52% of respondents believe that the supply chain is an equally important part to the business as sales and marketing or R&D and product development.

54% of global supply chain managers reported that supply chain issues have had a negative impact on their company’s revenue or profitability in the past few years.

In 2014, MHI and Deloitte questioned more than 450 large and small companies across a wide range of sectors, including: Retail and Wholesale, Consumer Packaged Goods, Automotive, Consulting, Life Sciences and Healthcare, Transportation and Warehousing, Material Handling and Supply Chain Equipment and Related Services.

Nearly 80 percent of these firms said that supply chain analytics is a “very important” or “moderately important” strategic priority.

A robust, transparent and ethical supply chain is a vital ingredient for achieving and maintaining a successful business. As such, a strong supply chain should never be considered as a ‘nice to have’, but rather a ‘need to have’.

As companies such as Marks & Spencer were able to demonstrate during the UK horsemeat scandal, a reputation for product excellence can allow companies to boost their revenues at a time of crisis, as customers switch to suppliers who enjoy a reputation for quality. More generally, Marks and Spencer’s Plan A has not only won numerous ethical awards for supply chain management, it has also firmly positioned the company in the public’s mind as a premium brand, allowing it to differentiate itself from its peers in an increasingly crowded marketplace.

In a recent EY survey of UK procurement managers and directors, 52% of respondents said they vet suppliers’ compliance with the UK Bribery Act. If it were discovered that companies were not compliant, 28% of respondents said they would be removed as a supplier, 20% said they would give them time to adjust and comply but would be removed if they failed to do so and 6% would retender the supply agreement. In addition, 6% of respondents said they have been made aware of unethical behaviour in the supply chain, compared with 92% who said they have not been made aware of unethical activity.

Only half of UK manufacturing companies are auditing their first tier suppliers for child workers, slaves and conflict minerals.

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TRUST IN TRANSACTIONS

Embarking on a merger can be an excellent way for companies to grow their market share, diversify into new areas and build scale and size. However, in the rush to complete the transaction, it is imperative that appropriate due diligence is undertaken and that the interests of external stakeholders are not forgotten. All stakeholders – be they majority and minority shareholders, clients, suppliers and regulators – will play a vital role determining whether the deal’s objectives can be delivered. Yet, in order for them to endorse the company’s plan, it is vital that they can be convinced of the plan’s benefits.

Nine out of 10 executives say issues raised by shareholders have shaped their boardroom agendas. Shareholder activists typically focus on organisations with high expense ratios; multiple, disparate and sometimes non-core operating units; and concerns around capital allocation.

Companies’ intentions to engage in larger deals (greater than US$500m) over the next year are up strongly, having doubled in 12 months. This is a sign that plans for transformational acquisitions, particularly among larger companies, are on the rise.

Nearly half (46%) of respondents feel that problems integrating management teams is a top root cause of deal disappointments. The same number blame a failure to assess cultural fit during due diligence.

About one-third of corporate respondents said that overstated revenue forecast was the most critical concern in accurately valuing a company, and about 28 percent cited understated expenses.

2 http://www.bain.com/Images/BAIN_BRIEF_Integrating_cultures_after_a_merger.pdf

55% of corporate executives and 54% of private equity executives cited ‘failure to integrate’ as a top concern.

Customer retention and expansion dominated the corporate responses in terms of which factors were the most important in achieving successful integration — 40 percent cited it as the top factor, almost double the next two responses, which were achieving cultural fit and capturing synergy.

In a Bain survey of executives who have managed through mergers, ‘culture clash’ was the number one reason for a deal’s failure to achieve the promised value.

<table>
<thead>
<tr>
<th>Target market</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Latin America</td>
<td>29%</td>
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<tr>
<td>North America</td>
<td>12%</td>
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<tr>
<td>Africa</td>
<td>55%</td>
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<td>Asia ex. Japan</td>
<td>24%</td>
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<td>Middle East</td>
<td>21%</td>
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<tr>
<td>Europe</td>
<td>12%</td>
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<td>Japan</td>
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Percentage of deals where bribery and corruption was top compliance challenge.
The five most important motivations for cross-border M&A

- Access to customers: 34%
- Intellectual property: 25%
- Industrial assets: 21%
- Human capital: 8%
- Natural resources: 12%

Human capital, while the principal driver in only 8% of transactions, is the second most important consideration in 25% of cross-border deals.

There is no one-size-fits-all approach to winning stakeholder approval for a company’s chosen transaction. However, the need to do so will be paramount, if execution risks are to be minimised. For many companies, failure to enter a new market or successfully integrate a recent acquisition, can adversely affect their market value.

In order to win stakeholder support, companies must establish what issues are likely to be of concern to each type of stakeholder, and also to be able to explain how those concerns will be met. Only once these concerns are met will stakeholders be likely to offer their support to the process. And, of course, in order to maintain that support going forward, any assurances that have been offered to stakeholders must then be delivered.

Key due diligence challenges for acquisitions motivated by access to industrial assets

- Uncertain tax environment: 29%
- Credibility of financial accounts: 27%
- Complex ownership structure/cross shareholdings: 27%
- Lack of clarity about ownership of IP rights: 3%
- Quality of local accountancy advice and support: 4%

Key post-acquisition business challenge for acquisitions motivated by access to customers

- Integrating systems and processes: 21%
- Retaining key employees: 18%
- Overcoming cultural differences: 17%
- Realising financial synergies: 16%
- Retaining customers: 16%
- Optimising and integrating supply chain arrangements: 8%
- Balancing integration process and running existing businesses: 4%

No one would contest that having a trustworthy, predictable legal context is a must for today’s global corporations to invest across borders. Businesses need a basic level of certainty to be able to operate effectively and sustainably. Issues such as transparency of law-making, non-retroactivity of laws, the independence of the judiciary, wider access to the courts, and the right to a fair trial are critical. When entering new markets, to be able to trust in the rule of law, to know that there is a level playing field, and that both citizens and lawmakers are equally subject to the law can be critical. In many western economies businesses can generally operate with certainty.

The reality is that for many companies investing across borders, such a scenario is not necessarily the norm. Where there is weak rule of law, government officers have a great deal of discretion. This means that bribery and corruption will likely be more widespread, which creates difficulties for companies that seek to operate throughout the organisation at a consistent (higher) standard - the playing field is immediately uneven. For businesses, and indeed economies, to thrive, it is imperative to have clear rules, a high level of certainty about the legal parameters of decision-making, and clear consequences for unlawful actions.

Where countries transition to market economies, this has generally resulted in such countries moving towards the rule of law, mainly to generate trust and attract potential foreign investors and thereby generate economic development. It is important to understand that the term “rule of law” is predominately an Anglo-Saxon term and is not yet fully regarded in a number of well established democracies with civil law or other legal framework origins.

Below is a map prepared by the World Justice Project (WJP), which attempts to measure the extent to which agents have confidence in and abide by the rules of law. Darker purple indicates lesser adherence to the rule of law.

The WJP Rule of Law Index

1 http://data.worldjusticeproject.org/
It is interesting to compare this to the world map of the control of corruption index from Transparency International, which measures the degree to which corruption is perceived to exist among businesses, public officials and politicians. Countries marked in dark red are considered to be at the highly corrupt end of the scale, while countries marked in yellow have been deemed very clean.

The different levels of trust in the rule of law also bring another level of uncertainty for businesses moving across borders. A related aspect which, arguably, is not intrinsically tied to the strength of the rule of law, is the difference in approaches to regulation by different institutions in different countries. Many companies feel that the inconsistency of regulation as well as the inconsistency of how that regulation is applied across borders makes doing business in other jurisdictions like navigating a minefield. In fact, according to PwC’s 17th Annual Global CEO Survey, CEOs are more worried about the impact of regulation on their business than they are about the state of the economy.

There are calls for more co-ordinated governance so that public and private sectors align efforts to implement cross border solutions to common transnational problems and to do so in accordance with guiding principles and fundamental norms to ensure that such governance is broadly regarded as legitimate.

Co-ordinated governance becomes critical when combating international criminal activity, organised crime, money laundering and terrorism as well as commercial issues such as illicit trade (for example, the counterfeiting of pharmaceuticals) and cross border disaster management.

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2 Transparency International corruption index map http://cpi.transparency.org/cpi2013/results/
3 http://www.pwc.com/gx/en/ceo-survey/index.jhtml?WT.ac=vt-ceosurvey
4 WEF paper on More Effective Design of International Initiatives - Coordinated Governance
We hope you have found Trust Matters useful. It is our view that some businesses achieve higher levels of trust than others and those that do will be better placed to deliver long term sustainable growth and returns to stakeholders. To help you consider how to build more trust in your business, we will be producing more on the topic of trust. Keep an eye on www.bakermckenzie.com/trustmatters for more topics which we will analyse through a trust lens, including:

- Building trust with regulators in the financial services sector
- Corporate governance and high performing boards
- Running a values-led company
- Trust in transactions
- Leadership that grows trust
- Developing trust in the global product supply chain
- Building trust in the digital age