The principles of trust and evolution of trust

To succeed in today's economy, businesses must consider trust. For new companies, that often means building trust from scratch with customers, vendors and other stakeholders. For established businesses dealing with significant challenges, restoring trust is crucial.

Different mechanisms can help cultivate trust, and it's important to understand the principles of trust that hold societies together and learn from events that triggered the creation of these mechanisms. When trust has been fractured in the past, the mechanisms that emerged in response to breakdowns often aligned with one or more of these principles.

Reciprocity

When people, businesses or other groups commit to each other, they often make agreements and contracts that can be enforced. This creates accountability and builds trust in the transaction, and it provides appropriate recourse should any party fail to deliver on the agreement. This could be the terms for a bill of sale, the conditions of a purchase order or some other promise between parties.

But this mutual understanding is still subject to risks. Cases of fraud, for instance, can initially give the appearance of upholding a contract, only to damage trust when discovered. And when *quid pro quo* is violated broadly, or at least perceived to be, damage to trust can extend from economic partners to supporting institutions.

In extreme cases, groups that aren't part of a transaction can be harmed when trust is violated on a large scale. The 2008 financial crisis and subsequent economic recession is one example.

> *"Early in an exchange parties do not know what to expect of each other; trust is initially developed by employing rewards and sanctions tied to specific outcomes. ... As time passes, a party learns more relevant information; trust may now be described as knowledge-based." – "Origins of inter-organizational trust," Laura Poppo, Handbook of Advances in Trust Research, edited by Reinhard Bachmann and Akbar Zaheer, Edward Elgar, 2013.*

Purpose

Trust is created when people share common interests and values and agree which values are most important. This can be personal and naturally understood, such as the trust between friends. It also can be more explicit, such as the trust a business hopes to gain through a corporate purpose statement.

In the business world, labor unions are an example of how people with shared interests and goals engage in a trust-based relationship. Within society, trust has been instrumental in volunteer efforts, such as collecting food donations or building homes for less fortunate people. More recently, technology has enabled social networks to bring together groups with a common purpose.

At the same time, polarization increases the chances for interests to diverge, posing risks to trust. Consider that in today's digital world, many people appreciate improved access to information and greater connectivity, yet concerns about security and privacy have grown. Managing those often-competing demands and maintaining trust in the digital age is an ongoing challenge.

"Life is easier in a community blessed with a substantial stock of social capital. ... Networks of civic engagement foster sturdy norms of generalized reciprocity and encourage the emergence of social trust. Such networks facilitate coordination and communication, amplify reputations, and thus allow dilemmas of collective action to be resolved." –Bowling Alone, Robert Putnam, Simon & Schuster, 2000.

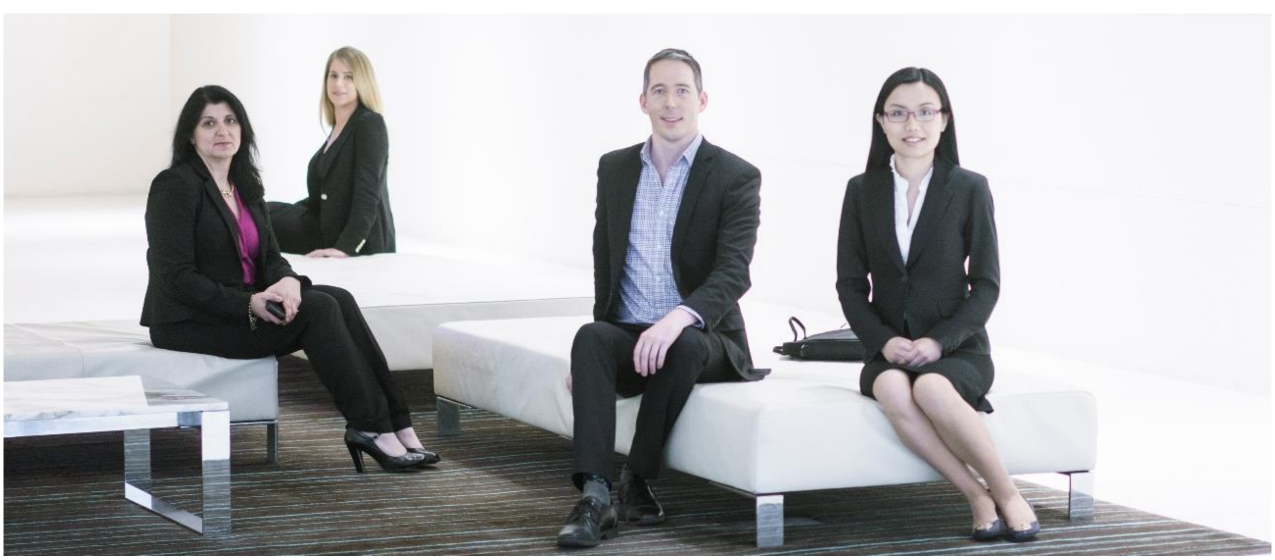
Consequence

When a party to a transaction breaks a contract or violates an agreement, trust is lost, and a third party may have to enforce the consequences. In business, this includes regulators, advocates, watchdogs and others who don't have a vested interest, and their presence helps preserve trust within the transaction.

Even if an individual agreement is upheld, other factors may lead to unintended consequences that can damage trust. Economic or industry changes during the lifetime of a contract can alter the conditions that were in place at the start and require new dialogue to avoid a third party's involvement.

In recent years, declining trust in institutions has made some people seek alternatives for transactions. New technology has opened opportunities that don't rely on a centralized authority and are outside the scope of current regulations. Transaction and contract options such as blockchain rely on peers rather than an established institution to ensure fairness.

"Institutions resolve issues of distributive fairness that are not resolvable between citizens. In a market economy, one of government's principal roles is to make secondary institutions (such as business) seem trustworthy by implementing regulatory assurances. But institutional safeguards should be carefully balanced. If all we rely upon is institutional trust, relational trust will erode." – "Public trust in the institution of business," Jared D. Harris, Adrian A.C. Keevil and Andrew C. Wicks, Handbook of Advances in Trust Research, edited by Reinhard Bachmann and Akbar Zaheer, Edward Elgar, 2013.



Transparency and information

> *"The opposite of trust is not distrust; it is the lack of trust. Strategic trust is all about reducing transaction costs by gaining additional information –be it positive or negative." – "Who do you trust?" Eric M Uslaner, Interdisciplinary Perspectives on Trust: Towards Theoretical and Methodological Integration, edited by Ellie Shockley, Tess M.S.Neal, Lisa M.PytlikZillig, BrianH.Bornstein, Springer, 2015.*

Trust in a transaction is enabled by transparency and information, which help ensure that the parties know who they're doing business with and understand the value provided through the agreement. The information itself must be trustworthy, creating the need for assurance, and how it is communicated helps determine its transparency.

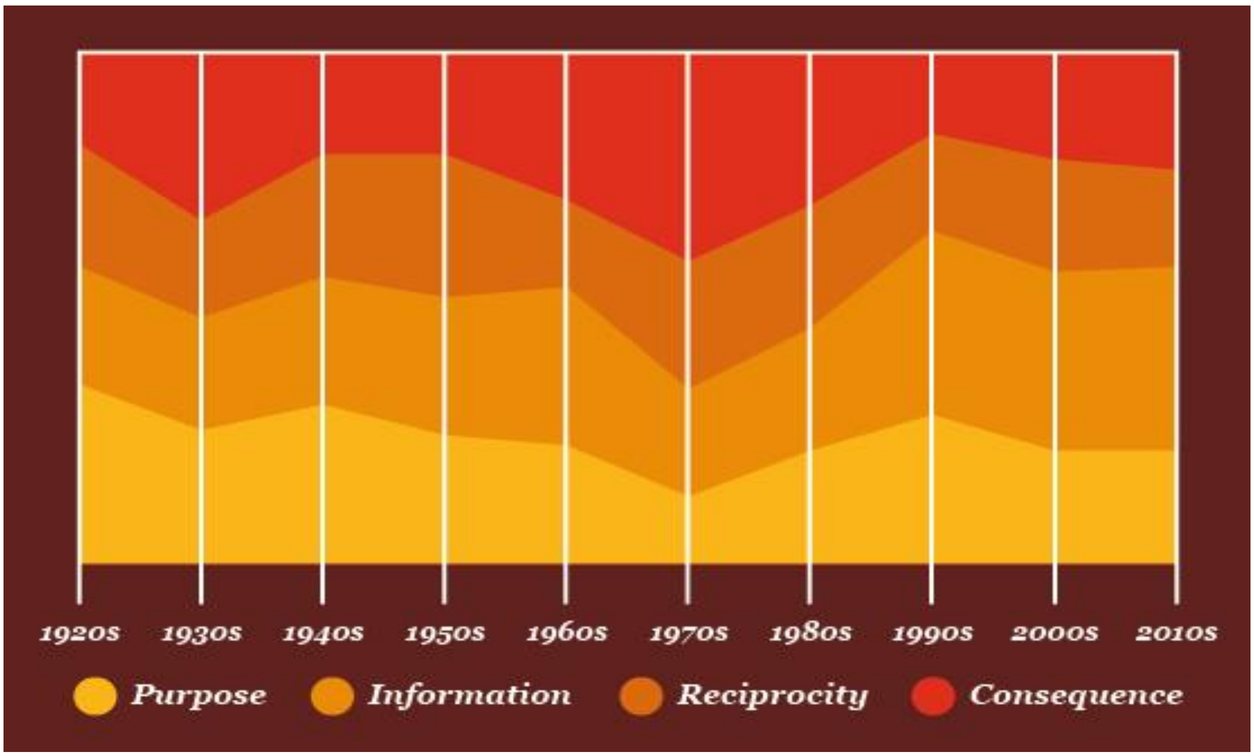
Small print, hidden terms and deliberate vagueness in agreements all are threats to transparency and can damage trust. In addition, withholding information – even if a party hasn't asked for it – can weaken a person's or company's confidence in the other party.

On the other hand, too much information does nothing for transparency, as relevant facts can be lost in the firehose of data. With better technology today, the challenge isn't a lack of information, but a lack of communicating the right information. Consider that the vast amount of potentially useful business information, including data relevant to detecting cybersecurity breaches, is still unstructured, often in the form of text. Yet only a small percentage of that data is analyzed.

The evolution of trust

The history of the past century shows how the principles of trust have shifted in response to significant events – from economic crises to new innovations. Post-war periods were often marked by prosperity that helped create a shared purpose. Market failures prompted mechanisms based on reciprocity and consequence. Major advances in technology created new demands and concerns regarding information – and new opportunities to mediate trust.

Overall, the principles of trust tend to expand or contract depending on the state of the economy or society as a whole. In a certain climate, one principle may be more relevant and play a larger role than the other three in creating or restoring trust.



"Trust is built into the heart of almost all economic activity. Once humans specialised, they required others to produce what they themselves did not—the farmer needed the blacksmith to produce his tools, the blacksmith needed the farmer to supply his food. A global trading system requires us to deal with complete strangers on a daily basis. We must trust companies to deliver the goods we order, our employers to pay our wages and the banks to keep our deposits safe." — "Trust Busting," the Economist, September 17, 2016.

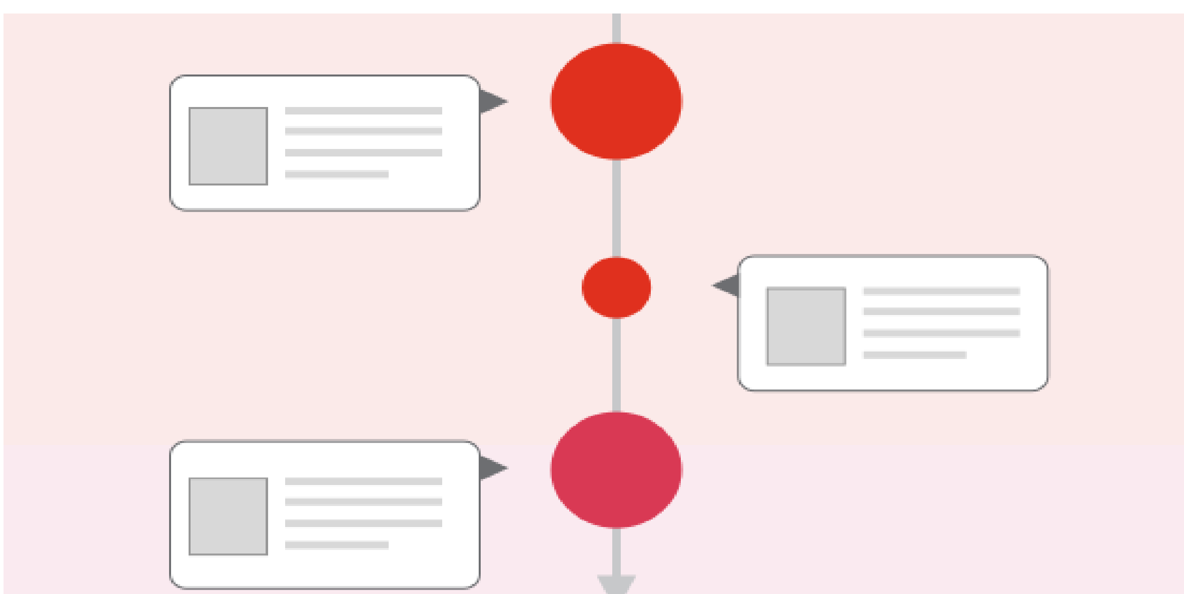
How events affect the balance of trust

Consider the globalization of the economy and rise of trade agreements. When business was conducted within the same community, trading partners had a common purpose. But with many people now just as likely to buy fruits and vegetables that were grown in another state or country than on a nearby farm, information and transparency are important for building trust.

That said, not all communities have the same access to resources, and the scarcity of essential needs such as water, food and health care also raises trust issues. In regions where basic needs are limited and the demand is great, it's essential for people to have confidence in how critical resources are governed and allocated.

The evolution of trust also has seen changes in how people view certain institutions. In times of crisis, the federal government tried to restore trust with mechanisms that prevent dire consequences. The Great Depression and ensuing New Deal programs of the 1930s are a classic example. In recent years, however, people have demanded more transparency from government and often take a more critical view of regulation and bailouts.

This shift extends to big business, with consumers increasingly asking if major corporations are interested in anything beyond the financial bottom line. Instead of simply providing goods or services through a transaction, more companies are trying to build trust by demonstrating a purpose beyond profits – through progressive corporate reporting, new structures like benefit corporations and other actions.

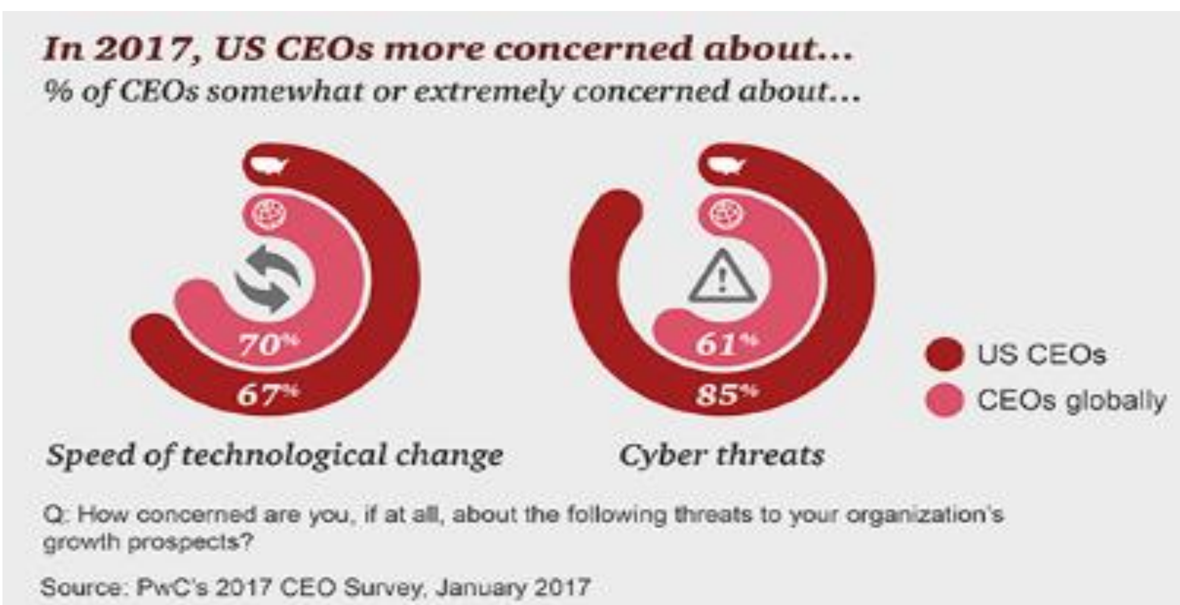


Trust and technology

Technology has played a pivotal role in the shift in trust principles. The rise of the digital economy has connected businesses to customers in more ways. While this makes transactions easier, it also raises concerns about how much companies know about their customers, how they might use that information and if the information is safe and secure.

At the same time, person-to-person transactions have enjoyed a rebirth. Far removed from a handshake agreement among neighbors in the same village, the sharing economy relies on trust among strangers who do business with one another – usually through a user-friendly intermediary. But while users may feel a common bond, the lack of oversight compared to regulated industries can have consequences.

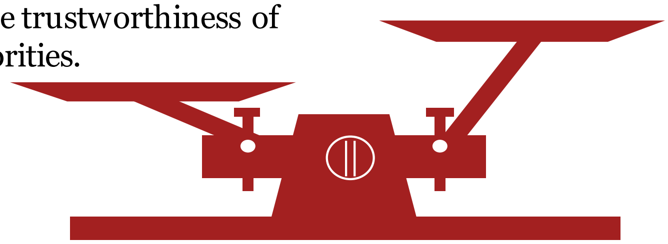
Increased trust in peers has changed the relationship between businesses and their customers. With people more willing to crowdsource a product recommendation, a repair issue or some other need, consumer brands and other companies are exploring how to be part of the digital conversation. In this landscape, trust is more likely when a business displays authenticity and transparency, not just a product and a slogan.

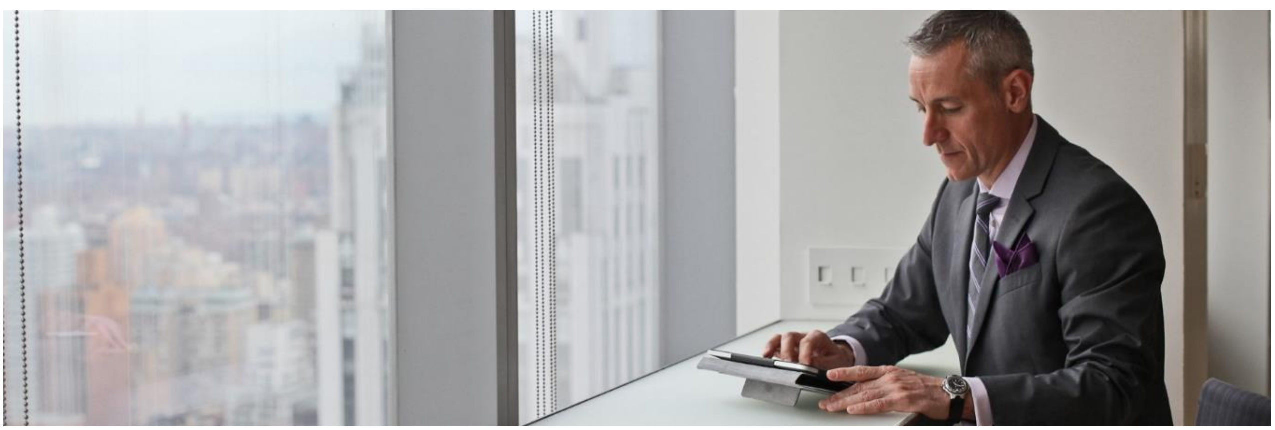


Managing risks as trust evolves

For companies today, earning customers' confidence and growing their business depends in large part on managing risks that have emerged as trust has evolved. The proliferation of vendors, suppliers and other business partners – often in other countries – can make it difficult to establish a shared purpose, important as that is. These larger networks and the digital boom also make transparency and the trustworthiness of information top priorities.

As trust continues to evolve, businesses are trying to balance the advantages and hazards of unprecedented connectivity – with their customers and with markets across the globe. New trust mechanisms can help provide that equilibrium and inspire confidence in companies among their customers, partners and other stakeholders.





Contacts

To have a deeper conversation about how a holistic risk management approach can help establish you as a trusted business partner, please don't hesitate to contact us.

Todd Bialick
Trust and Transparency
Solutions Leader
+1 (973) 236 4902
todd.bialick@pwc.com

Scott Greenfield
Advanced Risk and Compliance
Analytics Solutions Leader
+1 (646) 471 5383
scott.greenfield@pwc.com