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Rebuilding trust after times of crisis

A practical guide

Let's spin the wheel of trust

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'Public sentiment is everything. With public sentiment, nothing can fail. Without it, nothing can succeed.'

(Abraham Lincoln, Lincoln vs. Douglas debate, 1858)

In 1858 former US president Abraham Lincoln underlined the importance of public sentiment in one of his speeches; without it, nothing can succeed. A large body of scholars has validated the importance of sentiment (or confidence) in the years after this speech. For example research on the Consumer Confidence Index indicates that this index accounts for 10% to 21% of variance of GDP in the United States, eight quarters ahead (Afshar, Arabian, & Zomorrodian, 2007). Confidence thus fosters economic growth. Unfortunately, it has taken quite a blow during the last financial crisis – and still has not bounced back. Getting back on the public's good side is evidently quite difficult. Business organizations could play a leading role in doing so by restoring trust in their capabilities. Based on our research, we present a four step framework to guide organizations in rebuilding trust after crisis hits.

In order to understand how to get confidence back, we need to know what it is

In short, confidence is the expectation that something will happen with certainty (Blomqvist, 1997). A confident actor does not consciously consider alternatives due this certainty – nothing can go wrong. Participation in functional systems like the economy or politics involves confidence; one can either feel confident or unconfident in the way the systems are functioning but there is no alternative for participating in these systems.

When thinking about confidence, trust comes into play almost automatically because the terms are often used interchangeably. Interestingly, trust and confidence are not the same thing. A general definition of trust is the following:

'Trust is a disposition to engage in social exchanges that involve uncertainty and vulnerability, but are also potentially rewarding.'
(Bicchieri, Duffy, & Tolle, 1994)

This definition indicates that trust involves a conscious consideration of alternatives – the actor chooses to engage in a social exchange that involves uncertainty. In practice, a trusting actor chooses from a set of options and picks one over the other as he 'trusts' that option to be better (Luhmann, 1990).

Trust and confidence are obviously linked. Take for example the banking sector; generally speaking, a person has no alternative but to participate in the financial system. A person does have alternatives in terms of which organizations within the system to engage with – thereby trusting Bank X over Bank Y. It is likely that an individual who trusts more banks at an individual level will have more confidence in the banking system as whole. It follows that the link between trust and confidence is that the former (in part) drives the latter.

In accordance with this, DNB (De Nederlandsche Bank) states that confidence is a function of general economic indicators and trust indicators, as set out in figure 1.

Trust thus influences confidence while confidence boosts economic growth. It follows that (re)building trust will positively impact the economy.

Figure 1 Economic and Trust indicators for predicting confidence

General Economic indicators
- Unemployement
- Prices of houses
- Stock exchangerate
- Interestrate development
- Perceived inflation

Trust indicators
- Public trust in financial sector
- Public trust in Europe
- Political instability

Source: Neisingh & Stokman, 2013.

The value of trust lies in its ability to foster economic exchange under uncertainty…

Economists were not necessarily interested in trust early on (Lorenz, 1988); they modelled markets as being purely competitive and assumed perfect availability of information. Since there is no room for deception in such ideal markets, trust is irrelevant. Unfortunately, markets are rather imperfect and stakeholders are not uniformly well-informed in real life. This led economists to come up with theories surrounding these information asymmetries. Examples of these theories are adverse selection, moral hazard and principal-agent theory. The problems discussed within these theories can lead to a lack of economic exchange and hinder growth. The most effective way to overcome these information asymmetry problems is trust.

Adverse selection

Adverse selection arises when not all stakeholders involved in an exchange are equally informed and surfaces before a business agreement is closed.

Both buyers as well as sellers can have an information advantage in case of adverse selection. The insurance market is an example of a buyer having the advantage. Here, an individual's demand for insurance is positively correlated with the individual's risk of loss while the insurer is unable to assess how risky a certain buyer is due to lack of information.

Box 1 – The media indirectly affects confidence (and economic growth)
(Hester & Gibson, 2003; Goidel & Langley, 1995; Hollanders & Vliegenthart, 2009)

Research indicates that the media has an indirect effect on confidence as it influences consumer's perceptions of trust and economic indicators. Consumers base their assessment of these indicators on experience, which can stem from things ranging from personal experience (e.g. a close relative becoming unemployed or seeing your stock portfolio's value plummet all the way) to information provided by the media.

Unfortunately, news about the economy is more often framed negatively than positively. This can be explained by the fact news has a traditional function of warning society. Yet, a large portion of negative news is likely to cause people to have a gloom attitude about the future. This effect is strengthened as individuals pay greater attention to economic news during time of economic slowdown.

The market for 'lemons' -American slang for used cars- is an example of a market where the seller has the information advantage (Akerlof, 1970). As buyers are unable to assess the quality of used cars, they are only willing to pay an average price for second hand cars. Sellers of good second hand cars do not get a good price for their cars as a result of this, which causes them to leave the market.

Moral hazard

Moral hazard comes into play after a business agreement is closed. In the case of moral hazard, the actions of Actor A harm Actor B while Actor B is unaware of the actions of Actor A. A much used example comes from the market for car insurance. In this example, a driver with insurance may drive faster and more recklessly because the insurance company will pay for losses incurred in case of an accident. The insurer is unaware of the misbehavior of the driver.

Principal-agent problem

The principal-agent problem is caused by principals and agents having conflicting goals and objectives. If the principal is unable to monitor what the agent does, the latter is able to pursue his own goals over the goals of the principal.

In a high trust economy, adverse selection, moral hazard and principal-agent issues are unlikely to emerge. Research indicates that high trust economies bring benefits as they are focused on long term growth, foster co-operation and create efficiency gains (Coleman, 1997). In addition, high trust economies are characterized by large companies, eventually resulting in economies of scale (Fukuyama, 1995).

Trust is built over time – and difficult to repair

It has become clear that a trusting society is something to want. How to get to a trusting society is however still unclear.

What is clear is that experience can breed trust; as you interact with someone or something more often and this someone or something acts in a trustworthy manner you will build trust. Thus, trust is dependent on repetition (Cabral, 2005).

According to (Cabral, 2005) this gradual building of trust is a way to solve free entry or exit problems within markets. The argument is as follows: if it is easy for actors to exit the market after behaving untrustworthy and re-enter under a new name, these actors can potentially gain more from behaving in an untrustworthy manner. As a result of this, trust will not be the equilibrium. Because of this, creating a trusting relationship needs to come with advantages on both sides of the exchange.

Take for example the situation in which a borrower gets a loan from a bank and can easily borrow from another bank without paying back this bank. In this situation, the borrower has an incentive not to repay the loan as there are no repercussions from doing so. In order to overcome this problem, the bank can choose to gradually build a trusting relationship with the borrower. In this process, the bank lends out a limited amount of money to the lender first and increases this amount only if the borrower proves to be trustworthy. This gradual building of trust provides the borrower with an incentive to act trustworthy because the time invested in increasing the sum of the loan will need to be invested somewhere else again if the borrower foregoes the relationship.

It follows that it should be difficult to rebuild trust once it is broken in order for a trust equilibrium to be valuable. This idea is further underlined by Kahnemann and Tversky, who explain how heuristics influence human cognition (Tversky & Kahneman, 1974). Take for example retrievability of instances, which is driven by familiarity, salience and recurrence of occurrences. Due to this heuristic, some occurrences in our memory are more readily available than other occurrences. This means that if there has not been a crisis for a while, we 'forget' that a crisis is a possibility. It also means that if trust has recently been broken, we believe it disproportionately likely that it will be broken again.

Another heuristic that influences our cognition is insensitivity to predictability. Due to this heuristic, we predict future outcomes on the basis of past information and expect trends to continue in the way that they have moved in the past. The reason for this is merely that input information and output forecasts seem to 'fit'. This indicates that if humans have a precondition to trust or distrust something, they will continue this behavior as long as there is no salient event that alters these beliefs.

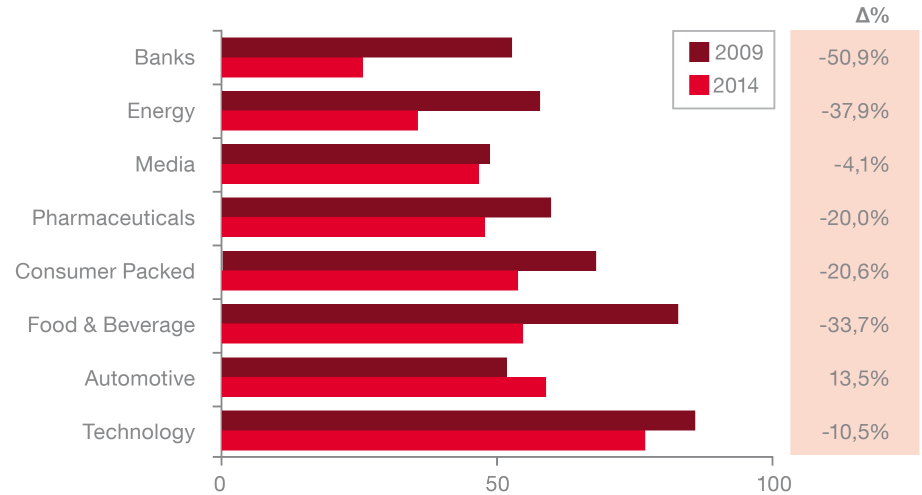
Over time, positive experiences foster trust between individuals and organizations, which can result in the creation of a trusting society. Trust is broken through salient events and difficult to repair once broken – the only way to rebuild is by consistently acting in a trustworthy manner.

Over the past five years, trust has taken a beating in the Netherlands…

Trust is an important driver of economic growth. But, what is the current state of trust in the Netherlands? Figure 2 provides an overview of the level of trust that the Dutch had in companies active within differing sectors in 2009 and 2014[1]. The figure indicates that trust levels dropped dramatically in response to the financial crisis and its aftermath. The only sector in which respondents' trust did not decline is the automotive sector.

The outcomes of the trust barometer are not very surprising in light of recent events involving Dutch companies. Take for example

Figure 2 Edelman Trust Barometer – Trust in business sectors (the Netherlands)



1 Economist consider impact of trust as not measurable (Perelman, 1998), but several research institutions have used surveys and/or adopted proxies for quantitatively assessing levels of trust.

the Dutch food and beverage sector. This sector was one of the most trusted sectors in the Netherlands in 2009, but has been a focal point of crises for a while now.

Trust in banks also took a blow over the past plus-five years. During the financial crisis, ABN Amro, ING and SNS had to bailed out by the Dutch government in order to stay afloat. Rabobank's recent involvement in the Libor affair further deteriorated public trust in the Dutch banking sector. Figure 3 provides an overview of Rabobank's reputation as perceived by the Dutch public as recorded by the Reputation Institute. This institute ranks the reputation of 30 large Dutch companies according to their reputation score. The figure shows that Rabobank got through the crisis unscathed while the Libor affair significantly affected public opinion.

...in line with expectations, this beating has directly affected confidence

As stated before, confidence is driven by a combination of economic and trust indicators. Interestingly, the Dutch confidence in the state of the economy plummeted much harder than the European average during the crisis (see figure 4) even though the economy was not performing substantially worse than that of other European economies.
This indicates that lower trust levels were the primary driver of lower confidence. Why did the Dutch respond relatively strongly to the crisis in terms of trust as opposed to other European countries?

Figure 3 Reputation scale of largest Dutch companies (Reputation Institute)

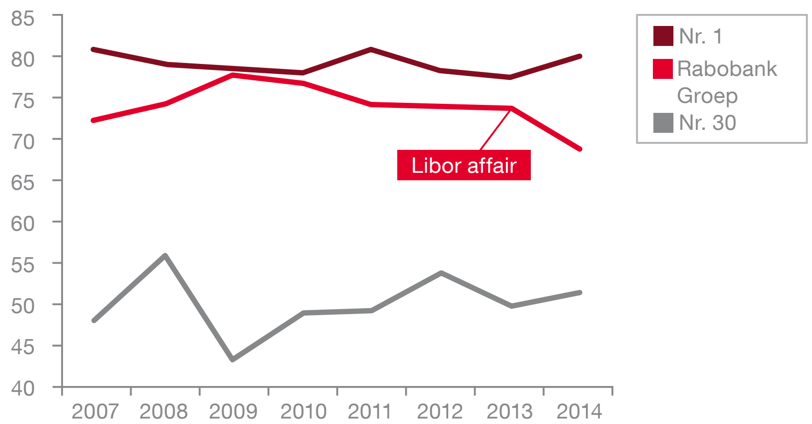
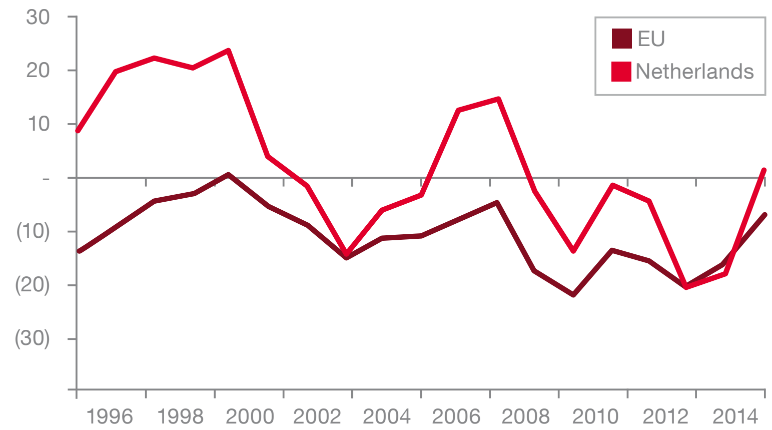


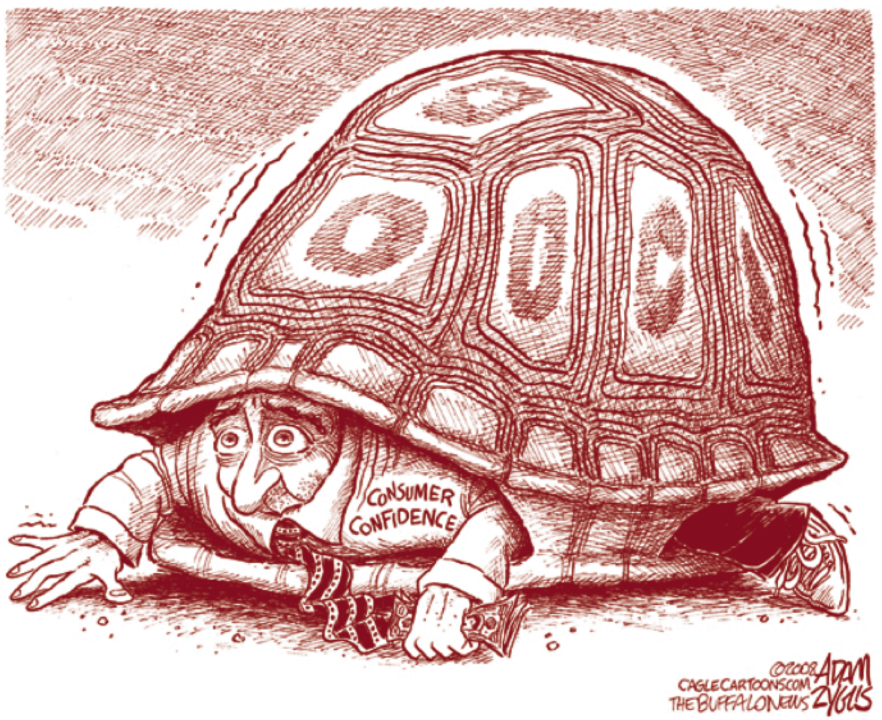
Figure 4 OECD – Consumer Confidence Index (Eurostat)



A possible explanation comes from Adam Smith. According to him, the Dutch are generally extremely faithful to their word (Smith, 1997 (1766)). It is possible that this cultural characteristic drives the relatively strong trust reaction of the Dutch; if a person is used to being loyal to his word and is also used to others being loyal to their word, it will come as a relatively big shock if someone behaves in an untrustworthy manner. If someone is less preconditioned to expect trustworthy behavior, the event of encountering untrustworthy behavior will come as less of a shock. Existing levels of trust will decline more modestly as a result.

Data from the SCP (Social Cultural Planning Bureau) indicates that the Dutch believed that they were relatively rich before the crisis started. Employment, housing and pensions were believed to be organized quite well (van der Meer, Steenvoorden, & Dekker, 2008). This firm base eroded quickly in light of the financial crisis as the housing bubble burst, unemployment rates surged and coverage ratios of pension funds deteriorated (Dekker & den Ridder, 2014) – leading the Dutch to the conclusion that things were not organized so well after all.

Figure 5 Consumer confidence is low



Bovens en Wille state that the Netherlands has relatively high confidence in politics compared to other European countries due to its long democratic tradition, low corruption and proportional electoral system (Bovens & Wille, 2010). Although the Dutch have grown more skeptical towards the European Commission (61% trusted this political body in 2009, in 2014 this number has shrunk to 47% in 2014 (European Commssion, 2014), the fact that there is a a relatively high level of confidence in politics indicates that rebuilding trust in another area might be more fruitful. Data from Edelman (figure 6) shows that the Dutch currently have least confidence in business, followed by the media and government (Edelman Berland, 2014).

The low level of confidence in business is interesting given that on a global level, the public has more confidence in business than in government and this gap has been widening (see figure 7). Business in the Netherlands thus has quite some catching up to do – making business a good place to start rebuilding trust.

Another reason why business is a good place to start rebuilding trust comes from Chaudury and Holbrook. These researchers indicate that a lack of trust in a company has adverse psychological and economic consequences due to its negative effect on brand satisfaction, loyalty, consumer’s recommendation intention, marketing efficiency, market share and profit (Chaudury & Holbrook, 2001). This means that rebuilding trust is not only good for the wider economy – organizations themselves also benefit directly from investing in trust.

Figure 6 Edelman Trust Barometer – Confidence in umbrella sectors (the Netherlands)

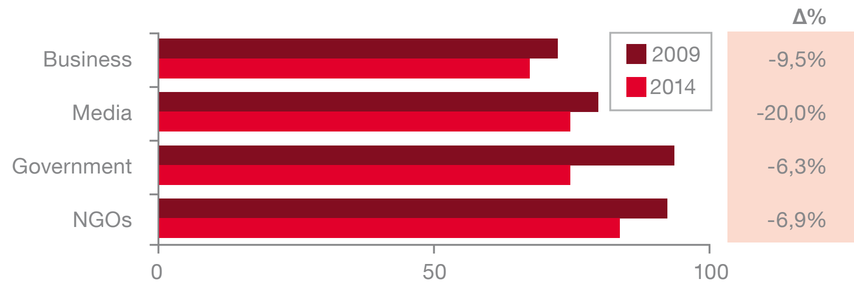
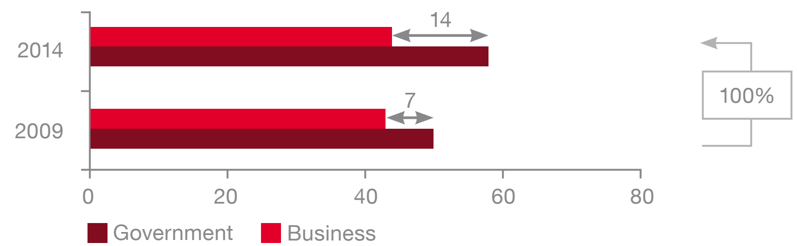


Figure 7 Edelman Trust Barometer – Global Confidence level in business and government



Understanding trust crises...

It is clear that it is important to rebuild trust and from the above it has also become clear that rebuilding trust in business is a good place to start. Unfortunately, actually rebuilding trust remains difficult (Kramer, 1999). In order to get an idea on how trust is rebuilt in practice we have taken a closer look at a selection of companies that experienced a trust crisis. More specifically, we analyzed the crises in terms of the actions that were (not) taken by organizations and qualitatively assessed the impact of the responses in terms of trust in the organization (as illustrated by figure A1 – A8) in the appendix). Accumulating the timelines of Toyota, Rabobank, BP, Albert Heijn, Johnson & Johnson, Arthur Andersen, Fitbit and Tesla has resulted in a general framework that can be used when facing a trust crisis.

...and creating common ground

The first thing that becomes clear from analysis of the cases is that existing trust (e.g., a good reputation) makes it easier for a company to overcome a crisis and while lack of trust makes it more difficult. Take for example BP and Arthur Andersen; both of these companies had a relatively low reputation before their crisis hit, and both had a hard (or even impossible) time rebuilding trust. Laufer and Coombs find the same relationship in their research (Laufer & Coombs, 2006). The authors state that reputable firms benefit from consumer's favorable interpretation of their response. Highly committed consumers even instinctively counter-argue negative information about a reputable firm. Another positive reputation effect is the finding that consumers perceive the danger from a crisis to be smaller when a highly reputable company is involved. These findings underline the importance of trust and reputation for organizations on an individual level.

On the basis of the analysis of the timelines a framework existing of four broad steps emerges.

1) Be in control of the situation

First, it is important to be in control of the situation. Being in control means three things to organizations: acknowledge the issue, make sure the issue is addressed and assume responsibility over the issue.

Toyota is an example of an organization that was not in control of a crisis situation because it failed to take all three of the steps mentioned above. First the company actively denied the existence of a defect in its cars regardless of evidence to the contrary. This denial led Toyota to postpone the addressing of the issue, which resulted in more accidents. Finally, once the existence of a defect was acknowledged, Toyota tried shifting the blame to one of its suppliers. Consumers did not appreciate this 'blame game' and Toyota's reputation declined accordingly.

Tesla is an example of an organization that was in control of their crisis from the outset. The company discovered a quality issue that could affect rear seat passengers itself and responded by recalling 1228 sedans. At the moment of the recall, Tesla had not received any customer complaints and did it know of any instances where something actually went wrong – as such they acknowledged, addressed and took responsibility over the issue without being under pressure from the outside world.

Depending on the nature of the crisis and the organization's response to the crisis, the resignation of the CEO or other responsible individuals may also be necessary. According to Coombs, three different types of crises can be distinguished: victim crisis (act of terrorism), accidental crisis (technical disruption) and preventable crisis (human failure) (Coombs, 1995). Resignation of the CEO is often necessary when the crisis could or should have been prevented but is also related to how a CEO handles a crisis after it emerges. Take for example the CEO of Tesla, Elon Tusk: he has frankly communicated about technical issues of Tesla vehicles, before the public or authorities were even aware of these issues and presented a game plan for resolving the issues. This way of acting has circumvented a crisis to emerge. Due the Libor affair, Rabobank's CEO, Piet Moerland, announced his resignation, while not being directly responsible for the Libor affair. Hence, several weeks later, internal pressure caused the responsible board member, Sipko Schat, to resign as well. This example stresses the point that it is important to fire the responsible person, not a scapegoat.

2) Address the crisis openly & trust your clients

In times of crisis, communication is key. In order to keep or regain trust, consumers need to be aware of what an organization is doing to solve the problem on a personal level. In addition to this, it is important to communicate that you are trustworthy by trusting your clients.

The Intel recall provides an example of an organization that failed to do this. In 1994, Intel testers discovered a division error in the Pentium chip but did not inform anyone outside of the company. When a consumer discovered the error and contacted Intel, the organization failed to respond. A little while later, the New York Times published an article on the faulty chip. In response to this, Intel offered to replace the chip, but only after Intel determined that the consumer asking for the replacement had used the chip in an application in which it could cause a problem. This communicated to consumers that Intel did not trust them and deteriorated the trust that they had in Intel. The organization was later forced to apologize and replace all chips upon request.

The Fitbit crisis is a schoolbook example of how to do it right. When customers complained about irritated skin resulting from the usage of one of Fitbit's products, the company swiftly reacted by ordering a recall of Fitbit. All customers were emailed personally to inform them about the news and told that they could return their Fitbit for a full refund. On top of this, the CEO of Fitbit wrote and published a personal, open letter on the company website to inform and apologize to customers.

3) Investigate the cause of the crisis

Once the worst is behind you, it is time to investigate the cause of a crisis as this enables you to make sure that it does not happen again. Both Fitbit as well as Johnson & Johnson are examples of organizations that handled this phase well.
In 1982 Johnson & Johnson faced a severe crisis as their painkiller Tylenol caused seven people to die. The organization took all Tylenol pills of the market and started investigating, quickly reaching the conclusion that their drug became lethal due to the malevolence of one person. An unidentified individual had replaced Tylenol tablets with cyanide laced pills. As a response to the incident, the organization.

When Fitbit got wind of the damage their product did to their consumer's skin, the organization started an internal investigation in cooperation with external experts. The investigation revealed that the reactions were caused by allergic contact dermatitis which was caused by adhesives and nickel used in the product. Fitbit also consulted with dermatologists to make sure that the reactions to the materials used in Fitbit were limited to the rashes experienced by some of the users and that these rashes would be expected to heal on their own.

4) Commit to change

The final hurdle in rebuilding trust is commitment to change – organizations need to address the issue and make sure it cannot happen again. Here, it is important that organizations make credible commitments and show that they are actually following up on these commitments.

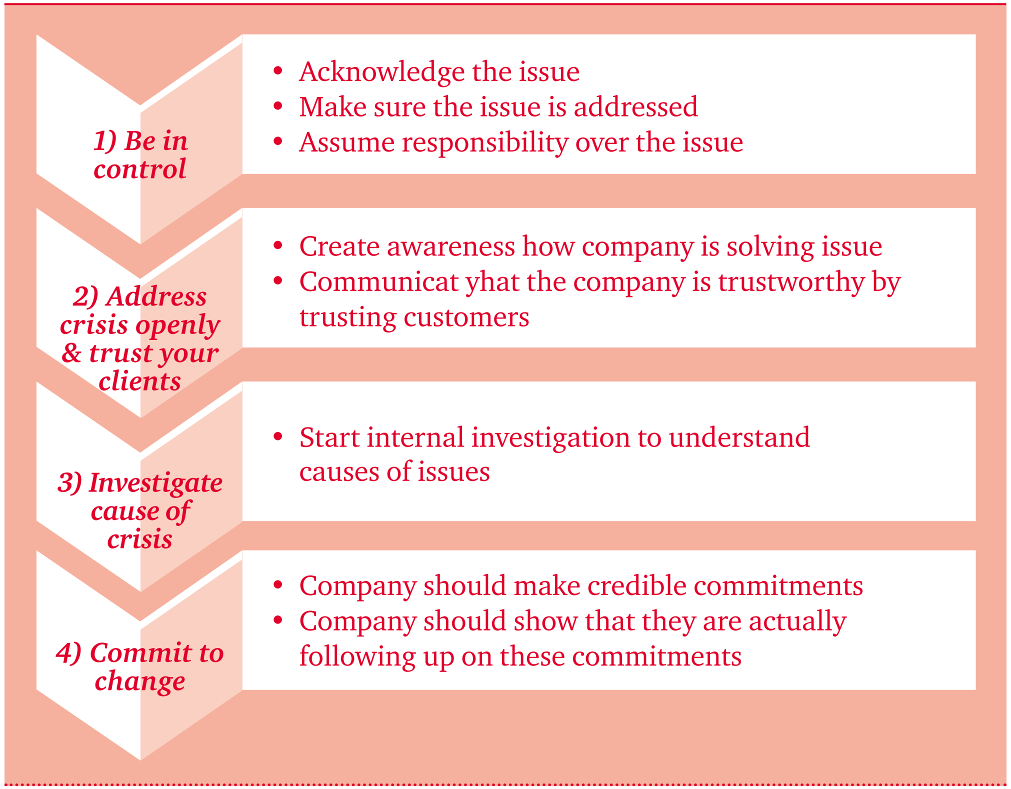
Arthur Andersen is an example of an organization that was not able to do this. The company was dragged into a crisis due to the misbehavior of several employees. Consequently, Arthur Andersen planned several measures to prevent such behavior to occur in the future; the organization intended to institute internal audit services and announced that it would no longer provide audit services to a selection of clients. This may have worked, if it weren't for the partners who did not accept the reforms. Arthur Anderson did not survive the crisis.

Johnson & Johnson credibly followed through on their commitment to provide consumers safe pain killers. The organization designed tamper resistant packaging. Johnson & Johnson was the first organization to implement this type packaging.

The financial crisis has severely harmed the reputation of financial institutions. General public regards bankers as people only caring about their own bonuses, while neglecting risks, potentially affecting the complex financial system. The Financial Conduct Authority has published guidelines for controlling finance crime. Moreover, financial institutions like Rabobank are striving to increase internal integrity in order to lower the chance that moral hazard issues will emerge in the future. It will be challenging for financial institutions to communicate to the general public that they will actually follow up on these commitments.

Organizations can rebuild consumer trust by following the four steps discussed above. Interestingly, shareholders are found to prefer a more passive strategy for handling crises as they believe active strategies (such as the one set out above) are costly. (Laufer & Coombs, 2006; Siomkos & Kurzbard, 1994). Consumers thus prefer to be treated differently than shareholders prefer consumers to be treated. This complicates matters for publicly traded organizations. However, organizations should focus on consumers, as a long term relationship between these two groups fosters long term perspective. Organizations adhering to shareholder's opinion will focus on short term gains, but risking long term growth.

Figure 8 Roadmap for restoring trust



Prevention before the cure

Of course, to prevent is always better than to cure. Ideally, organizations maintain trust by preventing crisis situations from occurring. The following three building blocks can help organizations to do exactly that:

1) Procedural competence

Brockner and Siegel note that procedural competence is important because it communicates information about motivation and intention to behave in a trustworthy fashion as well as the ability to do so in practice. (Brockner & Seigel, 1996). In support of this general argument, they report evidence that procedures that are fair in terms of structure and interactions tend to increase trust, whereas lack of perceived structural and procedural fairness tends to elicit low levels of trust (Kramer, 1999). Take Tesla as example: they have a well-managed procedure in place for handling recalls: The Tesla is picked up at convenient spot for the owner, who receives another Tesla, and within several hours the original Tesla is repaired and returned to the owner. This procedure increases trust in the Tesla organization.

2) High-quality products

Organizations focusing on high-quality products - supported by innovation - show they strive for long-term growth. A company could also have opted for selling low-quality products for premium prices, yielding high short term gains, but facing a deteriorating market position, as the public finds out about the low-quality products.

3) Transparency

Transparent companies will allow media coverage and public to continuously scrutinize their day-to-day business overcoming historical information asymmetry issues between business and society (Prahalad & Ramaswamy, 2004). Transparency contributes building a solid reputation, resulting in trust (van den Bosch, de Jong, & Elving, 2005). Transparency forms the start for organizations to engage with potential customers and to build up long-term (personal) relationships.

In conclusion

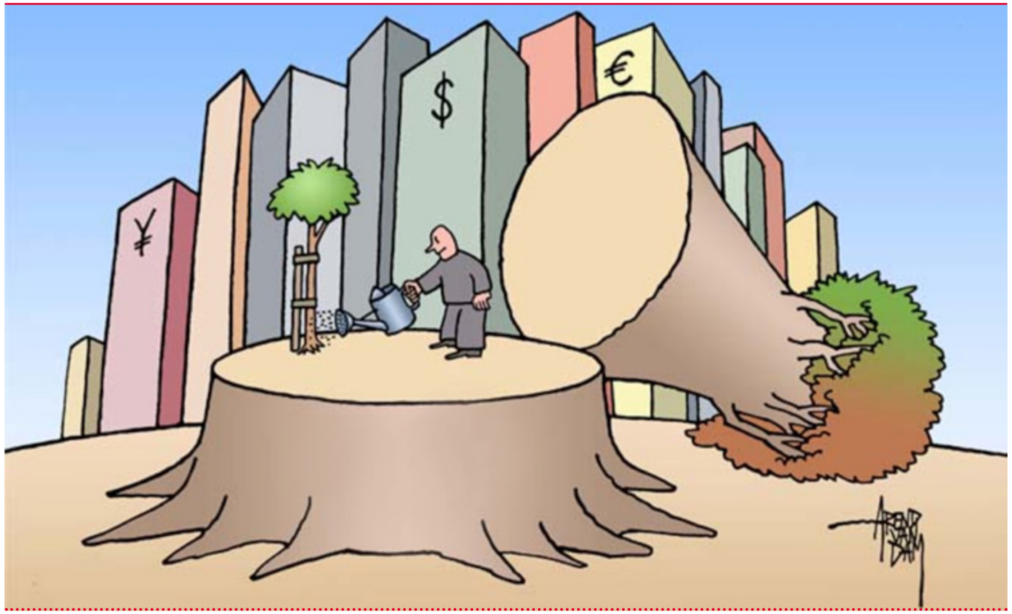
When organizations strive to institutionalize these goals (procedural competence, high-quality products and transparency) in their corporate culture, they will likely to prevent crises from occurring, especially the crises characterized as accidental and preventable. Moreover, it is recommended for a company to prepare for these crisis situations by stress testing: how would the organization respond to a newspaper article narrating that the company's products are causing harm to public health?

A company should always be aware that the chance exists for an unexpected event to shock the seemingly firm fundaments of an enterprise. The following steps will provide guidance in managing a crisis:

1) Be in control
2) Address crisis openly and trust your clients
3) Investigate cause of accident
4) Commit to change

Such a shock will pose a challenge for trust in the organization, but will simultaneously create opportunities to increase trust. Business restoring trust will enable public confidence to grow, which will stimulate the economy.

Figure 9 Goal: growing confidence



Appendix

Figure A1 Toyota – Recall crisis in 2009-2010

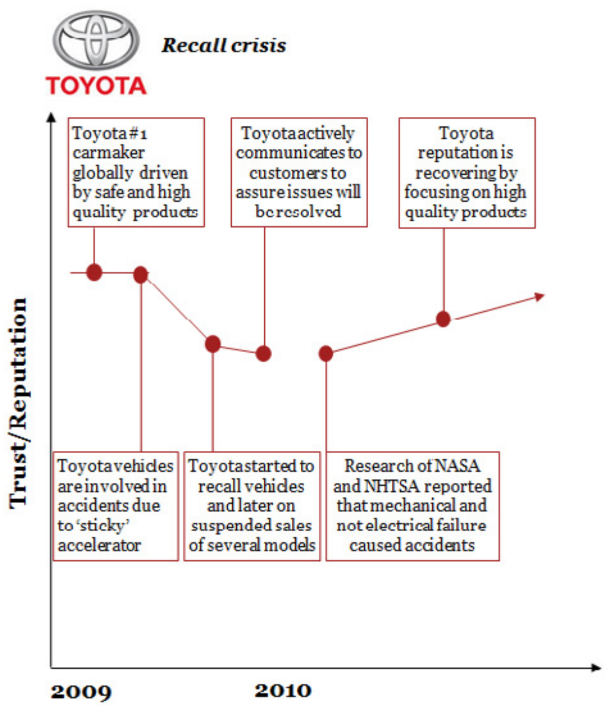


Figure A2 BP - Oil spill in Gulf of Mexico in 2010

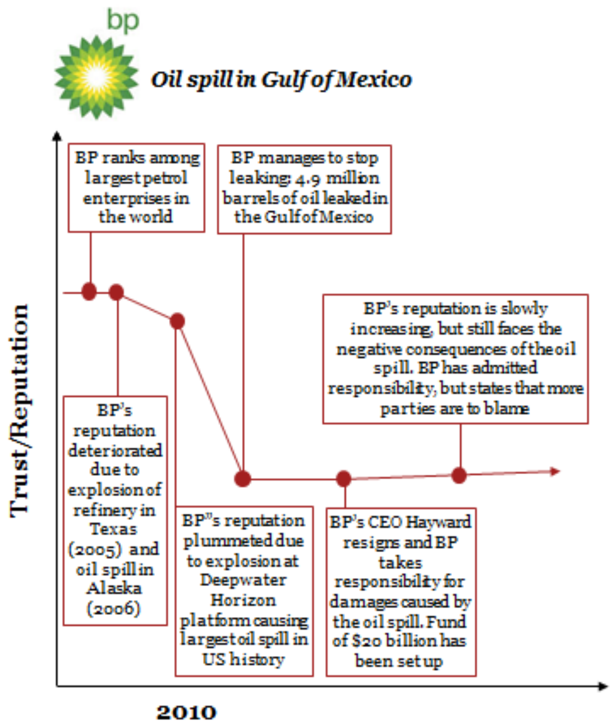
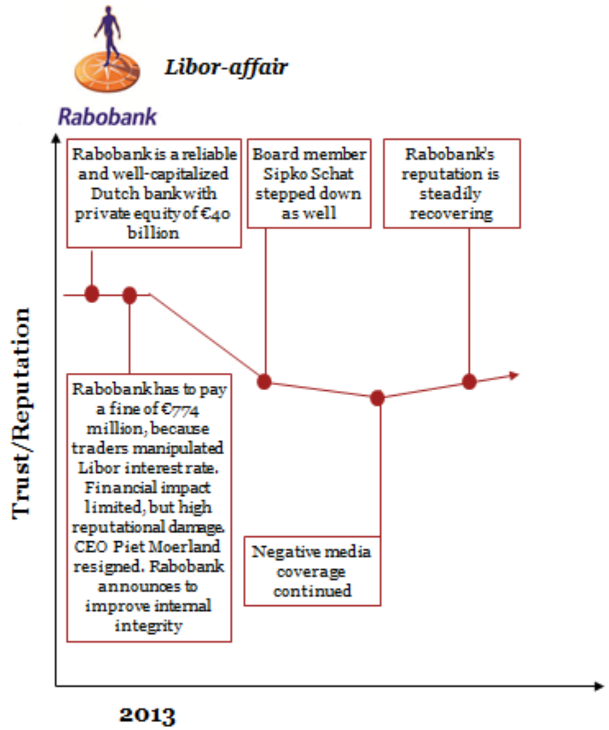


Figure A3 Rabobank - Libor affair in 2013



Timelines are high-level qualitative assessments of reputation levels based on published information.

Figure A4 Johnson & Johnson - Tylenol Crisis in 1982

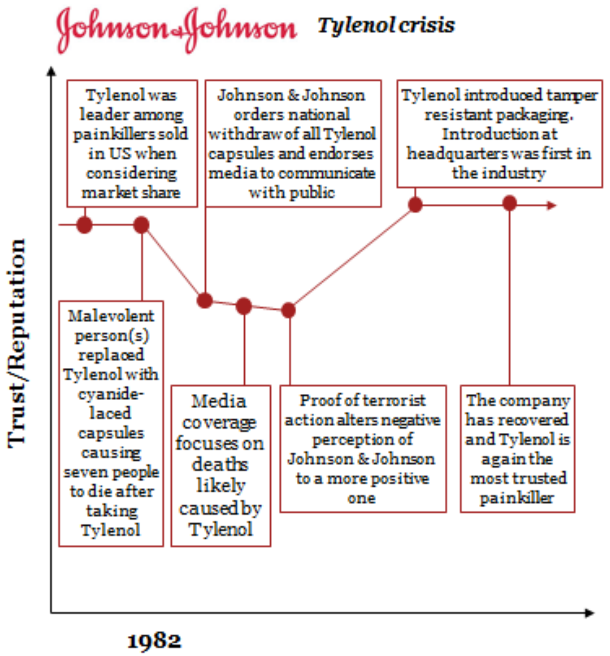


Figure A5 Arthur Andersen - Enron fraud in 2001

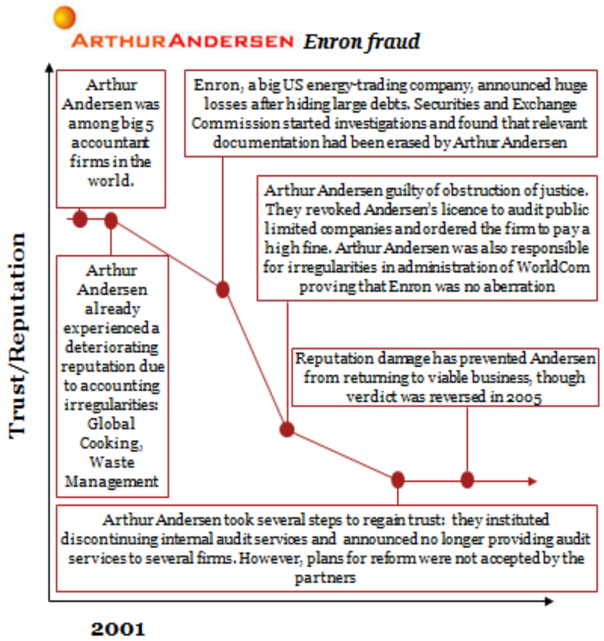
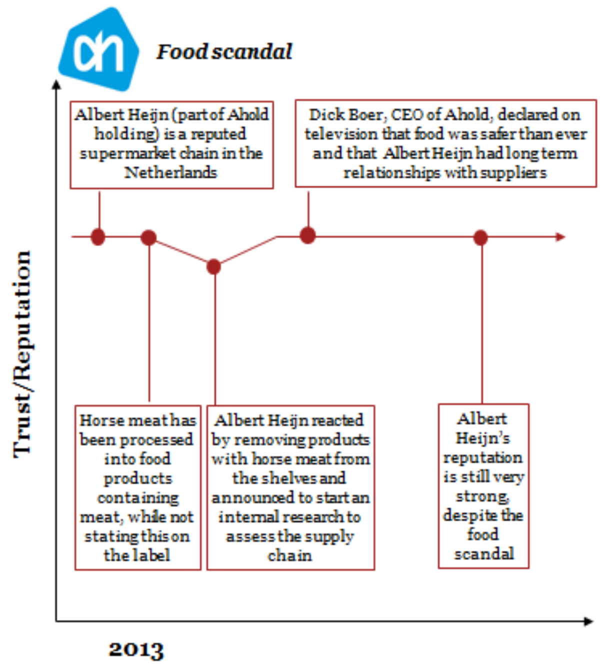


Figure A6 Albert Heijn - Food scandal in 2013



Timelines are high-level qualitative assessments of reputation levels based on published information.

Figure A7 Fitbit - Recall crisis 2014

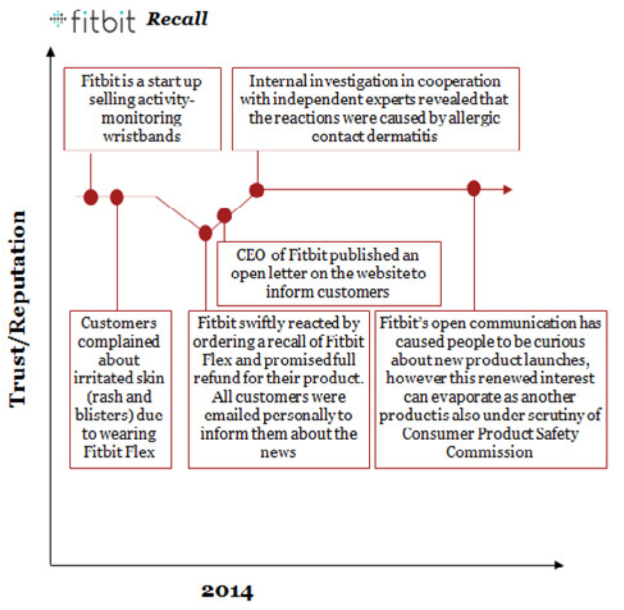
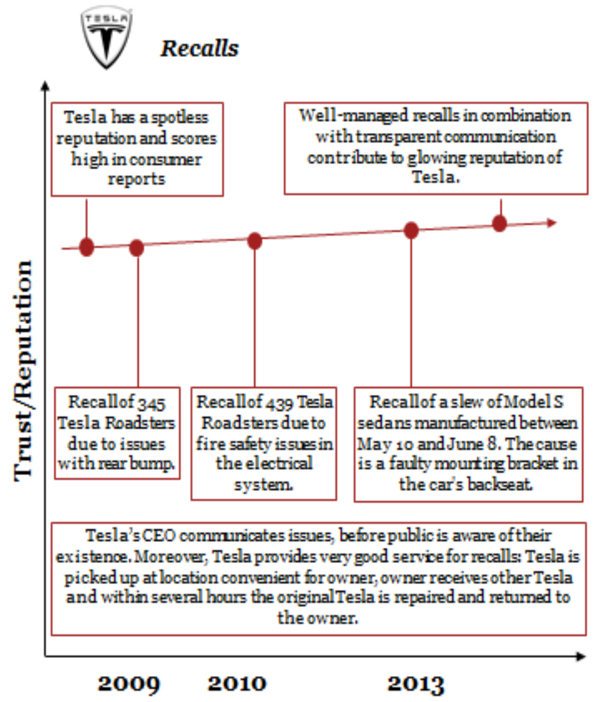


Figure A8 Fitbit - Recall crisis 2014



Timelines are high-level qualitative assessments of reputation levels based on published information.

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