Why trust is important in business and finance

Following the global financial crisis, public trust in governments, corporates, financial markets and financial institutions declined as societies in many part of the world experienced an erosion of economic well-being. As governments used unprecedented policy tools – including monetary, fiscal, regulatory, structural measures– to restore stability and growth, surveys have shown evidence of a gradual improvement in public trust.

However, more than a decade after the crisis, major economies are at a crossroads. Despite moderate growth across OECD countries, business and investment activities have been anaemic, and markets are increasingly vulnerable to downside risks. While progress has been made on financial reforms, implementation has been uneven. New concerns have arisen regarding competition, consumer protection, and privacy in digital markets. Many are questioning the extent to which post-crisis growth has been sustainable, fair, and inclusive, and whether investment and business practices are aligned with societal values, such as social and environmental issues. Strengthened public trust in business and finance will be important to encouraging the productive investment and commerce that contribute to inclusive and sustainable economic growth.

This introduction offers a perspective on public trust as it relates to business and finance. The first part briefly looks at the academic literature on public trust; the second part reflects on OECD work on trust in institutions and in business; and the third part offers a framework for considering trust in business and finance.

Perspectives on public trust in business and finance

Trust is a basic element for the well-functioning of institutions, including governments, markets, businesses, and for society more broadly. The concepts of public trust have been considered by a range of authors, including by Kenneth Arrow, Douglass North, Francis Fukuyama, and Robert Putnam, among others, who explore the importance of public trust for the functioning of institutions, markets, and commerce (see Arrow, 1999; Fukuyama, 1995; Putnam, 2000). Arrow suggests that virtually every commercial transaction has within itself an element of trust, as transactions conducted over a period of time have an element of uncertainty. He argues that much of the economic backwardness in the world can be explained by the lack of mutual confidence (Arrow, 1972). Fukuyama illustrates how societies with high social capital from public trust are more able to efficiently pool resources – labour, capital, ideas and innovations – to generate economic growth and progress, have low levels of corruption, and maintain level playing fields.

By contrast, low social capital societies tend to have lower non-government capital formation, less efficient markets and financial services, more corruption, and more costs associated with these inefficiencies that dampen the entrepreneurial forces for economic gains. Reflections on trust and society suggest that where social and legal mechanisms for the efficient resolution of principal-agent conflicts are weak– i.e. where most potential pairs

of economic transactors cannot trust each other– the private returns to production fall (Knack, 2015). In this regard, North argued that the inability of societies to develop effective, low-cost enforcement of contracts is the most important source of both historical stagnation and contemporary underdevelopment in some parts of the world (North, 1990).

According to Hawley and Kirby, trust in institutions (including corporations) derives from the capacity of these institutions to fulfil a commitment (Hawley, 2014), pp.1-20; Kirby et al., 2018), pp.75-129). Three observations are relevant to qualify trust in the financial system and commerce. First, some commitments are explicit while others are implicit, and eliciting implicit commitments is required to build trust. Second, some commitments are legally enforceable, while others are not. It follows that, while compliance matters, restoring or enhancing trust requires moving beyond compliance. Third, trust combines different levels of aggregation, from the trustworthy corporation to trust in a particular industry (e.g. the financial system) and trust in a set of social institutions (including government). From these conceptual studies, one can infer that the sharp deterioration of public trust in governments and private-sector institutions that engage in capital formation and commerce calls for the careful consideration of possible policy responses and actions.

The OECD's perspective

The OECD has engaged in measurements of public trust in government, public policy and more recently in business and digitalisation. The work on measuring public trust highlights that only a society where people cooperate with one another, and where public institutions act competently and are widely accessible to citizens, enables a higher quality of life for all. Trust in other people and trust in institutions are essential ingredients for social and economic progress, while a prospering society, in turn, is one in which trust can flourish (OECD, 2017a).

OECD (2017a) defines trust as a person's belief that another person or institution will act consistently with their expectations of positive behaviour. The same publication highlights that trust in institutions requires that they are "competent and effective in delivering on their goals, that they operate consistently with a set of values that reflect citizens' expectations of integrity and fairness", and is also dependent on the extent to which they align with business ethics and broader societal expectations. Underpinning these expectations is the distinction between rational trust, such as in strategic outcomes related to anticipated economic benefits, and moralistic trust, based on shared beliefs and norms of the individuals and societies doing the trusting (see Uslander, 2008 and Fukuyama, 1995). In particular, trust is critically important because it is: necessary to increase the confidence of investors and consumers; essential for key economic activities; and, is important for the success of many government policies, programmes and regulations that depend on cooperation and compliance of citizens. Appropriate government policies, including monetary, fiscal and structural policies, regulations, law, and enforcement are vital to establish formal behaviours that promote and reinforce trust.[1]

A trust framework for business and finance

In light of differing perspectives on public trust in various facets of societal engagement, a simple framework for structuring the elements of public trust related to business and finance is needed to better explore the relevance of trust in markets and business, where they may be fragile, and what can be done to strengthen them. The OECD descriptions of trust can be applied to stakeholders that are narrowly defined as participants in the financial and commercial

transactions, including those that supply, demand, and intermediate capital or commercial exchanges, or defined broadly with respect to societal expectations of behaviours and outcomes. Expectations of well-functioning arenas of business and finance would include: (i) effectiveness in ensuring predictability in engagement that yields economic benefit; (ii) that the exchange of those benefits is fair, and conducted with integrity; and, (iii) that behaviours pursued by participants in business and finance are aligned with ethical standards and societal values. They would include a disposition to fulfil a broader set of commitments, explicit (such as the ones above) or implicit, be they legally enforceable or not.[2]

The predictability of economic and normative behaviours are equally relevant for individual participants and the public at large. Individual participants in markets and business generally expect economic returns within a range established by historical precedence, and they might seek to achieve such benefits through trust in established norms of behaviours set by laws, regulatory guidance, or industry standards. Furthermore, given ample room for judgement within these explicit perimeters of engagement, participants would expect others to act with high ethical standards and in a manner that strengthens trust in this engagement.

Societal trust in finance and business rests upon expectations that these activities will contribute to sustainable and inclusive economic growth; will not lead to imposition of losses on society through excessive risk taking; and will be aligned with broader societal values related to environmental, social, and labour, among other issues.[3] To this end, one may argue that public trust in business considers the degree to which the public believes that business will act in a particular manner by which the business has included the public's interest into its own.[4] In this respect, evidence suggests that sustainable economic growth from well-functioning markets and business most often fosters greater opportunity, tolerance and diversity, social mobility, commitment to fairness, and dedication to democracy (Friedman, 2005). Mutually reinforcing behaviours have the potential to contribute to a virtuous cycle between sustainable and inclusive economic growth and trust. By contrast, the global financial crisis illustrated that when excessive risk-taking and skewed rewards contributed to unsustainable and exclusionary growth, public trust was impaired.

The following trust matrix illustrates core elements of trust between individual participants in business and finance, and the general public, using the core elements with respect to economic value, fairness and conduct, and integrity of behaviours that align with societal benefits. Of course, the relative strength of these expectations would depend on type of business and finance cultures in each jurisdiction, the level of formal state involvement in the economy, and societal values, among other factors. The tolerance for loss within the financial sector, to individuals and society, would depend in part on the formal state intervention in the economic regime, and circumstances. Also, the fairness and conduct would depend on society's acceptance of formal rules of engagement, such as to protect investors and consumers, or to ensure level playing field, which may set perimeters for economic gain and risks. Lastly, values alignment, which reflects behaviours aligned with moral and ethical principles distinct from formal laws and regulations, is associated with positive or negative impact of spillovers related to, for example, business culture, or considerations related to environmental or social impact.

Portions of the matrix are reflected in each chapter of the 2019 OECD Business and Finance Outlook and collectively the chapters cover all elements of the matrix. This gives a full picture of the ways in which behaviours in business and finance could undermine trust, and how to address them.

Table 1. Trust matrix

	Economic Value	Fairness, Conduct, and Integrity	Values Alignment
Participants (narrow)[1]	Predictability of general market and asset class performance and liquidity, such that participants can expect to receive investment outcomes relative to risks in a range of historical outcomes. Predictability of commercial behaviours through traditional and digital markets. Expectations of macroeconomic and macrofinancial policies conducive to stable growth that promotes investment and commercial benefits.	Expectation that behaviours align with established and explicit rules of acceptable conduct, which promote fair treatment, transparency, adherence to laws.	Behaviours that strive to achieve best practices beyond adherence and compliance, and which contribute to the reputation of the industry. Business cultures that promote behaviours and outcomes that align with societal values.
Society (broad)[2]	Expectation that the aggregation of market and commercial behaviours results in economic benefits to society, through sustainable and inclusive growth, without the socialisation of losses to society.	Expectation that policies and oversight of rules of conduct ensure sufficient fairness, a level playing field, and tolerated conduct to ensure integrity of markets and commerce. Expectation that there is a competent enforcement mechanism in place to minimise egregious breaches.	Behaviours that are widely considered to be positive for societal well-being beyond the economic sphere. Alignment of business and finance sector behaviours with environmental, social, and governance factors, among others.

Notes:

This guiding framework reflects elements of OECD work on trust, directly or indirectly, in its various divisions. The purpose of the framework is to provide a unifying conceptual approach that incorporates key elements of trust in finance and business, and to help readers understand how the chapters in this publication are interrelated.

1. Participants include:”
   - both those involved in the financial and commercial transactions and institutions that oversee the fairness, conduct and integrity of activities.
   - retail and institutional investors who provide capital, issuers that demand capital, and enablers such as market intermediaries (traders, funds, vehicles, and exchanges).
   - consumers and providers of goods and services that engage through traditional and digital exchanges.

2. Societal trust may differ from participants’ trust because societies may judge not just the behaviours but also the aggregate outcomes and their impact on society, such as with respect to social and environmental issues. When desired outcomes are not sufficiently achieved, citizens may call upon public policy to change the rules related to economic value, fairness and integrity. For example, current societal frustration with the effects of globalisation with respect to the distribution of economic gains is influencing populist movements that are challenging the current institutions and rules related to multilateralism.

Notes

[1] OECD trends and surveys point to six areas where trust in institutions can be improved: reliability, responsiveness, openness, integrity and fairness, better regulation and inclusive policymaking. See OECD (2017b).

[2] According to Kirby et al. (2018), such a disposition particularly matters under specific circumstances, in particular when there is a need to preserve systemic trust and where corporate political power can undermine a state's legitimacy.

[3] The key distinction between the market participant and society, which includes market participants, is that the trust of society is not necessarily predicated upon direct engagement in markets and commerce; societal expectations exist distinct from direct engagement and benefit with commercial and financial transaction.

[4] Adapted from Financial Times Lexicon, see FT website.

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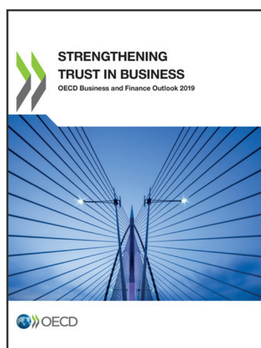

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