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In the wake of the financial crisis: rebuilding the image of the finance industry through trust

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Abstract

The financial services industry is undergoing one of the most tumultuous times in its history and the consequence has been a precipitous decline in the public's trust in the industry and in its leadership. This article provides an overview of the construct of trust, describes why crisis events erode trust, and offers guidelines for how to rebuild trust following a crisis. Using the principles of crisis leadership as a backdrop, the article demonstrates the significance of integrity, positive intent, capability, mutual respect, and transparency on the trust building process.

In a two week period in the fall of 2008, the U.S. witnessed the shocking collapse of several of its most seemingly stable and secure financial institutions. On September 14, Merrill Lynch entered bankruptcy and was quickly acquired by Bank of America. The next day Lehman Brothers filed for bankruptcy, was split up, and portions of the former firm were purchased by Barclays. The following week the nation's largest savings and loan association was placed into receivership, ironically on the same day as that firm's 119 year anniversary. The demise of Washington Mutual represented the largest single bank failure in American history. The landslide of financial failures started several months earlier when Bear Stearns, once recognized as the 'most admired' securities firm in Fortune's "America's Most Admired Companies" survey was acquired by JPMorgan Chase for U.S.$10 per share, down from the 52 week high of more than U.S.$130 per share. Among them, these once stalwarts had almost 450 years of history, having previously survived other economic downturns, including the Wall Street Crash of 1929.

The causes of what has come to be called simply 'the financial crisis' are too numerous to describe here. Economists, finance gurus, and the federal government will no doubt invest years in trying to identify the appropriate attributions. Already it is alleged, for example, that subprime mortgage lending practices played a major part. Credit issuers have been accused to have engaged in predatory lending practices, particularly for home mortgages, potentially contributing to massive loan defaults and lending institutions being forced to write-down billions of dollars in losses. At the heart of those losses were Freddie Mac and Fannie Mae, government-backed mortgage lending institutions that survived the financial crisis only with the substantial assistance of the U.S. government.

Banks and lending institutions were not the only industries affected by the crisis and in need of federal support. America's largest insurance company, AIG, was close to insolvency before the federal government intervened granting the company a sizable portion of a U.S.$700 billion 'bailout,' formally called the Emergency Economic Stabilization Act of 2008. America's big three auto makers (General Motors, Ford, and Chrysler) have met with the U.S. congress on multiple occasions to request bailout funds. Their initial visit to Capitol Hill resulted in a failed attempt to secure funds and a public relations nightmare for the auto companies when all three executives independently arrived in Washington, DC from the Detroit metropolitan area on their corporate planes. The public outcry toward this extravagance suggested that the executives were incapable of fiscal management. In light of these and other disturbing events, we have witnessed the collapse of what were formerly giants of the U.S. economy and experienced the pain of precipitous drops in the Dow Jones, marked most vividly by a 777 point drop on September 29 – what has been referred to as the most catastrophic day in U.S. market history. Needless to say this is a tumultuous time for executives and leaders in the finance industry. Whether fault for the current state of affairs lies with executives having mismanaged their firms, or with the ratings agencies that potentially overvalue financial institutions, or with short-sellers attempting to manipulate the market, or whether this is merely a normal business cycle correcting the excesses of recent years, there has been a sense of gloom, panic, and distrust in the air. There is plenty of blame to go around and in due time we will eventually learn as much as we need to know. The financial events of 2008 will become a footnote in history. But in the meantime the industry is faced with a considerable dilemma – an overwhelming lack of trust.

It should have been no surprise that the public's trust in the financial industry is low, and executives have expressed concern over the public's trust for some time. In 2004, the Business Roundtable's Institute for Corporate Ethics surveyed CEOs and found that regaining the public trust, effective management in the context of investor expectations, and ensuring the integrity of financial reporting were the three most important issues they faced. Their challenge is exacerbated because the public experiences an insurmountable power imbalance [Business Roundtable Institute for Corporate Ethics (2009)], where the industry holds the lion share of the power and is able to make decisions and take risks in ways that have tremendous impact on its stakeholders. Accompanying an imbalance of power is an imbalance in risk assumption and vulnerability, with the public assuming more risk than either an individual firm or the industry. With limited understanding and knowledge about the activities of the industry, the public is naïve to the potential impact of the industry's behavior until something goes terribly wrong. When it does, the public loses faith in the industry and in its leadership.

How can the financial industry rebuild its image? An obvious answer is through performance. Once investors and others begin to recoup losses and the market rebounds, any concern or hostility toward the industry will likely dissipate, at least temporarily. In fact, we are already seeing evidence of this beginning to happen. Yet, relying solely on performance to build and sustain public trust can be dangerous. Firm and industry performance is often cyclical, and in a downturn the chance of losing the public's confidence and loyalty can be high. This is particularly true when the public attributes a downturn of the magnitude of the 2008 financial crisis to the actions of firm leaders. In fact, the social psychological principles associated with attribution theory suggest that adverse situations that are perceived to be controllable and preventable (i.e., through effective decision making and action taking) are more likely to negatively affect one's feelings toward the accountable agent(s) than are those situations that are perceived to have derived from external forces or that are perceived to be beyond one's control [Weiner (1985)]. I argue that this relationship holds regardless of whether the accountable agent is an individual actor, an organization, or an industry. In short, stakeholders respond much more antagonistically towards a firm or industry when it is perceived to be at fault for the crisis. Under these circumstances, an industry can suffer irreparable damage to its image. Although performance is critical to image management, it cannot be the only recourse. The industry must consider alternative approaches to re-establishing credibility in the midst of the financial crisis. The approach I propose for doing so requires the careful and deliberate establishment of trust, a fundamental element of what I and others call crisis leadership [James and Wooten (forthcoming), Mitroff (2005)].

The nature of crises

Dutton (1988) describes business-related crises as a type of strategic issue that leads to a negative outcome unless corrective action is taken. She further argues that crises reflect situations that are critically important to an organization or industry and that they may be distinguished from non-crisis strategic issues because they are accompanied by time pressure and ambiguity. The more important, immediate, and uncertain the issue, the more likely it is to be characterized as a threat or a crisis. Pearson and Clair (1998) expand on Dutton's definition, claiming that crises are low-probability, high-impact events that threaten the security and well being of an organization or an industry, and their respective stakeholders. They define crises as also being characterized by ambiguity of cause, effect, and means of resolution, and consequently require decisions to be taken swiftly. These, and other definitions of crisis, include three key elements: ambiguity, high stakes, and urgency - all of which help serve to distinguish crises events from other problems or challenges an industry and its leadership may face. Given these articulations of crisis, the financial industry has clearly experienced a major threat. At the outset of the economic collapse there was ambiguity in both cause and response, with industry leaders and government officials scrambling for solutions as the economy spiraled downward. Moreover, the consequences of the financial situation in the U.S. had world-wide implications, and therefore the stakes were extremely high. Finally, the situation required immediate attention and from an array of sources. Under these circumstances, effective crisis leadership is an imperative.

Crisis leadership

Crisis leadership is more than managing communication and public relations (PR) during a crisis. Crisis leadership even goes beyond the parameters of the risk management or operations roles. I argue that crisis leadership is about building a foundation of trust not only within the industry, but across the industry's stakeholders as well. Effective crisis leaders then use that foundation to prepare their organizations for difficult times, to contain crises when they occur, and most importantly to leverage crisis situations as a means for creating organizational change and innovation. It is in fact those industry leaders who recognize that crises events can be a catalyst for positive change, and who have the wherewithal to act toward that end, who will propel the financial industry forward.

"Today's low levels of public trust, rather than signaling a capricious public or no-win situation, may represent opportunities for game-changing solutions that can lead to greater efficiency and value creation." [Business Roundtable Institute for Corporate Ethics (2009, p. 6)].

This sentiment is precisely what the U.S. congress asked (and some might argue mandated) of the Big Three auto manufacturers: to use their financial woes and lackluster reputations as a starting point to redesign their business model, to create a new and innovative product line, and to rebuild the U.S. image as an auto manufacturing powerhouse.

Crisis leadership, therefore, is a frame of mind accompanied by a key set of behaviors. The frame of mind is characterized by openness to new experiences, willingness to learn and take risk, an assumption that all things are possible, and a belief that even in times of crisis people, organizations, and industries can emerge better off after the crisis than before [Brockner and James (2008), James & Wooten (forthcoming)]. Clearly crises are traumatic events and I do not want to leave a false impression or indicate that there is not real pain and suffering resulting from them. Indeed this can be, and often is, the case. Crisis handlers must address and deal with these circumstances. Gifted crisis leaders, however, create possibilities even in the most dire of circumstances.

These leaders establish a followership based on trust.

A primer on trust and betrayal

Trust

Trust is built and sustained in part by the potential for reward when mutually understood expectations are met, and by a fear of negative consequences (i.e., losing clients) when those expectations are not met. In this way, trust can be interpreted as a market-driven, economic calculus derived by weighing the potential outcomes of creating trust relative to the cost of destroying it [Lewiki and Bunker (1995)]. Organizational and industry reputations are built largely on this calculus. Stated simply, when one party does not follow through in a competent and predictable manner, trust in the relationship is eroded. The financial industry is suffering from a lack of perceived trust. In recent months, the industry's clients have questioned the judgment and decision making of its leaders and their capability to manage in a transparent manner. Moreover, stakeholders (retailers in particular) feel unduly burdened by the consequences of the industry's actions. In blunt terms, stakeholders of the financial industry feel betrayed.

On the surface, the notion of trust seems a simple construct. It is one of the first lessons in childhood and it factors into every stage and phase of life. We either trust a person, or we do not. We are either trustworthy or we are not. Simple! Even the assumptions that we make about trust are relatively universal. Consider for example these common sayings: "trust takes a long time to develop, but can be broken in an instant" or "trust has to be earned." At its most basic level, trust represents our ability or willingness to depend on someone or something outside of ourselves. When we trust, we feel confident and secure in the other's actions towards us when or if we expect to be affected by those actions. And trust extends beyond mere interpersonal relationships to trust within and between organizations and industries. In general, there is a strong need to trust the industries of which we are a stakeholder. Despite the multitude of perspectives and definitions of trust, there are several features of trust that appear to be consistent across various definitions of the term. In his review of the trust literature, Mishra (1995) identified four common dimensions of trust: competence, openness, concern, and reliability. I discuss each briefly below.

A collective body, such as the financial services industry, operates most successfully when its constituents are engaged in an exchange relationship whereby the parties involved are competent in their contribution to the collective good. Competence-based trust, therefore, involves a confidence in the knowledge, skills, abilities, and judgments of others. Opennes, and to use a related term, honesty, is another key element of trust. Stakeholders must trust industry leadership to be open and honest about strategy, intent, and purpose. When there is openness in the relationship between an industry and its clients the better positioned it is to attract and retain followers and the more likely it is to establish coordination across firms within the industry and with external agents (i.e., regulatory bodies). A central aspect of coordination is agility, and openness creates an environment that allows industry leaders to be agile in working across businesses and firms internal and external to the industry. Agility and coordination, in turn, facilitate creativity and innovation in problem solving [Mishra (1995)], the primary activity in crisis resolution. The element of concern represents one party's belief that he or she will not be exploited by another. Stated in the affirmative, concern is the demonstration of interest and care in the well-being of others. To be clear, concern is a delicate balance of self-interest and other interest, but when the balance is skewed in favor of the self, the sense of trust from others dissipates. Research has shown that in the face of substantial organization or industry change, stakeholders evaluate leaders on the extent to which they can be trusted to be concerned with stakeholder welfare [Kotter and Schlesinger (1979)]. Finally, trust is characterized by reliability [Gabarro (1987)], or the perceived consistency with which decisions are made and actions are taken. Stakeholders gain confidence in an industry when its activity and outcome is predictable. In light of the aforementioned descriptors, a reasonable conclusion is that an industry that demonstrates reliable performance, that is perceived to have concern for the welfare of its constituents, that is seen as open and honest, and that is competent in its work is more trustworthy than an industries not characterized by such dimensions.

Betrayal

Betrayal is an actual or perceived breach of trust, and the economic crisis can be interpreted as a betrayal by retail customers, credit issuers, investment banks, and more. Betrayals are experienced both cognitively and emotionally [Lewiki and Bunker (1995)]. Cognitively, the violated party attempts to rationally process the significance of the violation and its ramifications on self and others. The conclusions that are reached from this deliberation are then used in deciding whether or not to continue the relationship. When the betrayal tips a certain threshold the relationship is severed. In addition to the rational processing of betrayal, stakeholders also respond emotionally to them. The violated party experiences feelings of despair, hurt, anger, and potentially a desire for revenge. Taken together, the consequences of betrayal can be severe enough as to debilitate progress at precisely the time when forward momentum is necessary.

Betrayal can be categorized as intentional or unintentional and can vary in its impact. Yet, even minor betrayals can prove problematic for both the betrayed party and potentially for the relationship. Betrayals hit at the core of what is important – a set of firmly entrenched values, assumptions, beliefs, and expectations (VABEs)[1] about how people, organizations, or industries should behave. When behavior contradicts or is somehow inconsistent with our VABEs we view that behavior as a betrayal regardless of whether it was an intentional or unintentional act. When we perceive a VABE violation our tendency is to draw a set of negative conclusions about the source of the betrayal. Those negative

1 I acknowledge my colleague Jim Clawson for having introduced me to the language and acronym (VABE) associated with values, assumptions, beliefs, and expectations, which itself is rooted in the psychological foundation of Rational Emotive Behavior Therapy. Ellis, A., 1957, "Rational psychotherapy and individual psychology," Journal of Individual Psychology, 13, 38-44.

conclusions subsequently lead to negative feelings, which then manifest in negative or unproductive responses. When the negative response is directed back to the original source we refer to that as revenge, and revenge has the potential to create an infinite loop of unproductive behavior. There are times, however, when an unproductive response to an initial betrayal is redirected to a third party. In this case the cycle of betrayal expands to other stakeholders.

Building trust in the aftermath of crisis

Building institutional and industry wide trust is not easy, but because of its central role in image and reputation management creating an environment characterized by trust is a worthwhile pursuit. For the financial services industry to be perceived as trustworthy, ethical, and high performing in light of the financial crisis it must develop the capacity to respond to, learn from, and generate positive outcomes even if the crisis is perceived to be one of its own making. To do so requires that the industry demonstrate integrity, positive intent, and clear capabilities [Covey (2006)].

Integrity

The financial services industry must act in accordance with a set of core values and beliefs. In other words, it must be guided by a clear set of VABEs. Moreover, these values and beliefs must be aligned within and across firms. Certainly individual firms or businesses within the industry will pursue unique goals. Investment banks have a different purpose than do credit issuers after all. Yet as an industry there should be an overarching belief system and set of values about how the various entities that comprise the industry will achieve their purpose, and there must be a unified commitment to visibly live and reinforce those values. Important questions for industry leaders to consider are:

- What does the industry stand for? What values do we espouse?
- Does what we stand for reflect a spirit of respect for all stakeholders?
- Do the structures, systems, and incentives reinforce industry values?
- Do the structures, systems, and incentives create a culture of honesty?

Positive intent

Creating a sense of positive intent toward stakeholders of the industry is a critical component in the trust rebuilding process. Behavior that is interpreted as malicious or self-serving undermines the possibility of creating trust, whereas behavior that is deemed to be steeped in a genuine care and concern for those affected by one's actions is more generative in creating trust. Positive intent requires that the industry be clear in its motives and that it communicate its motives to stakeholders. In most cases, motives that are mutually beneficial (to the firm and its stakeholders) are not only more likely to inspire trust, but they are more likely to be adhered to and to be at the forefront of decision making rather than an afterthought. Relevant questions to consider with respect to positive intent are:

- Does the industry have positive intent toward all stakeholders?
- To what extent are the underlying motives that drive industry behavior internally or externally focused?
- Do the processes and means of engagement within the industry reward cooperation or competition?
- Does the industry explicitly communicate its intentions and motives?

Capabilities

The financial services industry is ripe with talent. The intellectual horsepower of the employees in the industry has created innovative ways to structure loans, manage securities, and generate phenomenal wealth. Some might argue, however, that it is in fact this talent and skill base that has created a complexity in financial innovation products and models that outpaces an ability to manage it. Consequently, risks are being taken that might not otherwise if there was a greater transparency about the underlying assumptions of the innovations and potential unintended consequences. Nevertheless, trust in the industry can be rebuilt with a slight refocus of the capability that already exists. Moreover, explicitly pairing capabilities with positive intent and integrity will create fertile ground for trust to grow. Industry leaders might ask the following:

- Does the industry deliver value?
- Does the industry attract, select, and retain the best ethical and technical talent?
- Does the industry explicitly reward ethical behavior to the same extent that it rewards technical competence?
- Does the industry strive for continuous improvement and innovation?
- Does the industry have a system of checks and balances with respect to continuous improvement and innovation?

Underlying the three pillars of trust (integrity, positive intent, and clear capabilities) is the need for mutual understanding and transparency. In working with executives on building trust I highlight (if they do not) the significance of mutuality, because with it comes a recognition of risk and vulnerability for all parities in the relationship. Reina and Reina (1999) base their definition of trust on the concept of mutuality, stating that trust is a "relationship of mutual confidence in agreed upon performance, honest communication, expected competence, and a capacity for unguarded interaction." Leaders must work together to clarify the mutual values, goals, expectations for performance, and communication standards. Not only must leaders identify mutuality within the industry but also with their clients, regulators, and the general public. Doing so can help foster a sense of identification with each party. When there are common values and goals, customers and clients are more willing to believe that a firm or industry has their best interest at heart. Likewise, when a firm or industry identifies with the goals and values of its stakeholders they will be more deliberate in doing what is in the best interest of those stakeholders. When there are no mutually held values, assumptions, beliefs, or expectations, the perception of imbalance in power, risk, and vulnerability pervades, and trust cannot flourish under those conditions.

The pillars of trust also require transparency, especially in an industry that to the public seems muddled and complex. Transparency is created through communication. Attempting candor and open and honest communication in the midst of a crisis is likely to be met with some resistance, particularly when doing so may reveal information that reflects poorly on the industry or reinforces a negative image. It is in these moments and under these circumstances that a leader's mettle will be tested. Part of candor is accepting responsibility for things that are of one's own making, and accepting accountability for those things that may have been beyond one's control. Moreover, information flow to various stakeholders will occur more easily when there is a norm or expectation of transparency and an infrastructure that supports communication across real and perceived boundaries within the finance community. Only once a culture of mutual understanding and transparency exists can we expect trust to proliferate throughout the industry, and when there is trust we can more readily and collaboratively respond to threats and other crisis situations.

An example of rebuilding trust after a crisis

Perhaps the most startling example of a firm overcoming a crisis, salvaging its reputation, and building trust with constituents is Johnson and Johnson (J&J) following the Tylenol tampering crisis in the early 1980s. Although J&J had a bevy of products, Tylenol alone was responsible for 19 percent of corporate profits during the first three quarters of 1982, accounted for 33 percent of J&J's year-to-year profit growth, and held a remarkable 37 percent market share. In 1982, the successful Tylenol run almost came to a halt, and along with it J&J's longstanding reputation of trustworthiness. Someone had tampered with bottles of Tylenol extra-strength capsules and replaced the original Tylenol capsules with cyanide-laced capsules. The packages were resealed and distributed to stores and pharmacies in the Chicago area.

When the tampered products were purchased and used, seven consumers died from the poisoning and J&J was immediately thrown into crisis management mode. At the time, the story of the product tampering received more media coverage than any other news event with the exception of the assassination of President John F. Kennedy. Yet, guided in large part by the culture and values of the firm, J&J's leadership focused on people first and product second (consistent with their company credo) in devising a crisis response strategy. Despite the product tampering being localized to the Chicago area, J&J focused on long term-results (i.e., customer retention and loyalty) at the risk of dramatic revenue loss by pulling the product off store shelves all over the country. They also initiated a communication plan that invited stakeholder participation in the crisis response. In the end, the firm developed a tamper resistant packaging system spawning an innovation that might not have been realized if it were not for the crisis and the transparent dialogue among stakeholders.

Although the circumstances surrounding the J&J case and those surrounding the current situation facing the financial services industry are different, an important lesson can be taken from the handling of the J&J crisis. In what could have been a tremendous reputational and financial loss for the firm, the choice to act transparently and in accordance with its values, and to demonstrate integrity, positive intent, and capability throughout the process, the firm was able to create trust. Aligning behavior with values goes a long way toward building and sustaining trust. Consider the possibilities if the financial services industry were to follow suit.

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