

THE VALUE OF TRUST

Reading time ~ 5 min.

"We look for three things when hiring people – integrity, intelligence and energy. If the first trait is missing, then we want them dumb and lazy otherwise they will kill us."

Warren Buffett

Trust raises profits by simplifying structures, accelerating processes and pacifying relations. Lack of trust, on the other hand, leads to complex processes, piles of paperwork and bloated back-office personnel. This truism applies to people, families, businesses, societies or countries.

For example, research has shown that Jewish merchants have historically dominated the diamond industry because of their ability to rely on family and community reputations instead of complex legal contracts, expensive lawyers and public courts.

What creates or destroys trust? The key to the doors of trust is transparency. All sorts of very old expressions, in various cultures and languages, about "muddy waters" indicate that people have known this for centuries. This means the concept of *Trust Requires Transparency* has passed the hardest of all tests – the test of time.

If transparency creates trust, then what destroys it? Complexity destroys trust. The word *complexity* is often hard to translate. For our purposes, complexity means complex laws & regulations, long contracts, complex links between various legal entities, complex organisational structures and business processes, to name a few.

Therefore, transparency creates trust whereas complexity destroys it. Moreover, trust and complexity are mutually exclusive. It is almost impossible to create transparency when there is complexity.

People often try to compensate lack of trust with complexity – by creating long legal contracts, by appointing people who check on other people, by creating complex organisational structure. All this is done to minimise theft or government expropriation, because there is no trust.

The trouble is that complex structures or convoluted models never reduce risks, they simply replace one type of risk with another. The risk of theft or government expropriation is replaced with risks of generating losses instead of profits (because complexity raises costs), making major errors or omissions and so on.

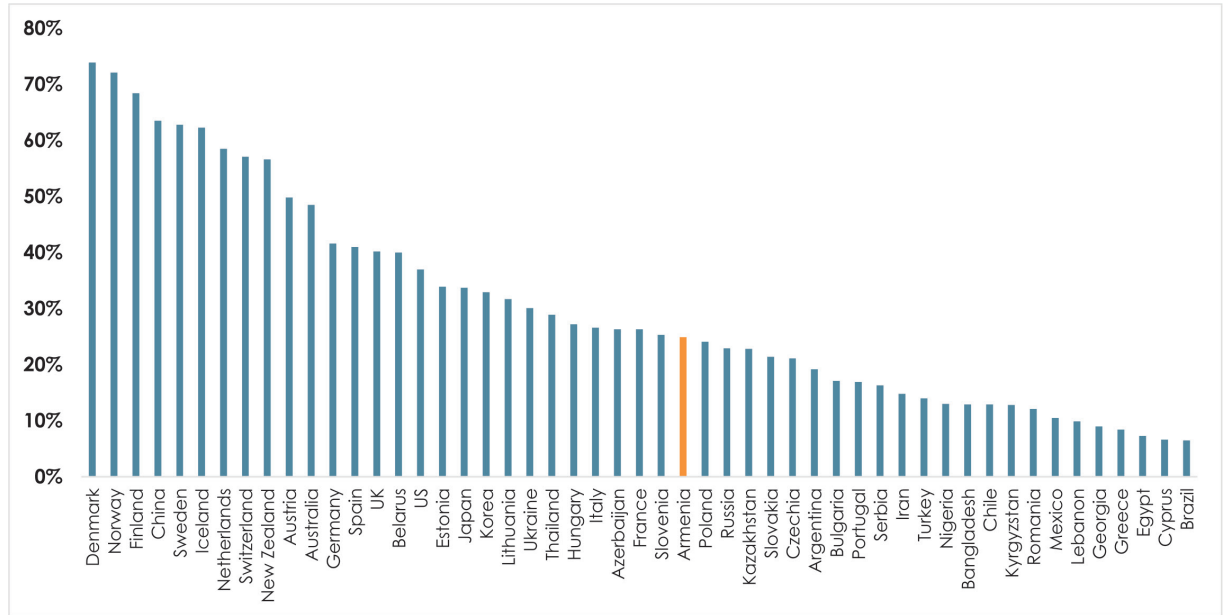
Incompetence is of course another fundamental factor that destroys trust. Incompetence combined with overconfidence is a recipe for major disasters. This is what Warren Buffett's quote, at the beginning of our note, states.

Bottom line: Lack of trust should be resolved by implementing measures aimed at creating trust. People, companies or countries, which try to replace trust with complexity are guaranteed to go from trouble to trouble.

Below see the charts on the level of trust in different countries and the relationship of trust with GDP per capita.

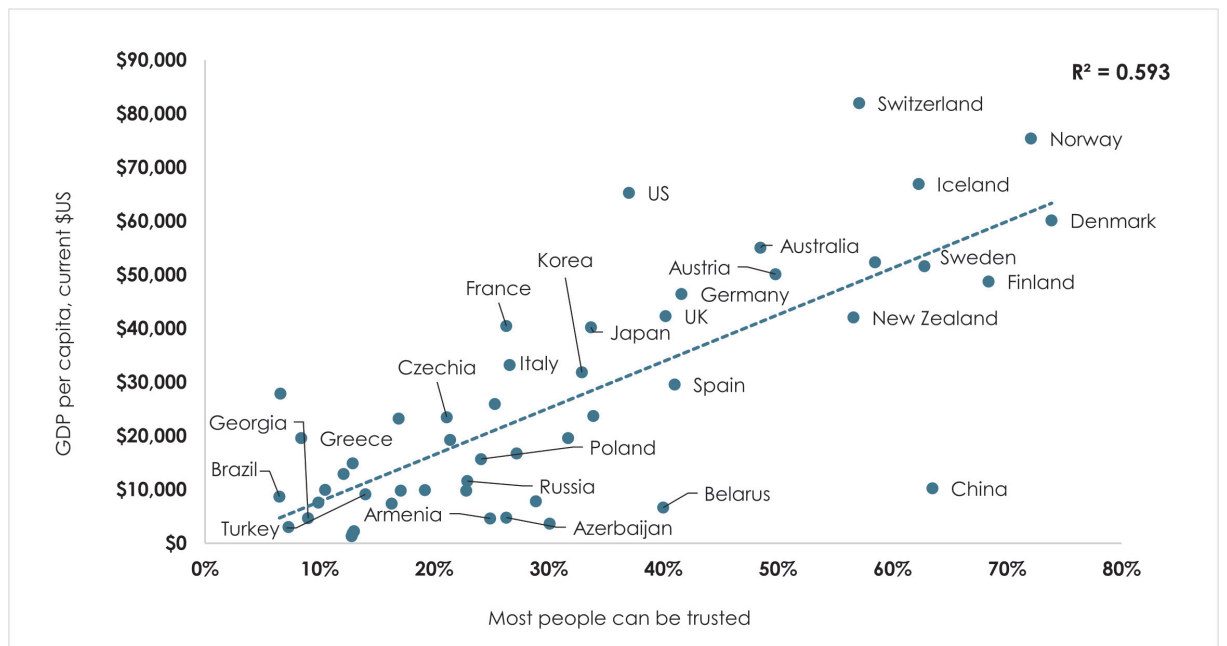


Chart 1. Percentage of Respondents Who Think Most People Can Be Trusted



Source: World Values Survey

Chart 2. GDP Per Capita Highly Correlates with The Level of Trust



Source: World Values Survey, World Bank

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