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Should Evaluations of Corporate Trustworthiness Be Trusted?

Year after year, organizations release lists of the top trustworthy companies in business. But how reliable are the methodologies used to measure whether these companies really are trustworthy and practice strong ethics?

Since the financial scandals in 2008 and 2009 that triggered the so-called "Great Recession," business organizations around the world have placed a high priority on regaining the trust of investors and the general public. In a 2009 special report titled "A Call to Action to Overcome the Present Crisis of Trust in Business," the Arthur W. Page Society—a public relations organization—and the Business Roundtable Institute for Corporate Ethics encouraged companies to take charge of their policies to build public trust, in turn lifting the economy out of the recession: "In the midst of this turmoil, the global economic crisis presents a unique opportunity for leaders to step forward and make business better. This is an opportunity we must seize."

Following that report, a number of organizations began to publish lists that indicate and rank the trustworthiness of companies. Using various definitions, standards, and measurements, the organizations generating these lists apply their own proprietary analyses—statistical and otherwise—to evaluate the management, financial, or accounting characteristics and results that each organization believes signify a company's ability to be trusted. The purported aim is to show investors and the general public which companies can be counted on to be honest, ethical, and a safe investment.

A closer look at two such lists, however, raises some questions about their reliability and accuracy. The Most Trustworthy Companies list, published by *Forbes* magazine and generated by GMI Ratings (the result of a merger of The Corporate Library, GovernanceMetrics International, and Audit Integrity), and Next Decade, Inc.'s Trust Across America (TAA) unit's list of trustworthy companies show a level of volatility that raises some concerns. Over the years, research has shown that a company's use of trust as a basic business strategy allows it to demonstrate superior performance on a number of other metrics. The application and practice of honesty, fairness, objectivity, and responsibility—the four overarching ethical principles of the *IMA® Statement of Ethical Professional Practice*—inevitably leads to an environment of trust and integrity. You would expect trustworthiness to be a long-term characteristic of an organization, based on a strong ethical corporate culture and resulting from the use of excellent governance practices. Instilling that kind of culture within a company doesn't occur overnight, however, and neither does it disappear so quickly. Following that line of thinking, an annual list of trustworthy companies would likely have some amount of consistency. Yet that hasn't been the case.

The year 2013 marks the sixth year that *Forbes* and GMI (or its predecessors) have produced the Most Trustworthy Companies list. GMI describes itself as "a clear leader in the understanding of risks affecting the performance of public companies worldwide." It uses publicly available data to drive its statistical "black-box" models that arrive at a risk score called the Accounting and Governance Risk (AGR®) Score. GMI believes this score is an effective measure of the quality of corporate accounting and management practices.

GMI says it emphasizes companies that "have consistently demonstrated transparent and conservative accounting practices and solid corporate governance and management." According to *Forbes*, GMI's use of the AGR Score "penalizes companies for unusual or excessive executive compensation, high levels of management turnover, substantial insider trading relative to their corporate peers, or high levels of short-term executive compensation, which encourages management to focus on short-term results." The weighting of these negative factors isn't disclosed, but the positive factors receive the same weight.

The *Forbes* article about the 2012 list contains more detail on GMI's methodology: To qualify, companies needed to have market caps of at least $250 million (the 2013 list also contains three microcaps), maintain AGR ratings of "conservative" or "average" over the last four quarters, have no amended filings or enforcement actions with the Securities & Exchange Commission (SEC), and no material restatements. They also had to be ranked favorably on GMI's Equity Risk Ranking and in the Bankruptcy Risk model. Supposedly, GMI's methodology didn't change significantly for 2013.

To construct the 2013 list, GMI studied 8,000 North American public companies. The 10 companies that achieved an AGR Score of 99 out of 100 are presented in Table 1 in order of market capitalization. Surprisingly, the companies named in 2013 differed substantially from those reported in 2012. None of the top 10 companies in 2013 were in the top 10 in 2012. Furthermore, only two of the 10 on this year's list were part of last year's top 100. Of the 100 most trustworthy companies for 2013, only 26% repeated from 2012.

The cause of significant, rather sudden changes in the evaluations of what should be relatively static conditions, like overall trustworthiness, could be because of either the difficulty in getting accurate measurements or the failure to measure the proper variables.

While the AGR Score may effectively reflect the probability of downside risk very well, the converse—the lack of downside events—may not be an effective measure of overall trustworthiness of an organization.

Table 1. *Forbes'* Most Trustworthy Companies

Large Cap

NetSuite Inc., a vendor of cloud computing business management software suites

Mid-Cap

Aspen Insurance Holdings Limited, a global insurance and reinsurance company

Athenahealth, Inc., a provider of integrated practice management, billing, and electronic health records solutions

Boise Cascade Company, a manufacturer of engineered wood products and distributor of a broad line of building materials

Casey's General Stores, Inc., an owner, operator, and franchisor of convenience stores, largely in the midwestern United States

Small Cap

Capstone Turbine Corporation, a producer of low-emission microturbine systems

Donegal Group Inc., a regional insurance holding company

EMC Insurance Group, a property and casualty insurance and reinsurance holding company

National Interstate Insurance Corporation, an insurer that specializes in transportation risks

United Fire Group, Inc., a regional insurance holding company

Unlike a number of organizations that prepare lists of best companies based on various characteristics, the companies on the *Forbes* list don't nominate themselves or submit private data. GMI appears to only use public information. Consequently, self-selection bias should be minimized.

The stated objective of the GMI rating is to improve the performance of investment portfolios. It seems highly unusual that trustworthiness, recognizable as a long-term qualitative characteristic of a company, would show extreme volatility in the companies rated as highly trustworthy. Use of such a volatile measure to determine desirability as a long-term investment seems highly questionable. When asked about the apparent volatility in its evaluations, GMI Managing Director Lev Janashvili said, "Ratings of trustworthiness don't need to be stable. They need to be right....The forensic risk profiles of corporate issuers can change materially based on the adoption of various accounting practices and the occurrence of high-risk events. Our model is designed to reflect these changes."

Next Decade, Inc.'s Trust Across America (TAA) unit's third annual ranking of trustworthy companies was based on public data from approximately 2,000 publicly held companies. TAA's method involves five quantitative indicators of trustworthy corporate business behavior, called FACTS® drivers: financial stability and strength, accounting conservativeness, corporate governance, transparency, and sustainability. All are weighted equally. TAA's analysis focuses on companies that work toward embedding trustworthy business behavior into their corporate culture to earn the public's trust. The result, according to TAA, is that "consumers can now choose to do business with these leading companies, while investors have an added level of protection from the next corporate misstep." TAA's top 10 companies (two tied for 10th place) for 2012, which are generally larger and more well-known than the companies in the *Forbes* list, are shown in Table 2.

Along with the report that shows the top-ranked companies, TAA also compiles a list of "Leaders by Sector," which is published in a separate document available on the company's website. This list includes 38 other companies from 16 different sectors. Only companies with at least "average" scores in each category of TAA's FACTS Framework are considered for this list. Consequently, four sectors aren't represented. Out of the 38 top companies by sector, 14 of them are given the Gold standard (first place), including seven of the overall top 10. The rest are considered runners-up. Of the various business sectors represented in TAA's listing of leaders by sector, finance had five Gold representatives (with four in the top 10) and retail/wholesale had one Gold, Green Mountain Coffee Roasters (also in the overall top 10), and four runners-up.

Comparing the top companies in TAA's lists from 2012 and 2011 finds virtually the same criticism as with GMI's lists—significant volatility rather than expected consistency. The only company that appeared on both lists is Nike, which took third place in 2011 and dropped to seventh place in 2012. Since TAA only reported the most trustworthy companies for 2011, it wasn't possible to perform a more complete analysis of consistency.

Changes in trustworthiness rankings may be caused by many factors—some of which might not be the fault of the company itself. On August 2, 2013, the SEC announced it had filed insider trading charges against a former manager of Green Mountain Coffee Roasters, the top-ranked company on TAA's 2013 list. A former IT manager for the company and an accomplice had access to earnings releases before they became public and garnered $7 million in illegal profits by correctly "predicting" GMCR's stock price reaction in 12 of 13 cases since 2010. "We are appalled at the alleged actions of this individual," said Brian P. Kelley, president and CEO of GMCR. "The alleged conduct of this individual is in violation of these policies and goes against our culture, our values, and everything the employees of GMCR stand for."

Forbes and TAA have taken important leadership roles in defining and measuring trustworthiness, a critically important aspect of business and society in general. Yet in light of the continuing divergence of opinions and constant sudden change in companies recognized, much more effort needs to be expended on setting the standards for the characteristics of a trustworthy company and gaining consensus on how to measure them appropriately. Only then will investors, creditors, and other stakeholders be able to utilize a designation of trustworthiness with confidence and make better decisions. **SF**

Table 2. TAA's Top 10 Trustworthy Companies

1. **Green Mountain Coffee Roasters**, a processer of specialty coffee and vendor of coffee makers
2. **Progressive Insurance**, one of the largest auto and casualty insurance groups in the country
3. **Hartford Financial Services**, a property and casualty insurer
4. **Western Digital**, a manufacturer of computer hard drives
5. **Teradyne Inc.**, a designer and manufacturer of automatic test equipment
6. **Capital One Financial**, a bank that offers diversified financial products
7. **Nike, Inc.**, a marketer of athletic footwear, apparel, and equipment
8. **Unum Group**, a provider of employee benefits programs
9. **McKesson Corp.**, a provider of healthcare services
10. (tie) **Prudential Financial**, a provider of financial products and services
10. (tie) **McGraw Hill**, a publisher of financial information and media services

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