The dark side of trust

By and large, trust is a good thing. But there can also be too much of a good thing. One needs to look no further than the scandal involving disgraced Wall Street financier Bernard Madoff to appreciate the detrimental effects of misguided or excessive trust, for which there are dire consequences.

"I think the Madoff affair was clearly a case of excessive trust - trust in individuals, trust in institutions, trust in mechanisms, says Martin Gargiulo, Associate Professor of Organisational Behaviour at INSEAD. "People were not monitoring (what Madoff was doing). The interesting thing was everybody thought someone else was doing it."

Madoff has since been sentenced and is now serving a 150-year prison term for operating a $65 billion Ponzi scheme that defrauded many unsuspecting investors, some of whom lost their entire life savings.

How did this come about? Gargiulo, who co-authored an article ‘The Dark Side of Trust’ believes it centres around the issue of trust - which in itself, he says, has an interesting dynamic, because “the dark side of trust is the mirror image of the benefit of trust.” In other words, the detrimental effects of trust are also closely linked with its purported benefits.

Finally, trust is associated with an expansion of the scale and scope of the exchange between the parties.

While these sound good in principle, it can go awry if too much trust is involved. “We typically tend to look at trust as a positive thing; we all would like to live in a high-trust environment … but the three benefits can also become liabilities,” Gargiulo told INSEAD Knowledge.

Excessive trust can lead to blind faith which then leads to the removal of safeguards and reduced monitoring levels beyond an optimal threshold. Parties to a high-trust relationship are also both less likely to perceive objective deteriorations in performance and will take longer to engage in appropriate corrective action. Finally, too much trust can lead to unnecessary obligations that act as added constraints for the party doing the trusting.

While trust can generate greater opportunities for cooperation, it can also give rise to opportunistic anti-social behaviour like malfeasance.

Gargiulo explains: “If we lower monitoring costs too much – we can use the resources for other purposes, yes – but you also create opportunities for some people to act in a way that defaults on the trust that
we place in them.”

“Malfeasance requires high trust – that’s the paradox … (Ironically) if you are in a low-trust environment, it is very difficult to commit fraud, because nobody trusts you.”

Gargiulo believes that Madoff’s deft art of deception was also largely facilitated by his rich social networks. “Madoff didn’t come from nowhere to sell funds; he started selling funds to (New York’s Upper East Side Jewish) community to which somehow he was a member of.”

This, Gargiulo says in his paper, is one of the ideal conditions to engender feelings of trust, as trust is more likely to occur between like-minded parties who belong to the same cohort. “Those closed networks may give the presumption that everything is going well … If everybody else thinks that somebody else is watching, nobody needs to watch,” he explains.

What’s interesting, Gargiulo adds, is that once Madoff established his reputation within this community, he started to branch out. Lured by good returns, investors were seeking him out, and suddenly he was in the midst of a very large network of investors spreading not just within the US, but to Europe and beyond.

That Madoff was a former chairman of the NASDAQ stock market also increased his credibility, putting him above suspicion. In fact, investors excessively committed to the funds that Madoff was managing – blatantly violating the principle of putting all your eggs in one basket.

There was also what Gargiulo calls, a blind faith in market mechanisms. “We tend to forget that those are human institutions too.”

What Gargiulo advises to do is to strike a balance by doing the right amount of monitoring, although he admits this can be very difficult in a context in which the naysayers are regarded as “crazy”.

“Because everybody believes in something, that doesn’t make it true. You have to ask the hard questions; they’re hard to ask because it takes time and energy (on) our part.”

Martin Gargiulo is the Programme Director for Management Acceleration Programme

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