

Integrity And Firm Performance – Only Time Will Tell

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Jack Welch, who led General Electric for two decades of great success, tells us in his book “Winning”, that integrity is his secret sauce for running a business. Integrity has the meaning of seeing oneself truthfully. This leads to profound consequences: being able to see your strengths and weaknesses, needing an open heart and true courage.

For a leader, this means the ability to acknowledge the boundaries of his/her ability to lead – so we don’t omit risks or bypass opportunities. For an investor, it is to admit the uncertainty of the future and to respect the market. For a corporation, it means a culture where people act truthfully.

Integrity is also the central idea that underpins corporate behaviours regarding business ethics, corporate governance mechanisms, and Environmental, Social, and Governance (ESG) practices, all of which are key to sustainable performance in the long run.

Better Efficiency

A corporate culture infused by integrity often leads to greater efficiency.

On one side, a culture of integrity means that employees can put more trust in leaders and colleagues and find their job to be meaningful. Guided by the culture of integrity, people are more likely to embrace policies, rules, and regulations because of better alignment between personal and corporate values. Peter Verhezen, in [this influential article](#), argues that moving from a compliance-oriented culture toward an integrity-oriented culture enables employees to speak up when corporate values are violated. In other words, under such a culture people are more likely to point out the “elephant in the room”.

Even in scenarios of conflict, a culture of integrity leads to more thoughtful and meaningful disagreement rather than emotional defence and attack. With a willingness to see things as they are, we are more likely to act on facts, instead of ancient instincts of aggression. Ray Dalio has [shown us](#) a very good example, when transparency was infused by a culture of integrity, leading to optimal solutions in running one of the largest hedge funds in the world – [Bridgewater Associates](#) has a culture that relies on “truthful and transparent communication to ensure the best ideas win out”.

The Test Of Time

Like many things in life, Integrity is much easier to talk about than act on – for both a person and an organization. [René Descartes](#) has been quoted as saying that “to know what people really think, pay regard to what they do, rather than what they say”. How to test whether someone puts what they say into what they do? – Only time will tell.

We have witnessed too many cases when a corporate empire emerged quickly to the top of the world, and then collapsed in the blink of an eye. Many corporate collapses have resulted from corrupted business culture and lack of integrity at the top. Under pressure from investors, and sometimes driven by personal incentives, managers suffer from the tendency to inflate short-term but unsustainable performance.

Accounting fraud is often involved. In a typical case, the story usually starts with a small alteration of the financial accounts, which is then covered by a slightly larger element of manipulation, which leads to more significant alterations, and on and on. Once the loop has started, there is less chance of turning back.

A recent case relates to June 2020, when [Wirecard AG](#), a multiple-billion German financial service provider, announced that 1.9 billion euros were “missing”. The company’s financial accounts were audited just a few months earlier by a big accounting firm where no inconsistencies were identified. The company ended up in liquidation and several executives were arrested.

Another recent case is [Luckin Coffee](#), which managed 4508 kiosks in China, more than Starbucks. The company was targeted by a famous short-selling firm, [Muddy Waters Research](#), which reported that Luckin has been overstating its financial and operational figures to maintain its image of a high “growth” company. Following that, Luckin’s stock price dropped from its highest point of 50 USD to 1.39 USD. The company was then fined \$180 million by SEC and was removed by NASDAQ in the same year.

Short-selling companies, like Muddy Waters Research, do not lead to such collapses. They act simply as the whistleblower, uncovering problems which were probably always there, waiting for people to discover. There is a long history of corporate failure that is associated with accounting fraud, and, usually, it is just a matter of time until the music stops.

Good For The Long Run

Integrity matters and it has an impact on firm value over the long run. There is no direct measurement of corporate integrity, while an indirect measurement is a company’s Corporate Social Responsibility (CSR) practices. It is commonly established in the academic literature that companies with robust CSR practices usually enjoy a higher market premium (e.g., [Ghoul, Guedhami, Kwok, and Mishra 2011](#); [Jo & Harjoto 2011](#))

Larry Fink, the CEO of BlackRock, [in his letter](#), points out an emerging trend: investors increasingly prefer companies with a focus on sustainable performance. This is evident as investors of mutual funds and exchange-traded funds (ETFs) were holding \$288 billion in sustainable assets around the world in 2020, a number that is 96% higher than 2019.

A culture of integrity goes a long way to ensuring robust company performance in the long run. As Mark Twain reminds us, “if you tell the truth, you don’t need to remember anything”.



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