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The challenge of protecting reputation

Risks to reputation can be among the most damaging a company can face. But because they are often intangible, they can also be extremely difficult to manage

Why is it so easy for executives to think about and plan for financial risks, but still so hard for them to understand that intangible risks to an organisation's reputation are far more likely to destroy shareholder value?

Consider recent crises at companies such as Wendy's, the fast-food chain, where a customer alleged that a severed finger was found in a bowl of chilli; at Boeing, where former CEO Harry Stonecipher was ousted after having an affair with an employee; and at Parmalat, where money was being siphoned off to family members. In each case, you will understand how devastating the challenges to a corporation's reputation can be, both financially and in terms of the inevitable and incessant media coverage.

Some of this ignorance about threats to a company's reputation stems from a lack of understanding about what the potential risks might be but, more likely, it relates to the emphasis in business on that which is measurable and tangible.

In short, managers should keep in mind Antoine de St Exupery's exhortation on the ephemeral: "What is essential is invisible to the eye."

◆ What is reputational risk?

In the past few years, there have been many attempts in books, articles and works by management gurus to define reputational risk, but no universally accepted definition exists. Part of the problem is that few truly understand what comprises an organisation's reputation in the first place.

Simply stated, reputation is based on the sum of how all constituencies view the organisation. Constituents'

assessments are based on the identity of the organisation, including statements about vision and strategy as well as actions over time; perceptions of the organisation from others, including pollsters and credible third parties; and performance, such as profitability and social responsibility.

Reputational risk, then, is a potential loss in reputation that could lead to negative publicity, loss of revenue, costly litigation, a decline in the customer base or the exit of key employees. A comprehensive reputational risk assessment is an estimate of the organisation's current standing across all its constituencies and its ability to operate successfully in the current environment.

Some companies seem to value this more highly than others. Goldman Sachs, for example, states very prominently in its Business Principles that: "Our assets are our people, capital and reputation. If any of these are ever diminished, the last is the most difficult to restore." Perhaps Goldman's clear understanding of and adherence to this principle explains why the investment bank has one of the most stellar reputations of any organisation in the world.

Strong reputations at companies such as Johnson & Johnson, The Virgin Group and Porsche lead to measurable results. According to research from the Reputation Institute, a US consultancy, organisations with solid reputations are likely to have stronger and more stable returns, an easier time hiring and retaining the best recruits, and a greater likelihood of enduring the challenges of a crisis.

◆ Managing reputational risk

CEOs like to believe that it is their responsibility to manage reputation. According to a survey of 200 companies conducted by the public relations

firm Hill & Knowlton and recruiters Korn/Ferry, nearly two-thirds of CEOs worldwide say that it is their personal responsibility to manage the company's reputation.

However, although most senior executives would agree that reputation is important, no single person or position is ultimately responsible for managing reputation and assessing its risk on a day-to-day basis. Sometimes that means that no one really assumes the responsibility. In that case, when reputation is threatened, no common framework exists for understanding the relevant attitudes within and across constituencies. As a result, before it can even begin to defend or regain momentum, the organisation inevitably burns up valuable time and opportunity in an internal struggle to reach a consensus about the state of its reputation.

In this reactive mode, it is almost guaranteed that the organisation will not have the full view of the context within which its reputation operates, and therefore will not deal with all its reputational assets. Only the loudest or most critical constituencies get addressed in those situations, which raises the risk among other constituencies. As a result, without skilful handling, an attempt to protect reputation can easily backfire.

Other than the CEO, possible candidates for managing reputation include a company's board, corporate communication departments, those closest to the organisation's key constituents (marketers for customers, investor relations officers for shareholders and so on), and specially appointed czars, such as chief reputation, chief marketing and chief legal officers.

Our research and experience shows, however, that having an engaged CEO along with a cross-functional task force is often the best insurance a company can have as it attempts to assess its reputational risk.

◆ How to assess threats and set priorities for reputational risks

No matter who is in charge or what process an organisation uses to prevent risks from becoming a reality and turning into the inevitable crisis, executives

need to think about threats in advance and set priorities in terms of their likelihood, potential severity and the company's ability to respond effectively. In addition, the way in which a company responds to a crisis will often determine whether its reputation improves or declines after the event.

◆ Assessing threats

Reputational risks fall into three categories: natural disasters, such as earthquakes, fires and hurricanes (how the company responds represents the risk); man-made fiascos, such as ethical violations (for example, Martha Stewart's questionable trades); and attacks from antagonists (such as attacks by the Centre for Science and the Environment, an Indian environmental group, on Coke and Pepsi).

Your company can and should prepare for such threats and determine a credible response. For example, airlines know that crashes are a possibility and can plan what to do if an accident happens. A recent Air France crash offers an excellent example of how being prepared can enhance a company's reputation.

In early August, when an Air France Airbus crashed at an airport in Toronto after landing in a thunderstorm, flight attendants were able to evacuate safely over 300 passengers in just over 90 seconds before the plane was engulfed in flames. By chance and good preparation, everyone survived the crash. Air France immediately and actively communicated the situation, and news networks around the world extolled the virtues of the flight attendants' preparedness for the calamity, rather than speculate about why the crew was unable to control the airplane.

On the other hand KPMG, the accounting and professional services firm, was seemingly unprepared when accused by the US Department of Justice of "demonstrating a concerted pattern of obstruction" in relation to questionable tax shelters and advice. Its actions following the accusation included withholding and delaying the release of documents related to the probe and obscuring its role in advising clients on questionable tax shelters.



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◆ **Setting priorities**

Today, risk management and crisis communication experts can help companies see the danger on the horizon and plan responses in advance. In my own work, I have found that clients with cross-functional teams can easily determine in a brainstorming or work-out session what the key reputational risks are for individual business lines, create an approach to "managing" those risks and work towards preventing problems before they even happen.

The previously mentioned KPMG incident offers an excellent example of how companies should be anticipating and assessing threats and, more importantly, setting priorities to avoid reputational risk. Given Arthur Andersen's scandal and ultimate dissolution, KPMG should have known that obstructing an investigation by the Internal Revenue Service could lead to serious reputational damage. The company should have seen this risk as a priority, co-operated with authorities immediately and thought about how to respond if attacked.

Executives should also keep in mind that business operates in an increasingly transparent environment. Non-governmental organisations, such as Greenpeace (focused on environmental issues) and Global Exchange (focused on fair trade), are monitoring business more closely, which means that companies need to be on their best behaviour at all times. Assessing possible threats to reputation and setting priorities in advance through collaboration with such organisations can help put a company in a better position before it finds itself in a crisis.

Given the potential scope of problems that companies face, executives will need to adopt a holistic approach to reputational risk by looking at the entire company - no easy task for large, complex organisations operating with huge workforces around the globe. Many companies focus only on one question: what would be the negative impact on the share price? Those organisations tend to respond immediately and aggressively if the share price is likely to be affected, but less so if the threat involves something more intangible, such as the morale of employees.

That is short-sighted because the more intangible issues can lead to even bigger problems for companies in the long run. Look at what happened to the accounting firm Arthur Andersen. Few could have imagined that its loss of reputation as a result of questionable actions in relation to clients such as Enron would have put the once-prominent accounting firm out of business, but it did.

◆ **New communication channels can damage reputation**

New technologies have made the situation even more complicated for companies trying to manage their reputational risk. Think about how

much faster information about companies travels through the internet, text messages and blogs. Today, if they are monitoring the right channels, your key constituents may know more about what is happening in your company than you do.

Over 20,000 blogs are created daily, which means that anyone who is unhappy with your company can not only tell their friends and family but also instantaneously broadcast their message to the entire world.

Christina Pikas, a librarian at The John Hopkins University, explained in a recent article in the trade publication Online that: "It's not the large number that creates the stir over blogs. Their power comes from the speed of information diffusion, their low barrier to access and the reader's ability to scan many blogs through XML feeds. The vast majority are not journalistic endeavours or political advertising. Blogs are as individual and unique as their writers - and can damage your company or brand very quickly." And the news cycle for a blog, which is the time from when an event happens and then gets posted on a blog feed, is now down to seconds instead of the weeks it took for many Americans to learn about the assassination of Abraham Lincoln in the 19th century.

Service providers who monitor blogs can aggregate and distribute news updates to subscribers hourly, which means that a story will be delivered to your computer or mobile phone without even asking for it. Thus, reputational attacks against a company can be almost instantaneous.

Most companies are unwilling to respond with the same speed, for reasons such as the bureaucracy inherent in large organisations; regulations such as Regulation Fair Disclosure, which has forced listed companies in the US to be more transparent, but also more careful with their communications; and lawyers, who are always questioning the release of any material information.

◆ **Potential effects to reputation**

The result of all this can be devastating to corporations operating in today's transparent, high-speed environment. Four possible effects of an attack on reputation include drop in share price, decline in market share, difficulty recruiting talent and discontent in the communities in which the company operates.

● **Share price decline** As the scandal around insurance and professional services giant Marsh McLennan broke in the media, its stock price fell by 40 per cent. In addition, credit rating agencies, such as Moody's Investor Services, downgraded the company's debt due to its failing reputation.

● **Decline in market share** Perrier was once the leading brand of sparkling water in the US. However, after a contamination scare in the early 1990s, which was poorly handled by the company's executives, the company lost

most of its market share and has never been able to regain its dominance. Compare this with Johnson & Johnson, which reacted swiftly to attacks on its Tylenol product in the 1980s. Tylenol remains the dominant brand of acetaminophen in the US, and Johnson & Johnson has been rated top in terms of corporate reputation five times in a row in a poll by Harris Interactive, a market research company.

● **Difficulty recruiting talent** Companies involved in reputational crises also have difficulty retaining and recruiting talent. US investment bank Morgan Stanley has seen an exodus of top talent following challenges to its leadership that led to the ousting of its chairman and CEO, Phil Purcell. And one can only imagine what the effect on recruiting will be for the once squeaky-clean investment bank as it tries to attract top talent from business schools this autumn.

● **Discontent in communities** Finally, companies can only operate in the communities in which they are present with the goodwill of the people. A loss in reputation can make a company a pariah in the community as chemical companies, nuclear power plants and paper companies have all learnt over the past 20 years. Not only is local pressure a problem for companies, but community discontent also fuels a legislative and regulatory reaction that potentially limits companies' ability to operate.

◆ **How should companies manage reputational risk?**

So what can you and your company do to manage reputational risk? The solutions are as simple as those for managing health risks for individuals, but equally daunting in today's financially oriented environment.

● **Prepare for potential problems** First, prepare for problems by following issues that are likely to affect your industry, monitoring websites and blogs related to your business, developing scenarios with outside consultants who are experienced in tracking such risks and brainstorming with experienced managers who know their individual businesses.

For example, companies in financial services providing loans to questionable accounts know that they run the risk of giving money to people who will not pay. The way in which the company deals with those customers will determine how constituents view it and whether or not they regard it as a reputable provider.

● **Develop a crisis management process** Second, develop a process for dealing with crises in your company. You can easily determine in advance who the right spokesperson is for a given situation, how you will notify key personnel in the event of an incident, which media you will need to contact and what approach you will take to solve the problem you are facing.

● **Plan your responses** Third, plan responses to the problems uncovered

in the preparation phase. If you know what the potential danger zones are, you can plan responses to most of the problems that are likely to occur and run simulations to see how you would perform under pressure.

Many companies run training sessions for senior managers that include videotaped trials of responses, make financially oriented managers sensitive to the possible dangers that lurk on the horizon and offer a venue for putting together a response to potential risks.

● **Analyse constituencies** Fourth, look across constituencies on a regular basis by actively tracking issues and trends that are the context for every organisation's reputation. Make the review and discussion of this information a regular component of executive committee discussions across business units, so there will be a current, common framework in the organisation for understanding the potential impact of reputational threats.

● **Provide as much certainty as possible** Finally, remember that reputational attacks almost always lead to an inevitable paradox: the company wants to say as little as possible to manage its risk and avoid exposure while its constituents want to know as much as possible so that they can understand the situation completely.

Peter Verrengia, president of the US eastern region at Fleishman-Hillard, a communications consultancy, suggests that companies can deal with this paradox by following his "certainty principle". He advises companies to "recognise that people want certainty about future outcomes. If they cannot have certainty immediately, they want to know when you will be able to provide it for them. If they can't get it from you, they will look for such certainty from other authorities. If none exists, they will at least want certainty about the process that someone will use to resolve the problem and what milestones will indicate progress."

By that principle, corporate America moved from ignoring the concerns of investors and the reputational impact of financial opacity, to the certainty of Sarbanes-Oxley regulation, provided by legislators and regulators, and the prospect of multi-million dollar legal settlements through the courts.

As Jack Welch, former CEO of GE said recently in a speech to my students: "Perception is reality!" Companies, however, often assume that their own perception of reality is sufficient, and underemphasise the importance of their constituents' perception of reality.

Remember that in a world of instant information flow, increasingly negative perceptions of business and greater complexity, how your constituents perceive what you are doing is as important as what you are actually doing to solve the problem itself.

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