

REPUTATION RISK

A RISING C-SUITE IMPERATIVE



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- WHY REPUTATION RISK IS IMPORTANT
- WHAT DETERMINES IMPACT
- HOW POTENTIAL IMPACTS CAN BE MITIGATED
- OWNERSHIP AND RESPONSIBILITY
- ACHIEVING RESILIENCE

TEN TAKEAWAYS

1. Reputational damage stems from a breakdown of trust. It challenges the perceived strength of a company and its management, and undermines relationships with key stakeholders.
2. Companies are exposed to reputational damage even when they have done little wrong. Conversely, a strong market position or brand may mitigate impacts even when a company is at fault.
3. An impaired reputation can affect companies in different ways over different time horizons. Assessments of potential damage should distinguish between visible effects such as share price, earnings, and balance sheet consequences, and the less measurable impact of continuous brand degradation.
4. Attempts to quantify reputational risk rigorously are fraught with difficulty. The use of scenarios can help companies gauge the potential magnitude of incidents and identify mitigation opportunities.
5. Reputation risk management involves more than just effective communication. In addition to external relations activities, it requires the integration of enterprise risk management practices, a strong operating culture, and corporate preparedness.
6. Good corporate behavior is the best safeguard against reputational challenges. Establishing a culture that is ethical and mindful of risk requires committed leadership, as well as processes and structures that allow less tangible values to flourish.
7. Chief Executives should set the tone from the top in building corporate resilience to reputation risk. They must also show visible leadership in a crisis and commit the company to putting things right.
8. A mishandled response to a crisis can generate more reputational damage, and spur greater financial consequences, than the incident itself. This is especially true when the response appears to undermine the company's core values.
9. As they recover from a reputational crisis, companies need to find an astute balance between ongoing sensitivity to stakeholders and hard-edged commercial decisions, to avoid underestimating or overestimating the scale of the predicament.
10. Brand development work can strengthen corporate resilience to reputation risk or recovery from an incident only when communication efforts are underpinned by tangible strategic, governance, and operational commitments.

Every month another major corporate mishap hits the news and sets off a complex chain of repercussions. An industrial accident. A revelation of unethical or criminal practices. A product recall. An extended service outage. Company reputations are in the spotlight like never before. Recent years have witnessed an explosion of social media commentary, strong interventions by regulators, and high-profile pressure group campaigns. At the same time, changes in the global economy have arguably made the risk landscape for businesses more complex – dependent on moves into new markets, longer supply chains, higher-risk operations, and increased pressure on costs.

Against this backdrop, companies need to re-examine their exposure to reputational challenges and their ability to respond to potential crises.

The best management frameworks are embedded long in advance of any crisis and approach reputational risk from multiple perspectives to identify both vulnerabilities and solutions. They are, moreover, led from the very top of the company and driven through the business units and functions. Without a strong framework, events can quickly spiral out of control and have far-reaching consequences for companies and their leadership.

Today's corporate preoccupation with reputation risk mixes a 21st-century view of brand economics with a more time-honored sense of propriety. The topic is firmly on the radar of executives and boards, who recognize that their company's reputation is an asset to be protected and nurtured, and that failings may be swiftly punished. Nonetheless, executives still struggle in assessing the risk and translating their understanding of the issues into clear, meaningful action.

Various analytical methodologies can be used to identify the percentage of a company's value that resides in its brand, and countless publications reaffirm the old adage that reputation takes a long time to build but can be destroyed overnight. It is often assumed that reputation risk is as monolithic as reputation itself. In fact, reputational challenges tend to be fluid and fickle. Threats can spring from many different sources (see Exhibit 1), and stakeholder tolerances can fluctuate.

Potential crises can take a range of pathways, giving rise to unanticipated consequences. Like a wildfire, incidents can quickly spread out of control, or they can suddenly fizzle out. The same type of event might burn one company very badly, while another might manage to ride it out with ease. In short, threats can be hopelessly underestimated and wildly overstated in equal measure.

This article combines insights from our own client experience with a review of multiple, well-publicized incidents. The piece starts by considering how reputational issues can affect businesses. It then analyzes the different factors that influence impact. This is vital for ensuring that risk management frameworks are anchored in a proper understanding of the potential damage. The final two sections set out the key characteristics of such frameworks and identify roles and responsibilities that must be allocated within a company.

Exhibit 1: Types of events giving rise to reputational risk*

Bad conduct

- Disreputable exposure to controversial clients or countries
- Misuse of customer data or information
- Doing business in an unethical manner
- Misrepresentation of company position to the market
- Illegal or fraudulent activities by rogue individuals/groups
- Workplace violence

Questionable judgment

- Unexpected exposures in non-core markets
- Unfortunate behavior by company leaders
- Overly aggressive tax avoidance and other regulatory “bending”
- Excessive executive compensation
- Business activities that contradict core brand values
- Mishandled response to operational/conduct failure

Operational shortcomings

- Major product or service quality failure
- Badly executed business strategy
- Poor customer relations
- Non-performance of core infrastructure (including IT)
- Poor labor standards and approach to labor issues
- Local or larger disaster caused by the company or its suppliers
- Business disruption from a natural or man-made disaster

External attacks

- Collateral damage from a peer company incident
- Incorrect or unfounded rumors and accusations
- Negative public remarks by politicians/public institutions
- Protest group opposition to business activities

* Actual events may overlap between these categories.

Source: Oliver Wyman

REPUTATION RISK: WALKING AROUND A DEFINITION

Reputation risk can be awkward to characterize. For some people, it is a specific risk with clear drivers and tangible business consequences, even if these are hard to quantify. For others, it is a risk of risks that does not exist on a standalone basis. A third perspective is that reputation risk is not a risk at all, simply an outcome of other risks.

Between them, these three views capture the essence of reputation risk. There are few reputational threats that are not intertwined with one type of business problem or another. Indeed, reputation risk most often appears as an amplifier of other risks and corporate vulnerabilities. In turn, however, reputational damage can provoke other risks, thus giving rise to additional challenges.

In assessing financial impacts, it is necessary to separate out the reputational amplifier from the operational losses and the associated costs of the underlying incident. It is additionally important to distinguish between the share price, earnings, and balance sheet consequences of a crisis – each of which differs in behavior and tends to crystallize over different time horizons.

Boards and senior management are also mindful of less tangible, but potentially lasting, outcomes such as negative external perceptions of corporate ethics and a degradation of the company brand, even if no immediate concrete damage from a particular event can be discerned.

WHY REPUTATION IS IMPORTANT

Unchecked, reputation risk can undermine corporate standing and financial performance in a multitude of ways over both the short and long term.

Reputational damage stems from a downward revision of expectations about a company. Strictly speaking, the upshot of such damage does not include the operational losses, imposed penalties, and recovery or restitution costs directly associated with an incident – these are the impacts of first-order risks, such as conduct failures. Reputational damage results, rather, in the diminution of corporate value, constrained future opportunities, and an increased cost of future business that are a consequence of how the company is perceived following an incident.

Negative perceptions destabilize the previously assumed strengths of a company – its strategic positioning, technical competence, and the hard financials of quarterly performance. This reevaluation also often casts aspersions on the judgment of a company’s senior management and possibly the Board – the depth of their knowledge of the business, their attention to detail, and the quality of their governance.

A breakdown of trust and a loss of confidence lie at the heart of the matter, adversely affecting the behavior of key stakeholders. Existing or future customers, who are anxious about a certain product or service, or who do not want to be associated with a tarnished brand, may withdraw their business, leading to a decline in market share. Suppliers may be unwilling to offer the same terms of business as they previously did. Employee morale may dip, and it could become harder to attract top talent. Regulators may tighten their expectations of

12.6%:
Proportion of sudden stock price drops that are related to reputation, image, pricing, and presence in the market*

* A “stock price drop” is defined as a drop in the company stock price that is greater than 20% within a 10-day period relative to changes in the industry average. Stock price drops from reputational damage emerged as the largest category in the study.

Source: Wharton, Corporate Strategies for Managing Catastrophic Risks in the S&P 500 (preliminary study), 2013

the company and even the whole sector. Shareholders may take a dim view on all of the above, including the strength of management, and decide to withdraw their capital. Some institutional investors will actively seek to influence company policies where they fear existing behaviors will lead to value erosion over the long term.

The harm from these actions can be very significant and will vary over different time horizons. The short term might see a dip in the share price, cash flow or liquidity impacts, and revenue loss due to customers switching to competitors – temporarily or permanently. From a strategic operational perspective, the intermediate term might see an inability to secure major contracts, the need for significant relationship-building efforts with key stakeholders, or a major technology or process overhaul.

From a financial perspective, key indicators (such as debt ratios) might come under threat, and the company might experience lower creditworthiness, a higher cost of capital, and the possible need for asset sales or capital redeployment.

Long-term concerns might include a failure to recover market share, excess caution in launching innovations, multiple foregone opportunities (known or unknown), and the threat of takeover. In the worst-case scenario, when the reputational damage is so devastating that future commercial operations are no longer sustainable or permissible, the outcome can be company death.



INCIDENTS AND IMPACTS – CASE STUDY INSIGHTS

- **UBS – rogue trader (2011):** The announcement of trading losses of more than \$2.3 billion quickly led to a further decline in the bank’s share price versus competitors, greater regulatory scrutiny, and the resignation of several business leaders (including the CEO). The incident influenced subsequent decisions to reduce the risk profile of the bank and shift the investment bank division’s focus away from trading and toward private banking.
- **News Corporation – phone hacking (2011):** Widespread outrage about admissions that the *News of the World* newspaper in the UK had accessed the voicemails of hundreds of celebrities and victims of crime resulted in legal claims and redundancies costing in excess of \$340 million. Additional damage included the closure of the newspaper, 30%-40% lower sales and advertising revenues in the replacement paper, a government block on the parent company’s attempt to take full ownership of the broadcaster BSkyB, and increased regulatory scrutiny of journalistic practices.
- **BP – oil spill (2010):** The blowout on the Deepwater Horizon rig saw numerous impacts beyond the operational losses from containment and cleanup. In financial terms, this amounted to a 50% fall in the share price and a failure to pay dividends for three quarters, litigation with individuals and affected US states running to more than \$42 billion of payouts, and the need for \$38 billion in asset sales. In strategy terms, the company signaled an exit from solar and wind, and was banned from applying for new government contracts in the US. The firm fell from being the second to the fourth-largest oil company worldwide by market value.
- **Toyota – defective accelerators and brakes (2009-2011):** The requirement to recall more than 14 million vehicles worldwide led to an estimated global loss of \$2 billion in repairs and lost sales, in addition to at least \$1.1 billion in litigation, settlements, and fines. The automotive manufacturer’s US market share tumbled from a market-leading 17% in early 2009; and in 2012, the company sat in third place with 14.4% behind Ford and General Motors.



WHAT DETERMINES IMPACT

Understanding how reputational crises may arise, and the conditions for a perfect storm, is critical for developing response strategies.

History shows some reputational disasters that have seriously impaired a company's ability to operate in the marketplace. On the other hand, other equally high-profile incidents have had minimal (sustained) impact on companies' share price and long-term growth prospects.

In our view, the power of reputational issues to amplify the damage from an incident is determined by five factors (see Exhibit 2). These relate to the event itself (its origins and characteristics), the broader context (the particular situation of the company and external influences), and the quality of the company's response to the incident. These factors can be used by companies to assess the potential damage from particular events and shape the response agenda.

EVENT-BASED FACTORS

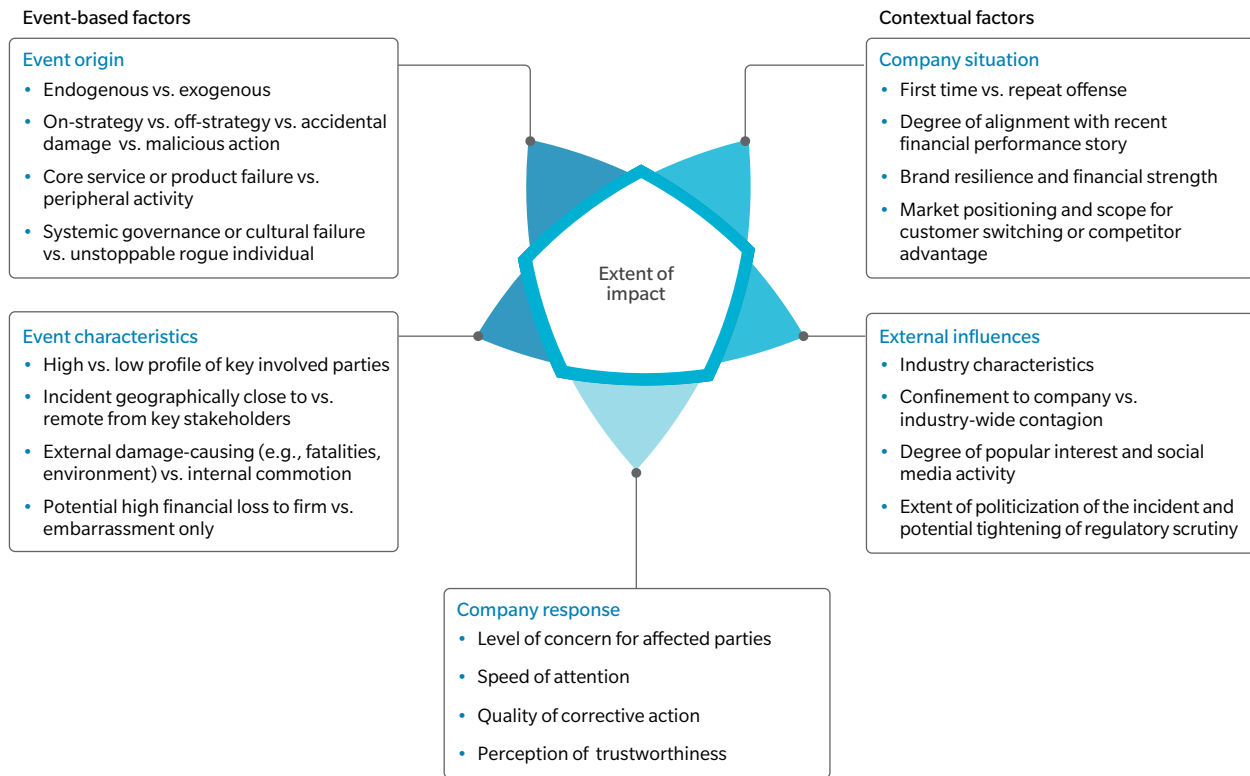
Regarding the **origin of an event**, it is generally true that the closer an event is to the heart of a company's operations, the greater the concern of stakeholders. Thus an event pertaining to unsuccessful strategy

execution, or the failure of key products and services, will spark questions about the core competence of the company and its reliability in delivering against its goals and targets. On the other hand, an incident arising from an off-strategy activity will inevitably beg questions about the wisdom of engaging in that area. Indeed, off-strategy incidents are often more penalized than on-strategy incidents.

Being the victim of an external event or accident might be regarded as bad luck, and forgiven, provided the damage cannot be ascribed to poor management judgment, security weaknesses, or an inherent vulnerability in the company's market positioning. Indeed, when the source of the incident is internal, events that can be construed as the consequences of systemic governance or cultural failures will always be viewed more poorly than pure shocks that good practice might reasonably not have anticipated.

Viewed through a different lens, the **characteristics of an event** will also influence reputational impacts. Stakeholder unease will be higher if culpability can be attributed to members of the senior management or

Exhibit 2: Determinants of impact



Source: Oliver Wyman

executive team. Similarly, reputation is more at risk when the problem occurs in a key market, where there may also be a large investor or customer base, rather than in a minor market. On the other hand, extended supply chains and potential variations in cultural practices across business units in different countries present multiple threats for companies that do not have clear, universally embedded procedures in line with core corporate values.

External apprehension will inevitably be greater where there are fatalities, major environmental damage, societal inconvenience, or economic disruption as opposed to just internal commotion. Incidents affecting personal safety (such as cars and consumer products) are very likely to

result in customer attrition. However, the degree to which a sudden financial loss will engender more reputational trouble than some kind of embarrassment (a crisis in the CEO's private life, perhaps) tends to depend on the exact circumstances of each situation.

80%:
How much Olympus' stock price fell over one month after the discovery of long-term major accounting irregularities

CONTEXTUAL FACTORS

The event-based factors discussed above may be amplified or qualified by contextual factors. Regarding the **company situation**, it will usually make a difference whether an incident is the company's first offense or a repeat occurrence. The latter scenario suggests a company unwilling or unable to learn from past failings, and thus raises the prospect of further incidents. Moreover, if the problem appears to align with the company's performance story (such as major technical failures or safety standards breaches following a cost-cutting program or a merger), the market may fear that the company has undermined its core capabilities. There can be further reputational implications if the causes of the incident contradict the company's existing brand values.

Indeed, a weak brand (particularly in certain consumer-oriented sectors) provides little comfort for customers and shareholders in a time of crisis, and companies will be more vulnerable to prevailing attitudes as expressed in traditional and social media. By contrast, companies with strong brands stand a greater chance that an incident will be viewed as uncharacteristic or as an accident, and the impacts may be softer as a consequence. Similarly, companies that occupy dominant positions in the market are more resilient than their competitors, as it is harder for customers to switch providers or move to substitute products. Of course, in some sectors (such as retail banking and energy supply), customers prove to be "sticky" notwithstanding the general reputation of the major players. Finally, it is worth noting that companies



CAUSES OF REPUTATIONAL DAMAGE – CASE STUDY INSIGHTS

- **Major banks – Libor market manipulation (2012):** The discovery of secret, long-standing attempts to interfere with the open market rate revealed an unacceptable trading culture and governance shortfalls in banks such as Barclays and UBS. The systemic financial sector effects of the activity (with knock-on impacts for consumers) resulted in senior executive resignations, greater political and regulatory scrutiny, and reform of the Libor rate-setting mechanism.
- **Olympus – concealment of losses (2011):** Discovery of the long-term high-level cover-up of major accounting irregularities raised major questions about corporate governance and the quality of the company's assets. The scandal saw a rapid drain in investor confidence, with the share price falling nearly 80% over one month and not recovering for 17 months.
- **Peanut Corporation of America – contaminated products (2008-2009):** By repeatedly shipping products known to carry salmonella, the food manufacturer was responsible for at least nine fatalities and the largest food recall in US history. Federal investigations blamed a toxic, profit-at-all-costs culture led by the president and senior management that ignored regulatory compliance requirements to the extent of falsifying food safety certificates. In the face of public and political outrage, the company halted operations and filed for bankruptcy soon afterwards.
- **Arthur Andersen – inadequate scrutiny of Enron's accounts (2001):** The high-profile downfall of Enron exposed Arthur Andersen's failure to fulfill its core professional responsibilities and the inherent conflict of interest between the accountancy firm's audit and consulting practices. Widespread market concern about the commodity trader's \$63.4 billion bankruptcy, and Andersen's conviction for obstruction of justice (later overturned), led to the company surrendering its US licenses to practice and the subsequent unviability of its international operations.

with little by way of a financial cushion may suffer additional reputational damage if they appear to face cash flow difficulties or breach the thresholds of the core metrics on which their credit rating depends.

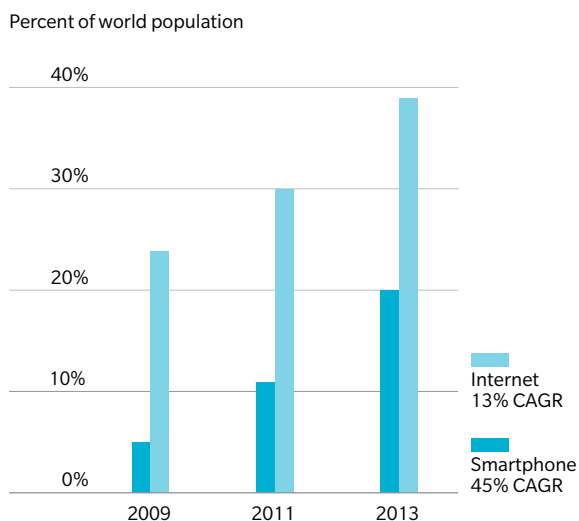
External influences are also important. Views on the severity of the reputational damage from a particular event will vary between industries. For example, fatalities in the extractive industries will usually be judged less harshly than fatalities in, say, the financial services sector due to assumptions about the nature of the work. It is also recognized that some industries, like upstream oil and gas, often operate in countries with significant political governance challenges and high levels of social inequality. However, a company that is exclusively troubled by an incident will suffer more if unaffected competitors are able to take advantage of its predicament. On the other hand, the converse can also be true. Well-managed companies can suffer from

industry-wide contagion stemming from a problem at one of their peers. In such a situation, the reputation of the entire sector is tarnished, and all firms may suffer the consequences of a customer backlash and tighter regulation. Indeed, the reputational damage from a similar incident at a second company may be magnified due to increased stakeholder sensitivity.

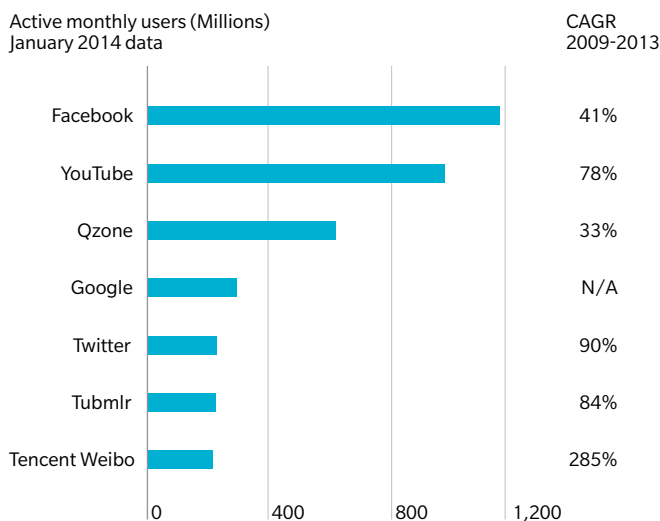
Reputational damage will often increase in line with the level of external interest. Information and opinions (regardless of the truth) can be disseminated on short notice and at great speed via traditional and social media (see Exhibit 3). Stories and details that capture the popular imagination will tend to gain the greatest traction and have the largest staying power. Incidents that align with the agenda of pre-existing or ad-hoc pressure groups will become the subject of additional investigation, and campaigners may obtain further publicity by recycling long-forgotten, past events.

Exhibit 3: Rise in social media

A RAPID RISE IN CONNECTIVITY...



MATCHED BY A GROWING USE OF SOCIAL MEDIA...



OVER WHICH COMPANIES HAVE LIMITED INFLUENCE

Sources: Connectivity: IDC, CI Almanac, Nua Ltd., Internet World Stats, ITU, BI Intelligence estimates, Gartner, IDC, Strategy Analytics, company filings, World Bank 2013. Social media: Marketing Land, 2012, USA Today, ComScore 2009, Mashable Youtube facts, Social Time, SEC Filings, press releases, TechCrunch 2009 and 2013, Mashable 2009, Bloomberg 2014, Web2Asia 2009. Rounded approximations for January 2014 for all except YouTube, which is from 2013. CAGR since 2009 unavailable for Google+ due to 2011 launch date. Oliver Wyman analysis

Moreover, consumer or political outrage may encourage regulators to apply greater scrutiny, and possibly sanctions, to the offending company and impose more stringent obligations on their entire industry.

COMPANY RESPONSE

How a company handles an incident also determines the severity and duration of the impact. External stakeholders will take a dim view of a company that withdraws into itself, arguing on technicalities and

focusing more on absolving itself from blame than on any damage caused. Significant time lags in addressing failings, or the perceived inadequacy of the corrective actions, can also amplify the reputational damage. They give the impression that the incident, and its underlying causes, are not a priority for the company, and that its leaders believe external concern will die down in due course. This can further reduce levels of trust in the company.

The key attributes of reputational crisis management are dealt with in more detail in the next section.



CAUSES OF REPUTATIONAL DAMAGE – CASE STUDY INSIGHTS

- **Budget clothing retailers – collapse of the Rana Plaza garment factory in Savar, Bangladesh (2013):** The widespread use of extended supply chains in the developing world, involving multiple third parties and difficulties in authenticating standards, meant that retailers such as Primark and Gap did not adequately understand their exposures in distant geographies. The scale of the devastation in Savar, with 1,129 fatalities, refocused media attention on the sincerity of retailers' commitment to ensuring acceptable labor conditions in their suppliers.
- **European utilities – country abandonment of nuclear energy programs (2011):** The breach of the reactor core at Fukushima after the earthquake and subsequent tidal wave threw a spotlight on the nuclear energy industry in other parts of the world. On the back of increased public concern, policymakers in Germany, Italy, and Switzerland decided to run down their nuclear energy programs despite the strong safety record of their plants over the past 20 years.
- **BP – oil spill (2010):** The Deepwater Horizon incident had high media visibility from the start, with a burning rig, 11 fatalities, and an oil slick in the ocean. Irrespective of different views on the exact volumes leaked, there was significant environmental and economic damage in the five US states with a Gulf of Mexico shoreline, resulting in multiple, ongoing claims for damages. The high degree of political interest at state and federal levels ensured a robust legislative and regulatory response. The incident, set against a backdrop of the Texas City refinery explosion (2005) and the Alaska oil spill (2006), highlighted BP's difficulties in balancing its efforts to standardize and strengthen operational safety with its goal of cost leadership.
- **Toyota – defective accelerators and brakes (2009-2011):** The alarming nature of the faults and the resulting fatalities ensured a high level of media coverage that further undermined customer confidence in the safety of the vehicles. This was magnified by a highly critical congressional hearing, which revealed that a major operational savings drive and the use of temporary labor at a time of rapid growth had resulted in reduced safety testing on the production line in the years leading up to the incidents. The implicit contradiction with a brand built on quality amplified the reputational damage.



HOW POTENTIAL IMPACTS CAN BE MITIGATED

Companies can reduce the potential consequences of reputational damage through robust management action. Conversely, a failure to take the threat seriously can often result in the rapid escalation of a problem, greater value destruction, and a longer recovery period.

Reputation risk needs to be addressed both before concern arises and after an incident has taken place (see Exhibit 4). Moreover, a truly effective management approach requires the integration of enterprise risk management (ERM) activities, public relations work, operational management, and executive team decision making. Companies where these capabilities are aligned will exhibit better anticipation and faster resolution of crises.

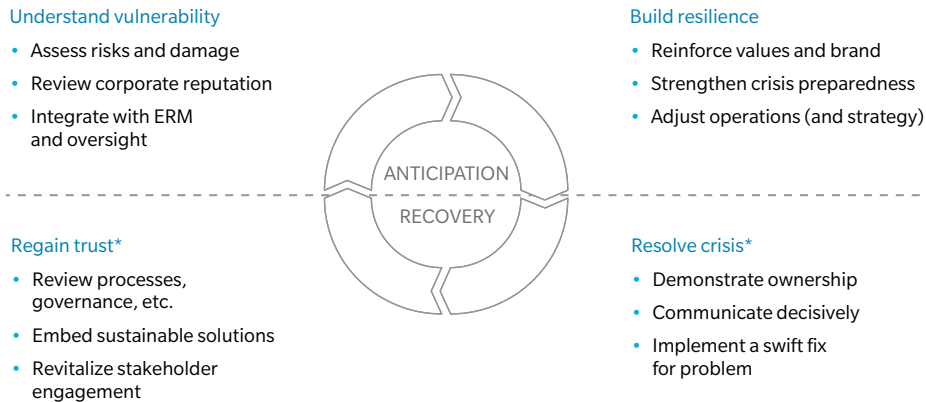
UNDERSTANDING VULNERABILITY

As a key first step, companies need to assess their vulnerability to reputation-related damage. This requires developing a baseline view of both the company's existing reputation and its core risk base.

Companies need to analyze how key stakeholder groups – customers, suppliers, regulators, employees, shareholders, and the wider public – perceive them. How much do they trust the company? What expectations do they have? How do they view the company's commercial acumen, depth of business relationships, quality of governance, and commitment to corporate social responsibility? To what extent do the stakeholders have an emotional engagement with the brand? How aligned are the company's operating behaviors with the brand? How are perceptions of the company colored by views on its competitors and the industry more generally?

Companies should also examine their risk base through a reputational lens. Which of the threats (mostly operational, but occasionally strategic) identified in the risk register could be significantly amplified through additional reputational damage? In what ways might

Exhibit 4: Reputation risk management phases



*Required measures will vary depending on the incident.

Source: Oliver Wyman

the company get caught up in the fallout from incidents at competitors, suppliers, or elsewhere? How might the reputational dimension of such risks crystallize, develop, and affect the company's financials? Triaging a long list of threats using the criteria in Exhibit 2 will help with prioritization and create a more detailed understanding of drivers, impacts, and vulnerabilities.

Historical data risk scenarios are valuable in gauging the potential scale of a risk and exploring the bounds of possibility. Attempts to quantify reputation-based damage more analytically can be challenging. Major operational risk events with associated reputational impacts can have a very high upper bound to the exposure, and estimating the damage from changing perceptions comes with a wide margin of error. Moreover, some incidents might have major short-term consequences (share price dip), but negligible impact over the longer term. Conversely, other incidents might not worry investors immediately, but still inhibit future earnings and growth. The assessment metrics selected should therefore be appropriate to the nature of the risks being analyzed and key areas of strategic, financial, and operational concern.

The assessment of corporate vulnerability to reputation-related damage needs to be integrated within governance frameworks and decision-making processes. In other words, it must be specifically included in the mandate of appropriate oversight committees, corporate preparedness programs, regular risk reporting, stress-testing scenarios, and new business evaluations. Topics and indicators that might herald the onset of a crisis should be tracked. This might be the number of negative press mentions (for controversial business activities, perhaps), the number of lawsuits facing the industry (for particular health and safety issues), or the weight of disapproval in social media comments. More generally, a dashboard can be used to monitor changing perceptions of the company from the perspective of different stakeholder groups. In addition, companies can include reputational concerns in their risk appetite frameworks, enabling them to set thresholds of acceptability against relevant leading indicators.

BUILDING RESILIENCE

The assessment framework in Exhibit 4 provides the rationale for actions that can build resilience. Building resilience should take four main forms: strengthening corporate culture; making adjustments to operations or strategy; strengthening the brand; and building crisis preparedness. In taking these steps, companies should be mindful of the spillover consequences of reputation risk, not just the technicalities of the underlying operational vulnerabilities.

Corporate culture is the best safeguard against reputational challenges. All company personnel need to adhere to high standards of conduct and exercise good business judgment. Clearly allocated risk management responsibilities, strong governance checks and balances, standard operating procedures, compliance requirements, monitoring regimes, and whistle-blowing facilities are all valuable mechanisms for instilling appropriate behaviors. But they will not be fully effective unless the detailed requirements are rooted in well-understood values, the tone is set from the top, and efforts are made to embed them consistently through all levels of management and other personnel. In strong, risk-oriented cultures, personnel are able to expose bad conduct and challenge management where they believe commercial imperatives are increasing risks unacceptably. Moreover, executives need to be aware of key operational risks, track front-line perceptions of how the risks are managed, and drive through changes where required. Dangers often arise when a team, business unit, or level of management coheres over time around high-risk attitudes that are either undetected by other parts of the firm or hard to challenge.

Consideration for potential reputational damage should be built into major strategic and business planning decisions. Risk assessments should influence decisions to reject proposed initiatives or spur early investment in strategic or operational mitigation measures where the cost is justified by the potential damage of a crisis. Measures might include adjusting customer offerings, tightening process and infrastructure safety, investing further in health, safety, and environment

(HSE) capabilities, reinforcing crisis and response preparedness activities, and more deeply embedding risk-minded behaviors. Companies that have emerging solutions for key risks usually do better in a crisis than those that give the impression they are inventing fixes in real time. The only exception to this is when the existence of work-in-progress on a topic implies that the company has been over-hasty in rolling out a product or process that has significant unresolved risk issues.

For financial protection against reputational damage, there are limited insurance options. Difficulties in evaluating the reputation dimension, and in formulating and parameterizing payout triggers, have constrained product development and uptake in the market.

Strengthening the brand can help to establish a reservoir of good will with major stakeholders that can bolster the company during a crisis and give credibility to its communications and actions. A powerful brand can reinforce core company values, goals, and behaviors, and influence stakeholder responses to an unexpected event. Brand strength may reside in how a company's approach to its products resonates with customers. Alternatively, it may be based on the company's commitment to corporate citizenship, possibly as evidenced in its implementation of the principles of the UN's Global Compact, although this is rarely strong enough on its own.

Finally, developing, practicing, and reviewing crisis management skills help prepare senior teams and their advisors for sudden events. Crisis plans must have a clear reputation management dimension that interacts

30 minutes:
How quickly Southwest Airlines released a statement after a plane's landing gear collapsed, allowing it to control the narrative of the crisis

appropriately with safety or other measures designed to resolve the incident that has occurred. It is critical that plans are tested through tabletop exercises and other simulations to examine the quality of decision making and communications (internal and external) under pressure in an evolving situation.

RESOLVING A CRISIS

Companies with well-established and effective crisis-management capabilities quash reputational threats and remove them from stakeholder radars as soon as possible. Conversely, a mishandled response to a crisis can generate more reputational damage than the

event itself, and spur greater financial consequences. This is particularly true when the company's response appears to undermine the firm's core values. Nonetheless, companies still struggle with when to admit publicly that an unfolding incident might turn into a crisis. Surprisingly, firms also struggle with whether or when to announce bold steps that might nip damage in the bud, albeit at a material cost to earnings, even though history and best practice show this is the best way to minimize reputational and other impacts.

Decision-making challenges for senior management are greater in the early hours of an incident when the nature and scale of the problem may be unclear. Indeed, company personnel may be talking down the incident;



MITIGATING IMPACT – CASE STUDY INSIGHTS

- **Southwest Airlines – crisis management via social media (2013):** Following an incident where a plane's landing gear collapsed on landing, the airline took control of the story through statements via multiple channels – Twitter, Facebook, and traditional press releases. An initial statement was issued approximately 30 minutes after the incident. Avoiding an information void gave the airline more control over how the narrative of the crisis developed. The airline's emerging media team monitors multiple social media platforms around the clock and connects these interactions with pre-existing contingency planning and rapid-response capabilities.
- **Oil majors – contagion management (2010):** In the wake of BP's Gulf of Mexico disaster, ExxonMobil, Chevron, ConocoPhillips, and Shell agreed to pool \$1 billion to set up a company that could quickly address deep-water oil spills. Given the issuance of a federal moratorium on exploratory drilling, their goal was to reassure the public and Congress of their commitment to safety and hasten the resumption of deep-water drilling.
- **Halifax Bank of Scotland (HBOS) – swift deployment of crisis management capabilities (2008):** When false market rumors regarding liquidity issues at the UK bank caused shares to fall by 17% in just 10 minutes of trading, a coordinated, global response enabled the bank to promptly and unambiguously deny the rumors, with the Bank of England moving to reject speculation of a liquidity crisis and reassure the marketplace. The share price recovered 10% by the end of the day.
- **Johnson & Johnson – prioritizing public safety in a crisis (1982):** When it learned that an unknown quantity of Tylenol bottles had been maliciously contaminated with cyanide, the firm directly issued a US-wide recall and set up a free customer helpline. Although this cost over \$100 million at the time (\$240 million in today's dollars) and the Tylenol brand market share slumped from 37% to 7% in the immediate aftermath, the decisive action built good will among stakeholders. One of the key solutions, the development of triple-seal tamper-resistant packaging, had already been in the works, and Tylenol's ability to expedite its rollout facilitated the successful reintroduction of the brand into the market.

external parties may have access to better intelligence than the company; and the truth of the situation may be clouded by hearsay. Notwithstanding concerns about “creating” a crisis through overreaction, firms must show they are on top of the situation regardless of the known severity at the time. It is usually better to acknowledge an incident from the outset, especially when external parties are affected or if public awareness is likely. Dangers arise when data shortages contribute to a mindset of denial (“it’s not a large problem”, “we have it under control”, “it’s not our fault”), and downplaying the situation risks elevating stakeholder concerns. It is important to note that, when looking back at a crisis, most stakeholders will judge the company’s attitudes and performance with the benefit of hindsight, not relative to the information available at the time.

Fast, transparent communication is vital. If companies are reticent, the vacuum will be filled by other shapers of opinion, who might have less accurate information and be inherently unsympathetic toward the company. As a result, concern about one particular product or the quality of operations in a single geography might rapidly taint the broader business in other geographies.

CEOs, or appropriate deputies, need to step into the limelight quickly and show that the incident is being taken seriously at the top of the organization. Leadership involves taking responsible action in the event of an incident, even if the company is only culpable in a minor way. In effect, this means showing overriding concern for the welfare of any (potentially) affected parties and a commitment to resolving the situation. Stakeholders will expect a fast diagnosis of the problem, the decisive implementation of a fix based on considering the different options, a robust (but fair) approach to offending parties, and a pledge to developing a longer-term solution, where this might be required. The cost of such measures, however significant, may pale by comparison with the brand damage and long-term value destruction from a pennywise or self-interested response.

REGAINING TRUST

As companies seek to restore their reputation and recover their performance, they should aim to balance three approaches in their planning: a thorough reflection on the causes of an incident and the outcome, an acknowledgment of stakeholder expectations, and the implementation of hard-edged business decisions that are right for the company over the long term. These perspectives should inform both operational adjustments and the communications agenda.

The focus of a recovery plan will depend on the source of the incident, the extent of the reputational damage, the potential business consequences, and the ambitions of the company. Companies might simply choose to cut their losses by axing an offending business line or withdrawing from a particular market, if they judge that other parts of the company have not been, and will not be, tainted. Alternatively, they might feel the need to engage in a wide-ranging overhaul of governance or processes. Indeed, ensuring a deep-rooted and pervasive response might require refreshing the company’s vision and values, and assessing whether business activities and operational controls are in line with them. Some remedies focused on revitalizing procedures and aligning behaviors will need to be taken down to the level of the individual employee. This can be a considerable investment for multinational corporations, and it can be quite some time before a company can

80 weeks:

Average time for the company stock price to recover after a sudden price drop*

* A “stock price drop” is defined as a drop in the company stock price that is greater than 20% within a 10-day period relative to changes in the industry average. Stock price drops from reputational damage emerged as the largest category in the study.

Source: Wharton, Corporate Strategies for Managing Catastrophic Risks in the S&P 500 (preliminary study), 2013

confidently claim that new approaches have been properly tested and embedded in a way that the likelihood of repeat offending is very significantly diminished.

The recovery effort can also bear fruit in corporate communications. Companies can engage with internal and external stakeholders about the journey they are going on and when they have arrived. With respect to the latter, a new corporate positioning, visual identity,

and tagline can be a powerful way of signaling that a new chapter has begun. A revitalized brand, underpinned by real reform at operational level, is a good platform for chief executives to engage with employees and markets, and to assert that the effort has not only resolved the problems underlying the crisis, but also helped to build an even more robust and dynamic organization. Such announcements need to be carefully timed, and cannot take place before reputational wounds have healed and new, supportive measures have been embedded.



RESTORING CONFIDENCE – CASE STUDY INSIGHTS

- **Clothing retailers – strengthening corporate social responsibility commitments (2013):** Faced with the unattractive alternatives of ignoring the safety problem or exiting from the country in the aftermath of the Savar factory collapse, leading clothing retailers selling garments manufactured in Bangladesh are joining forces to inspect the factories that supply them and support improvements to worker safety.
- **Citibank – brand revitalization after a crisis (2012):** The bank used the occasion of its 200th anniversary to remind stakeholders of its strong heritage rather than its problems during the financial crisis. With the tagline “Progress informed by the past and inspired by the future”, the campaign focused on the bank’s funding of key, global projects (including the Panama Canal and the Space Shuttle), previous innovation (from its Foreign Exchange Network in 1897 to the ATM in 1977), and future plans (such as partnering with Google Wallet).
- **News Corporation – commercial reorganization (2011):** Following multiple allegations of phone-hacking, the company closed down the offending newspaper (the *News of the World*) and instituted a new paper in its place (the *Sun Sunday*) to retain a strong presence in the weekend market. It also split the parent company of the media businesses into two distinct listed entities (21st Century Fox for broadcasting and film assets, News Corp for publishing assets) to reduce economic and political contagion and unlock value through more focused management.
- **Siemens – new anti-corruption measures (2008):** Following the revelation that it had paid more than \$1.4 billion in bribes for contracts over a six-year period, which resulted in massive fines and prohibitions from certain contracts, the engineering and electronics conglomerate instituted far-reaching changes to transform its organizational culture. A month-long amnesty was set up alongside an internal inquiry. The CEO, President, and many other managers were replaced by external hires, and former executives were prosecuted. New anti-corruption processes were instituted, and hundreds of compliance officers were hired, resulting in compliance hotlines, a new investigation unit, and a thorough training program for employees.



OWNERSHIP AND RESPONSIBILITY

In some companies, ownership of reputation risk is unclear or too narrowly scoped. With clear direction from the top, responsibility for different management challenges should lie with identified individuals and departments, who have defined protocols for interacting with each other.

Ultimately, the Chief Executive owns the issue. Accountable for the strategic decision making of the company and its operating culture (from senior management to the front line), he or she must consider the reputational consequences of new priorities and initiatives. The Chief Executive also has a critical role in providing oversight and direction to the crisis management team in the event of a crisis, and revitalizing the company's reputation during the recovery phase. Personnel throughout the firm will take their cue from him or her, and a failure to exercise expected leadership, or alternatively a too-close association with the risk event, may result in their eventual resignation or dismissal.

Below the Chief Executive, key functions and units need to understand their particular obligations (see Exhibit 5) and contribute to an integrated reputation risk management plan. Although the organizational location of these functions may vary across industries and companies, coverage of the different challenges should be the same.

The Risk function should provide guidance on how to assess the consequences of reputation-related damage. It should also ensure that analyses are appropriately undertaken, aggregated, and reported on, that good discussions on mitigation take place, and that proper crisis preparedness teams and plans are maintained.

Exhibit 5: Functional responsibilities for key reputation risk management activities



Note: The organizational location of these functions varies across industries and companies. Moreover, Business Continuity may sit within Risk, Operations, or independently. Source: Oliver Wyman

Compliance (where this is separate from Risk) should highlight the potential reputational consequences of compliance breaches in its communications addressing the responsibilities of all personnel, and additionally support the oversight of preparedness programs.

Operational business units are the front line of reputation risk management on a daily basis, and they also need to be ready to respond in a crisis. They should take ownership of the safety measures and mitigation activities that bear on their business activities, cognizant that lapses and failures may result in reputational damage beyond operational losses. The team responsible for business continuity and disaster recovery should support a company’s reputation by ensuring that viable operations are achieved during a crisis, or restored as soon as possible after it occurs.

Marketing’s interest in corporate reputation is more about the upside of investing in the brand than the downside of the company’s exposure to possible risk events. But the department should also have insights into the lost upside that might result from reputational damage. The Communications function has multiple responsibilities regarding reputation management. It supports external brand-building and is well positioned

to understand baseline stakeholder perceptions of the company, including changes over time. Likewise, it is instrumental in embedding a strong corporate culture. As part of a crisis management team, it plays a major role in helping to salvage the company’s reputation during and after a crisis.

Indeed, the existence of a crisis management team is critical for ensuring the best possible response to an incident. The team should contain key executives and additional leaders from relevant business lines and functions. They must each have specified roles and areas for which they are responsible when an incident occurs

Seven:
Size of the strategy team established by the Chairman of Johnson & Johnson during the Tylenol contamination crisis to restore the company’s reputation

so they can work independently and efficiently with defined points of interaction to ensure good decision making, effective measures, and active communications.

The threat of reputational damage should be overtly addressed within the mandate of a general management-level Risk Committee. Key duties include aligning on the top reputational risks, assigning primary owners to these risks, tracking changes in the internal

and external environment, identifying mitigation actions (including preparedness), and monitoring implementation. Reputational considerations should also be a prominent feature of a Board Risk Committee's agenda and form part of the dialogue between Board and management regarding the adequacy of mitigation and crisis management efforts. Some companies, particularly in the financial sector, have set up Board-level committees with an explicit focus on reputational risk.



GOVERNANCE – CASE STUDY INSIGHTS

- **HSBC – Board oversight (mandate since 2011):** HSBC has a Group Reputational Risk Policy Committee, which is chaired by the Group Chairman. The committee looks at areas and activities that present significant reputational risk and, where appropriate, makes recommendations to the Global Standards Steering Committee for policy or procedural changes to mitigate such risk. Reputational Risk Policy Committees have also been established in each of the bank's geographic regions.
- **Unilever – Board oversight (mandate since 2006):** Unilever's Corporate Responsibility and Reputation Committee is responsible for overseeing the company's corporate social responsibility obligations and reputational standing with key stakeholder groups. The committee reviews external developments and attitudes, provides guidance to the business on how to handle internal and external issues, recommends changes to the company's Code of Business Principles, and ensures that appropriate communications policies are in place.



ACHIEVING RESILIENCE

Reputation risk may be high on company agendas, but the depth of engagement is often cyclical. Constant vigilance and preparedness is required to ensure corporate resilience.

Management efforts tend to be strongest after a crisis faced by the company or a watershed event in the industry – when companies recognize that they are under a microscope and that the impact of any subsequent event will be unduly magnified. But by embedding reputation risk management more effectively, companies can reduce the likelihood of highly damaging surprises and avoid the gradual erosion of their brand over time. They can also permanently strengthen their response capabilities.

Many companies are predisposed towards one dimension of the challenge or another – risk prevention or crisis management, mitigation efforts or communications – and tend to privilege one stakeholder group – customers, investors, or regulators – above others. But only those that bring

together different types of expertise – risk analysis, crisis preparedness and management, brand development, operational improvement, and external relations – in a common management framework and in accordance with a clear set of corporate values can claim to be approaching the issue strategically.

Those that invest in such a framework will be alert to changing risk levels, sensitive to evolving norms of stakeholder expectations, and appropriately flexible in their risk management and preparedness priorities. Equally importantly, they will be able to integrate downside risk management activities with upside reputation and brand development ambitions. Companies that bring all this together are therefore not only being mindful of near-term threats but also investing in the long-term sustainability of the firm.

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