When disaster strikes

Almost everyone at board level is well-drilled about the need to manage reputational risk – but what should you do to be prepared for the worst? **Anthony Fitzsimmons** takes a look.

Reputation is a valuable but uninsurable intangible asset.

As Warren Buffett famously observed, it takes years to build and minutes to destroy. Gerald Ratner's infamous lunchtime speech, when he proudly admitted selling 'crap', was an unforced error that seriously damaged his business and personal reputation. However, reputations are more typically lost under the intense pressure of a crisis for which the organisation and its leaders are not properly prepared. UK boards are now exposed to potential personal liability for the consequences of a lack of preparation.

A series of studies on the effect of catastrophes on shareholder value, covering firms across the breadth of the world economy, concluded that when crises strike, companies cluster into two groups: those that recover and those that don't. Both groups typically dip in value initially; but recoverers typically went on to gain 5 per cent or more in shareholder value, whereas non-recoverers declined by around 15 per cent. Few fell between these groups, and these averages conceal more extreme cases.

There are many examples of companies that have had to deal with major crises with important reputational aspects. Some did well; some did not. They include well known names such as Arthur Andersen, British Midland, Coca Cola, Greenpeace, Intel, KPMG, Mercedes, Perrier, Railtrack, Shell and Union Carbide. Indeed, there are now two high profile crises unfolding before our eyes: Heathrow's Terminal 5 story and the OFT's Statement of Objections addressed to 112 firms in the construction sector, alleging 240 breaches of competition law.

The contrast between Arthur Andersen and KPMG is instructive. Andersen was founded in 1913, and carved a reputation for integrity and independence in auditing. Its problems developed from the rise of its lucrative consultancy practice, which risked structural conflicts with the audit business. In 2002, when a team at a local Andersen office was found to have shredded documents in relation to Enron's collapse, the firm fought the resulting prosecution. It put its reputation for trustworthiness – an essential core value for an auditor – at risk, and its conviction sealed its fate. A Texas judge subsequently commented, in another case, that Andersen had shown a 'callous, reckless disregard for its duty to investors and the public trust for decades'.

A few years later, KPMG had been advising clients on tax sheltering. In the course of investigations by the US tax authorities, the firm was criticised severely for taking steps alleged to be designed to hide its tax shelter activities, and like Andersen was thought to be open to charges of obstruction of justice. However, KPMG admitted guilt and accepted 'full responsibility for the unlawful conduct', expressed 'deep regret' for the actions concerned and sacked dozens of partners – as well as discontinuing sales of the tax schemes concerned.

KPMG was helped by the fact that the earlier prosecution of Andersen had reduced the Big Five to the Big Four – meaning the Department of Justice was undoubtedly reluctant to create a Big Three. However, KPMG's bold acceptance of guilt – accompanied by actions to show that they had learned all the important lessons – made it possible for prosecutors to decide that a prosecution of KPMG was not necessary.

What can go wrong, will go wrong

Some risks are direct risks to reputation. These range from unsatisfactory quality or values, through arrogance, group-think and a belief that 'spin will fix it', to a lack of good strategy, planning and practice for major crises. An unjustifiably good reputation can also be a sword of Damocles. It is often overlooked that there is potential for secondary but serious damage to reputation, where what seem to be very low impact issues are mismanaged so that they develop into something much larger and nastier.

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Institutional taboos can be a problem. A group of taboo risks to reputation may relate to the executive team. There may be a charismatic CEO, who believes that as they have overcome all problems so far, they can overcome anything life throws at them. Or, the problem may be an executive team consisting of those with whom the CEO has not yet fallen out – and no one prepared to contradict them. In the same family is the CEO who reacts badly to being told unwelcome news.

Additionally, many reputational risks are strategic, and these may be taboo or invisible to a risk manager below board level. This is why the audit committee and its chair should be actively involved in the analysis of reputational risks, and it is important that experience, independence and objectivity are brought to the exercise.

Crises invariably arrive at an inconvenient time. Pressure is intense, and those affected will want information with an intensity that will be extreme if loved ones may have been killed or injured. On top of this, the media will demand information to fit with broadcast and print schedules.

Operations need to divide into two streams – 'normal business' and 'the crisis'. Normal business must be maintained, but the management team is typically cannibalised for the emergency. Running a major crisis is highly stressful and unfamiliar to most. Inadequate resourcing or facilities may force the crisis team to work 20-hour days for an unsustainable period. Tiredness leads to unnecessary mistakes.

A clear crisis strategy, planning and practice are key to minimising damage. The strategy and the corresponding values should be thought through in peacetime. Crisis strategy will be closely allied to general strategy, but it may contain subtle differences of emphasis that are important. In particular, the values that matter most in a crisis may be more profound than those in 'daily use' and their importance is easily overlooked. All this needs to be turned into something practical and succinct enough to be compulsive reading in a crisis.

Under the spotlight

Much is made of the importance of perceptions and crisis communications. Few could afford the scale of media coverage that results when something goes badly – and publicly – wrong. The organisation or brand will be much better known after a major crisis. What for is a different question.

In the first instance, only words and images are available, so the media will focus on what happened: what, when, where and, if it was a physical event, how many were killed or injured. These questions are about the past, about which little can be done, and must be dealt with using care and integrity.

However, within a day or so, the media and public will compare the message – from before and after the crisis – with actions. The intensity of media coverage means that the organisation's words and actions, the quality of its decisions, its ethics and its strategy are reported in real time and dissected within hours.

Reputation is strongly based on perceptions, but most give actions far greater weight than words. Media focus will quickly move to 'what is being done' and 'why did it happen'. Professional commentators – the so-called 'commentariat' – will answer the question '...and what does it all tell us about the organisation involved?'. This is when reputations are made and broken – and when planning, a clear strategy and practice pay off.

However, companies should not forget other information channels – particularly internal communication. Staff are an important and influential stakeholder group, and no amount of contractual 'gagging' will keep employees silent if they think there is something that ought to be revealed. If the workforce knows that its leadership is not telling the truth, someone from within *will* tell the press.

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All UK boards, including charity boards, should be reviewing their reputational risks and their strategy to protect against them.

This is more important now than ever before. There is a new statutory duty under the Companies Act 2006 which will require directors to consider their company's reputation in all decision-making: meaning directors could now be personally liable if enterprise value is reduced as a result of inadequate reputational risk analysis or inadequate crisis strategy or planning.

UK politicians have also been developing the notion that, used more cannily than in the past, reputational damage may be a useful penalty. Thus, the new Corporate Manslaughter and Corporate Homicide Act gives the courts the power to force a convicted company to publicise its conviction in a way that is intended to cause reputational damage. Might we even see a convicted supermarket ordered to supply all its customers with free, sustainable, long-life branded carrier bags bearing the zippy tag: 'By focusing on profit, we killed three of our customers'?

There is no substitute for preparation. Objective analysis of reputation and effective planning should lead to a strategy resilient enough to guide the organisation even through unforeseen crises. Practice is highly desirable. Dry runs are not only road tests of strategy and planning: they represent an unparalleled opportunity to learn from both the simulation and from mistakes made – away from the glare of the public eye.

No organisation enjoys thinking about what could occur if things go badly wrong, but it is the board's duty to be well prepared for the good of all. Being properly prepared is also in their personal interests. For, as Warren Buffett also wryly observed, it's when the tide goes out that you discover who's been swimming naked.

ABOUT THE AUTHOR

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