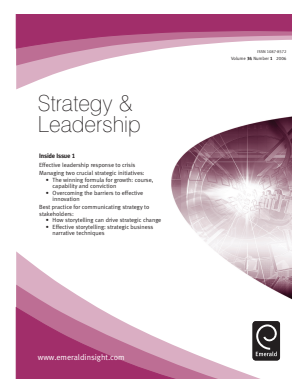


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# Building and protecting corporate reputation

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# Building and protecting corporate reputation

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**R**eputation is the strongest determinant of any corporation's sustainability. Stock price can always come back. Business strategies can always be changed. But when an organization's reputation is gravely injured, its recovery is difficult, long-term, and uncertain. A risk to its reputation is a threat to the survival of the enterprise.

Leaders who have built a strong corporate reputation know what it takes: an internal culture that forges a positive opinion of the company by successfully coping with both expected and unanticipated challenges. They know that PR is not a bandage that will cover risky behavior. Most of all, they know they must understand their stakeholders, and that every company's solution must be unique.

A company's approach must include structured engagement with investors, regulators, activist organizations, communities, and the media. The primary feature of this engagement is active listening. It provides a means for developing a trained intelligence that enables leaders to anticipate external responses to their actions. And, when necessary, it delivers a perspective that helps protect them from the kind of competition-driven excesses that seem to arise so easily in our pressurized market environment.

Failure to build a culture of attentive engagement can prove devastating, and the world has witnessed spectacular reputational collapses over recent years. Enron and WorldCom are the best known, but, at bottom, these are simple cases of thievery and fraud. An admonition not to steal would be lost on those who are striving to be creatively criminal.

Of far greater interest to the great majority of CEOs, and more instructive of the dangers that can lurk in any corporation's DNA, are the reputational compromises that have occurred at such companies as Merck, Marsh & McLennan, Arthur Andersen, and Monsanto. In these cases, subtle drifts in corporate culture, made in increments so small as to go almost unnoticed, brought companies into damaging confrontations with investors, regulators, and the public. The results have included loss of careers, erosion of shareholder value, long-term decline of business franchise, and, in Andersen's case, extinction of a thriving company.

As a dramatic case in point, compromising a reputation many considered "gold-plated," the pharmaceutical pioneer Merck is now facing an extended series of lawsuits based on allegations that it suppressed research that showed its anti-inflammatory medicine Vioxx significantly increased patients' risk of heart attack and stroke. This alleged compromise of scientific research has caused the loss of a management team, deep embarrassment to the company, and potential liabilities that analysts say could surpass \$15 billion.

In another example of ethical drift, the insurance unit of Marsh & McLennan lost its management and paid out huge fines for systematic bid rigging in the sale of large institutional insurance policies. The company collected commissions on both sides of its insurance deals – from the companies who bought the insurance, which was appropriate,

and from the underwriters who sold it, which was not. To be sure commission-paying underwriters won enough business, Marsh, Inc. rigged the bids and got its competitors in the industry to do the same. Sued by the State of New York, Marsh forfeited a large part of its gains. Management resigned, and the company was left to find another business model that would make up for the loss of about half its revenue. In addition to the heavy civil sanctions, eight former Marsh executives face criminal charges.

In a third example of ethical compromise, the big five accounting firms were reduced to four after Arthur Andersen & Co. admitted to covering up financial irregularities that occurred at its client Enron. The subsequent reversal of the criminal conviction against Andersen on a technicality did little to help the world forget the image of a troop of faithful accounting consultants lined up at paper shredders in the Enron accounting department. The fact that Andersen showed no compunction about destroying evidence in protecting a prized client strongly suggests that an aptitude for gross illegality lay dormant in the company's culture until a triggering event brought it out.

This possibility of having the seeds of disaster entrenched within their company should, more than any other threat, give pause to business leaders everywhere. The challenge is to recognize it.

In contrast, the crisis that erupted at Monsanto offers a lesson on how ethical conflicts can emerge unexpectedly. In the 1990s, the firm developed a biotechnology so powerful that it seemed to bring the chance for a meaningful reduction in world hunger. Monsanto's genetic manipulation enabled farmers to grow grains in a wider range of environments, and it could make crops immune to herbicides, thus permitting an application dosage and schedule that would free fields of weeds. The company, seeing itself in a historically advantageous position, adopted a hyper-aggressive marketing strategy. It decided to license the technology within the seeds as intellectual property rather than sell the seeds to farmers outright. Farmers were thereby prevented from collecting seed from current crops for future planting seasons, reversing traditional farming practice. Monsanto's management seemed deaf to the rising clamor of opposition. Activists warned that the genetic modifications might be harmful to humans or the environment, and that they might jump to other plants with unforeseeable consequences. The debate both frightened and enraged the public, and as a result the European Union imposed a five-year moratorium on all genetically modified seed. The company soon lost its independence in a "merger." In a concessionary statement to the activist group Greenpeace, Monsanto Chairman Robert Shapiro said:

Because we thought it was our job to persuade, too often we forgot to listen.

### A new landscape

These examples reflect the historic changes that have taken place in the corporate environment. The days of the fortress mindset of corporations are over. We have entered an era where scrutiny and judgment by the press, society, shareholders, regulators, and other stakeholders (such as Greenpeace) is intense. Consumers are beginning to judge companies as they judge politicians: for their values.

The current era is increasingly characterized by a democratization of corporate oversight. The internet has created a public super-consciousness, delivering extraordinary access to information. Now NGO's, the press, and stakeholders of all stripes stand ready to expose corporate misbehavior. It seldom matters whether misdeeds are real or imagined. Groups in

**“A risk to its reputation is a threat to the survival of the enterprise.”**

opposition to corporations can now organize both message and massive action with the push of a button on a computer or cell phone.

### The common thread of failure

The reputational collapses in the four examples (Merck, Marsh, Andersen and Monsanto) share a single striking feature: they were not just limited to a small group of corporate manipulators, or a cabal, operating behind closed doors. Each was the result of a multifunctional consensus within the company to engage in misconduct. There was enterprise involvement. Moreover, each constituted a kind of behavior that few of the individuals involved would have tolerated in their personal lives. But something happened when they all came together and their competitive juices began to flow.

Competition, of course, is essential, but the fact that it is the prime driver of business also creates the need for leaders to develop a finely tuned moral ear – not out of altruism, but in the interest of their own survival. A company's ability to maintain a sense of acceptable conduct in the heat of the competitive market place is attainable only through true engagement with its constituencies. Constant feedback from outside is the best protection against management's own excesses. And the first step in creating such engagement is active institutional listening.

Institutional listening is achievable only through carefully developed feedback structures by which stakeholder opinion can be gathered and processed for use by senior decision-makers. Such mechanisms include a regular cycle of perception studies and forums that elicit the views of significant constituencies. Essential to this process is a leadership culture that recognizes adherence to stakeholder values as a pillar of the company's sustainability. Merck, Marsh, Andersen and Monsanto were clearly lacking the kind of information that would have identified unsustainable behavior and the effective internal voices to deliver it.



### Good ideas are born of experience

Some of the leaders in this area are those who have had little choice in the matter and are forced by the nature of their business into reputationally precarious positions. Examples of these are the energy and mining companies who must go wherever the earth yields up their valued product. They are companies that dig up the terrain, move communities in order to pursue their goals, and often have to work with undesirable governments. In this age of intense scrutiny by activist organizations, these groups have had to generate strategies that would earn them what has become known as the “social license to operate.” So, extraction companies, whom much of the world loves to hate, have had to become thought leaders in developing strategies that demonstrate ethical behavior.

BP, for example, consulted thousands of land tenants – overwhelmingly poor – along its thousand-mile pipeline through Azerbaijan, Georgia and Turkey. These conversations helped the company determine the least disruptive route through communities, pipeline depth in specific areas, the location of power stations, and many other factors. Then BP gave \$30 million to NGO's to invest at their discretion in hospitals, water systems, schools and other social assets along the route. BP applies similar processes to its projects in many countries and has institutionalized its system for feeding the intelligence gained through such engagement up through a hierarchical reporting structure to top executives and the board.

BP is notable for having embedded reputation risk management in its global enterprise well before Enron and others put it on the front page. The company has the experience to know that fierce opposition comes with the territory. So, it attempts to structure the planning of such operations to answer critical questions before they are asked. Its business plan is designed to create a record of responsibility well before it is challenged.

As an example of how not to do this, the apparel giant Nike suffered severe reputational damage several years ago when its management seemed to learn at approximately the

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same time as the rest of the world that some of its Asian subcontractors were employing children and forcing them to work in appalling conditions. It appeared that the company had simply not been interested in what was going on in these factories, and Nike's name became associated with the “don't ask-don't tell” school of doing business overseas.

With its reputation in tatters, Nike went into a quiet period, partially due to a lawsuit, during which the company examined its entire supply chain strategy and the levels of transparency that had surrounded it. At the end of that time, Nike published a list of every supplier it used throughout the world on its web site, including their addresses, so that anyone could visit and develop conclusions.

In developing this solution, Nike established an unprecedented standard in transparency. The company converted the deep embarrassment it had experienced into a concrete contribution to the way business disclosure is conducted. In a small way, it is reminiscent of Johnson & Johnson's solution that followed the Tylenol poisoning scare in 1982. The safety caps Johnson & Johnson introduced changed forever how the world opens a bottle of medicine.

### **The search for best practices**

While companies often cite their own specific efforts to implement “best practices,” it is not clear what they are doing to develop a culture that supports a desired reputation. Industry forums where companies with similar challenges share perspectives have proven a highly useful source of ideas. In addition, some companies have turned to what may seem an unusual, but ultimately logical, place in their search for concrete principles. It is the US Justice Department's guidelines for its attorneys prosecuting corporate cases. The department instructs them to consider specific questions both in deciding to go forward with prosecutions and in making sentencing recommendations to judges after convictions are obtained. They are such questions as:

- Is the company a repeat offender? Does it have a history of continued misconduct?
- Has it been transparent and forthcoming with information, particularly in the voluntary reporting of any failure to comply with regulation or law?
- Has the company instituted controls designed in good faith to prevent the offense from recurring?

When translated for internal corporate use, these principles offer some of the clearest and most widely applicable “best practices” leaders can adopt to manage risk.

Regardless of whether the company has identified these principles or others as best practices, it must create a structure for their implementation. Bertelsmann, the global media conglomerate, has established a practice at some of its US businesses in which senior management groups carry out what Chief Ethics and Compliance Officer, Andrea Bonime-Blanc, calls “risk brainstorming.” These groups examine their own risk profiles in areas that range from anti-trust issues to discrimination to intellectual property. They institute training based on their findings, then monitor progress, all in a continuous cycle. There is no way for the company to prove that the funding of these practices is worth the investment, since it is impossible to assess the cost of missteps that did not happen. But Bertelsmann

has attempted to maximize the support a good reputation requires, and, very importantly, it has demonstrated its commitment and the intention of the enterprise to all observers.

### The case for investment

Reputation is one of the great paradoxes of corporate life. While no one questions its importance, senior executives seldom focus on it in the same way they address the more concrete aspects of their businesses. A 2003 survey conducted among more than 100 companies by insurance broker AON determined that, after business interruption, reputation loss was considered the greatest hazard these companies faced. Yet only 22 percent of those interviewed had implemented a formal strategy to manage reputation risk[1]. A McKinsey study published in early 2006 showed that only 3 percent of more than 4,000 executives interviewed in 116 countries thought their companies were doing a good job in responding to sociopolitical challenges[2].

One reason for this contradiction between belief and practice is that business leaders generally limit their considerations of risk to those factors that can be measured. Risk management, often called "enterprise risk management," is one of the most avidly attended topics among senior executives and boards of directors. Consultants, many associated with insurance companies, promote risk management products and services. These tend to cover information systems, internal audit controls, physical assets, security (including protection against terrorism), regulatory compliance systems, product liabilities, and environmental damage. Seldom, however, do you see reputation included on a list of risk management issues. One reason: firms cannot assign a return-on-investment figure to the money spent on it because they never know how much the event that did not happen would have cost.

Not only is risk to reputation hard to measure, but management often fails to prepare adequately for risks that come with strategic initiatives into new territory.

For example, the recent experience in China of Microsoft, Google, and Yahoo underscore the importance of understanding the dangers of pioneering an unfamiliar landscape. None of these companies anticipated the buzz saw of congressional and public objection that arose from their acceptance of the Chinese government's demand to accede to the suppression of free speech, censorship, and betrayal of dissidents.

Infatuated with China's unmistakable opportunities, the internet giants had rejected overtures from groups active in these areas that had wanted to alert them to the sociopolitical implications of doing business there. They thereby failed the engagement test. They had gone into China without a plan. After being taken to task like children before the House International Relations Committee, they then belatedly sought out those groups to whom they had previously refused to listen.

### Lessons for leaders

Solutions to reputational challenges start with a new management mindset. As Nike and BP proved, companies must engage the world that surrounds them rather than try to manipulate it through contrived communications. They must do this in a carefully structured, intentional way.

When a company becomes part of the dialogue, rather than its external manipulator, it creates for itself an opportunity to influence the terms and vocabulary the world uses to discuss its affairs. This convergence usually creates cooperative relationships with those external groups (investors, special interest activists, the press, and the community) in whose minds the reputation of the company forms, and who therefore exert a profound influence on its long-term sustainability.

### Building a corporate reputation infrastructure

Following are some initiatives companies have taken to develop a culture that supports reputation:



1. Fundamental principle: ties among institutions are always ties among individuals.
2. Stakeholder mapping:
  - Understand who the influencers are in:
    - Capital markets: institutional portfolio managers, analysts, financial press.
    - Industry associations.
    - NGO's with interests impacted by company operations.
    - Lobbying groups both inside the industry and in others where operations are likely to have an effect.
    - Consultants, thought leaders, established special-interest forums.
    - Regulators: federal, state, county, foreign.
    - Community organizations and officials.
    - Media: general, financial, community.
  - Chart the special interests of each and how they match and/or diverge from those of the company.
3. Appoint a reputation coordinator to oversee the process and report to the CEO or the board.
4. Allocate responsibility to existing staff for following each stakeholder on the map. Emphasize:
  - personal relationships among individuals;
  - frank conversations on convergence and divergence of interests;
  - capture of intelligence gained from contacts; and
  - frequency of contacts.
5. Create regular internal forums where shared information and experience become part of the group intellectual reservoir.
6. Establish a reporting mechanism by which the intelligence gathered by each group is filtered up through the organization and becomes available to senior decision-makers.
7. Institutionalize continuous staff training by experienced individuals and by cycling new people into the effort. Involvement in the corporate reputation program should be a factor in career advancement.
8. Become a source of ideas in your industry. Sponsor conferences and seminars in specific spheres of stakeholder interest. Benefits include:
  - improved ties among a regular circle of stakeholders;
  - development of a mechanism that brings new institutions into the company's orbit; and
  - greater recognition of the company's ideas throughout the stakeholder universe.

*Danger signs: symptoms of weak commitment to reputation*

- Unwillingness to invest in reputation management because ROI is unprovable.
- Reluctance to speak to the press because "they always twist things."
- Reduced access to management imposed on analysts with unfavorable opinions.
- Persistence in misconduct while regarding government fines as "part of the price of doing business."

- Belief that wages paid to workers compensate for environmental and social harm done to communities.
- Rejection of opposing points of view by disparaging their sources.
- Unrealistic financial performance hurdles.
- Claiming security of competitive data as a pretext for withholding unfavorable information that investors and other stakeholders can generally expect to receive.

### Notes

1. Maitland, Allison, "Reputation: you only know what it's worth when it lies in tatters," *The Financial Times*, March 31, 2003.
2. Maitland, Allison, "The frustrated will to act of public good," *The Financial Times*, January 24, 2006, available at: [www.ft.com](http://www.ft.com)

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