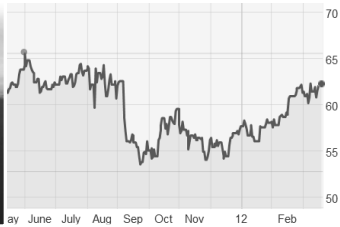


## BURGUNDYREPORT



2012RB-01 > April 2012

# Corporate Reputation: Is Your Most Strategic Asset at Risk?

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An impassioned intrapreneur, Serban successfully founded new groups within a number of multinationals by implementing novel business concepts and models. His unique approach has been documented in two books. In the 2010 book "Oser Intraprendre", Professor Louis-Jacques Fillion, HEC Montréal details Serban's experience as an intrapreneur. In 2003, Boyd Hendriks published in the Netherlands the book "De ontwikkeling van passie in organisaties" which outlines Serban's approach in creating a passion for excellence and management innovation in large organizations.

He was a co-author with CIRANO of the book "Integrated Risk Management for Mega-events"

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***Key findings based on a literature review of studies done over the last 12 years combined with the results of an exploratory study with 80 major companies in Quebec:***

- Reputation is the single most important driver in value creation or value destruction.
- Reputation provides a unique competitive advantage which enables a company to outperform the market by up to 100 percent.
- Two-thirds of Canadian consumers consider the reputation of a company as their most significant buying criteria.
- Reputation buffers a company's financial results to prevent loss of value during periods of market decline and economic turmoil.
- A one-point decrease in reputation is associated with an average market loss of about \$5 billion if the methodology is applied to the top 50 listed companies in the U.S.
- Research shows that there is an 80 percent chance of a company losing more than 20 percent of its total value at least once during a five-year period.
- In Quebec only 50 percent of companies in our sample ever mentioned reputation in their corporate reports or other communication materials.
- In Quebec, none of the companies that mentioned reputation as an important asset had a formal system to measure and manage reputation. Reputation was seen as an outcome of other activities such as public relations, marketing, or quality control.

*“Without reputation, we are nothing.”*

*— Warren Buffett*

# EXECUTIVE SUMMARY

## *Burgundy Report*

Corporate reputation is increasingly identified as the most important strategic asset in value creation for a company. Scholarly interest in the concept of corporate reputation has led to a five-fold increase in the number of peer-reviewed articles and studies over the past decade (Barnett *et al.*, 2006). Yet, there is no commonly accepted definition.

We propose a definition of corporate reputation based on a number of academic sources as well as work by practitioners. Corporate reputation is an intangible asset that is built up over time and represents the value and trust that stakeholders have for the company. It is a key asset, which favours the achievement of strategic objectives such as value creation, profitable growth, and sustainable competitive advantage.

Companies' reputations are more vulnerable than ever today because of globalization, increasing business complexity, economic and financial turbulence, the exponential growth of social media, and the speed of the news cycle. These factors can provoke difficult to predict crises which can destroy even the most carefully built reputations. Recently, both corporate board members and risk management professionals identified risk to reputation as the number one risk facing companies (EisnerAmper, 2011; Economist Intelligence Unit, 2005).

We are all aware of crises that have severely damaged well established corporate reputations, causing at the same time a dramatic loss of stock market value. One example is Canada's largest,

most prestigious tech company, Research In Motion. RIM began 2011 as Canada's fifth most admired company in ratings established by *Canadian Business* magazine and the Reputation Institute (*Canadian Business*, May 19, 2011). Then, a failed product launch and a disastrous loss of service to millions of BlackBerry users set the company on a steep slide in value. The loss of trust in RIM intensified when company executives waited three days before offering a public explanation and apology for the loss of service. RIM shares dropped 75 percent in value between March and December of 2011 (*Canadian Business*, January 19, 2012). A more recent case, in February 2012, is that of Canada's most respected engineering firm SNC-Lavalin, which has seen its shares drop by over 20 percent due to issues of questionable expenses.

This report combines the authors' exploratory study of Quebec's top companies with the review of most of the current studies and research on corporate reputation published over the last 12 years.

Our Quebec survey shows that only half the companies surveyed recognize the importance of reputation. None appear to be managing reputation in a proactive way.

CIRANO and Preventa will introduce a framework and processes to improve the way organizations manage their most valuable asset. This report provides a road map for companies to make the transition from reactive management to proactive management of reputation.





Corporate reputation has a higher profile now than at any previous time. Interest in the concept of corporate reputation has led to a five-fold increase in the number of peer-reviewed articles and studies over the past decade (Barnett *et al.*, 2006). Yet, there is no commonly accepted definition.

We propose a definition of corporate reputation based on a number of academic sources as well as work by practitioners. This definition will help in understanding the importance of managing reputation as a key corporate asset.

**Corporate reputation is an intangible asset that is built up over time and represents the value and trust that all your stakeholders have for the company. It is a key asset, which favours the achievement of strategic objectives such as value creation, profitable growth, and sustainable competitive advantage. Each corporate reputation is unique and impossible to copy. It can protect a company in difficult economic conditions and in the event of a crisis.**

When researchers focus on reputation as a **corporate asset**, different from corporate “image” or corporate “identity,” they tend to adopt the “**stakeholder approach**” to clarify the concept. In this view, corporate reputation is an aggregate of evaluation by many stakeholders (Barnett *et al.*, 2006).

Each stakeholder has his own perception of a company’s reputation based on his direct experience with the company plus influence by third party opinions (public perceptions, the media, and personal contacts). Each stakeholder’s perception is filtered by his own interests, priorities, and needs.

The same company may rank higher or lower in reputation when viewed by a customer who buys its products, by the investor who buys its shares, and by an employee for whom the workplace is the most important factor. A company’s credibility and reputation are thus viewed differently depending on which

stakeholder holds that view. The perspective of a non-governmental organization which is assessing the company's performance in protecting the environment sees the company's reputation differently from a shareholder who observes the same company to see how much it will bring in return on investment. These perceptions change over time and with changing circumstances.

This means a corporate reputation is not static, but rather, it is constantly changing, multidimensional, and the result of a dynamic process. At any given time it is the sum or aggregate of all the stakeholders' assessments. Corporate reputation changes with the shift in importance of different stakeholders and is influenced by specific economic market conditions and trends.

Some stakeholders have particularly high impact in building a company's reputation. Depending on the industry sector and the type of business, the key stakeholders for building reputation may be investors, government regulators, employees, or suppliers.

This report will demonstrate that a company needs to manage its reputation as its most important strategic asset, versus what is done today where its reputation is seen just as the outcome of other activities (activities such as marketing or public relations). This shift in the executive's perspective from outcome to asset is fundamental if the company wants to build a strong and sustainable reputation.

This Burgundy Report is structured as follows:

**Part 1.** Reputation: Understanding Its Value and Key Drivers

**Part 2.** Exploratory Study in Quebec

**Part 3.** How to Create a Reputation-Intelligent Enterprise

**Conclusion**

# Reputation: Understanding Its Value and Key Drivers

Intangible assets, such as intellectual property or brand, represent a significant portion of company value. R. Hall points out that corporate reputation may be considered as an intangible asset which provides a sustainable competitive advantage for firms that enjoy a strong reputation (Hall, 1992). The latest surveys of the business community have shown that it considers reputation to be a valuable asset. However, it is very important to notice the gap between recognition of that value and the systems put in place to manage reputation. In a 2003 study in the U.S., K. Harrison reported that only 19 percent of companies had a formal system in place to measure the value of their corporate reputation (Harrison, K., 2003). In these companies, the reputation management was done by various divisions: marketing, sales, human resources, corporate communications, public relations, or government relations. When many departments work simultaneously on reputation, it is important to have a unifying framework in order to establish priorities and integrate the programs' outcomes.

## HOW TO MEASURE REPUTATION EFFECTIVELY

A measure of intangible asset could be the difference between the market value and the book value. Over the past 20 years the gap between a company's book value and the value placed on it by investors has been widening considerably (Larkin, 2003). Oxford Metrica suggested that the value of a company can be viewed as a composite of three factors: tangible value (book value, real assets), corporate brand value (measured by Interbrand<sup>1</sup>), and premium value (the value in excess of book value at which the firm trades on the open market which is not represented in the brand).

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<sup>1</sup> <http://www.interbrand.com/en/best-global-brands/best-global-brands-methodology/Overview.aspx>

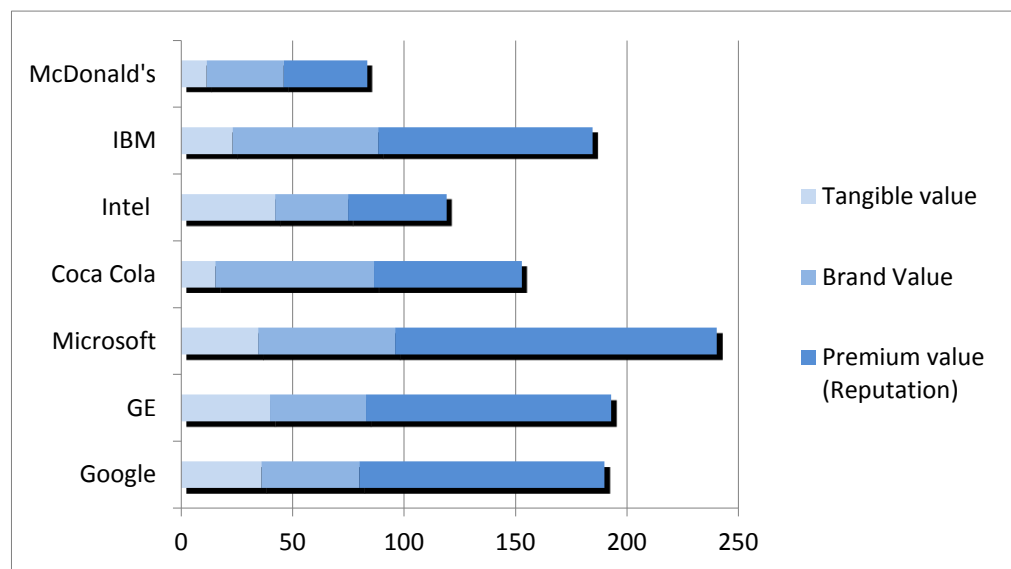
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The reputation  
can be worth  
much more than  
the tangible  
value and the  
brand name  
combined.

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Reputation equity can be thought of as being premium value (Oxford Metrica, 2011). For example, in 2010 the tangible value for Google was around US\$36 billion, the brand value was around US\$44 billion, and the premium value was estimated around US\$110 billion. For GE, the tangible value was around US\$40 billion, the brand value was around US\$43 billion, and the premium value was estimated around US\$110 billion (Oxford Metrica, 2011). So, the reputation can be worth much more than the tangible value and the brand name combined (see Figure 1).

**Figure 1**  
**The Elements of Value in US\$ billions**



Source: Adapted from Oxford Metrica, 2011

### REPUTATION SURVEYS AND RANKING OF THE MOST ADMIRABLE COMPANIES

Over 80 percent of companies in the U.S. that mentioned reputation as an important asset relied on outside surveys to give them an idea of how well they ranked in their industry compared with their main competitors (Harrison, K., 2003). Such surveys are general in nature and are not meant to give a valuation nor to provide priorities and reputation factors that might be at risk.

Reputation surveys are commonly seen to provide a good sense of which companies are admired by opinion formers and management peer groups (Larkin, 2003). *Fortune* magazine, The Reputation Institute, *Canadian Business* magazine, and *Les Affaires* publish reputation surveys which provide annual rankings of the “most reputable companies” or the “most admired companies” based on reputation scores. Each of these ranking systems uses its own criteria, surveys different groups and gives a different weight to various components or drivers of reputation (see Annex).

### ***The World’s Most Admired Corporation Ranking***

*Fortune* magazine surveys top executives and directors along with financial analysts to identify the companies that enjoy the strongest reputations within their industries and across industries. The “World’s Most Admired Corporation Survey” seeks the opinions of more than 4,000 people to arrive at a classification based on the following nine attributes of reputation:

1. Innovation
2. Financial soundness
3. People management
4. Use of corporate assets
5. Community and environment
6. Quality of management
7. Long-term investment
8. Quality of products and services
9. Global competitiveness

Raters are asked to evaluate each company on each attribute by assigning a score from 0 (poor) to 10 (excellent). The overall corporate reputation score is an average of the attribute scores. In 2011, *Fortune* rated the world’s most admired companies to be Apple, Google, Berkshire Hathaway, Southwest Airlines, Procter & Gamble, Coca-Cola, Amazon.com, FedEx, Microsoft, and McDonald’s. For instance, number one Apple’s overall score was 7.07 out of 10.

### ***The Most Reputable Companies Ranking***

Fombrun *et al.* (2000) draw attention to existing surveys that provide league tables of reputational attributes. The methodological limitations of these surveys include the restriction to publicly traded companies, the overrepresentation of senior managers, directors, and financial analysts in samples, and the lack of direct experience relevant to some attributes (Bromley, 2002). Based on Fombrun’s

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Reputation surveys are commonly seen to provide a good sense of which companies are admired by opinion formers and management peer groups.

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The top ten most admired Canadian companies in 2011 were The Jean Coutu Group, Tim Hortons, Shoppers Drug Mart, WestJet, Research In Motion, Bombardier, The Yellow Pages Group, Alimentation Couche-Tard, Canadian Tire, and Saputo.

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research, Reputation Institute created an index of global companies. These companies are both well regarded in terms of reputation in their home markets and successful in managing their reputations around the world. Reputation Institute surveyed 47,000 consumers across 15 markets. The score out of 100 is a measure of corporate reputation calculated by averaging perceptions of trust, esteem, admiration, and good feeling obtained from a representative sample of at least 100 local respondents who are familiar with the company. Seven key dimensions are evaluated:

1. Products and services
2. Vision and leadership
3. Innovation
4. Workplace environment
5. Citizenship or social and environmental responsibility
6. Governance
7. Financial performance

The rating indicates that a company has an excellent (above 80), strong (70-79), average (60-69), weak (40-59), or poor (below 40) reputation with global consumers across 15 international markets. Reputation Institute's global top ten most reputable companies in 2011 were: Google, Apple, the Walt Disney Company, BMW, LEGO, Sony, Daimler, Canon, Intel, and Volkswagen.

#### ***The Most Admired Canadian Companies Ranking***

Starting in 2010, *Canadian Business* magazine and Reputation Institute joined forces to assess the reputations of 50 of Canada's biggest companies, focusing on those which dealt directly with consumers or had a high public profile. The top ten most admired Canadian companies in 2011 were The Jean Coutu Group, Tim Hortons, Shoppers Drug Mart, WestJet, Research In Motion, Bombardier, The Yellow Pages Group, Alimentation Couche-Tard, Canadian Tire, and Saputo. Four Quebec companies ranked among the top ten. The survey was published in May 2011, before RIM experienced the first in a series of crises of confidence. Reputation Institute consultant Rob Jekielek noted at the time that "RIM scored highest in categories like products, innovation and leadership, but rated lower on trust, esteem and admiration" (*Canadian Business*, May 19, 2011).<sup>2</sup>

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<sup>2</sup> [www.canadianbusiness.com/article/26490--companies-we-love](http://www.canadianbusiness.com/article/26490--companies-we-love)

In Quebec, *Les Affaires* publishes an annual ranking of Quebec's 150 most admired companies. Every year, Léger Marketing conducts a survey of 10,000 Quebecers to assess the popularity and recognition factor of 260 companies doing business in Quebec. The question is simple: “Do you have a good/bad opinion of the company or do you not know the company?” They calculate a score out of 100 (for instance, 98 good opinions and 2 bad opinions give a score of 96). The top ten most admired companies in Quebec in 2011 were: Cirque du Soleil, Google, Le Groupe Jean Coutu, RONA, Sony, CAA-Quebec, Johnson & Johnson, Familiprix, Bombardier, and Uniprix (see Table 1).

**Table 1**  
**Most Admired Companies in Quebec (Top 10 in 2011)**

	2011 Scores	Good opinions	Bad opinions
<b>Cirque du Soleil</b>	<b>96</b>	98	2
<b>Google</b>	<b>95</b>	97	2
<b>The Jean Coutu Group</b>	<b>93</b>	96	3
<b>RONA</b>	<b>93</b>	96	3
<b>Sony</b>	<b>92</b>	95	3
<b>CAA-Quebec</b>	<b>92</b>	94	2
<b>Johnson &amp; Johnson</b>	<b>92</b>	94	2
<b>Familiprix</b>	<b>92</b>	93	1
<b>Bombardier</b>	<b>91</b>	94	3
<b>Uniprix</b>	<b>91</b>	94	3

Source: <http://www.lesaffaires.com/classements/liste/150-admirees-2011>

Companies cite the results from the rankings on their Web site or in their annual report. For example, CAA-Quebec (part of the top 10 in 2011) has on its Web site:

*“We are delighted to hold this special place in people’s hearts,” says José Garceau, Senior Vice-President of CAA-Quebec. “This shows that in the eyes of the public, CAA-Quebec is much more than just a towing service. We are valued for the savings, the assistance and the privileges we give to our members, as well as for the advice the general public can benefit from. For us, this is a sign that our work is appreciated. We see it as an encouragement to all our employees who work very hard every day to earn this trust.”<sup>3</sup>*

There are other measures of reputation by activist groups or non-governmental organizations (NGOs). Human resources consulting firms have measures that assess employee satisfaction and engagement. They usually do not ask employees directly

<sup>3</sup> [www.caaquebec.com](http://www.caaquebec.com)

how they feel about the reputation of their company. However employees are more motivated when they feel that their company has a good reputation.

### **KEY DRIVERS TO BUILD REPUTATION**

As previously mentioned, the correct way of evaluating and managing reputation is to consider it as a strategic corporate asset. Every corporation has a specific number of key stakeholders such as customers, regulators, government, non-governmental organizations (NGOs), suppliers, media, or organized labour. Each stakeholder will have its specific set of reputational drivers that will be used to measure the reputation of their business partner. Some of the most common drivers will be the quality of products or services, the workplace environment and benefits, rate of innovation, leadership style, and financial performance. For this study, we decided to focus on only two key drivers of reputation – corporate social responsibility and credibility. They are two of the most significant. Corporate social responsibility can represent as much as 40 percent of the total value of a corporation's reputation. Credibility is the driver supporting and reinforcing most of the other reputational drivers. Without credibility, a corporation will not see benefits from most of their reputational investments.

#### ***Corporate Social Responsibility***

Some CEOs and senior managers focus on investment in corporate social responsibility (CSR) as a way to protect and build their reputation (Pharoah, 2002). CSR has been viewed as a key driver of reputation by the corporation's commitment to integrate economic and social consideration into competitive advantage. CSR is based on the belief that companies should be responsible in their use of resources, whether natural, human, community, or anything else (Larkin, 2003). Surveys indicate that 87 percent of people expect the corporations they trust will act in a responsible way within their communities (Edelman, 2010).

Some of the criteria used in the reputation scores are related to corporate social responsibility (CSR). In *Fortune's* rating system, the role of CSR has a very small weight since the community and environment attributes are the equivalent of less than 10 percent of the evaluation. However, the Reputation Institute places a much stronger emphasis on corporate social responsibility. There, workplace, citizenship, and governance attributes give CSR a weight of more than 40 percent in the reputation score (see Annex 1).

Phillippe and Durand (2009) demonstrate that environmental information could give a positive or negative signal which could have an impact on reputation. For big



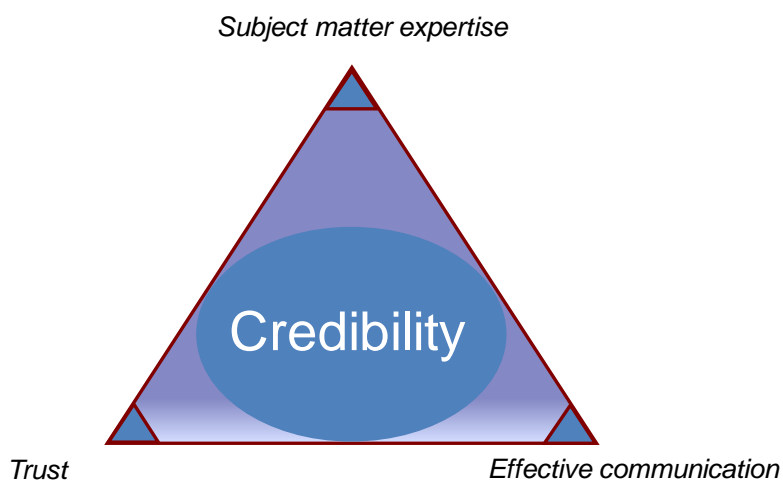
firms, CSR could be viewed as an insurance against reputation risk (Cardebat and Cassagnard, 2010).

### ***Credibility and Reputation***

In their model of reputation building and destruction, Herbig, Milewicz, and Golden clearly demonstrated the relationship between the credibility and reputation of a firm (Herbig, Milewicz, and Golden, 1994). Credibility is much more than trust. Credibility is the quality or the power of inspiring belief. In other words it is the perception of trustworthiness that the company can elicit in others. Based on our practical experience in dealing with major crisis management situations and then afterwards building and implementing recovery programs, we have defined credibility as the sum of three factors (see Figure 2):

- 1.** Subject matter expertise – the expert or the corporation must be a recognized expert in specific fields.
- 2.** Trust – the expert or the corporation must have a proven track record of integrity and delivering on promises over a long period of time.
- 3.** Effective communication – the expert or the corporation must understand the key stakeholders’ emotional filters.

**Figure 2**  
**Credibility**



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A firm whose reputation score moved from 5 to 8 would register as a result a reduction in the annual cost its equity capital of 1 percent. This would create an increase in firm value of 7 percent.

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Too often, companies rely on only their internal technical expert to provide opinions to the CEO while a crisis is taking place. They do so without realizing that the internal expert might not rank high in credibility with their most important stakeholder at that specific moment.

One of the most important elements of any crisis management system and recovery management system is to have a clearly identified list of credible resources based on the characteristics and needs of each stakeholder.

### **CHANGES IN REPUTATION: IMPACT ON CORPORATE VALUE**

Changes in reputation could have a corresponding impact on corporate value. Srivastava *et al.*, 1997, provided evidence on how a firm's corporate reputation may influence the equity markets' evaluation of that firm (Srivastava *et al.*, 1997). They used the reputation score from *Fortune* magazine's Most Admired Corporation Survey to show that a firm whose reputation score moved from 5 to 8 would register as a result a reduction in the annual cost of its equity capital of 1 percent. This would create an increase in firm value of 7 percent. For a company worth \$3 billion, this change corresponds to an increase in firm value of \$210 million. The payoff associated with reputation can be very substantial.

Oxford Metrica did a value analysis of the largest 500 European companies to measure the contribution of reputation equity to shareholder value performance. They reached the conclusion that firms with strong reputations can outperform their competitors by over 100 percent (Oxford Metrica, 2011).

Reputation Institute examined 35 companies and compared their reputation scores with their stock prices. A positive one-point increase in reputation score was associated with a higher average market value of about \$147 million, while a one-point decrease in reputation score was associated with a lower average market value of about \$5 billion (Fombrun and Foss, 2005). The financial impact of reputation loss can be catastrophic, whether through a decline in revenue, a depletion of asset value, an increasing cost of capital, or even bankruptcy.

The *Consumerology Report*, a Canadian survey commissioned by Bensimon Byrne and conducted by The Gandalf Group, was designed to discover how important macro trends may be impacting individual consumer behaviour. It found that two-thirds of Canadians said that corporate reputation significantly impacted their brand choices (Byrne, 2010). Reputation Institute established that 58 percent of people's willingness to recommend a company was driven by their perception of the

company, and only 42 percent depended on perceptions of the company's products and services (Reputation Institute, 2011).

### **NEW CHALLENGES WITH SOCIAL MEDIA: A CASE STUDY**

An exponential increase in the use of social media raises new threats to reputation as employees may disclose confidential information or take actions which reflect negatively on the company. The Information Security Forum (ISF), a non-profit world organization which maintains standards for business Internet security, predicts the threats to company security — and potentially to corporate reputation — are on an upswing. There is a growing risk of malicious use of social networks, be it to deliberately damage the company's reputation, to release confidential information, or to deliberately attack a rival company. Social networks are also changing the way companies communicate with their clients. Individual consumers exploit the power of social networks to gain support for social or consumerist movements that often force companies to reverse an unpopular policy. In late 2011, Bank of America was forced to withdraw a plan to impose a \$5.00 a month user fee for debit cards after one woman started a social network campaign on Change.org and gathered over 300,000 signatures against the plan.<sup>4</sup>

Non-governmental organizations also have learned to use social media to publicize issues that may be damaging to company reputation, as in the case of Nestlé. A Facebook video showed a young man at his desk biting into what looked like a Kit Kat bar made by Nestlé, but was not. He was actually snacking on orang-utan paws, his teeth dripping blood like Dracula's.<sup>5</sup> The Kit Kat logo was replaced by the word "Killer" (see Illustration 1). This marked the beginning of a social media campaign by Greenpeace International to call attention to the fact that the Swiss food giant bought its palm oil from an Indonesian company which Greenpeace said had cleared rainforest and destroyed animal habitat to grow its palm oil.

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An exponential increase in the use of social media raises new threats to reputation.

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<sup>4</sup> "In Retreat, Bank of America Cancels Debit Card Fee." *New York Times*, November 1, 2011.

<sup>5</sup> <http://www.youtube.com/watch?v=1BCA8dQfGi0>

**Illustration 1**  
**Greenpeace's Web Site**



Source: <http://www.greenpeace.org/international/en/campaigns/climate-change/kitkat/>

The video went viral, and from March 17 to March 22, 2010 there were 215,000 Tweets recorded as mentioning Nestlé. The company defended itself, saying this supplier was only responsible for 1.25 percent of its palm oil and that it was working towards buying only from environmentally responsible suppliers. Nestlé, one of the world's largest food companies, was caught off guard. The price per share dropped. Within days, the multinational had managed to recover, announcing its partnership with The Forest Trust (TFT). Nestlé announced responsible sourcing guidelines and became an active member of the Round Table on Sustainable Palm Oil. Greenpeace eventually saluted Nestlé's actions, using the orang-utan in its online messages to thank Nestlé for protecting the rainforest (see Illustration 2). However, this time it did not go viral.

## Illustration 2

### Greenpeace's Campaign



Source: <http://www.greenpeace.org/international/en/campaigns/climate-change/kitkat/>

In an interview with the *Wall Street Journal*, a press officer at Greenpeace pointed out: “This is the place where major corporations are vulnerable.”<sup>6</sup>

The Nestlé example clearly demonstrated the impact of social media on the value of the company. Initially Nestlé had the typical approach of quality control as guardian of reputation. The supplier from Indonesia didn't impact the safety or the quality of the product. However, that supplier clearly contradicted the reputational driver of some of Nestlé's key stakeholders with a direct impact on the company's valuation.

Managing reputation as a strategic asset together with the “stakeholder approach” as defined in our definition is the only sustainable and effective way of protecting and enhancing shareholder value.

### **REPUTATION IS ALSO VIEWED AS THE RESERVOIR OF GOOD WILL IN TIMES OF CRISIS**

A good reputation could protect an organization in times of corporate crisis. In public relations terms, it serves as a “reservoir of good will” (Jones *et al.*, 2000; Fombrun and van Riel, 2003). An organization with a favourable reputation is deemed to have a bank account containing reputation capital (Coombs and Holladay, 2006). Companies with good reputations are also considered to enjoy the benefit of the doubt with stakeholders in the event of negative events or bad news

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<sup>6</sup> “Nestlé Takes a Beating on Social-Media Sites.” *Wall Street Journal*, March 29, 2010.

about the company. Larkin said that the investment in establishing a good reputation is similar to having an insurance policy which can provide protective cover for well regarded companies in times of intense pressure (Larkin, 2003).

Moreover, Coombs and Holladay show that reputation gives a halo effect or acts as a shield that deflects the potential reputational damage during a crisis (Coombs and Holladay, 2006). Even more interesting is the evidence that in the absence of a crisis, a good reputation can provide benefits as a buffer to prevent loss in times of general economic turbulence and uncertainty. When the U.S. stock market took a sudden, unexpected downturn, the stock of companies with better reputations dropped significantly less than those of companies without that positive standing (Jones *et al.*, 2000).

## Exploratory Study in Quebec

**G**iven the increasing preoccupation with risk to reputation among companies, CIRANO and Preventa chose to undertake an exploratory study of Quebec corporations to determine the importance they attach to reputation, the way the concept of reputation is included in their annual report and Web site, the role of corporate social responsibility, the way they manage the company's reputation in a time of crisis, and their score in reputation rankings.

### METHODOLOGY

We selected 80 companies from among the 500 largest companies in Québec as identified by *Les Affaires*. We focused our research on larger companies. The likelihood is that the largest companies, and especially those operating on a multinational scale, are most aware of reputation issues. Because they have a higher public profile, they are most likely to be targeted in the media. Also, it may be assumed that larger companies have a larger budget to devote to corporate social responsibility and potentially, to managing risk to reputation. The companies we selected were representative of 16 sectors of industry in Québec including engineering, media, food distribution, telecommunications, restaurants, aeronautics, transportation, and banking.

For each of the 80 companies, we analyzed Web sites and we obtained public documents including annual reports and CSR reports. Information about the companies was gathered and included size, financial data, international activities, and CSR report. We analyzed the amount of space devoted to reputation and CSR in their corporate documents (quality of information), and if they were mentioning "reputation risk" and "CSR risk." We added information about media coverage<sup>7</sup>, and past crises affecting the company or its industry. We reported their reputation

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<sup>7</sup> Influence Communication offers media monitoring and exhaustive analysis of Canada's media outlets as well as those in over 160 countries ([www.influencecommunication.com](http://www.influencecommunication.com)).

score from the 2011 *Les Affaires'* most admired corporation survey. Out of the 80 companies, 37 were part of the 2011 ranking.<sup>8</sup>

In addition to the collection of data, directed interviews were conducted by phone or in person with public relation representatives and some CEOs of a sample of these companies. We asked specific questions:

*Is reputation considered a priority for senior management and the Board of Directors at your company?*

*Who "owns" reputation management in your company?*

*Do you have a specific framework for measuring reputation?*

*Do you think your company knows the effect of reputation on its financial valuation, customer loyalty, customer satisfaction, employee turnover, or share/price volatility?*

*Do you devote company resources to CSR?*

*Do you think CSR could be an insurance against reputation risk?*

## **RESULTS FROM THE INTERVIEWS**

This is an exploratory survey, presenting interesting opportunities for further study. However, conclusions and recommendations can be made:

- **Reputation risk is a highly vulnerable corporate asset for Quebec companies.** All respondents agreed that reputational risk ranks among the most important challenges faced by companies today. Almost all believe that reputational risk has increased or become more important. This quote illustrates this sentiment: *"Reputation has always been important, but its impact is more critical nowadays."* However, we have not seen any company that is focused on managing its reputation. There is a gap between the vulnerability and the system put in place in response to that vulnerability.
- **Communication and marketing departments are viewed as the guardians of the reputation.** Most companies view management of reputation as the responsibility of the communication department or a function of public relations. Reputation is seen as an outcome of these activities. However,

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<sup>8</sup> Romain Lenclos and Mohamed Fayçal Mahfouf from École Polytechnique de Montréal helped with the data collection. See also Lenclos (2011).



companies need to manage their reputation as their most important strategic asset. This shift of perception from outcome to asset is fundamental if a company wants to build a strong and sustainable reputation.

- **Companies still focus on quality of products and services.** Companies have a tendency to focus on the quality of their products or services and assume that threats to reputation will be the traditional threats experienced in the past, related to quality of service or products. In fact, studies show a dramatic reduction in crises related to product quality because of improvements in quality assurance processes, introduction of advanced technologies, and increased government regulations.
- **Reputation is evaluated and measured by outside organizations.** The majority of the respondents do not allocate resources within the company to monitor potential risks to reputation. Companies are content to allow their reputation be measured and ranked by external institutions, like *Fortune* magazine, or *Les Affaires* in Québec. They follow the rankings. *“If my company is in the 150 most admired companies in Quebec, I am fine for the year. It’s a good signal for all the stakeholders.”* But given that reputation is the most valuable asset to the company, it does not seem prudent nor in the strategic interest of the company to let the reputation rankings to be determined only by outside organizations. Such organizations have very different factors of evaluation compared to what is important to the company and its key strategic stakeholders. The outside rankings should be used only as a way of benchmarking the internal evaluation with a third party opinion.
- **For most respondents, history is a good indicator of future risks.** This is a very prevalent view among top executives that corporate reputation is not at risk and everything is under control since in the past, they didn’t have a crisis that affected their reputation. Companies consider the past to be a good indication of the future, which does not take into consideration all the changes in recent years, for example social networking, the rise of consumerism, and increasing globalization and complexity of their business environment. Such a view increases the risks to their reputation since new elements are not considered in the management process.
- **Reliance on advertising.** Companies assume they can continue to improve their reputation and communicate their message through press releases and advertising. This traditional communications model is no longer valid when you consider the high level of public cynicism and distrust towards businesses that is evident in public opinion surveys. A Nielsen survey presented at an

international conference in London in 2011 entitled “Social Media Driving Change in Consumer Perception” clearly demonstrated that in the public’s mind the word “false” is the word most often associated with advertising. There is a huge credibility gap that needs to be addressed.

- **Reliance on a crisis management process.** For all of the companies interviewed by CIRANO and Preventa, crisis management is considered the key element for protecting and saving the company’s reputation in times of crisis. Quebec companies are aware of a risk of contagion of a reputation crisis within a sector, of being tarred by the same brush. The companies are also aware of the risk of financial losses as a result of a reputation crisis affecting a supply chain partner. The bad reputation of the construction industry affects the reputation of all companies working in the same sector.
- **Corporate social responsibility is not perceived as important in reputation risk management.** Most of them said that CSR has become increasingly important for companies but that there is no direct correlation between corporate social responsibility and reputation. In time of crises, some of the respondents mentioned “CSR could help but it’s not essential” while other said that “it could be even worse”. Corporate social responsibility programs are not perceived to help a company in time of crisis. There are two important points to consider. The first one is that CSR can represent as much as 40 percent of the reputation value for some stakeholders. The second point, which affects international companies, is that the impact of CSR varies significantly across geographies as demonstrated by the study of Boston College Center for Corporate Citizenship and Reputation Institute (2008).

#### **STATISTICS FROM OUR SAMPLE<sup>9</sup>**

- **46.2 percent of the companies in our sample mention reputation in their corporate annual reports.** For instance, Molson Coors Brewing Co. wrote “*The success of our business relies heavily on brand image, reputation, and product quality.*”<sup>10</sup> Some of them speak of their “good reputation” as an asset.
- **47.5 percent of the companies in our sample identified risk to reputation in their corporate annual reports.** For instance:

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<sup>9</sup> See also Lenclos (2011).

<sup>10</sup> Molson Coors Brewing Co. Annual Report 2010, p. 20.

*“Reputation risk is the risk that an activity undertaken by an organization or its representatives will impair its image in the community or lower public confidence in it, resulting in the loss of business, legal action or increased regulatory oversight. Reputation risk can arise from a number of events and primarily occurs in connection with credit, regulatory, legal, and operational risks. Operational failures and non-compliance with laws and regulations can have a significant reputational impact on us.”<sup>11</sup>*

*“HACCP certification under the Food Safety Enhancement Program ensures compliance with the standards of the Hazard Analysis Critical Control Point system and assures consumers of food safety and wholesomeness. Moreover, if such a risk were to materialize, it could result in an expensive product recall and would severely damage the Company’s reputation.”<sup>12</sup>*

- **90 percent of the companies that mention the importance of reputation in their annual report also mention risk to reputation.** Companies that were most likely to identify a risk to reputation were in the sectors of banking, distribution, agriculture, transportation, and services.
- **55 percent of the companies in our sample devoted considerable attention to CSR in their corporate documentation.** More than half of the companies had CSR information which was either of good or very good quality, according to our criteria. However, about 25 percent of the selected companies had no information about CSR on their corporate Web site, or the information was of poor quality.
- **50 percent of the companies in our sample identified the existence of a possible risk related to CSR,** interpreted as the possible loss of financial resources or of reputation because of environmental or social factors. In particular, it was more significant for companies in the fields of power, transportation, oil and gas.
- **46.25 percent of the companies in our sample were in the 2011 most admired Canadian companies ranking.** We used the probit statistical method to estimate the relationship between the mention of reputation in annual reports and the most admired Canadian companies ranking. **The mention of reputation in corporate annual reports increases the probability of being in**

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<sup>11</sup> RBC Annual Report 2010.

<sup>12</sup> Lassonde Industry Inc., Annual Management’s Discussion and Analysis – Year ended December 31, 2010.

**the most admired Canadian companies ranking.** With our sample, we found also that international activities increase the probability of being more aware of reputation risk.

The study has identified some interesting patterns. In Quebec **only 50 percent** of companies ever mention reputation in their corporate reports or other communication materials. **None** of the companies that mentioned reputation as an important asset have a formal system to measure and manage reputation. Reputation is seen as an outcome of other activities such as public relations, marketing or quality control. There are differences between industry sectors, with banking, distribution, agriculture, transportation, and services being more aware of the risks to reputation. The same awareness of risks is found in companies that have international operations.

# How to Create a Reputation-Intelligent Enterprise

*“It takes 20 years to build a reputation and five minutes to ruin it.  
If you think about that, you’ll do things differently.”*

— Warren Buffett

There is an urgent need to implement and manage reputation very differently from the way it is done today. The high level of economic uncertainty, the globalization of businesses, and the fact that the whole planet is hyper connected through the new social media force companies to move from risk awareness and compliance to risk intelligence. The gap between the risks to the company’s reputation and what is in place to build and protect that reputation is widening fast according to our research. As we have seen from many recent surveys such as those done by Eisner Amper, 2011 or the Economist Intelligence Unit, 2005, the vast majority of executives and board members have an understanding of the value of reputation. They also rank it on top of their risk priority list. However, when we investigated how the companies evaluate, manage, enhance, and protect their reputation, the overwhelming response was that they do not specifically manage their reputation. The gap between what is needed and what is done is wide and it needs to be addressed.

## THE FIVE MAJOR DRIVERS FOR DOING THINGS DIFFERENTLY TO PROTECT YOUR REPUTATION

The following five points are the key market drivers that have a significant impact on the way corporations are viewed and evaluated by their stakeholders. From all the studies reviewed as well as talking to the executives, there is a consensus that these market drivers will shape the way reputation is evaluated for the foreseeable future.

- 1. The emergence of social media** as the main communication platform. Today, the business environment is best described as a “goldfish bowl.” There is no place to

hide or to control the information about our company, products, or services. Social media has changed the communication context and strategies. Corporate reputations can be affected globally by single individuals or groups that know how to use such platforms. Social media has a significant effect of magnifying the risk perception in the general population (de Marcellis-Warin and Peignier, 2012).

- 2.** The continuous **increase in the complexity** of the business processes. The implementation of new technologies and the globalization of markets, customers, and the supply chain make it imperative to have a new way of managing the risks introduced by higher complexity.
- 3.** **The increased expectations** of what businesses should do. Since the 90s, businesses are expected to contribute much more to the society where they operate than to just make a profit for their shareholders. Corporations are expected to improve on and have a positive impact on the places where they do business. CSR and sustainability programs have been developed to respond to such increased expectations.
- 4.** **The increase of intentional crises.** Most of the companies have crisis management programs designed to manage unintentional events. The globalization of distribution and supply chain made the businesses more vulnerable to intentional criminal acts. The melamine in Chinese milk scandal is just one example of how a supplier in China committing a criminal act can affect the reputation of entire industries and corporations in other parts of the world. A study done by Reid *et al.* (2006) noted that in the United Kingdom for the period of 1998 to 2003, of the total of 3,740 incidents, 86.4 percent were accidental. The rest, 13.6 percent, were intentional or of unknown origin. With the increase of terrorism activities worldwide, and with organized crime on a global scale, it is just logical to expect that in the future, the risks to reputation due to intentional events will increase.
- 5.** **Public cynicism and loss of trust toward corporations** and other institutions has increased, especially since the 2008 financial crisis (Edelman, 2011).

The typical approach of risk management that is prevalent in the marketplace is focused on compliance. Companies are reviewing hundreds of risks that are afterwards organized into a **risks-versus-impacts matrix**. Such an approach is very bureaucratic and does not provide the tools to actively manage the most important strategic assets of the company. In recent years, especially since the financial crisis, numerous studies and publications document the **failures of the classical risk management approach**. In the financial and investment sectors, Nassim Taleb published two best-selling books, *Fooled by Randomness* and *The Black Swan*, where he clearly demonstrated the serious

problems of the reactive, accountant-compliance driven approach (Taleb, 2001, 2011). Douglas W. Hubbard in his book *Failure of Risk Management* says “the research is overwhelmingly conclusive — much of what has been done in risk management, when measured objectively has added no value to the issue of managing risk. It may actually have made things worse” (Hubbard, 2009). Our experience over the last 20 years agrees completely with these assessments. Risk management has to change significantly in order to add value. It has to move from a static, bureaucratic risk awareness to a dynamic, risk-intelligent approach.

We define a reputation-intelligent enterprise as a company that considers reputation as its most valuable strategic asset. It fully understands its value and impact on the company. Such an organization has a focused approach all the way from its board and top executives to its employees. It has the systems and tools in place to actively manage, enhance, and protect its reputation. The corporate culture is in sync with its reputation.

In this report, we review three of the elements that allow a company to “do things differently.”<sup>13</sup> These elements are the risk framework, the risk anticipation model, and the corporate reputation maturity matrix. The elements that we selected are important, since they give a company using them three important tools: a framework to evaluate, understand, and manage its risks and vulnerabilities; a proven model to actively anticipate potential crisis; and a road map to becoming reputation-intelligent.

The reputation maturity matrix is a methodology designed to build a road map that will support a company to move from being simply reactive (acting only when there is a crisis) to becoming a reputation-intelligent enterprise, where reputation is part of the core values, a part of the DNA of the organization.

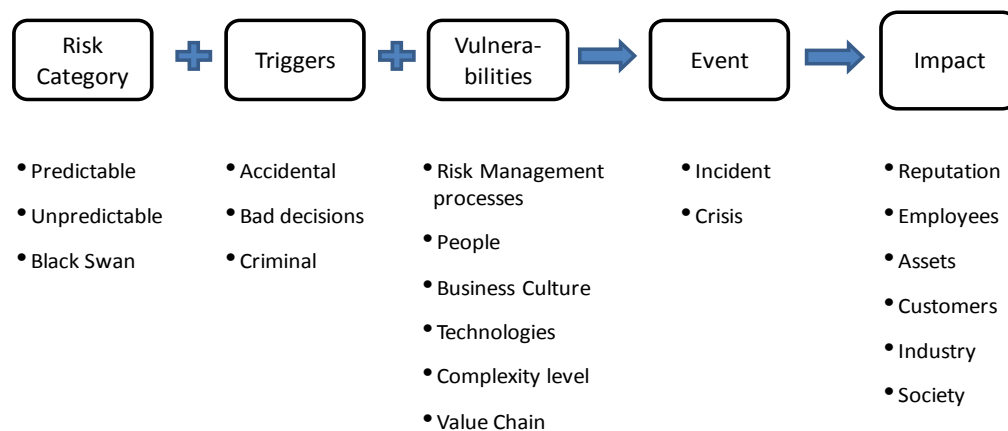
## **THE RISK FRAMEWORK**

The first and one of the most important steps in building a new way of managing and protecting reputation is to implement a risk framework. The risk framework provides the process of linking all the elements and stages of going from potential risk all the way to an incident or crisis.

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<sup>13</sup> Other elements, such as the recovery management process, the establishment of reputation drivers by stakeholders or the evaluation of the reputation culture, will be presented in a later study.

**Figure 3**  
**Risk Framework**



Source: Preventa

What follows is a brief description of each element of the risk framework.

### **Risk Category**

All corporations face three categories of risks: predictable, unpredictable, and black swan. **Predictable risks** are associated with the day-to-day business operations. These risks are well understood, well known, and well documented. They can come from employees not performing according to accepted standards. These risks can be associated with manufacturing or service practices. They also include risks introduced by suppliers providing goods and services outside specifications.

**Unpredictable risks** are known but very difficult to predict when they might be active. Examples of unpredictable risks are natural risks such as earthquakes or tornadoes. A company that works in a high earthquake zone knows of the risks of an earthquake, but cannot predict when it will happen. It must develop risk management systems that are dynamic to respond well to the crisis when it arrives. Other types of unpredictable risks can be of a political, social, or technological nature. Many of the unpredictable risks are also associated with the type of strategy a company undertakes and its implementation.

Finally, **black swan risks** are totally new, unknown risks. As such, a company cannot plan for them, but with good risk methodologies and tools in place, it will fare much better in the case of a black swan event than a company that doesn't have a sound risk program in place.



## Triggers

Triggers are the actions or events that transform a potential risk into a crisis or incident. The big failure of the classical risk management approach is to focus too much on the matrix of risk versus impacts. **A company is proactively managing risks only by knowing and managing the triggers.**

Triggers can be **accidental**. For example, in a manufacturing environment, the breakage of a piece of machinery is an accidental trigger. It can be mitigated by putting in place a preventative maintenance program.

The more difficult triggers to manage are also the ones that will have the biggest impact on the reputation and the value of the company. They are **bad decisions** and **criminal acts**.

**Bad decisions triggers** happen when management or employees make decisions without considering the consequences. For example, a plant manager needs to reduce the operating costs. He has different options but decides to significantly reduce the costs in the preventative maintenance department. Most of the bad decision triggers are related to the business culture prevalent in an organization and the way people are rewarded to do their jobs. There are proven methodologies to evaluate, manage, and change business cultures to match the strategic needs of the organization and at the same time protect corporate reputation.

**Criminal triggers** happen when people, for personal gain, intentionally go outside the law and accepted standards. The melamine contamination of milk in China was a clear example of a criminal trigger. The importance of understanding and managing the triggers is critical since it will have a direct impact on how much the reputation of a corporation will be affected during the crisis and its ability to recover in the long run.

**With an accidental trigger**, a company with a good reputation has a reservoir of **good will** and has the **support** of its key stakeholders. This makes it easier to manage the crisis and rebuild the corporate reputation and share value afterwards.

**Accidental trigger + good reputation = support from all stakeholders.** It is easier to manage the crisis, and rebuild reputation and value afterwards.

**Criminal or bad decision triggers = outrage and huge loss of reputation with all of the stakeholders.** The process of rebuilding reputation takes much longer.

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A company is proactively managing risks only by knowing and managing the triggers.

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### ***Vulnerabilities***

It is of utmost importance to understand the weak spots of a company in its capability of evaluating risks, managing the triggers, and responding to crises. **Vulnerabilities** can be divided into five major categories. **Risk management processes** are the types of risk management processes implemented. **People** refer to how well people are trained, evaluated, and provided with feedback in terms of managing day-to-day risks. **Business Culture** refers to accepted behaviours and values. **Technologies** refer to the types of technologies implemented in the company, the rate of introduction, and the ability of the employees using these technologies. **Complexity level** is determined by the risks imbedded into their products, their suppliers and distribution value chain, the level of globalization, and also the regulatory environment. **Value Chain** refers to the potential partners in the value chain such as suppliers or distributors. They could be the weak link in the reputation of a company as demonstrated by the Nestlé's case.

### ***Event***

An event is defined as the result of the combination of risks, triggers, and vulnerabilities of a company that results in an undesirable result. It is important to understand that not all events have the same impact.

**Incident:** This is an undesirable event that is contained within the confines of the company. For example, it can be the case of a food company that realises that it has a bad production batch, but their food safety processes found the batch in time, before it went outside the plant and into the food supply chain. It is serious incident but it is not a crisis. The systems in place worked to prevent this incident from developing into a crisis.

**Crisis:** A crisis is an event that has potential for bringing an organization into disrepute, which could endanger its future profitability, growth, and possibly its survival (Lerbinger 1997). A crisis also focuses attention on a company's public, social, economic, legal, and ethical responsibilities (Carroll, 1979; Jones, 1980; Alpaslan *et al.*, 2009).

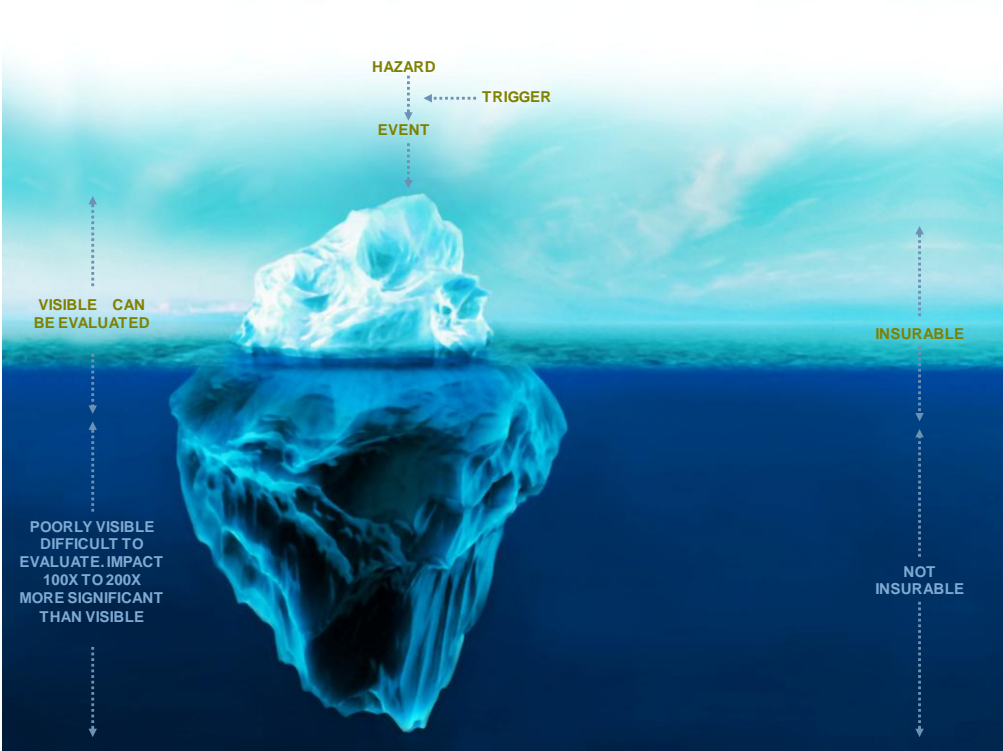
### ***Impact***

In order to properly evaluate the full impact of a crisis, it is important to understand and to try evaluating the impact on each of the following categories:

- Reputation
- Employees
- Tangible Assets
- Customers
- Industry
- Society

Most companies have systems in place to evaluate the loss of tangible assets and the cost associated with managing a crisis. It is much more difficult to estimate the total impact of a crisis. Many of the quantifiable impact costs can be insurable. As demonstrated in the study of reputation and value by Rory F. Knight and Deborah J. Pretty from Oxford Metrica, the total impact of a crisis is much higher than the direct costs of managing the crisis. It can be as much as 100 to 200 times the cost of the crisis itself (Knight and Pretty, 2001). The best image to illustrate the totality of impact is to use the iceberg impact analogy (Illustration 3).

**Illustration 3**  
**The Iceberg Impact**

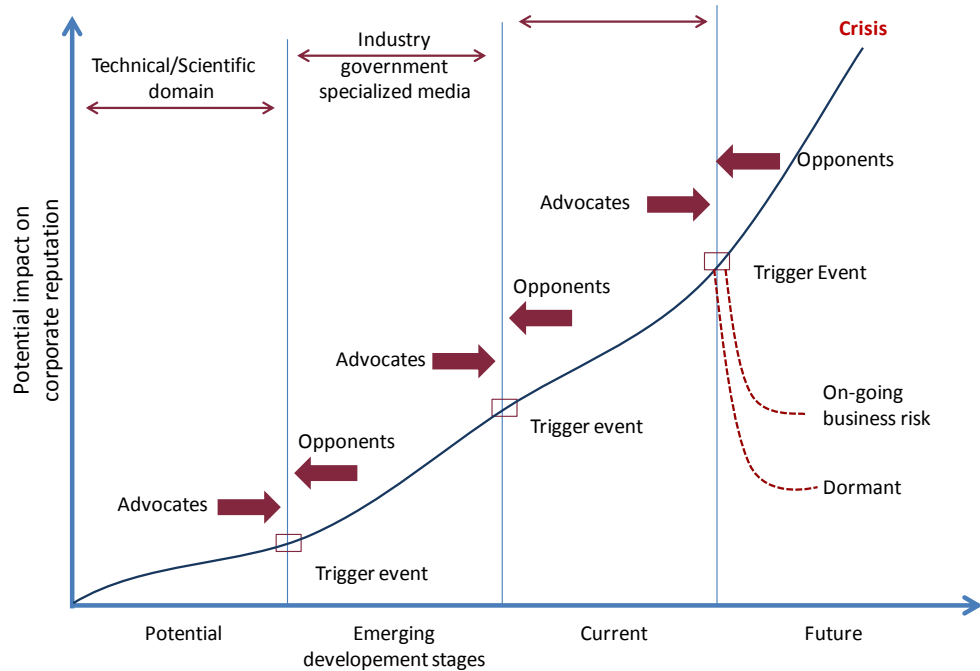


Source: Preventa

**RISK ANTICIPATION MODEL**

It is commonly accepted that crises are negative events that are very difficult, if not impossible to predict. In many instances, a crisis occurs when many separate events happen simultaneously. However, in many instances, if properly managed, a company can anticipate the development of a crisis. Within the categories, such as technical, scientific, political or economic, risk follows a pattern offering many opportunities for intervention to prevent negative events from becoming a full blown crisis.

**Figure 4**  
**Risk Anticipation Model**



In this model, the advocates are those who say there is a potential risk associated with the use of a product or technology. An example that has been very much in the public domain over the last few years is the potential health threat to cell phone users. Opponents are those who have the ability to defuse the threat by providing information that contradicts and demonstrates the opposite of advocates' opinions. For a company to make the right strategic decision, it is important to properly evaluate the credibility and potential impact of both advocates and opponents. At each stage, the advocates and opponents might change. An in-depth analysis with specific evaluation criteria is necessary.

There are four distinct phases in the anticipation model:

- **Potential phase:** In the early stages of an event, awareness of the potential risk is limited to discussions in technical publications. Then a trigger event, such as the release of a technical study, brings it to wider attention.
- **Emerging development phase:** In this stage, the risk may be discussed among industry and government agencies or specialized media. At this stage opponents of the emerging risk can intervene.
- **Current phase:** In this stage, the risk is becoming more widely known, disseminated through the news media and social media.

- **Future phase:** The last stage is the point at which a negative event either becomes a full blown crisis or an on-going lower level business risk. It also can simply disappear from the public eye and remain dormant until a future potential trigger event generates a new potential crisis.

It is very important for companies to integrate a risk anticipation model in their strategic process. This model should be used on their core products or services. It must be adapted to fit the geographical differences.

## **CORPORATE REPUTATION MATURITY MATRIX**

The corporate reputation maturity matrix has been developed with the needs of senior executives and board members in mind. The objective is to assess risks, identify vulnerabilities, benchmark performance and achieve continuous improvements in protecting corporate reputation. The matrix encompasses 11 indicators that are designed to evaluate, manage, and protect the reputation. Each indicator is assigned a maturity value from one to four, one being the lowest value and four the highest in terms of performance. The methodology employs structured interviews at different levels of the organization, in-depth consultancy audits, and documentation reviews. The analysis identifies the underlying causes of the organization's reputational risks and potential organizational weaknesses, and it provides a detailed continuous improvement road map.

What follows is a brief description of the main characteristics of each reputation generation.

### ***Generation 1: Reactive***

- No mention of reputation on any corporate communication media.
- No understanding of the impact of the reputation on the results and value of the company.
- Undefined and unstable business culture.
- Strategy driven by the very short term.
- No social corporate responsibility or sustainability programs.

### ***Generation 2: Awareness***

- Reputation is mentioned in corporate media.
- Top management is aware of the importance of reputation.

- To actively evaluate and manage reputation is seen as impractical and not as a priority.
- Reputation is one of the many activities delegated only to the marketing and communication departments.
- Corporate social responsibility programs and sustainability programs are seen as costs and not strategic investments with a clear ROI.

***Generation 3: Commitment***

- The top management fully understands the value of reputation.
- The top management and the employees find important the company's ranking in the most admired companies list.
- Company policies exist to manage and protect reputation.
- Investments are made in corporate social responsibility and sustainability programs. Such programs are seen as important elements of their unique value proposition.

***Generation 4: Core Value – Reputation-Intelligent Enterprise***

- Full board and top executives commitment – part of their priority tasks.
- Clear understanding throughout the organization of what drives the reputation and who the key stakeholders are.
- Dynamic and practical systems in place to monitor, evaluate, manage, and protect corporate reputation.
- Regular board reviews of the reputation audits and trends analysis.

**Table 2**  
**Reputation Maturity Matrix**

REPUTATION INDICATORS	GENERATIONS			
	1	2	3	4
<b>1. Reputation factors – model by stakeholders</b> Ranking the reputation factors by major stakeholders				
<b>2. Risk framework</b> The road map linking risks, triggers, vulnerabilities, events and impacts				
<b>3. Risk management process and standards</b> The processes used to identify, evaluate and manage risks (There are now many risk standards available, such as ISO 31000)				
<b>4. Risk anticipation process</b> The model for tracking and anticipating potential risks to reputation				
<b>5. Crisis management process</b> The systems in place for managing a crisis in real time				
<b>6. Recovery management process</b> The methodology to evaluate the impact of a crisis, as well as the root cause analysis, to put in place value recovery programs				
<b>7. Business culture</b> Evaluating, measuring, and developing the company’s business culture drivers in order to support the strategic objectives				
<b>8. Roles and responsibilities</b> The structure, responsibilities, accountabilities, and activities of people directly responsible for corporate reputation				
<b>9. Reputation audits</b> Regular review of the reputation value with the major stakeholders				
<b>10. Data management</b> The full analysis of data coming from reputation audits,				
<b>11. Training</b> Regular training on the latest reputation methodologies and continuous improvement seminars				

Source: Preventa

Based on our practical experience over the last 20 years with hundreds of companies in many different industry sectors across the globe, the maturity matrix approach is the best way to guide a company in its journey towards protecting and maximizing the potential of its corporate reputation. The matrix enables executives to set clear priorities, sends positive messages to the key strategic stakeholders, and empowers the employees to manage reputation on an ongoing basis.

#### **CASE STUDY: BP'S GULF OF MEXICO OIL SPILL**

This case is interesting for many reasons: the impact it had on the environment, the fact that it affected a company that spent so much time building its reputation, and the leadership position BP had in the oil industry. However, one critical factor whose impact could have been anticipated was the trigger of this huge crisis.

On April 20, 2010, an offshore drilling rig called Deepwater Horizon exploded after the blowout of an oil well. The well was one mile below the surface of the Gulf of Mexico in the United States. BP was named the responsible party among all the companies involved in the drilling operation by the U.S. government. Eleven men were killed and seventeen others injured. The story dominated the news for months as BP and the other companies involved took 89 days to finally cap the gushing oil well.

#### **Illustration 4**

**BP's logo before and after the accident seen on Social Media**



Before this accident BP had invested billions in corporate social responsibility and taken a leadership role among oil companies to reduce the effects of hydrocarbon emissions to combat climate change. BP also acted quickly in the Deepwater Horizon disaster, setting aside nearly \$40 billion to cover the costs of clean-up and to compensate fishermen and others who lost their livelihood because of the spill. Yet a number of communication gaffes dominated the news, when then-CEO Tony Hayward said he wanted to “get his life back” and at one point called the worst oil spill in U.S. history “a tiny trickle.” The price of BP stock fell by 52 percent in 50 days as a result of this crisis. A year and a half later, BP stock had only partially recovered. Meanwhile, the company continues to negotiate legal settlements resulting from the crisis and to await court cases which might increase its financial liability.

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*“The disaster can be attributed to an organizational culture and incentives that encourage cost cutting and cutting corners that rewarded workers for doing it faster and cheaper but not better.”*

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## **THE MAIN TRIGGER: BAD MANAGEMENT DECISIONS DUE TO BUSINESS CULTURE**

The term “business culture” began to be used in relation to organizational performance and development in the 1980s. There is a wide consensus that business culture is one of key elements that allows organizations to achieve their goals and avoid expensive errors. The National Commission’s Report on BP to the President concluded: *“The disaster can be attributed to an organizational culture and incentives that encourage cost cutting and cutting corners that rewarded workers for doing it faster and cheaper but not better.”*

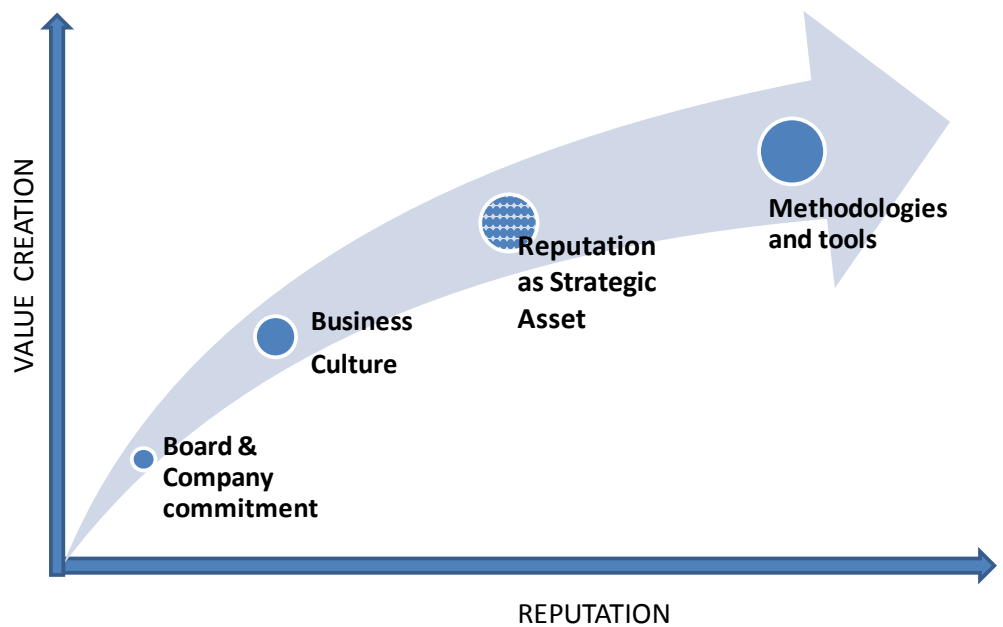
A “deficient” business culture was also the main trigger in the NASA three major crises, the loss of two space shuttles and the initial technical problems with the Hubble telescope.

## **HOW TO CREATE A REPUTATION-INTELLIGENT ENTERPRISE**

To become a reputation-intelligent organization, a company must have the following characteristics and priorities in place:

- 1. Reputation is part of the Board’s and CEO’s priorities.** The research has overwhelmingly demonstrated that corporate reputation is the biggest value driver in any organization. Therefore two priorities of any board and CEO are to put in place strategies and to allocate resources to create sustainable shareholder value and ensure the ongoing strategic concern of the company. The board and the CEO will have to be accountable and directly involved in the management of corporate reputation.
- 2. Business culture.** It is the fundamental element that makes all the investments and processes work together to achieve the expected results.
- 3. Ongoing evaluating, managing, building and protecting the key reputation factors.** It is important to have clarity on the top 10-15 key reputation factors that drive the reputation of the corporation. These key reputation factors have to be specific and relevant to each of the important stakeholders of the corporation.
- 4. Risk management methodologies and tools specifically designed to protect corporate reputation.** In order to manage, enhance, and protect corporate reputation, it is important to have tools and processes that have been developed specifically to manage the key reputation factors.
- 5. Risk anticipation model.** There are proven ways to anticipate the severity and impact of major risks to reputation by implementing a robust anticipation model.

**6. Recovery management process.** The vast majority of corporations have a crisis management process in place. It is designed to give a framework for the company to deal with an *emerging or existing* crisis. Very few companies have a recovery management process in place to deal with the *aftermath* of a crisis and to serve as a platform for building back corporate reputation. To have a solid recovery management process in place is one of the most significant drivers of recovering and further building corporate reputation. Oxford Metrica showed that many companies came out of a crisis with a higher corporate value than before the crisis. This can be achieved only through having a recovery management process.



Source: Preventa

Robert S. Kaplan and Anette Mikes from Harvard Business School clearly explained the choices the companies are facing when moving from reactive to proactive status: “Risk Management is certainly not free and can often be expensive. But the forgoing of it can be far more expensive. To paraphrase an old TV oil filter commercial, organizations can pay now for risk identification, measurement and mitigation — or they can pay later. Now is generally cheaper. Boeing, BP, and the financial institutions that failed in 2007 and 2008 learned the high costs of paying later rather than paying now” (Kaplan and Mikes, 2011).

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“Risk Management is certainly not free and can often be expensive. But the forgoing of it can be far more expensive.”  
 (Kaplan and Mikes, 2011).

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**T**his Burgundy Report has shown that corporate reputation is by far the most strategic asset in value creation or destruction for any company. It helps to manage the strategic direction of a company. To drive the full benefits, a company must proactively manage and protect its reputation. The present unstable economic and political conditions will continue for the foreseeable future. The impact of social media will continue to grow. Uncertainty and high risk environments represent the new reality for all companies.

It is of utmost importance for all companies in Quebec to understand the value of reputation. Based on our study, 50 percent of companies in Quebec need to take this first step. Corporate social responsibility programs are critical components of corporate reputation. Their significant impact is grossly underestimated.

All companies are aiming to achieve a unique competitive position in the marketplace. Reputation, when built, managed, and protected in a structured and organized way represents this unique asset for sustainable value creation. Investing now in managing and protecting corporate reputation is a much better investment and more cost effective than paying later when a crisis has arrived and the survival of the company is at stake.

We would like to end with the words of one of the most respected businessmen in Quebec. Mr. Rémi Marcoux, Chairman of the Board of Transcontinental, was interviewed at his last board meeting on February 16, 2012. He said:

*“More than anything, Transcontinental has built an excellent reputation over the last 35 years. It is of inestimable value! I was the guardian of this value and it is now up to my daughter Isabelle [now chairwoman] and Francois Olivier [president and CEO] to safeguard this treasure.”*

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# Annex: Comparison of Reputation Ranking Systems

 <p>Most Admired Companies</p>	  <p>Most Reputable Companies</p>
<p>Score from 0 (poor) to 10 (excellent) on the following dimensions:</p> <ul style="list-style-type: none"> <li>• Innovation</li> <li>• Financial soundness</li> <li>• People management</li> <li>• Use of corporate assets</li> <li>• Community, environment*</li> <li>• Quality of management</li> <li>• Long-term investment</li> <li>• Quality of products and services</li> <li>• Global competitiveness</li> </ul> <p>Score is out of 10.</p> <p>* This dimension is also measured in corporate social responsibility. One CSR dimension out of nine is about 10 percent.</p>	<p>Degree of admiration, trust, good feeling and esteem (“How do stakeholders feel about your company?”) on the following dimensions:</p> <ul style="list-style-type: none"> <li>• Products and services</li> <li>• Vision and leadership</li> <li>• Innovation</li> <li>• Workplace environment*</li> <li>• Citizenship or social and environmental responsibility*</li> <li>• Governance*</li> <li>• Financial performance</li> </ul> <p>Score is out of 100.</p> <p>* These dimensions are also measured in CSR. Three CSR dimensions out of seven are about 40 percent.</p>

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