REPUTATION – TIME TO BE VIEWED AS CAPITAL

A review of 2015 and the evolution of reputation as a manageable capital programme

January 2016

A review of companies that faced reputational issues in 2015 highlights the ever-increasing risk to shareholder and commercial value. Management discipline needs to change to view reputation on a similar basis as financial capital. Sufficient data and tools are available to enable Boardroom decision-making to manage reputation risk and create strong reputation capital buffers and drivers.

A review of 2015 enables us to analyse the cases of UK FTSE 350 companies that faced significant reputation issues over the calendar year. For the purposes of this paper, we have examined five companies we believe would comfortably rank in the top 10 of reputational damage in 2015. We have chosen these not for the purpose of naming and shaming, but to continue our campaign for reputation to become a core element of senior management decision-making. Accurate and accessible data is now available for informed decisions to be made on reputation, along the same lines as they are for other strategic, financial or operational requirements. The provision of such data should encourage senior management to view and manage reputation as they do assets and liabilities - as Reputation Capital.

We encourage senior management to view reputation the same way as they would the financial capital of their business. Essentially, the greater the reputation you have, the greater the buffer you can secure against reputation loss – just as a higher financial capital ratio covers against significant economic loss.

Very few organisations are dealt a singular reputational blow that severely damages their business. It is more usual that it is a series of events over time. As such the senior management should be able to judge that its Reputation Capital is declining and take the required actions, based on sound data.

In each of the five cases we examined, the reputation damage inflicted on them was not the result of a singular occurrence, but a series of events, that in many cases probably were not seen internally as increasing in severity. But, as their Reputation Capital declined across different stakeholder groups, so the risk of reputation impact increased. We view this as the elasticity of reputation - as Reputation Capital decreases, the potential negative impact increases. This is not uniform across stakeholder groups as, in reality, each stakeholder group's Reputation Capital requirement is different. This raises a key difference between Reputation Capital and financial capital, which reduces in proportion to the financial loss incurred. Reputation Capital is often unaccounted for and needs to be measured separately across different stakeholders.

Traditionally, reputation has been seen as an asset which, like a brand, can provide a return or be in decline and is closely aligned to goodwill. However, with reputation it isn't so linear. Each of our five cases were impacted for very different reasons, ranging from severe failure in corporate governance; or operations; or commercial markets; or regulation; to financial under-performance. All very different issues that led to significant reputational damage.

Historically, such reputational damage would probably be viewed through a single lens, matching all stakeholders on the same level. This is out of date. The concept of Reputation Capital is based on the ability for the Board to measure and understand each stakeholder in their own right and then take the appropriate action to rebuild that capital loss.

This brings together reputation as both an asset and a liability. Looking ahead, companies need to recognise that reputation is the sum of stakeholders' expectations. Reputation damage is the difference between those expectations and the actual performance of the company. This is the liability side of the reputation ledger.   Each stakeholder has a series of expectations based around their belief in each company's obligations to them. A failure to meet these obligations leads to reputational damage. It is only by measuring and understanding each stakeholder's liability that a company can build a complete account of its Reputation Capital and, most importantly, then be able to address any expectation shortfall in its programme to manage its reputation.

For each of our five cases, the road to Reputation Capital return is going to be different, balanced between the demands of the impacted stakeholder groups. We can easily look at the equity devaluation for each company (on average a decline of 39% for calendar year 2015), but how should each company respond?

[NOTE: Our own research in 2015, undertaken in partnership with Deloitte, showed that the FTSE 350 constituents estimate that 41% of their market/enterprise valuation is accounted for by their reputation. A close correlation to the 39% equity devaluation in our five cases.]

In each case it is too early to tell the true impact of the reputation damage at a financial and commercial level. However, as we outlined from our own research last year, there is a growing correlation between corporate reputation and commercial outcomes. Today's end users of products care not only about the brands they buy or are associated with, but increasingly about the corporate reputation behind them. There are many social, economic and technological trends behind this, such as the question of corporate responsibility in society; the willingness and ability to confront and challenge the role of corporations; a declining trust of business; and the public's growing environmental awareness.

The result is that we are seeing a direct convergence between Reputation Capital and commercial success. This is being accelerated by technology and digital developments, changing the way we communicate and source our information. The consumer is increasingly placing greater faith in online channels as opposed to traditional media for their information. Everyone can now be informed or be an informer. If a stakeholder has a bad experience, the story can be shared and expanded to break out of that traditional stakeholder silo to become a mainstream reputation issue impacting the media, public opinion, policymakers, regulators, investors and other corporate influencer groups. Our belief is that Reputation Capital now yields such a potential commercial impact, that it must become a key part of corporate strategy and decision-making.

For each company we analysed, the starting point for the reputation return will be different. As an example, the business that has faced significant corporate governance issues must clearly address its shareholders where the biggest liability lies on the basis of expectations not meeting obligations. However, this company will also need to understand what impact this has had on other stakeholders such as customers and suppliers. Media analysis already shows a clear decline in support from influential business journalists. On the opposite side, the business with operational reputation damage must address its customers as the foundation of its reputation rehabilitation. But again, what impact has this has had on regulators and the capital markets will need to be understood.

Our research last year examined the evolution of reputation within the UK corporate world. Only 34% of respondents claimed to use reputation as a key business driver across all stakeholders. The research showed that reputation is not yet subjected to the same type of vigorous management techniques used in other areas of commercial management. However for us, the key finding was that only 16% made any effort to measure reputation and link it to businesses outcomes.

In fairness, we believe many organisations are looking at the constituents of reputation, but are doing so in silos, rather than understanding its complex nature in its entirety. 78% of respondents claimed they are now focused on a broader range of stakeholders, fundamentally moving away from a singular focus on shareholders which has dominated business ethos for decades.

But the challenge remains for companies to understand how these different stakeholder groups link together in the modern digital era; and how to evaluate the impact of the change in reputation amongst one stakeholder group on the overall reputation of an organisation.

If Boards and senior management teams can embrace the concept of Reputation Capital, then reputation as a form of return on investment will be a major step forward. Organisations need to be able to forecast potential reputational issues and manage the organisation to address these commercial risks in advance.

On our basis of Reputation Capital, companies need to start to understand the constituent parts of reputation – as both an Asset and a Liability. Our research showed that consumer/client service is the most important factor in the building blocks of reputation (figure 1). Second is culture and ethics, then the vision of the senior management and in fourth place financial performance.

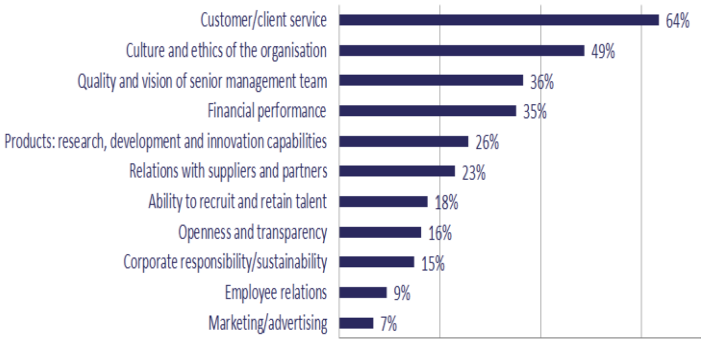

Figure 1

Our five case studies will need to understand this. In order for reputation to be managed and enhanced, these factors all need to be understood holistically within a single platform, so that we can see how different stakeholders assess them and how they impact an organisation. What our research also showed is the traditional response through marketing and/or PR is not solely adequate. Companies are now seen for what they do and how they behave, rather than what they say. Transparency is a requirement, not a choice. Attempts to manage reputation solely through the media or paid-for content will not be sustainable.

Furthermore, the complexity of reputation and how it differs between each organisation means that no one approach will fit all. Senior management must create a programme tailored to its own situation. In order to achieve this, firstly each organisation has to be able to measure and understand the role of reputation and the impact that has been made to its Reputation Capital. This involves bringing together every stakeholder important to an individual organisation, creating its own stakeholder matrix of connectivity, and conducting primary research to understand the building blocks of reputation – expectation and obligations. The findings, on a statistically representative basis, will enable the fundamental understanding of how a company's reputation is viewed by each stakeholder. The findings of the primary research then need to be correlated to ongoing data analysis to enable the Board and management to take the appropriate actions. Just as financial capital is managed on a regular basis and continually reviewed at the Board, so should Reputation Capital.

The necessary tools and information are available for companies to do this successfully. Boards and senior management teams can then make the appropriate decisions to protect and enhance reputation, both internally and externally.

Our experience demonstrates that multi-stakeholder research allows a company to put a marker in the sand from which to manage, build and shape its reputation. Having established a baseline understanding, which includes qualitative and quantitative feedback from multiple stakeholders, a company can then plan ahead, put a programme of actions in place and set KPIs to track performance as part of the Board agenda. Measurement and the subsequent action planning should become part of a company's business planning. This represents a real commitment towards managing Reputation Capital and embedding it within the business, which will lead to better risk management and enhanced commercial opportunities.

From our work, we have seen that the Financial Services sector is placing reputation firmly on the agenda. This is largely in response to the significant impact of the financial crisis. They have been one of the first sectors to truly witness the increasing link between Reputation Capital, stakeholder behaviour and commercial outcomes. It is no coincidence that the sectors' regulators have identified Reputation Risk as an area requiring active management and encasing it within their framework. We forecast that over time such requirements to understand and manage reputation will flow into other sectors and management practice.

Looking forward, we believe that companies and Boards that look to actively understand and manage their Reputation Capital will generate a significant return on investment. Corporate reputation and its management is still relatively early in its evolutionary cycle, but as commercial success is more influenced by it, and the tools exist for Boards to manage its development, then Reputation Capital will become a core Board discipline and differentiator.

AUTHORS NOTE: As a business, we have a strict policy that we never name the companies we have or are working for. The data we provide, and the advice given, are commercially and financially sensitive. On the same basis, we have not named the five companies we analysed.

REFERENCES: Reputational Risk Management in the Financial Institutions. Incisive Media 2014.

FOR FURTHER INFORMATION:

Fergus Wylie: fergus.wylie@sifastrategy.com
Ben Morton: ben.morton@sifastrategy.com
Madeleine Palmstierna:
madeleine.palmstierna@sifastrategy.com