Protecting reputation by preparing better for crisis

How companies respond to crisis situations can have a significant impact on their reputations. Despite this, too few prepare for the almost inevitable day when something goes badly wrong

By **Herbert S Winokur, Jr**

For almost any company, reputation is a key asset. Few have enough market power that they can afford to ignore the effect of reputation on customers, suppliers and so on (with Microsoft in the early days of Windows or IBM in the early days of mainframes being notable exceptions).

Businesses that sell only commodities (eg, financial intermediaries) must compete on service as well as price. Their reputation is the summation of how their service has been perceived in the past. Businesses that sell products (eg, industrial, auto and medical products) know all too well the effect on revenues and stock price when reputation takes a hit from a safety incident or a quality problem. Examples include BP, Toyota and Johnson & Johnson.

As representatives of shareholders, directors are responsible for monitoring reputation (some do it directly and some indirectly), avoiding risks as much as possible and responding well when the inevitable crisis occurs. However, boards often fail to monitor risks as well as they could and fail to plan responses to the crises which do occur. This article offers proposed approaches to both risk management and crisis response. If followed, these should help to protect reputation – both the company's and the directors'.

Mapping the risk

Risk mapping is a vital function that every organisation should undertake and boards must be properly organised in order to do so. Risk mapping offers a substantially more productive method of defining risk than current practice. Risk mapping requires an in-depth look at all types of risk that could affect the organisation. It requires reviews of history, competitive practices, regulatory activities, approaches to personnel and compensation, corporate value system and intellectual property, as well as brainstorming, simulations and war gaming about possible scenarios that could affect the organisation.

Given the need to examine known risks and speculate about unknown risks, typical board meeting structures and schedules are inadequate to the task. In addition, on most boards only a few independent directors are intimately familiar with the activities of the organisation that they are overseeing (other directors may be chosen for reasons of specific expertise, customer or supplier relationships or diversity). Other individuals who are likely to have a deep understanding of risks are senior (including recently retired) executives below the chief executive officer or chief operating officer, and recently retired directors of the organisation or of its competitors.

Boards' agendas have become increasingly crowded with check-the-box activities, and committee and board meetings have expanded to ensure that defensive processes are followed. As a consequence, board committee charters have become more stove-piped, which hinders board committees from ensuring that risks that cut across the organisation are being considered and monitored appropriately. In addition, board members receive information from within the

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Risk-mapping action steps

- It is important for the board to take initial control of the crisis management process, both to avoid conflicts and to keep management focused on the company's operations.
- To be able to take initial control effectively, a board must have a well-considered crisis management plan.
- If it becomes clear that the crisis can be appropriately handled by management without conflict of interest or diverting attention from operations, the board may reassign lead responsibility back to management.

Focusing the mind of a director

- How should a director be as prepared as possible for the inevitable crisis?
- When the crisis hits, how should directors organise to minimise the impact on the enterprise, the shareholders and themselves?
- What conflicts between advisers are likely to complicate directors' responses?

organisational hierarchy, which is by definition limiting.

Risk mapping might be approached as follows. A group of people – perhaps five to eight – drawn from the groups mentioned above could be organised to form a risk-mapping advisory committee. Outside counsel, brand consultants, enterprise risk management specialists and insurance experts are examples of potential staff who could support the committee. Enterprise risk management processes, with the help of outside experts, can be a good complement or support to the advisory committee. It is important that the risk management process be separated from the time and experience limitations that any board faces, so that risks can be reviewed with adequate time from a 360-degree perspective.

This group should meet three or four times a year for part or all of a day, outside the board meeting cycle. Its charter would be first to identify as many risks as possible and to quantify them by both the likelihood of their occurring and the consequences to the organisation if they were to occur. Second, the charter would empower the committee to determine which organisational units were responsible for addressing and mitigating these risks and, by default, which risks were not being addressed. The committee would be charged with reporting to the full board of directors once a year and with providing interim reports as necessary. The board would then be better informed about both the organisation's risks and areas in which additional focus or mitigation would be required.

Some scenarios are worth considering. If, for example, a director of a large financial organisation, home builder, insurance or building products company had asked, "What happens if housing prices decline nationally by 5% to 105 and stay lower for an extended period?", an interesting discussion might have ensued. If, in another case, a director of a large financial institution, energy company or pharmaceutical firm had asked, "What is the trade-off between our current short-term profit-maximising practices and the alternatives of building brand value over a longer period by tightening compliance, safety, and/or lobbying practices?", some important declines in market value might have been avoided. A trustee of a major

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research university might have wondered about the trade-offs in allocating endowments to increasingly illiquid investments and the resulting consequences to stability in faculty hiring and construction projects.

Management should be encouraged to provide information on the company's internal risk management activities to the risk-mapping advisory committee, and to coordinate those activities with the committee. The committee process should be designed to preserve privilege and to be sensitive to disclosure issues.

After the risk-mapping advisory committee reports to the board, a number of responses should occur:

- The board should ensure that all identified risks of consequence are being considered by one or more organisational units and appropriate steps for risk mitigation are being taken.
- To the extent that changes in strategy, processes or procedures are required, such changes should be made.
- The board's nominating committee may consider the risks identified as a partial basis for determining the kinds of expertise that would be beneficial to obtain from new directors.
- The board may explore possible responses to negative outcomes that might occur, with the help of a crisis consultant or other advisers.

While it is unlikely that the negative outcomes will actually happen, crisis management preparation of any kind is helpful in any scenario. The new committee could be a potential source of advice should a crisis occur. By repeating this process over time, the organisation is likely to reduce the impact of a major negative surprise on its activities.

Preparing for crisis

A new director of a public company or a large non-profit should expect to be involved in at least one crisis during his or her service. A crisis can come in many forms: it may involve health issues of senior executives, product recall, the violation of laws such as the Foreign Corrupt Practices Act, financial restatements or the violation of codes of conduct. The list of possible causes goes on. But the question is essentially when, rather than whether, a crisis will occur.

New directors should concentrate on three questions to prepare for the (almost) inevitable crisis:

- What should a director do in advance to be as prepared as possible?
- When the crisis arrives, what are the proper questions to ask and steps to take to minimise the impact on the enterprise, the shareholders and the directors themselves?
- What conflicts will emerge that may make coping with the crisis even more difficult?

Answers to the second and third questions depend on the situation, but thoughtful preparation will pay real dividends.

Preparing for a crisis will help to mitigate its impact. Yet many boards do little or nothing to prepare, and hence, when the crisis arrives, they start from a defensive and disorganised base. This is particularly untoward because in many crisis situations, the company's responses in the first 24 to 48 hours will be vital to managing the situation successfully. Directors should be educated on the principal laws that affect their businesses, understand the nuances of their directors' and officers' liability insurance policy, and assemble and drill with a core crisis management team. Crisis plans should include, at minimum, succession planning for the illness or death of senior executives (including discussion of the appropriate disclosure), and, depending on the company, product recall and accounting, financial fraud or foreign corruption charges. Plans to cope with physical, bio and cyber-terrorism should also be addressed.

Crises often have ramifications for the ongoing operations of the business, including – but certainly not limited to – access to capital markets and retention of key employees. While some of the preparatory work should be delegated to appropriate committees, at each regular meeting the full board should address the aforementioned questions in an appropriate sequence. External resources – including counsel, forensic accountants, security consultants and crisis communications support – should be involved to provide briefing materials and contingency plans. Screening and selecting these specialised advisers in advance is critical – they will provide major input when the crisis arrives. Internal crisis management teams may also be involved (such teams are usually organised into functional areas such as information technology, health, safety and the environment and physical security).

When the crisis arrives, the first step should be to select a leader of the crisis response effort. That leader may be the lead director or the chairman of a major board committee. The leader should supplement the core crisis response team as necessary. The team will usually involve top management, unless there is some evidence of a potential conflict (eg, financial fraud). The team should include a small group of independent directors, appropriate technical advisers and communications support. To the maximum possible extent, the crisis management activity should be separated from ongoing business to reduce disruption to employees, suppliers and customers.

Once the team has been assembled, the next step may be to issue a statement clarifying the company's position or taking responsibility for the consequences of the crisis event. Simultaneously, the team should start fact finding to identify what is known, what is uncertain and what consequences are likely to result. In the case of senior management health issues, the process may be relatively straightforward; in the case of product recall, illegal payments or financial fraud, the process may require extensive fact finding over a period of months and may involve coordination with regulators. The issue of notification of regulators (ie, how much to report and when) is complicated, with the answers depending on facts and circumstances. In many situations, fact finding is a slow process, requiring reviews of emails, written correspondence and so on. What is thought to be true often turns out to be false, and vice versa. It is important that the company inform its outside auditors and lenders in a timely but appropriate way. The auditors will need to consider interim filings, control opinions and the consequences of forensic work to be done by an independent firm if necessary. To the extent that the company's loan documents have representations about material adverse events, lenders and investors may need to be informed. How much to disclose and when are questions that require careful thought. Counsel and public relations firms often offer contradictory guidance, leaving directors confused.

Directors should anticipate that crises arise with little or no warning and, at the onset (and perhaps for some time), they will receive little and imperfect information. Pressured decision making will often be required, without much analytical support (in contrast to the regular board process, with thick binders, detailed presentations and carefully vetted management recommendations).

The full board should be kept well informed on a regular basis, but its focus should continue to be monitoring company performance and reputation. In the early stages of a crisis, much is likely to be unknown. "Murphy's law" seems to apply more often than not, in that new information which emerges is more likely to be negative than positive – unearthed email files may contain all kinds of bad news and disgruntled employees may emerge with all kinds of story.

As the crisis develops, certain risks are inevitable, and directors should be prepared to address them. *iam*

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Action plan A

In order to maximise the value of a crisis management strategy, the following should be borne in mind:

- It is important for the board to take initial control of the crisis management process, both to avoid conflicts and to keep management focused on the company's operations.
- To be able to take initial control effectively, a board must have a well-considered crisis management plan.
- If it becomes clear that the crisis can be appropriately handled by management without conflict of interest or diverting attention from operations, the board may reassign lead responsibility back to management.