RISK MANAGEMENT STRATEGIES TO MAINTAIN CORPORATE REPUTATION

by

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“I declare that RISK MANAGEMENT STRATEGIES TO MAINTAIN CORPORATE REPUTATION is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.”

SUMMARY

All companies, are vulnerable to events that could impact their reputation. These events can arise from various factors, such as a company's employment practices, economics, natural disasters, pollution, poor governance or poor management. Effective risk managers identify the different circumstances and factors that may impact on the reputation of a company, prior to the incident occurring. In order to assist risk managers, this dissertation proposes a structured approach to the management of reputational risks, which would ensure that the impact on the reputation of the company is minimised. The proposed approach was collated and deduced from the actions taken by companies that have suffered attacks against their reputations, but have successfully mitigated the consequences and minimised the damage to their reputations. Specific South African legislative requirements are also taken into account. This approach is highlighted and confirmed by contrasting it to the actions taken by companies that failed to counter the attacks on their reputation.

<u>Key Terms</u>

Reputation; approach; risk managers; steps; damage; events; vulnerable; poor governance; action plan; counter attacks.

DEDICATED TO MY PARENTS, MY MOTHER ROSENARA JOOSUB HABIB, AND THE LATE SULIMAN JOOSUB HABIB.

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CHAPTER 1

RISK MANAGEMENT STRATEGIES TO MAINTAIN CORPORATE REPUTATION

1.1 Introduction

An event or crisis will, in most cases, cause investors to overreact, resulting in serious implications for the value of the firm. Therefore, a company must be aware of the depths to which investors' capricious behaviour can manifest itself as jitters in the financial market, thereby impairing one of the company's most valuable assets: "Reputation".

Thus, one of the primary concerns of any company is for that company to protect itself from the risk of a tarnished reputation. Businesses that offer consumables or services, work hard to build consumer loyalty. When these businesses succeed in their ventures, consumer goodwill generates repeat business and referrals. However, due to the fact that most firms operate through a goldfish-bowl effect - i.e. through the media's consistent and persistent glares - any incident can cause a dent in a company's reputation.

The ability of a company to maintain a good reputation is directly linked to that company's ability to retain its stakeholders and to keep them optimistic. During an event or crisis situation, a company must demonstrate that it has the correct systems and resources in place, and that responsibilities and priorities are clear. A crisis reveals management's ability to deal with the situation: they have to deliver effective management during the crisis, because an inability to do so will be exposed, via the media, to all stakeholders concerned. If management is able to manage the crisis or event successfully, this is reflected in the share price: it often occurs that in the aftermath of the situation the company fairs better (Petersen, 2005).

Companies must also strive to develop a social conscience, and to contribute to society by developing and maintaining quality products and services. In addition, companies should also implement proper governance principles.

A company should have integrity 'in the eyes of its shareholders', and should not intentionally let shareholders down, nor mislead them. It must continually work towards enhancing its overall reputation. In this day and age, it is imperative for a company to do the right thing and have a good reputation, particularly in light of all the rather unfortunate incidents which have plagued the commerce industry in recent years, such as the incidents involving Regal Bank, Leisurenet, Macmed and so on.

1.2 Background

Companies have experienced, and continue to be vulnerable to, adverse publicity that is created from some form of crisis or event. If proper crisis management is lacking, this event could damage a company's standing, which directly translates to Reputation. 'Reputation' is the goodwill that the company has achieved through a formidable approach to enhance its credibility as a reputable company (Fombrun, 1996:23).

Risks to reputation can arise from many sources. The major drivers are:

- Financial performance and profitability

- Poor corporate governance and unethical behaviour
- Employees and corporate culture
- Product/Professional liability
- Major adverse event /publication
- Product recall and litigation
- Marketing innovation and customer relations (Rayner, 2003:15).

The focus of this dissertation will be on the impact that ineffective reputation risk management will/could have on a company's financial value. Additionally, the dissertation will illustrate how the different causes of adverse reactions of a crisis can have adverse effects on total credibility as perceived by investors, if handled incorrectly.

The empirical part of the dissertation will focus on global companies, as well as listed South African Companies from diverse sectors of the Johannesburg Securities Exchange, that have experienced varied forms of crises. The empirical chapter will examine the actions taken by companies that were able to manage reputation risk, and successfully recover from the event unscathed. The reaction of the successful companies during the event will be used as a yardstick to measure how other listed companies fared during a crisis or event. This will determine the overall criteria that should be used during the management of a crisis or event, in order to avoid major damage to the company's reputation.

1.3 Research Problem and Objectives

Reputation risk is still in its infant stage as a major risk category. Developing this study and showing the different risk factors that can affect the reputation of a company can be limiting, due to the apparent lack of knowledge that this risk could have on shareholders' value. The empirical part of this study will focus on different events that affect the firm, and the emphasis will be on showing how successful companies have managed the event or crisis, without causing damage to the company's reputation.

1.3.1 Primary Objectives

The primary research objectives are outlined below:

(1) To determine the impact on the reputation of a company of ineffective management strategies followed during a crisis.
(2) To recommend a risk management model that can be implemented during a crisis.
(3) To identify the management strategies that successfully assisted in averting reputational damage.

1.3.2 Secondary Objectives

1) To identify how internal factors have an impact on the reputation of a company.
2) To identify how external factors have an impact on the reputation of a company.

1.3.3 Research Design and Methodology

The literature study will involve the analysis of case studies. Using this analysis as a framework, specific risks will then be identified and used to show how different companies managed the risk, as well as identify an appropriate management approach to minimize the consequences of the event. The empirical study will give a brief description of the said crisis or event, and will attempt to show how management reacted to the event. Lastly, it will be determined whether or not the company was able to recover from the event or crisis, and how this recovery was facilitated.

1.3.4 Sample

The sample will comprise of twelve companies, selected on the basis of various reputational crises or events to which the companies were exposed. The selection will be conducted across the diverse sectors of the Johannesburg Securities Exchange.

1.4 Summary of Chapters

Chapter 2: **Risk**

This chapter will highlight and identify the different risks that companies may face. Each risk facing a company is unique, and, therefore, requires a unique management response. Different risk factors, which can impact a company, are identified. In order to effectively manage the risk during the period that a company is exposed to the said risk, it must carry out an appropriate risk management strategy. The reasoning behind the strategy of effective risk management is to minimise the damage that the risk factor could cause. If the risk is handled appropriately, the obvious derailment of a company's intended objective does not materialise. However, it is virtually impossible for a company to be able to predict the exact risks that will affect it, throughout its course. Therefore, in the event of such a circumstance occurring, the management of speculative risk will be in the form of crisis management.

Chapter 3: Reputation

Reputation is both defined and introduced in this chapter. Reputation risk is real and perceptual, and reputational damage can occur as a result of a wrongdoing, as well as from the perception of a problem. Its impact is more difficult to evaluate and quantify than other types of risks. It is an area in which “guilt by association” refers to, being part of a partnership, wherein the other party’s reckless management of a situation can impact both companies’ reputation, resulting in a devastating impact. Reputation risk is, therefore, more difficult to manage as it is difficult to quantify the exact level of ‘loss’ of the goodwill factor.

Chapter 4: **Causes of Reputational Damage**

The purpose of this chapter is to focus mainly on five different factors that have a direct impact on the reputation of a company:

- Firstly, management. This refers, mainly, to the approach, integrity and ethical compliance of management with regards to enhancing the reputation of a company.
- Secondly, the risk of associating with companies or products that could have a negative impact on the reputation of a company.
- Thirdly, reinvention or merger: the purpose here is to highlight situations wherein companies try to introduce new products, and completely sidetrack their primary goals; this directly impacts the company’s earnings, as the company will be unable to compete successfully with the obvious, more experienced, competitors in the field. Consequently, the company could be

perceived as being totally inexperienced, thereby negatively impacting the reputation of a company.

- Fourthly, physical accidents. Accidents are created through intentional or unintentional means. Intentional means occur when someone purposely tries to destroy the company's image by tainting the product of the company. Unintentional means occur when damage is incurred as a result of external factors.
- Lastly, the media. Due to the fishbowl effect, it is difficult for companies to squash rumours effectively, without the media creating a proverbial media event with the story. This, therefore, creates the factor of publicity, which could seriously impair the reputation of a company, if it is not handled correctly. The risk is created by the media not allowing the company sufficient time to correct the situation, before it reaches the point of damaging a company's reputation.

Chapter 5: Managing Reputation Risk and Corporate Governance

While opaqueness allows fraud to prosper away from the spotlight of informed investors, capital markets often provide their own pressures in aggressive earnings management. With investors focusing on profits as an indicator of a company's wealth, top executives look at accounting to make their business appear more profitable. The trend has been to inflate earnings and distort a company's true financial position, thereby transgressing acceptable accounting standards.

This chapter will focus on corporate governance issues. It will identify companies that have adopted corporate governance principles, thereby adding credibility to the company. Investors are more attracted to companies that practice good governance. Globalisation of businesses is dependent upon common principles of governance; in other words, the main concern is the transparency (reliability, openness and informativeness) of corporate disclosure.

Chapter 6: Methodology

Using case study methodology, an explanation of how the documentation was researched and obtained, as well as what other methods were used to obtain all relevant information, is explained in this chapter. Chapter 6 provides a detailed description of how the research was conducted.

Chapter 7: **Implementation of a strategy for managing reputation risk during a crisis.**

The focus of this chapter is to present a brief overview of global case studies. Each of the case studies selected represents the different approaches adopted by the relevant companies, as well as the manner in which each particular crisis was handled. Both Tylenol and Ford/Firestone were affected by external factors: for Tylenol, it was tampering of a product, and for Firestone, the production of a defective product. Johnson and Johnson and Ford/Firestone had to recall the products, which led to more media attention. The next three case studies of Exxon Valdez, Coca Cola and Perrier will show a lack of effective management of the crisis or event, thereby impacting the reputation of the company. The companies that successfully manage the event will be used to develop an appropriate model of how to manage reputation risk, and recover from an incident unscathed.

Chapter 8: South African Case Studies

This chapter will analyse local case studies as a benchmark. Using successful global case studies, the same model will be used to measure how local companies manage reputation risk. However, the fact that companies face unique factors when situated in a specific country will also be taken into account.

Chapter 9: Conclusion

This chapter will provide a summary of the study, highlighting the main findings of the analysis. The emphasis here is to recommend an action plan that can be used by management to avert any negative consequences from the impact of an event or crisis. The correct approach is highlighted and confirmed by contrasting it to the actions taken by companies who failed to successfully counter the attacks on their reputation.

CHAPTER 2

RISK

2.1 Introduction

Risk is an important component of a company's investment strategy. It is, thus, important to know the source of the risk, as well as to identify and evaluate factors contributing to risk. The relationship between the different types of risk is evaluated in this chapter, and the definition of risk, as well as the management thereof, is given and explained. Reputation risk is introduced, and different indicators, whereby reputation risk can increase, are identified. Risk managers have a crucial part to play in responding to and preparing for reputational events. Extensive risk management procedures have to be integrated. Managers can only respond to reputation risk once they have identified traditional risks, and then worked out events that could impact reputation.

2.2 Risk

Oxelheim and Wihlborg (1997:18) define risk as a measure of the timing and magnitude of unanticipated changes, which is evaluated relative to expected changes in variables. These changes could be either anticipated or unanticipated - risk is a measure of unanticipated changes. The anticipated change is measured by the expected change, which is normally a result of forecasting.

A company is vulnerable to all types of risk. Risk is inherent in business, not only because the organisation operates in a risky environment, but also because the business itself is continuously changing. Certain risk relates to variability in returns caused by factors that are unique to the company, such as the type of industry in which the company operates, and the product that it sells. This is often referred to as unsystematic or unique risk. An investor may eliminate this type of risk by diversification. The other risk that remains is the non-diversifiable portion or the market risk. Variability in a share's total returns, which is directly associated with overall movements in the general market or economy, is called systematic risk. Systematic risk directly encompasses interest rate, market and inflation risks, and cannot be avoided through diversification (Gitman, 1994:234).

2.3 Different Types of Risks

A company is exposed to all kinds of risk; however, the basic types of risk that affect a company are the following:

- Market risk
- Operational risk
- Business Risk
- Financial risk
- Credit risk
- Reputational risk

2.3.1 Market Risk

Market risk is the risk associated with movements in security prices, especially in share prices. If an individual buys a share and the market as a whole declines, the price of the specific share will probably fall. Conversely, if the market increases, the price of the share will also tend to increase (Mayo, 2001:183). Essentially, understanding market risk assists in understanding price behaviour. The causes of changes in market price are usually beyond the control of the company. An unexpected war, the end of a war, an election year, political or terrorist activity, speculative activity in the market or the outflow of gold are all tremendous psychological factors in the market. Whatever the reason, the drop in the market is a temporary cyclical swing that causes a temporary drop in the price of the share.

For most companies, interest rates and foreign exchange rates are the main market risk exposures. Alternatively, some companies are exposed to commodity and energy prices. Where the corporation is subject to volatile market risks, or where it uses derivatives to manage its market risk, measures must be adopted in order to control the exposures from the different elements apparent in the market.

There are four key Market Risks:

2.3.1.1 Interest rate risk

Reilly and Norton (2003:711) define interest rate risk as the uncertainty regarding the ending-wealth value of the portfolio, due to changes in market interest rates between the time of purchase and the target date. It involves two component risks in turn: price risk and coupon-reinvestment risk.

Price risk occurs because varying interest rates may cause the market price for the bond to change over time. If rates were to increase after the time of purchase, the market price for the bond would fall, whereas if rates declined, the realised price would rise. The point is that, as a result of uncertainty as to whether rates will increase or decrease, there will be uncertainty about the bond’s future price prior to maturity.

The reinvestment risk arises because the yield-to-maturity computation implicitly assumes all coupon cash flows will be reinvested at the promised yield to maturity.

If, after the purchase of the bond, interest rates decline, the coupon cash flows will be reinvested at rates below the promised yield to maturity, and the ending wealth will be below expectations. In contrast, if interest rates increase, the coupon cash flows will be reinvested at rates above expectations, and the ending-wealth will be above expectations. Again, as there is uncertainty about future interest rates, there will be uncertainty about the reinvestment rates (Reilly & Norton, 2003:711).

2.3.1.2 Foreign Exchange risk

There are three types of risk for firms that operate in an international market place:

- Transaction risk
- Translation risk
- Economic risk

2.3.1.2.1 Transaction risk

Transaction risk is the risk that transactions already entered into for imports and exports, and for which the company is likely to have a commitment in a foreign currency will have a variable value in the home currency because of exchange rate movements (Arnold, 2005:607).

For exports that are on credit, the company's debtors are subject to fluctuation. With regards to imports, the payment to foreign creditors will be in terms of the home currency, which will, in turn, depend on forex movements. Transaction risk also arises when companies invest abroad. Companies that borrow in a foreign currency commit themselves to regular interest and principle payments in that currency, and are, therefore, exposed to forex risk (Arnold, 2005:607).

2.3.1.2.2 Translation risk

Translation risk arises because financial data denominated in one currency is then expressed in terms of another currency. Between two accounting dates the amounts can be affected by exchange rate movements, thereby distorting comparability. The financial statements of foreign subsidiaries are usually translated into the local currency, so that the subsidiaries can be consolidated into the group's financial statements. Income, expenses, assets and liabilities must be disclosed, in order to reflect in which country the company is situated. This is simply translation, not the conversion of real money from one currency to another. If exchange rates remain stable, then comparing financial performance of subsidiaries would be simple, whereas, if there is a change in the exchange rates, there will be distortion. There are two elements to translation risk:

- The balance sheet effect. Assets and liabilities denominated in a foreign currency can fluctuate in value in home currency terms, due to forex market changes.
- The profit and loss account effect. Currency changes can have an adverse impact on the group's profits because of the translation of foreign subsidiaries profit (Arnold, 2005:608).

2.3.1.2.3 Economic Risk

A company's economic value may decline as a result of forex movements, consequently causing a loss in competitive strength. Arnold (2005:610) stresses that the worth of a company is linked to the discounted cash flows payable to the owners. It is possible that a shift in exchange rates can reduce the cash flows of foreign subsidiaries, as well as home-based production, in the future. There are two ways in which a competitive position can be undermined by forex changes:

- Directly - if a company’s home currency strengthens, their foreign competitors are able to gain sales and profits at the company’s expense, as its products are more expensive in the eyes of customers, both abroad and at home.
- Indirectly - if the home currency does not move adversely to the customer’s currency, the company can lose its competitive position (Arnold, 2005:610)

2.3.1.3 Equity risk

Equity risk is the risk associated with fluctuations in share prices or stock indices. There are two aspects to equity risk: sensitivity to changes that affect an entire index, and changes affecting the company itself. Investors may protect against the latter by diversifying their share portfolio. Equity risk is the main market risk feared by investment managers and retail investors, because stock market crashes have a massive impact on the value of their portfolios (Chorafas, 2002: 126).

2.3.1.4 Commodity risk

Commodity risk is the risk of price changes in commodities. Commodity prices tend to be more volatile than those of financial products because of the possibility of under- or over-supply in the underlying physical market. Commodity producers, intermediaries and consumers are most affected by commodity risk, and are the biggest users of commodity derivatives. Recent legislative changes have had a direct impact on commodity risk. The changes have affected specific rules regarding the disclosure of derivatives, and the adoption of fair value accounting. This has added to the transparency of derivatives, making them more visible on the face of the financial statements. These changes have increased the need for companies to adopt market risk management (Lawrence, 1996:73).

2.3.2 Management of Market Risk

In order to assist in controlling interest rate risk, as well as foreign exchange risk, interest rate positions may be hedged with futures, swaps, options, forward rate agreements and government bonds. Exchanging floating interest rate payments in two different currencies can be used to control foreign exchange risk. In order to control equity risk, investors may use equity derivatives, such as futures and options.

Market risk is managed with a short-term focus. Long-term losses are avoided by avoiding losses from one day to the next. On a tactical level, traders and portfolio managers employ a variety of risk metrics, duration and convexity, the Greeks and beta, in order to assess their exposures. These methods allow management to identify and reduce any exposures that they may consider to be excessive. On a more strategic level, organisations manage market risk by applying risk limits to traders' or portfolio managers' activities. Some organisations also apply stress testing to their portfolios (Risk Jigsaw, 2002).

There are several ways for companies to manage commodity risk. Firstly companies can study each security in an attempt to understand its price behaviour. Shares that have shown a growth pattern in the past will demonstrate a similar trend for the future, unless some extraordinary event affects the company, thus reversing certain expectations. Shares tend to reflect a certain pattern, but not an exact pattern. Secondly, based on analysis, shares that have the lowest amount of market risk will be selected. Ordinary shares demonstrate both growth and income, and do not have the same degree of market risk as the recessive or cyclical shares. Investors, therefore, try to select shares that offer both growth and income. Shares that are recessive carry risks and penalties, and are, therefore, generally avoided. Thirdly, the timing of the purchase of shares is extremely important. The standard error of the estimate is used as a gauge. Shares are purchased when they are below the limits of one standard error of the estimate, and sold when they are above those limits (Bernstein & Damodoran, 1998:64).

The VAR (Value at risk) method is, increasingly, being used in order to define and monitor risk limits. It persuades treasury departments to impose risk limits on market risk exposure, and to manage risk in a more efficient manner. Calculating the company's value at risk helps to determine the aggregated risk exposure. VAR provides information about the potential for losses in value for a given position or portfolio (Pickford, 2001:121).

2.3.3 Operational Risk

Operational risk represents the next stage in improving shareholder value, by reducing the amount of risk to the earnings of the firm. There is a growing recognition that a major source of earnings volatility is not due to financial risk. In fact, it is not related to the way a firm finances its business, but rather to the way a firm operates its business, and is called operational risk (King, 2002:7).

Operational risk is concerned with the adverse deviation of a firm's performance, due to the way in which the firm is operated, as opposed to how the firm is financed. It is defined as a measure of the link between a firm's business activities and the variation in its business results (King, 2002:7).

Culp (2001:432) states that risks such as market and credit risk can often lurk undetected in hidden exposures of a company. Operational risk seems to suffer the reverse malady: the concept itself is so broad that operational risk can be found in just about everything. For this reason, identifying operational risk, in general, should not be the goal of the firm. Rather, identifying meaningful operational risks that could have a significant impact on the value of the firm is the task at hand, and it is not an easy one. Culp (2001:433) further emphasises that operational risk identification is more art than science, and can get ‘sticky’ for several reasons. Firstly, the definition of operational risk - and its distinction from business risk - at any particular firm, depends strongly on the risk management and business strategies of the firm.

A second complication to operational identification arises from the linkage between the risk and the loss. Operational risk-related losses are quite often driven by market, credit or liquidity risks. For example, the failure of Barings Bank to recognise the huge position that was held by Nick Leeson, was an operational risk management failure. It was a failure of internal processes and systems: in other words, the case illustrates basic internal control failure, as well as ineffective operational risk management, which, consequently, failed to identify process, personnel and systems problems (Culp, 2001:434).

The Barings Bank Case:

Barings Bank had a long history of success and was highly respected as England’s oldest merchant bank. However, in February 1995, the Bank suffered a major setback: Barings Bank, a bank with a pristine reputation and $900 million in capital, was forced to claim bankruptcy because of debt to the value of $1 billion, incurred by one of the bank’s employees, who had carried out unauthorised trading losses. Two years prior to the predicament, the Bank hired a young clerk, named Nick Leeson. He was appointed as general manager of a subsidiary of the bank in Singapore. As manager of the operations in Singapore, he managed both the trading and the back office. This dual function allowed him to conceal all unauthorised trades, as well as losses incurred. A bonus for Mr Leeson was the fact that the senior managers knew very little about trading. Therefore, Mr Leeson showed huge profits, and, in trading, huge profits are only possible by taking risky positions - a fact that should have already raised alarm bells for senior management. Unfortunately, due to their lack of knowledge on trading activities, this fact went unnoticed.

Senior management were also led to believe that Mr Leeson held matched positions on the Singapore International Monetary Exchange (Simex) and the Osaka Exchange, and, hence, was making a low risk profit.

However, Mr Leeson was trading derivative contracts on the two exchanges that were of different types, in some cases, and in mismatched amounts in other cases. For example, Mr Leeson executed a trading strategy known as a “straddle”, with the objective of making a profit by selling put and call options on the same underlying financial instrument, in this case, the Nikkei 225 index. A straddle will, generally, produce positive earnings when markets are stable, but can result in large losses if markets are volatile. Mr Leeson created an error account numbered 88888 to hide an initial loss of 20 000 pounds sterling. He hoped to cancel the loss with profits from future trade. However, this account was used for all profits and losses that were made on all unauthorised trades. He continued taking huge risks by increasing his open positions, and this made him vulnerable to the volatility of the market. An earthquake in Japan was the last straw. This natural disaster caused the Nikkei equity index to drop, which subsequently forced Mr Leeson to admit his unauthorised trading positions, as he had, by now, incurred huge losses on his open positions. The losses totalled $1 billion, and Barings Bank was forced to declare bankruptcy. The whole debacle occurred as a result of the lack of proper, basic internal controls, such as lack of understanding of business, poor supervision of employees and lack of clear reporting lines (Barings Bank, 2002).

Operational risk helps management to determine what factors affect earnings, in terms of the overall operation of a company. Factors that cause changes in earnings should be investigated, in order to determine the overall effect. Management must understand the cause of the risk, so as to effectively manage the risk and obtain the desired balance between risk and return. There are many benefits to managing risk and maintaining earnings (King, 2002:8):

1. Avoid unexpected losses and improve operational efficiency. If management understands operational risk, this will assist in understanding the operational activity of the firm and, thereby, being able to effectively strategise operational risk. This allows management to avoid large losses.
2. Efficient use of capital. Capital is budgeted based on future earnings. Capital usage helps to optimise the risk return trade-off for capital allocation decisions.
3. Satisfy shareholders. Risk measurement can help influence shareholder views, and improve areas that are needed to avoid shareholder surprises.
4. Comply with regulations. Operational risk management is a board level responsibility, which can be effectively maintained through the implementation of corporate governance principles, and the use of operational controls.

Operational control would be a controlled way of providing assurance on achieving certain performance objectives. Risk helps to determine the effect of fluctuations on performance of a company, and operational risk determines the connection between the fluctuation and business activities. Decreasing operational risk creates a domino effect, whereby reduced earnings create an increase in value for the company (Culp, 2001:447).

Most operational risks become potential losses for a company, because they, basically, expose the company to market, credit and liquidity risk.

2.3.4 Business Risk

Business risk is defined as the uncertainty inherent in projections of future returns on assets - or of returns on equity, if the firm uses no debt - and it is the single most important determinant of capital structure. It can also be defined as the uncertainty inherent in projection of future operating income or earnings before interest and taxes (EBIT) (Lee, Finnerty & Wort, 1990:266).

A company’s capital structure affects the riskiness inherent in a company’s share, and, therefore, affects its required rate of return and the price of the share. A company’s capital structure policy requires choosing between risk and return. When a company increases its level of debt, this increases the riskiness of the firm’s earning stream; however, the company also experiences a higher expected rate of return. High levels of risk tend to lower a share’s price, but high levels of expected rates of return tend to raise it. Therefore, if a company manages to maintain a balance with the optimal capital structure, this maximises the price of the share (Lee, Finnerty &, Wort, 1990:266).

Fluctuations in the company’s EBIT can be the result of many factors: upturn or downturn in the economy, launch of new successful products, labour strikes and natural catastrophes. However, there is also the possibility of a long-term disaster, for example, changes in technology, which could render products obsolete and could permanently depress the company's earning power, i.e. lower the earnings. This element of uncertainty about a company's future return on equity is the company's basic business risk. Business risk varies within the different industries, and can also change over time. Smaller companies that sell or manufacture a single product will tend to have a high level of business risk (Lee, Finnerty & Wort, 1990:267).

Brigham and Weston (1992:626) suggest that business risk depends on a number of factors, the more important of which are the following:

- Demand (unit sales) variability. The more stable the unit sales of a firm's products are, provided that other things are held constant, the lower its business risk.
- Sales price variability. Firms whose products are sold in highly volatile markets are exposed to more business risk than similar firms whose output prices are relatively stable.
- Input price variability. Firms where input prices are highly uncertain are exposed to a high degree of business risk.
- Ability to adjust output prices for changes in input prices. Some firms have little difficulty in raising their own output prices when input costs rise; the greater the ability to adjust output prices, the lower the degree of business risk. This factor is especially important during periods of high inflation.
- The extent to which costs are fixed: i.e. operating leverage. If a high percentage of a firm's costs are fixed, and, hence, do not decline when demand falls off, this increases the company's business risk. This factor is called operating leverage.

Each of these factors is determined partly by the firm's industry characteristics, but each is controllable, to some extent, by management, for instance, through their marketing policies: i.e. stabilising both unit sales and sales prices through advertising or discounts.

2.3.4.1 Management of Business Risk

Business risk is managed with a long-term focus. Techniques used to do this include the careful development of business plans, and appropriate management oversight. Book value accounting is generally used, so the issue of day-to-day performance is not material. The focus is on achieving a good return on investment over an extended horizon (Risk Jigsaw, 2002).

Business risk should be managed from two different sides. Firstly, how does a company manage its own business risk? The company will have to evaluate the impact that the potential risk could have on it. Secondly, a company must decide whether or not to use external techniques to manage the business risks. If the company uses external techniques, this will, obviously, make the company vulnerable to factors that are apparent in the business environment, and which will then impact the different portfolios (Risk Jigsaw, 2002).

Companies have to manage a potential business risk throughout the lifetime of a business. Most business risk is managed because of past experience, as well as by skilled managers, who possess that unique acumen, coupled with a natural instinct. In today’s business environment, there is prevalent fraud, and it is highly difficult to predict movements in markets; this makes it harder for companies to be able to identify business risk. Another problem is that business risk is on the increase because companies tend to transfer risk; therefore, some sectors will be affected more than others, such as financial institutions. In addition, technology has also impacted business risk. Lastly, due to global markets and the increase in mergers and acquisitions, companies are purchasing outside their area of expertise, thus adding to the overall business risk (Risk Jigsaw, 2002).

Once a business risk is identified and assessed, a company must make a decision on whether to retain (i.e. manage) the risk or to transfer the risk. The isolating and transferring of the risk is part of the classic risk management market: the use of derivatives. However, it must be remembered that a company cannot offload the volatility of its complete portfolio of business risk. Some exposure is, therefore, retained and a funding mechanism is used to spread out the losses over a certain period (Lawrence, 1996:198).

2.3.5 Financial Risk

Financial leverage refers to the use of fixed-income securities, debt and preference shares. Financial risk is the additional risk placed on the ordinary shareholders, as a result of using financial leverage.

Companies have a certain amount of risk inherent to their operations: this is its business risk, which is defined as the uncertainty inherent in the company's earnings before interest and taxes (EBIT). When the company takes on debt and preference shares (financial leverage), the firm concentrates its business risk on the ordinary shareholders. This portion of the shareholders' risk, over and above basic business risk, resulting from the use of financial leverage, is the financial risk (Lee, Finnerty & Wort, 1990:268).

2.3.5.1 Management of Financial Risk

Brigham and Weston (1992:627) state that a firm's optimal capital structure is that mix of debt and equity, which maximises the price of a company's share. At any point in time, the company's management has a specific target capital structure in mind, presumably the optimal one, although this target may change over time.

2.3.6 Credit Risk

Credit risk refers to the possibility that a borrower may fail to repay a loan. Lending from credit cards to corporate loans is the largest and most obvious source of credit risk (Oxelheim & Wihlborg, 1997:21). However, credit risk exists in some form or another throughout all companies, both on and off the balance sheet, from acceptances, inter-bank transactions, trade financing, and derivatives trading to guarantees and settlement. Fund managers and investors are directly exposed to credit risk in their fixed income investments. Companies are exposed to the risk that another company, supplier or foreign partner could default, or fail to meet deadlines. New tools used to manage credit risk have allowed companies to absorb certain inherent risk. These include the use of credit derivatives and securitisations, increasing the risks to which banks are exposed (Risk Jigsaw, 2002).

Companies must identify all credit risk exposures. This allows management to understand the credit risk and to assess how best to manage the risk. Firstly, how does one determine a credit rating for a company? Due to a lack of publicly available data on different companies, it is technically impossible to apply statistical methods; therefore, subjective methods have to be used. Most financial institutions use financial ratios, based on the information obtained from financial statements, to assess a company's credit standing (Chorafas, 2002:97).

Another popular method used to assess credit risk is called the Merton Model. This model is based on the principles of Robert Merton, and primarily considers the company's equity as a call option on the value of the firm's assets, in which the strike price of the option is related to the liabilities of the firm (Chorafas, 2002:259). This then allows the credit assessor to estimate the probable default. The technique also allows banks to manage their loan portfolios (Chorafas, 2002: 259).

Other techniques used to assess the credit ratings of companies are called quantitative techniques; in other words, portfolio credit risk models. These models help make credit value at risk (VAR) a practical measure for bankers, as well as other portfolio managers, to assess likely portfolio credit losses. Although VAR models are easier to use for market risk, they remain difficult for credit risk, because liquidity is lacking. The negativity aspects related to the use of the models is that default correlations are difficult to measure, and, thus, the true credit risk of a portfolio is difficult to determine (Risk Jigsaw, 2002). Therefore, companies should implement credit policies that will help manage credit risk. The Basle committee has issued guidelines to assist companies in implementing a proper credit risk management programme. Companies should:

-Establish an appropriate credit risk environment
-Operate under a sound credit granting process
-Maintain an appropriate credit administration
-Measure and monitor processes
-Ensure adequate controls over credit risk exist (Risk Jigsaw, 2002).

2.3.6.1 Management of Credit Risk

For companies adopting either a credit limit or credit line perspective, credit risk management means comparing actual exposures to risk tolerances, either ex-ante or ex-post (Culp, 2001:417). Limit stops must be exercised, and management must carry out continuous monitoring of the loans. With financial contracts or derivatives, companies must be wary of the fact that when entering into these contracts, the exact monetary exposure cannot be determined; this makes the contract values misleading, because of the embedded credit exposure (Chorafas, 2002:263).

There are two methods - which are commonly used by companies - that lower potential credit losses from the use of derivative contracts: netting and collateral. Most merchant banks use bilateral closeout netting agreements to prevent a defaulting counter-party from stopping payments on contracts with a negative value, while demanding payment on those with a positive value. The International Swaps and Derivatives Association has made these netting agreements legal and enforceable. Another commonly used method is the use of collateral: whether or not a company stands to lose if a counter-party defaults, depends on how the market moves over time. However, there are certain limitations with regards to collateral, such as lack of expertise and legal uncertainty (Chorafas, 2002: 263).

Companies can manage credit risk exposure by using credit derivatives, which are: credit default swaps, total return swaps and credit options. Another popular tool used to manage portfolios, thereby reducing credit risk, is the concept of securitisation. Securitisation allows banks to remove loan assets from credit card receivables to commercial loans from their balance sheets. Securitisation also helps management to remove credit risk of loans from financial statements, which may add excessive emphasis on the loan portfolio (Risk Jigsaw, 2002).

New methods are continually being tested to create a balance between risk and return, as well as to lower regulatory capital.

2.3.7 Reputation Risk

Reputation is a collective representation of a company's past actions and results, which describes:

(a) the company's ability to deliver valued outcomes to different stakeholders, and

(b) how each stakeholder experiences the company's brand through its daily operations and conduct (Fombrun, 1996:48).

Therefore, a company's reputation is built upon the relationships it has with its stakeholders. Important relationship issues include the various kinds of benefits (tangible and intangible) offered to shareholders, and how shareholders judge the past behaviour of the business. According to Rayner (2003:15), the reputation of a company is driven by:

- Financial performance and long-term investment value: A company that demonstrates a consistent financial performance is deemed a reputable company and, therefore, a safe investment.
- Corporate governance and leadership: The effective corporate governance of the business helps to safeguard the company's reputation.
- Regulatory compliance: Companies that contravene legislation can rattle shareholder confidence and impact corporate reputation.
- Delivering customer promise: Companies have to maintain customer expectation, so as to maintain a good reputation.
- Workplace talent and culture: Employees must be satisfied with their working environment so as to exalt the company name.
- Corporate social responsibility: Companies can benefit from a good reputation if they demonstrate a commitment to corporate social responsibility.

- Communications and crisis management: A company must have a contingency plan in place, in order to deal with any crisis, so as to maintain company reputation.

(The above will be explained in more detail in chapter 3.)

The management of a company has a fiduciary responsibility to protect the interests of both shareholders employees and creditors; this is a responsibility that is also at the heart of managing the reputation of the company (Rourke, 2004). In disposing fiduciary responsibility, a company has to tread between legal obligation and ethical practices. This entails situations, which may be legal but not ethical, thereby placing the reputation of the company at risk (Rourke, 2004).

Reputation risks do not take place in isolation; instead they interact with psychological, social and cultural processes. It is this integration that helps us to determine how we experience risk. Rayner (2003:46) maintains that there is no such thing as reputation risk - only a risk to reputation. However, there are different kinds of risk which impact reputation. The following definition captures the essence of reputation risk: “Reputation risk is any action event or circumstance that could adversely or beneficially impact an organisation’s reputation” (Rayner, 2003:47).

Reputation risk also arises from the negative publicity that can occur due to a certain event or to mismanaged business practices. The publicity results in a decline in the customer base, thereby affecting revenue. It can also cause liquidity constraints and significant depreciation in market capitalization, due to an erosion of customer loyalty. Michael Collins (2002) explains that a company’s reputation is a critical component of its value, and is monitored by customers and prospective customers, business partners, investors, rating agencies, regulators, employees and legislators. Reputations are created in different ways. Different circumstances can enhance a reputation, but it is the value that the company provides to the shareholder that determines the value of the goodwill element. Therefore, reputation risk increases during a crisis, as the control thereof decreases. During a crisis or turmoil, management is unable to create a balance that would extinguish the risk and maintain the reputation of the company concurrently. Collins (2002) also suggests that during a crisis, management must communicate consistently, openly and honestly with its constituents, in order to ensure that an individual's or a company's reputation is not irreparably damaged during a crisis.

Corporate crisis and vulnerability to reputation risk can arise from many sources, including: financial performance and profitability, corporate governance and quality of management, social, ethical and environmental performance, employees and corporate culture, marketing, innovation and customer relations, regulatory compliance and litigation, and communications and crisis management. A weakness in any one of these areas might be enough to significantly damage a reputation, while weakness in multiple areas might bring a company to its knees (Collins, 2002).

There are three broad indicators of a loss of reputation: an adverse movement in share price, an increase in negative media coverage and a loss of sales. A company must have a structured policy that will manage reputational risk. If reputational risk is not properly managed, the consequences can include:

- Reduced revenue, increased expenses (including lawsuits and settlements) and liquidity issues
- Lower security prices, reduced agency ratings, and unavailability of investor funding
- Deterioration in partnerships and relationships with suppliers and customers

- Inability to attract and retain high-quality employees

(Mayer & Settar, 2003: 7).

Other factors, which can also impact reputations, are:

- Poor performance directly connected to product and/or services
- Poor performance with respect to achievement of relevant company aims
- Value conflicts or violation of specific values, public relations crises and fundamental ideological rejection (Green, 1992:93).

Reputation risk is difficult to quantify because it is a risk in its own right, as well as a derivative risk from other areas of risk. Disruptive business practices, transgressions of legislation, unfair or deceptive practices - both intentional and unintentional - affect compliance risk, legal risk, and reputation risk. The business of high-risk products or controversial products also affects legal risk, credit risk, and reputation risk. Companies that are dependent on outsourcing and third party arrangements are also vulnerable to reputation risk, in addition to operations risk and credit risk (Fombrun, 1996:347).

2.3.7.1 Management of Reputation Risk

In order to manage reputation risk, management must identify all risks systematically, and document them, once identified. All significant risks must be clearly understood and consistently assessed by the individual directors. This will allow risk expenses arising in different areas of operations to be compared and contrasted; subsequently, specific remedies and a more proactive reaction can be structured (Rayner, 2003: 94).

There are certain factors that affect reputation, and it is important for management to be able to identify possible risk to the reputation. As Alsop (2004:19) stresses, companies must always be alert in identifying possible threats to their delicate reputations, and should develop defences, policies, procedures, and allies to assist in pre-empting or quickly overcoming these threats. This helps in avoiding the impending disaster, by identifying the indicators, which provide management with sufficient warning that the company's reputation could face possible jeopardy. Therefore, management is able to change tactics and avoid the possible disaster.

2.4 Conclusion

Risk awareness is largely a matter of corporate culture and education. Corporate governance is the practice that ensures that the board of directors and management has established the appropriate organisational processes and corporate controls to measure and manage risk across the company. This is, increasingly, required by regulatory standards and voluntary codes of conduct around the world.

The integration of risk management into the revenue-generating activities of the company - including business development, product and relationship management, and pricing - is crucial. It is these activities that most immediately generate risks, and, thus, a great deal of the efficiency of risk management is tied to the inclusion of risk as a factor in everyday decision-making. Managers need to ensure that their business complies with the overall corporate policy on risk: that risks are considered in the pricing of existing businesses and the development of new ones, and that unusual or large risks are referred to the appropriate authority for approval.

The following chapter will introduce and explain reputation as an asset, as well as the factors that can increase reputational value.

CHAPTER 3

REPUTATION

3.1 Introduction

In this chapter reputation is introduced, and the different factors that affect and enhance reputation are explained. The different drivers of reputation are also elaborated upon, and, lastly, the value of reputation is discussed.

3.2 Reputation

Fombrun (1996:10) states that a company's name is one component of its identity. It conveys to us the company's most distinctive traits, and influences our behaviour. When a company serves its constituents well, its name becomes a valuable asset. It creates reputational capital – a form of intangible wealth that is closely related to what accountants call "goodwill", and marketers term "brand equity".

Reputation is, therefore, a perceptual representation of a company's past actions, as well as future prospects, that describes the firm's overall appeal to all of its key constituents, when compared with other leading rivals (Rayner, 2003:2). These perceptions and beliefs are often built over a period of many years, i.e. every contact, every media mention, every rumour, every leak and every piece of gossip has a part in forming an overall impression of an organization's standing (Rayner, 2003:1).

3.3 Valuing Reputation

Intangible assets are made up of intellectual capital, such as patents competencies, innovation and reputational capital (Fombrun, 1996:18).

According to International Accounting Statement (IAS) 38, an intangible asset is an identifiable non-monetary asset, without physical substance (SAICA, 2005). IAS 38 also gives further guidelines that clarify the measuring of identifiability: the identifiability criterion is met when the intangible is separable - in other words, capable of being separated or divided from the entity, and being sold or licensed.

Fombrun (1996:90) suggests that assigning value to reputational capital is directly linked to how much a third party might pay to lease a corporate name. Licensing arrangements are actually royalty rates for corporate names. The more a licensee is prepared to pay, the greater the drawing power of the company's reputation. Royalties on corporate licences, generally, range between eight and fourteen percent of sales. Therefore, one estimate of the value of a company's reputation is the present value of all expected royalty payments over a given period. Fombrun (1996:91) also suggests an alternative approach to estimating a company's reputation: that stock prices incorporate all known information about a company and fully reflect a company's future prospects. Therefore, the value of reputation is its market value, over and above the liquidation value of the net assets involved in producing and selling the company name.

Establishing reputational capital helps a company to cushion the blow during a crisis: the possibility that the crisis was a once-off occurrence will be considered, due to the company's established reputation (Larkin, 2003:5). Alsop (2004:17) reiterates that when companies are firing on all cylinders, they build up "reputation capital" to tide them over in turbulent times: it is like opening a savings account for a rainy day. Should a crisis strike or profits shrink, reputation suffers less and rebounds faster. Chambers, of the Institute of Internal Auditors, mentions the Brouillard study, which indicates that the shares of the ten most admired companies - as highlighted in Fortune Magazine - dropped less and recovered faster, while the shares of the ten least admired companies plunged three times as far, during a particularly trying period. Companies that have a good reputation reap real dividends (Chambers, 2001).

The ratio of a company's market value to its book value is an indicator of a company's accumulated pool of reputational and intellectual capital; in other words, its intangible assets. Large numbers indicate investor appreciation for their invisible capital, and a willingness to bid up the share price of companies with valuable intangibles (Fombrun & Van Riel , 2004:74).

When companies face crises, they generally lose market value. To some extent, the loss constitutes the stock market's best guess about the damage done to the company's future profitability - that is, to its credibility and reputation. Companies with good reputations also show higher Price/Earnings ratios, which demonstrate that reputation is as much about promise as it is about history (Larkin, 2003:6). Corporate reputations also have bottom-line effects. A good reputation enhances profitability because it attracts customers to the company's products, investors to its shares, and employees to its jobs. In turn, esteem inflates the price at which a public company's securities trade. The economic value of a corporate reputation can, therefore, be gauged by the excess market value of its shares (Fombrun, 1996:91).

3.4 Accumulating Reputational Capital

A company with a large reserve of reputational capital actually gains a competitive advantage against rivals, as its reputation enables it to charge premium prices for its products, to achieve lower marketing costs, and benefit from great freedom in decision-making. In other words, reputation-building is a form of enlightened self-interest (Fombrun, 1996:21).

Companies have to develop unique styles in order to rise above the rest in a similar industry. This gives the company a competitive edge, as well as a reputation. The company must continually monitor all major stakeholders'' expectations, and ensure that there is a breakeven point, whereby a matching is achieved. In other words, the expectations should match the reality of their daily experience of the company (Rayner, 2003:14). If companies exceed the stakeholders' expectations, this will then enhance the reputation of the companies. Rayner (2003:15) states that the following seven drivers of reputation help build reputational capital:

- Above average financial performance and long term investment value
- Proper corporate governance and leadership
- Regulatory compliance
- Delivering customer promise
- Workplace talent and culture
- Corporate social responsibility
- Communications and crisis management

Fombrun (1996:84) reiterates the above by stating that, in order to build an enduring and resilient reputation, a company must establish strong relationships, not only with customers, but also with other key constituents, such as, employees, investors, as well as the communities it serves. A company must also remember government agencies, financial ratings agencies, corporate conscience agencies, and, lastly, consumer agencies.

(The aforementioned drivers will be briefly discussed in Chapter 5).

3.4.1 Financial performance and Long Term Investment Value

Financial performance consists of two components:

3.4.1.1 Financial Performance and Long-Term Investment Value

A company that has a solid financial performance, and is also profitable, is deemed a safe investment and, therefore, provides value to shareholders. Companies that fail to create value for investors suffer by losing reputational capital, whereas by meeting shareholders' expectations, the company benefits from the lowest sustainable cost of capital and the highest sustainable share price. As a rule, stakeholders expect the following:

- Solid financial performance
- Clarity on value drivers and sources of future growth to generate long-term shareholder value
- Transparency, i.e. no critical issues are concealed
- Reliable, relevant and timely information
- Honest, accurate and consistent accounts
- Management of risks to an acceptable level
- Minimisation of cost of capital
- No fraud
- Profitable going concern (Rayner, 2003:109).

3.4.1.2 Financial Statements

Investors must have confidence in companies' financial statements: financial statements must be honest and transparent, thereby reflecting the true value of the company. Where companies resorted to inflating earnings, both share prices and reputations fell when the truth was uncovered, and earnings had to be restated (Rayner, 2003:109). Alsop (2004:12) states that some of the worst offenders had, ironically, fooled some people into believing they were highly reputable. In hindsight, such reputations were clearly fake. Enron, for example, was ranked as the most innovative company by a survey of executives, directors, and securities analysts, conducted by Fortune Magazine, just months before the energy company was exposed as a fraud. In another example, Ahold, the Dutch supermarket company was placed first in a 2001 study of corporate reputation conducted by Harris Interactive and the Reputation Institute, but later came under government investigation for massive accounting irregularities. Dubious accounting practices occurred at Xerox, Global crossing, Qwest, Merck, AOL, and Leisurenet, where R900 million in contingent liabilities were deliberately left off the balance sheet. This combined effort from the various companies has destroyed investor confidence.

3.4.2 Corporate Governance and Leadership

Corporate governance can be defined as the system whereby entities are managed and controlled (King, 2002). Effective corporate governance throughout the business is fundamental to effective risk management, as well as to the safeguarding of corporate reputation and shareholders confidence (Rayner, 2003:110). It is critical for companies to get the basic corporate governance framework right, so as to avoid tarnishing the company reputation, and retaining the trust and confidence of the stakeholders. In order to safeguard a company's reputation from corporate governance risk, management must understand the rules, standards and best practice guidelines relevant to their jurisdiction – as well as the highest standards if the company is operating across national borders - and apply them to the board and boardroom processes. The relevant considerations with regards to corporate governance are as follows:

- Compelling vision and strategy
- Responsible, accountable and dynamic leadership
- Balanced and effective board
- Independent, challenging and proactive non-executive directors
- Appropriate remuneration and incentives
- Relevant and effective board committees
- Comprehensive and cohesive risk management and internal control systems
- Robust oversight and assurance
- Full and transparent disclosure
- Availability and responsiveness of directors (Rayner, 2003:132)

Enforcing the above principles with clear policies, standards and procedures, backed up by regular reviews and audits that ensure continuing compliance, and, consequently, assure all stakeholders that the company is complying fully with all relevant legislation, helps to maintain reputation.

3.4.3 Regulatory Compliance

“All the world’s a jury” (Hantler, 2005).

Contravening the law, can lead to litigation, which in turn leads to harmful publicity, and a diminished share price. When a company contravenes legislation, it can badly rattle shareholder confidence and impact corporate reputation, as in the cases of Regal Bank, CorpCapital and Macmed, among others. Hantler (2005) states that the threat of a lawsuit and the related media damage can present a no-win situation for companies. Companies must, therefore, either settle a false claim, in order to end the bad publicity, or fight the facts, but get tarnished in public anyway. Often, the damage to a company's reputation and sales exceeds the legal risk the company wants to avoid: lawsuits are no longer tried exclusively in a courtroom, but in the court of public opinion. Companies should, therefore, have a contingency plan that will help shape the way emerging issues or facts will materialise, supported by inflammatory coverage and other legal issues. A 'perfect storm' will swamp any company that does not see it approaching (Hantler, 2005).

Companies must also comply with a barrage of laws and regulations: general laws, such as tax, employment and human rights, or environmental laws and intellectual property laws (Rayner, 2003:162). Failure to comply can result in the loss of a license to operate; this occurred in the case of Arthur Andersen, which lost its license to practice because it was convicted of obstructing justice, related to Enron, one of the company's clients.

A court case due to non-compliance can result in reputational damage, with the media helping to add the proverbial fuel to the fire. The problem with a court case is that the perception for the stakeholders is that the company is probably guilty, even before it is actually found to be guilty. If the court then rules in favour of the defendant, the company's reputation would still be severely damaged.

Companies that go beyond general compliance, such as being a leader in adopting a new regulation, can create a competitive advantage and, thereby, add to the reputational capital. Companies must maintain documented policies in order to ensure compliance of all laws and legislation. Evidence of this, as well as training of staff with regards to laws, and ensuring implementation and compliance thereof, can help the company to successfully defend itself in the event of a breach, as it has added to its reputational capital by being proactive (Rayner, 2003:117).

3.4.4 Delivering Customer Promise

Poor customer service is one of the chief shortcomings that companies face, which also undermines a corporate reputation (Alsop, 2004:122). Slow and inept service upsets customers extensively, because it costs them the most precious of commodities: time. The customer is ultimately the most important stakeholder for every competitive business and commercial operation (Zaman, 2004:109). A company should understand that customers do not evaluate a product or service on its own – they do so relative to their expectations. When customers' expectations are too high, and the delivered product does not meet those expectations, the customer will, most likely, not repeat the purchase. Therefore, companies must try to narrow the gap between customer expectation and experience; this is a key element in mitigating reputational risk and creating value in customer relationships, and, ultimately, building reputational capital (Zaman, 2004:133).

Rayner (2003:121) states that attracting initially customers is only part of the challenge: retaining them and enjoying their repeat custom is another. Customers are faced with wide and varied choices. It is, therefore, easy for them to turn to alternate suppliers if they lose confidence or if their expectations are not met. Also, it is vital to maintain customer expectations, in terms of quality and competitive pricing. Faltering on this credo can result in a severe dent to reputation.

If a company suffers from a stigma of bad service and inferior products, then it should admit that it has a problem. The company must then make improvements, and develop a strategy to identify the underlying causes and to, effectively and efficiently, deal with the problem (Alsop, 2004:123). Lack of effective communication can result in consumer discontent and, consequently, reputational damage, as the consumer could turn to the media to lodge a complaint, and the media will, in turn, highlight the plight of the consumer and name the offending company. The company is then forced to concede and provide either an apology or financial compensation. Using customer service departments to help highlight problems can generate reputational capital (Rayner, 2003:123).

3.4.5 Workplace Talent and Culture

Human capital is one of the company's most valuable intangible assets. Companies must ensure that employees are fairly rewarded for their work, and are treated equally. If employees are not paid adequately, it could lead to employee misconduct and undermining of the companies' ethical code, thereby impacting the reputation of the company. Shareholders want their investment to be in capable hands: the company must be able to recruit the right skills, and hire competent individuals. Reputational capital increases when employees are happy with their job situation (Rayner, 2003:144).

3.4.6 Corporate Social Responsibility

“Corporate Social Responsibility is the commitment of business to contribute to sustainable economic development working with employees, their families, the local community and society at large to improve their quality of life” (WBCSD, 2000).

A company that integrates its reporting efforts in both financial and non-financial areas, using guidelines from the Global Reporting Initiative, shows a commitment to the environment in which it operates. This adds to its appeal, as investors are attracted to a company that shows empathy towards the environment (Neef, 2003:78). Such companies offer better quality, less volatile earnings and are seen as safe, long-term investments (Rayner, 2003:174). For companies operating in South Africa, a commitment to health issues - which include responsible HIV/Aids policies, and local community involvement by contributing to employee housing - can enhance the company’s corporate social responsibility image.

3.4.7 Communications and Crisis Management

No company is immune to a crisis. Therefore, companies must be prepared and able to respond immediately should a crisis or event affect the company. There must be a contingency or recovery plan in place, in order to deal with the event effectively (Fombrun, 1996:112).

An event can become a crisis when it threatens a company’s short-term prospects, as well as - if the event is mismanaged - its long-term survival. Companies rely on delicate interrelationships for their mandate to operate. When these relationships are jolted and profitability is threatened by an internally- or externally-generated disaster, companies with a strong reputation that act quickly to maintain stakeholder confidence, underpin sales, protect their market position and communicate with regulators, will be the companies that go furthest toward guarding shareholder value (Sherman, 1999).

As Fombrun (1996:117) states, over time, some companies recover lost value quickly and the crisis fades. Others experience more extended damage. Research suggests that the difference lies in how this crisis was handled and in what the reputation of the company was before the crisis arose. Good reputations have considerable hidden value as a form of insurance – they act as a “reservoir of goodwill”. The insurance value of reputation derives from its ability to buffer well-regarded companies from problems. When faced with a crisis, companies must ensure that all information regarding the event is honest, and that communication is transparent. Companies must select the right spokesperson to deal with the media, and manage the media with care. Companies must be available to respond to queries and must continually update the media, as well as the public, about the development of the crisis. Trying to solve the disaster behind close doors will only make the public more suspicious of the situation, and allow media to speculate on possibilities. If a crisis is handled well, it can enhance the reputation of a company.

3.5 Fragile Asset

Once a company has established its reputational capital, it must then preserve it. An event or crisis situation can help unlock the value of a company’s reputation, or show the lack of reserves. The example of Arthur Andersen provides a valuable lesson in demonstrating a key feature of reputation, i.e. its transience (Fombrun, 1996:32). Reputation takes years to build, but it can be destroyed in an instant. As

Warren Buffet, CEO of Berkshire Hathaway states: “It takes twenty years to build a reputation and five minutes to destroy it”.

Zaman (2004:50) states that there are three factors, which can weaken the reputation of a company:

- Poor performance directly connected to products and/or services
- Poor performance with respect to achievement of relevant company aims or with regard to relations with various stakeholders, and especially with employees.
- Value conflicts or violation of specific values (such as social values), a public relations crisis and fundamental ideological rejection.

Arthur Andersen’s case provides a valuable lesson in explaining how important reputation is, and how easily it can be destroyed. Arthur Andersen was one of the top auditing firms, globally. It had enormous reputational capital, including tangible assets - i.e. intellectual capital - that contributed to the firm’s reputational image over 89 years of being an auditing firm. However, one client, Enron, and one employee who had been in charge of the Enron account, managed to bring down an entire company and reduce its name to smithereens (Foss, 2002). The audit firm was found guilty of obstructing justice by shredding documents related to the audit client, Enron, thereby thwarting an ensuing investigation. Shareholders lost confidence in the company’s ability to perform its basic duties according to the required standards. Andersen no longer had legitimacy. An auditor whose integrity is in question, and who is seen to lack independence and objectivity, simply cannot operate in a business environment (Rayner, 2003:102).

3.6 Other Factors

Fombrun and Shanley (in Bromley, 1993:175) carried out surveys on a firm's performance and prospects, and then refined the results of a survey of reputations, which rated firms in the business sectors, using the following eight attributes of reputation:

- Quality of management
- Quality of products and services
- Long term investment value
- Innovativeness
- Financial soundness
- Ability to attract, develop and keep talented people
- Community and environmental responsibility
- Use of corporate assets

Fombrun and Shanley (in Bromley, 1993:176) then used multiple regression techniques, i.e. they showed that reputation was significantly predictable from measures of profitability, size and visibility, and accounted for 27-35% of the variation in reputation. In terms of the survey, respondents had to nominate leading firms in a particular sector, and the firms were rated in terms of the eight attributes, using an eleven-point scale from "poor" to "excellent". This was done in order to determine a "common factor" that would help define corporate reputation.

Fombrun and Shanley (in Bromley, 1993:176) factor-analysed the correlations between the eight attributes of reputation and developed a common factor that accounted for 84% of the variance. Factor analyses on comparable data confirmed the stability of their solution. A time series analysis was then carried out on the results obtained from technical indices appropriate to the analysis of corporate character:

- Size
- Economic performance
- Riskiness
- Extent of institutional ownership
- Favour ability of media exposure
- Differentiation (advertising and charitable contributions)
- Diversification

The three variables most highly correlated with reputation were profitability, market value, and risk. The only statistically insignificant variable was yield (dividend/price ratio). The time series analysis indicated that reputation was influenced if a firm indicated a history of profitability, advertising intensity and size, and was influenced unfavourably by riskiness. Statistical regression also showed that market value, dividend yield and institutional ownership influenced reputation when other factors were held constant. Media exposure, however, had an unfavourable influence when these other factors were controlled, indicating that close media scrutiny raised suspicions about a firm. The effect of charitable contributions was favourable for firms that funded charitable foundations.

Fombrun and Shanley (in Bromley, 1993:177) were able to summarise their results with a rank order of variables, arranged in order of importance for their effects on reputation, namely:

1. Profitability
2. Market value
3. Media visibility
4. Dividend yield

5. Size
6. Charitable foundations and contributions and advertising

3.7 Conclusion

A definition of shareholders' value is: corporate value, minus the debt. Or, to put it another way, a company's shareholder value is calculated as the present value of future cash flows of the business, discounted at its weighted average cost of capital, less the value of debt. However, the more fundamental principle is that a company only adds value for its shareholders when equity returns exceed equity cost (Mars & Weir, 2000).

Identifying reputational drivers means exploiting opportunities for reputation enhancement, performance improvement and competitive advantage that will add real value to the bottom line (Rayner, 2003:15). A positive and sustainable reputation is now a major determinant of a business's future ability to generate wealth and succeed in the long term. Corporate reputation is not only a measure of past performance, but also an indicator of future promise (Rayner, 2003: 16).

The different factors that can cause damage to reputation will be discussed in the following chapter.

CHAPTER 4

CAUSES OF REPUTATIONAL DAMAGE

4.1 Introduction

The purpose of this chapter is to show how reputation can be impaired. The environment surrounding a company can unleash potential problems, which impact and destroy a reputation. Identifying these factors assist in developing a strategy for management to manage reputation risk.

Reputation can be impacted by:

- Economics - the company is perceived as unresponsive and out of touch.
- Nature - for example, should a hurricane occur, the question will be asked: why was the company operating in a flood prone area?
- Operational: the company was ill-managed
- Pollution - the company has allowed unsafe practices, which are damaging to health, safety or the environment.
- Employment practices - there are discrepancies between the company's published values and the reality
- Governance - there are lapses in governance standards or ethics
- Unfair competition practices - the company behaves in a way inconsistent with its published charter of values
- Human - involuntary product or service failure; the company is threatened with litigation
- Voluntary - there is breach of security (Louisot, 2005).

The list is endless, because the environment is vast. However, this chapter will show how reputation can be damaged, and will demonstrate, using factual cases, how reputation is affected by executive behaviour and ethics, physical accidents, by association, by reinvention or merger and, lastly, by the media.

4.2 Factors which impact reputation

A company does not operate in isolation, and, therefore, its relationships with the environment can impact its reputation. The following factors will demonstrate how the reputation of the company can be affected.

4.2.1 Executive Behaviour and Ethics

When an event impacts the reputation of a company, a company's management must quickly accept responsibility for a scandal and punish those responsible. In 1991, Warren Buffet, CEO of Salomon Brothers, purged the top personnel at investment bank Salomon Brothers, an action that expressed the company's moral outrage at their ethical lapses. It sent a clear message, to regulators and investors, that the company recognised its delinquency and would take whatever steps were necessary to avert a recurrence (Fombrun, 1996:383).

Most companies define and publish their mission as a corporation. They also make a formal commitment against which individual managers and employees can measure their own performance - or indeed, direct their staff, peers or even their bosses - when standards appear to be in conflict with some of the points in the mission statement. However, a weakness inherent in some mission statements is that they are not broad enough to cover most eventualities (Haywood, 2002: 31).

Managers and directors have both their personal, as well as the corporate responsibility for reputation. They will not be able to exercise this properly unless they know and understand how an organisation operates. Directors, in particular, must understand the processes by which the reputation of the company is developed. Haywood (2002:4) stresses that the reputation of a company is dependent on far more than polished words and impressive visuals. What the company does, matters just as much as what it says: its products and services create as much goodwill as its communications. The company's attitudes towards its consumers also influence the attitudes those consumers will have towards the company. A company has to project the values in which it believes, and which shape the unique approach to consumers; if not, then the competitor could successfully court the consumer (Haywood, 2002: 4).

In order to ensure a good reputation, companies must ensure that the primary requirement for any management policy is that of transparency: in other words, management must be open and honest, with no hidden agendas. Decisions that are made openly make corporate life simpler, whereas decisions that are surrounded by a high level of secrecy are bound to be exposed, sooner or later (Larkin, 2003: 154).

The media enjoys exploiting a confidential decision that has been accidentally leaked, and this could have serious ramifications for the company. A transparency-based decision-making process highlights the honesty policy of a company. Haywood (2002: 21) stresses that if a company does not want a certain action to become public knowledge, then the simple rule is not to carry out that action. He, therefore, recommends that all companies should have an effective public relations programme, which must be constantly reviewed by management. This review should cover the following:

- Objectives: What is to be achieved, over the coming period, to support the mission statement or corporate objectives?
- Strategy: What tone of voice is being adopted to achieve these objectives?
- Perceptions: How is the company seen?
- Messages: How do you wish the company to be seen?
- Tactics: What communications methods are to be used?
- Initiatives: Are there special events of which you should be aware?
- Calendar: What are the major activities in the corporate calendar that have public relations implications?
- Concerns: What issues might the communications professionals wish to discuss?
- Competition: Are there public relations activities by competitors that should be discussed?
- Appraisal: How effective is the programme, overall?
- Management: How effective is the competence of those charged with managing the function?
- Resources: What is the total cost of the activity proposed, including staff time? (Haywood, 2002: 21).

Neef (2003:90) states that the recent scandals, which have plagued organizations, concern executives; sponsored accounting fraud, and general corporate mismanagement. It is important to note that before Enron’s collapse, most of the ethical incidents that plagued companies – costing them share value, financial penalties, or customer loyalty – came, not from problems with corporate governance, but from issues concerning product safety or violations of employment or environmental laws (Neef, 2003: 90).

Enron had a Chief Ethics Officer, a code of conduct, as well as a value statement that pledged them to “communication, respect, and integrity”. However, this approach did little to prevent the illegal and unethical activities that brought about the company’s ignominious collapse (Neef, 2003: 92).

Arthur Andersen did not have a formal and ethical document. When the Securities and Exchange Commission served Andersen with an Enron-related subpoena, the company shredded documentation and deleted computer files related to its activities with Enron. The company was only fined $500 000, but the audit firm’s reputation was undermined to such an extent that the company was essentially ruined, within a matter of days (Neef, 2003: 103).

Enron was part of a prestigious group of companies, which were listed in Fortune magazine. One of the criteria used to rank the companies in the magazine was turnover. For the year ending 31 December 2000, Enron’s financial statements disclosed a profit of $979 million. This large profit provided a façade for the investors, showing a company that was committed to growth. The financial statements smartly hid the time bomb on which the company was sitting, i.e. that it was a company riddled with debt (Glater & Schwartz, 2002).

Enron’s difficulties were related to its activities with derivatives in the energy market, and the creation of a series of special purpose entities (SPEs). The company used these special purpose entities to conceal large losses from the market, by giving the impression that debt exposures were hedged by third-parties. However, because the SPEs were in reality subsidiaries of Enron itself, the reality was that Enron’s risk was not covered. The SPEs, which should have been consolidated, were conveniently left off balance sheets, by capitalising on an accounting loophole. The SPEs were also used to transfer funds to Enron’s own directors. In October 2001, Enron declared an operating loss of $1 billion, and also had to disclose a $1.2 billion write-off against shareholders' funds. Later in October, Enron disclosed another accounting problem, which exacerbated the situation, because it reduced Enron's value by over half a million dollars. This made the company vulnerable to a takeover from a rival, Dynergy. However, a disclosure of Enron's huge debts scared Dynergy, allowing the deal to fall through. In December 2001, Enron filed for bankruptcy. (Oppel & Eichenwald, 2002).

Enron directors were given free reign, and their actions were never questioned. Both SPEs and other creative accounting techniques were accepted as correct. Arthur Andersen did raise questions about the use of SPEs and Enron's activities, but failed to dig deeper and unearth the real problem. This lack of a quality audit, and the lack of compliance with legislation, by shredding valuable paperwork related to Enron, sealed Andersen's fate. The shredding of important documentation added to additional concerns about Andersen's knowledge of potential accounting irregularities. Andersen faced a public relations disaster, because its behaviour was seen as unethical (Morgenson, 2002).

Wyatt (2003) states that reputations are gained, in part, from a firm's policy on how tough a stance to take on the interpretation of accounting standards. In one instance, Andersen resigned from a large railroad engagement because the firm disagreed with a particular accounting principle that was accepted in that industry. Later, it resigned its entire savings and loan clients, again because the firm disagreed with an acceptable accounting principle involving deferred taxes applicable to savings and loans. While that position proved advantageous when the savings and loan fiasco developed in the late 1980s, the point is that the firm took tough positions on accounting standards, without regard to immediate revenues lost. Those stances were followed by relatively rapid increases in audit revenues. The underlying rationale at Andersen, at the time, was that most clients wanted their auditors to keep them out of trouble and, therefore, expected the auditors to object when the client wanted to follow an accounting policy that might lead to problems in the future. One's auditing firm was the epitome of trust, honesty, and decency – all attributes that a successful business enterprise was expected to possess.

However, over its last five years, the firm had been involved in several other major accounting scandals. It had audited both Sunbeam and Waste Management, which have had to re-state their earnings, after admitting that there was fraud in their financial statements. Andersen paid $110 million to settle lawsuits by Sunbeam shareholders.

Another potential problem Andersen faced regarding Enron was that of Enron's relationship with other energy-trading companies - including Calpine, Dynergy and Mirant - which Andersen also audited. Improper accounting with these companies added to Andersen's woes (Morgenson, 2002).

As the firm battled to retain some form of credibility, it came to light that the firm had failed to pick up on a $644 million error in the accounts of NASA, the US space agency. Andersen blamed the discrepancy on a "good faith misinterpretation" of the guidelines, and said it "raised no inference of a lack of due professional care". Also, in Australia, Andersen faced criticism over its role as Auditor to HIH, an insurance group that collapsed in March 2001. Andersen was also auditor to Global Crossing, the telecommunications provider that filed for bankruptcy protection (Berenson & Glator, 2002).

Andersen, an 89-year-old firm, and Enron’s auditor for more than a decade, started losing clients. Delta Airlines, the third largest US passenger carrier, dropped Arthur Andersen as its auditor after 53 years; thereafter, Freddie Mac (mortgage purchaser) and Merc both made the same move.

The firm also faced lawsuits and criminal charges relating to the accounting issues surrounding Enron. To add to an already tarnished reputation, Andersen was stripped of its license to practice in some states, and faced billions in civil suit claims. The company name became a liability, and the firm was convicted for obstructing justice. Arthur Andersen had to accept defeat, and the company ceased to exist (Kadlec, 2002).

4.2.1.1 Conclusion

Management of a company must observe an allegiance to a central code of ethics. This will ensure that they set behavioural characteristics for all other employees in the organization. A proper code of ethics will help to achieve transparency with regards to all management action and decisions, and help to avoid dishonest or fraudulent acts, and hidden or selfish agendas. Once business integrity is caged within the organization, this helps the company to avert possible reputational damage.

Management at Enron and Arthur Andersen displayed a total lack of ethics with regards to their actions and decisions. This resulted in both companies seeing their reputations sullied, and facing financial ruin.

4.2.2 Physical accident (Intentional i.e. Product Tampering)

A physical accident can be created through intentional or unintentional means. Intentional means occur when someone purposely tries to destroy the company's image by tainting the product of the company. Unintentional means occur when damage is incurred due to uncontrollable external factors.

A company may have done everything possible to anticipate and guard against reputational threats, but if an accident occurs, and you are caught unprepared or respond inappropriately, you may find your reputation in tatters (Rayner, 2003: 203).

When an accident takes place, an important role for management is to preserve the reputation of the organisation by fronting the media push, and by ensuring that the organisation reacts, promptly and firmly, to the accident. A prompt and careful response, made by convincing figureheads, can entirely head off negative publicity. If an accident is handled well, the reputation of management may even be enhanced – it need not just be a matter of damage limitation. However, it is not just a matter of managing the accident properly; it is also ensuring that reputation is a genuine priority at the level of the board, as well as below the board, in order to create and maintain reputation in the long term. This entails significant investment (Chambers, 2001).

In October 1982, Johnson and Johnson had to react quickly when it was found that seven deaths in the Chicago area were attributed to cyanide-laced Tylenol tablets. The company immediately recalled all 31 million bottles of the tablets, costing Johnson and Johnson $100 million. The company also instructed customers not to use Tylenol products until the issue was resolved (Pride & Ferrel, 1989:499).

Even though eight million capsules were tested, it was determined that only eight bottles had been laced with cyanide, and it had occurred on store shelves. The company ensured that it co-operated fully with the media, and also installed customer hotlines. In addition, the company offered a $100 000 reward for the identification of the perpetrator.

The company decided to re-launch the tarnished product. Due to the tampering incident, the federal government of the United States of America required that manufacturers package all over-the-counter medicines in tamper-resistant packages. Johnson and Johnson's packaging subsidiary, Mcneil, repackaged Tylenol with glued-end flaps, a plastic-neck seal, and an inner-foil seal, with a label instructing consumers not to use the product if the safety seals were broken. Although the government required only one of the three preventative measures, Johnson and Johnson did not want to take any chances, and decided to rather include all three of the precautionary measures. Thereafter, the company launched a massive production and distribution effort to make the newly-packaged product available, as soon as possible. This concept in packaging was innovative and is now broadly used by food and pharmaceutical manufacturers globally (Kaplan, 1998).

The company's sincere effort during the product-tampering incident helped entrench Tylenol as a favourite with consumers. Tylenol gained a 24 percent share. Due to the remarkable handling of the situation, the company was cited as an excellent example of an organisation that commits itself to acting in its employees, as well as the public's, interests, during good and bad times. This view helps build strong relationships with the public, who uses this as goodwill, and gives an organisation the benefit of the doubt during a downtime (Kaplan, 1998).

A company's best weapon during an event is actually its day-to-day business operations that build its reputation, due to a strong corporate culture, because of consistent good behaviour. Management at Johnson and Johnson took an uncontrollable event, and, using proper management principles - that is, responding to the disaster in a most professional and exemplary manner - managed to avert reputational damage. The company took the following steps:

1. Recalled all Tylenol capsules in the retail and wholesale channel for full credit.
2. Advised consumers to destroy, or return for credit, all Tylenol capsules in their possession.
3. Instituted a testing program for capsules returned, in order to determine the extent of the tampering.
4. Instituted a review and testing of their internal manufacturing and quality assurance procedures, in order to confirm that no confirmation risks existed in these areas.
5. Co-operated fully with federal, state, and local officials responsible for the investigation of the incident.
6. Responded fully and openly to all press inquiries, and held regular press briefings to keep the public informed of actions taken and progress made in uncovering the source of and responsibility for the poisoning.
7. Supported changes in FDA regulations requiring immediate modification in packaging techniques to eliminate the opportunity for undetected tampering with over the counter pharmaceuticals (Govoni, Eng & Galper, 1986:471).

As was previously mentioned, the above steps incorporated the company's basic corporate business philosophy. Yet, what gave the company further impetus through the crisis was the lack of a singular objective: i.e. the selfish drive towards earnings. Instead, the company incorporated a positive attitude by putting the interest of the consumer first. This enhanced the reputation of the company as an enlightened, concerned, and public-spirited corporate citizen.

Due to the new enhanced reputation of the company, Johnson and Johnson's Tylenol brand was re-marketed by the trade and the public, and it re-established itself as a well-respected brand.

4.2.2.1 Conclusion

Companies are never immune to a crisis. However, when a company develops and rehearses a crisis, and integrates this into its overall business continuity, it helps to minimise damage to reputation during an actual crisis.

Openness and honesty during a crisis are prerequisites for allaying stakeholder fears, and maintaining the confidence of the public. Johnson and Johnson gave convincing explanations of the crisis of the product tampering, and, thereby, consumers knew the true nature and extent of the problem: this helped them to conclude that the company had nothing serious to hide. Johnson and Johnson's instinctive reaction to the crisis was the right one: it satisfied the customers and quickly restored their confidence and trust.

4.2.3 Risk by association

Risk by association is the risk of associating with companies or products that can have a negative impact on the reputation of a company.

Companies often form alliances with other companies, thus capitalising and increasing market share through these alliances. However, an alliances' success is dependent on a company's investment in the alliance. The longer the alliance lasts, the stronger the bond between the partners (Zaman, 2004: 235).

An association can fail due to a lack of commitment or due to a lack of experience in dealing with a partnership. Lord Brown emphasises that an association or partnership will work if the following factors are pursued (in Zaman, 2004:235)

- Working towards joint goals
- Delivering on promises
- Being (and visibly acting) humble
- Thinking long term.

Zaman (2004:237) states that, when reviewing a potential alliance or association with a company, a company must determine a potential partner's value adding capabilities, as well as how the potential partner is perceived in the market place, and, most importantly, the potential partner's reputation. Potential partners should be sought out because they are viewed as being a valued company with which to partner (Zaman, 2004: 237).

Fombrun (1996:195) further stresses that a company's reputation is derived from the relationship it establishes; in other words, the quality of the relationship shapes the particular image that the company develops with its alliances. The relationship depends on the way information flows between the company and the alliance, the frequency of their contact, and the level of trust between them. Globally, the trend is to enter into a plethora of relationships, as corporate reputations are tied to these partnerships. Therefore, risk management must ensure more effort is placed on capitalising on the relationship, and continually building on the reputation, thereby increasing and sustaining reputational capital. More funding, close social ties and effective communication will ensure that both partners in the alliance benefit reputationally (Fombrun, 1996: 196).

Business partners who fall short of the required expectation from the alliance can impact on the reputation of a company. Companies must, therefore, insist that the alliance or association adhere to certain codes of conduct or undertakings

Ford and Firestone added an important chapter to Risk Management, after the Tylenol case. In the Ford/Firestone case, not one, but two companies, with a long and complex relationship, had to juggle saving customers' lives, as well as their own corporate reputations, as they dealt with a product that was out on the road, rather than on a supermarket shelf (Ackman, 2001).

Ford Motor Corporation, and tyre manufacturer Firestone Inc were faced with a major product recall after discovering there was a fault with the Ford SUV Explorer, involving the tyres that were used on the vehicle. The partnership had obviously impacted both companies' reputation. Ford and Firestone were involved in a partnership and, therefore, both companies were required to act. Ford made the first move by offering to replace the tyres. Firestone lagged behind, and blamed Ford and its consumers for the problem, stating that improper tyre pressure and maintenance was the cause of the tyres shredding (Bott, 2000).

Instead of reassuring the consumers, the companies enraged them, turning a problem that could have been fixed into a public relations fiasco. The inability of both companies to accept responsibility impacted both companies' reputation. However, both companies did attempt some last-minute publicity stunts, by apologising for the deaths, as well as the inconvenience that the tyre recall had caused to the consumers. However, neither company accepted full responsibility for the problem. Instead, both companies resorted to public finger-pointing. This finally resulted in Firestone severing its ties with Ford, a relationship that went as far back as the model T, which was developed by Henry Ford and Harvey Firestone (Greenwald, 2001). The fact that these two companies had been partners for 95 years, and still exhibited such a dispute, increased public suspicions and provided plenty of interest for the media. All this added a dent to the companies' credibility (Bott, 2000).

Due to the poor way with which the issue was managed and communicated, both companies suffered a setback, because of their respective handling of the situation. Neither company acknowledged the risk potential of the situation, which eventually, led to a dramatic fall in share prices and profits for both companies. Furthermore, both companies did not behave in a way that recognised the value of reputation or the importance of treating stakeholders intelligently (Larkin, 2003: 53).

With regards to this case, three issues of failure were highlighted:

1. Inability to identify the risk early
2. When Ford and Firestone did, finally, recognise that they had a problem, they did not share information or acknowledge the problem. The issue was managed in isolation.
3. When the story broke, there was no evidence of responsible behaviour or of working in partnership. Instead the companies blamed each other.

The partnership of Ford and Firestone had to deal with a problem product, as well as an ethical issue, i.e. how to tackle the partnership's problem product, without tarnishing each other's reputation. The preferable action in the Ford/Firestone debacle should not have been to place mutual blame, but, rather, to have ensured the safety of the customer. Johnson and Johnson pulled its Tylenol brand from store shelves after tampering was discovered, thus showing that they put the consumer first. This enhanced the company’s public image, which is the first step in enhancing reputation (McClenehan, 2001).

4.2.3.1 Conclusion

Both companies suffered financially, and, to a lesser degree, their names were sullied. Firestone spent more than $350 million on the recall, and is only beginning to settle what could amount to billions, in various lawsuits. However, both companies clearly face major challenges in rebuilding their public images (Bott, 2000).

The conclusion of this debacle depicts the one fact that forms the cornerstone of reputational damage: Firestone’s share value dipped. Ford is trying to separate itself from Firestone, but consumers will need time to disconnect the two companies. Ford chose Firestone tyres for its cars, and, from the consumers’ point of view, they don’t necessarily buy the body of a car from one manufacturer, and tyres from another. Consumers perceive that they are buying the total package of a car, in this case, from Ford (Greenwald, 2001).

4.2.4 Reinvention or merger

The purpose here is to show a situation where a company tries to introduce new products, and becomes totally sidetracked from its primary goals. This circumstance directly impacts the company’s earnings, as the company would be unable to compete, successfully, with the obvious, and more experienced, competitors in the field. This results in the company being perceived as completely inexperienced and, thereby, the company’s reputation is affected.

Companies must maintain a certain goal, which is to continually provide shareholder value. If companies manage their goal in an appropriate way, and if foreseen - as well as unforeseen - circumstances are catered for, the company will be allowed to maintain a stable cost of capital and an attractive share price, which induces the investor to purchase shares in the company (Rayner, 2003: 53).

Opportunities for growth and diversification must exist within core businesses. That way, a sustainable growth factor can be maintained. If investment in new and unchartered fields is attempted, proper feasibility studies must be conducted by management, in order to demonstrate both their competence and their commitment to maintaining the reputation of the company, as well as the shareholders value. A company that lacks vision and clear strategy can create a ripple effect that will infect every principle on which the company stands. Company's that change business strategies without a proper plan of action suffer from falling profits and an obvious fall in the share price. Shareholders invest in companies where they know that management is in control. Management must have a good grasp of the risk facing the company - both threats and opportunities - and should also have systems in place to control them effectively (Black, Wright & Davies, 2001:140).

If a company decides to extend its brand by moving into new areas that are totally unrelated to its primary objectives, it is important that management assesses obvious risk exposures. Brand extension can cause damage, instead of enhancing a company's image, if not managed correctly. There are new risks and threats that the company will face (Rayner, 2003: 149).

Before a company embarks on a new market, or extends its brand, it must take heed of the following principles:

- Do you understand the risks of moving into this new area?

- Are the exposures acceptable?
- Do you have the in-house expertise to manage these risks and put appropriate controls in place? If not, can you acquire it quickly?
- How well can your key policies, processes and procedures be transferred across to the new venture, so that it is bound by your values, tolerance to risk and strategic objectives?
- Are you able to monitor the effectiveness of risk controls? Do you have access to auditors with relevant skills and experience for the new area?
- How will progress be reported and integrated into your corporate risk management framework and disclosure processes?
- Think “out of the box”: how could your brand – and potentially corporate reputation – be damaged by this new venture? (Rayner, 2003: 149)

Coca Cola illustrates a situation whereby management tried to reinvent the product by introducing a newer version of the successful drink. However, the global market did not accept the new product, and this impacted the company’s earnings. Management had to re-introduce the original flavour of the drink, with new labelling, i.e. Classic Coke. The quick thinking to reintroduce the original flavour saved the company from irreparable damage.

4.2.4.1 Conclusion

When Coca Cola introduced the New Coke, a new advertising campaign was launched simultaneously. The media helped to reach 89% of the population. The reaction to the media launch and to the discontinuance of the old coke dumbfounded the company. The public reacted unexpectedly: a loud outcry was raised. After hearing that the old Coke was to be discontinued, consumers said that they hated the new coke, even though they hadn’t even tasted it. In addition, blind tastes had shown a consistent preference for the new formula (Reid, 2004).

What the company had totally ignored was the simple concept of building the product and developing the brand over so many years, thus creating that security that most consumers identify with a brand. The competitors, namely Pepsi, used this opportunity to stress the importance of their product, citing that Coca Cola had tried to formulate a product that was similar to theirs: i.e. Pepsi's sweet taste. Pepsi emphasized this point by stating that it tasted better than Coke. Coca Cola had to admit that it had made a mistake. It had misjudged the loyalty of the consumers with regard to the old Coke, and it had underestimated consumer loyalty for a product that had instilled and given the company its reputation (The public relations fiasco, 1997).

4.2.5 The Media

Because of the fishbowl effect, it is difficult for companies to squash rumours effectively, without the media creating the proverbial media event with the story. This, therefore, creates the factor of publicity, which, if not handled correctly, could seriously impair the reputation of a company. The risk is created by the media not allowing a company sufficient time to correct the situation, before said situation reaches the point of damaging the company's reputation.

Management must effectively try to use the media to its advantage: it should use the media to market the company and enhance the overall reputation of the company. Management must be experienced enough to determine in which direction a media event will flow. Contingent plans must be implemented in order to utilise the exposure effectively, or to diminish the effect in a professional manner (Neef, 2003:173).

The market is precipitated by intense scrutiny from both media and shareholders. Shareholders are easily influenced by the media, which still maintains the throne in dictating which company has the best reputation. Therefore, when a company is faced with a crisis or abnormal event, management must understand how to handle the situation. Management should communicate effectively with the media, and not allow gaps, which the media can fill with rumour and fiction, to exist. Companies must implement an effective business continuity plan, as well as proper disaster recovery procedures. Ineffective management – in other words, communication with the media - can impair reputation (Larkin, 2003: 65).

Key considerations for effective communication:

- Ensure that communications are fully transparent and include all material issues of interest to stakeholders. Information should be accurate, prompt, honest, consistent, and, where possible, go beyond the statutory minimum, in order to build confidence and goodwill.
- Put your communications across in an accessible, jargon-free style, and ensure that the person delivering any verbal communication adopts an appropriate tone and approach, particularly during a crisis. Provide media training to key personnel, be honest and sincere, commit to learning from any mistakes, and don't try to "pass the buck".
- Try, at all times, to strike an appropriate balance between quantity, quality, timeliness and relevance. Tailor-make your communications to individual shareholder group audiences, so as to ensure that their information needs are met.
- Avoid surprises. Convey bad news as soon as practicably possible. Never put yourself in a position where you believe that you could benefit personally by withholding bad news.

- Monitor media activity and manage the media with care. “Good News” stories must be backed up by solid fact and evidence, as pure public relations spin will be, swiftly, exposed. Beware of trying to take the moral high ground, as it often backfires.
- Carefully consider the timing of communications, particularly of multiple statements over a relatively short period, so as to ensure that messages are consistent and cannot be misconstrued (Rayner, 2003: 209).

In 1986 Audi had to recall 250 000 Audi 5000 models that were sold between 1978-1986. The company had to install an automatic shift lock in order to prevent unintended acceleration. The order to install came through from the Federal Government, because of a number of reported incidents of unintended acceleration (Hewitt, 2002).

In a bid to be viewed as being cautious and prudent, the company also decided to recall the idle stabilisation value in a separate action, so as to demonstrate that consumer safety comes first. This recall was carried out in order to appease the American public. The company acknowledged problems with the idle stabilisation value, but insisted that the defective part was not responsible for the unintended acceleration. An Audi investigation of some 300 incidents of unintended acceleration found no idle stabilisation value defect in any of these cars (Hewitt, 2002).

CBS 60 minutes, a TV show, carried an account of the Audi 5000. The show described the car as a “car possessed by demons”. The documentary showed an insert of a woman who had her young son open the garage, just before she drove into it; the car then accelerated unintentionally, thereby killing her six-year-old son (James, 1998).

The effect of the 60 minutes broadcast was devastating. Audi was forced to go to court in order to defend itself. A class action suit was also taken up against the company, causing Audi to suffer major monetary losses, as well as losing tremendous market share. The company's sale of units dropped by 57% (James, 1998).

However, the real tragedy of the situation was that the 60 minutes report was false. The team had misled the public, as the woman who claimed that the car had accelerated had, in fact, changed the story. The incentive was a claim of $48 million dollars. In reality, she had put her foot on the accelerator, instead of the brake, by mistake. The investigating police officer and witness at the scene testified that the woman had admitted that her foot had slipped off the brake. Moreover, the jury found no defect with the car (James, 1998).

4.2.5.1 Conclusion

60 minutes had doctored the car to accelerate, so as to reinforce and prove the point that it was trying to relay to the public. Audi lawyers, however, managed to implicate 60 minutes and confirm that the program had falsified the defect for the show. Further tests, by reliable sources, proved that the 60 minutes inset was false - there was no defect with the car. Then, the obvious question is: why did Audi still carry out a recall? Audi stated that the point of the recall was to add a device that would keep drivers from shifting into gear, unless their foot was on the brake (Hewitt, 2002). It probably only cost 60 minutes a small amount of money to make the car look defective. However, the damage to Audi, the manufacturing company, was huge.

Companies should not underestimate the power of the media in telling a story, because the media interpret, amplify, and shape news stories through commentaries that affect how consumers think about companies (Fombrun & Van Riel, 2004:113). Negative media coverage virtually ensures high negative visibility.

Organisations should be constantly vigilant and available for comment. They should also try to maintain cordial relations with the media in their major countries of operation, because businesses are now exposed wherever they, or their major suppliers, operate in the world. A company has to ensure that a story is backed by fact, by robust management, monitoring, and reporting systems, because good news can rebound negatively on the reputation of a company (Rayner, 2003:199). What begins as a small story can also become a very big story, even if no direct single tragedy, accident or incident is involved.

4.3 Conclusion

Damage to reputation from the above factors is directly linked to the way the event is managed and the ability of the company to react and deal with said event. However, as Louisot (2005) states, beyond normal risks, executive teams must remain in tune with the stakeholders, at all times, and prove to be able to adapt to changes – even to abrupt changes that may result in dislocation. Recognising potential risks to reputation and fine-tuning a pre-emptive organisation strategy can help mitigate the offending risk. Senior management and directors must make it the company's objective to implement methodologies in order to achieve this goal.

The effective and proactive management of reputation risk across an enterprise has become a necessity. The following chapter will provide guidance on managing reputation risk and discuss corporate governance.

CHAPTER 5

MANAGING REPUTATION RISK AND CORPORATE GOVERNANCE

5.1 Introduction

Corporate reputation has emerged, or perhaps re-emerged, as a core economic value or marketable asset, not only internationally, but also locally. In order to build reputation for integrity, companies must adhere to sound principles of corporate governance. This chapter will explain the importance of managing reputation risk effectively.

Reputation is a valuable asset. It must, therefore, be protected by companies through an ongoing commitment to legal compliance and high ethical standards through daily business activities. Zero tolerance for unethical behaviour must be maintained.

Accounting giant Arthur Andersen, one of the oldest and largest accounting firms in the world, saw its reputation destroyed by the company's association with Enron's suspect accounting practices. Shortly after Enron's collapse, Andersen's clients deserted the company, and this forced Andersen to retrench staff. The company was later convicted of obstructing justice regarding Enron's case. Andersen was a profitable company, but lost ground within a few months, because of its tarnished reputation.

A company's reputation is important, but so is the reputation of the country in which it operates. Poor corporate governance, whether through tax avoidance, insider dealings, or lack of transparency and accountability, can prevent companies from expanding and experiencing growth.

The global economy is not static and, therefore, companies must adopt modern and efficient methods in order to compete. Thus, old practices cannot be maintained. Management must work as a team, in order to create a more transparent and responsive corporate governance system. Good corporate governance contributes to sustainable economic development, by enhancing the performance of companies and increasing their access to outside capital. A company that ignores corporate governance risks litigation, diminished reputation, and shareholder movements aimed at the company's board of directors.

5.2 Managing reputation risk

Louisot (2005) says that managing reputation is an essential part of the strategic role of the board of directors, who must take into account all stakeholders, whose perception of the organisation will determine its reputation. Risk or uncertainties, both positive and negative, must be managed in a holistic systematic approach, as there is no such thing as reputation risk – rather, all risks may impact on reputation. Therefore, the best management of risks to reputation is sound enterprise-wide risk management. Louisot's (2005) words aptly distinguish corporate governance as an essential characteristic of managing reputation risk.

Darman (2003) emphasises that the recent corporate scandals and failures each stemming from different causes, mean that companies and institutions cannot afford to have their reputations tarnished by inadequate oversight, lack of transparency and irresponsible business conduct. The decline in public trust has to be restored. Good corporate governance is an essential element of sustainable economic growth in a market economy.

Companies are aware of the importance of managing reputation risk, but the task appears daunting. Therefore, most companies rely on reactive, rather than proactive measures, after a reputation risk event has occurred. The measures taken after the event are costly and often prove the adage, “too little, too late”, However, due to the fact that the measures are event-directed, they do not provide an ongoing risk structure for the company to identify and control other issues that could cause reputation risk (Petersen, 2005).

Reputation risk is difficult to manage, because it is a qualitative, rather than a quantitative risk. Most companies implement risk management processes and systems, which have two fundamental characteristics: firstly, they protect against risk in a vertical way, i.e. against credit, market or liquidity risk, to name but a few. However, if risks intersect, thereby causing a domino effect, then the company is caught unaware. Secondly, most of the risks and controls have generally been quantitative; for instance, the Rand value of loss can be ascertained, and the controls utilised are capable of performance measurement. This means that both vertical and quantitative risks must be controlled. However, due to the fact that reputation risks are not all quantitative in nature, the “quant model” solutions cannot answer all the questions (Petersen, 2005).

5.3 An approach to managing reputation risk

Therefore, in order to manage reputation risk, the board must use a different approach. Larkin recommends that to manage reputation risk, one should follow the following six steps (Larkin, 2003:58):

5.3.1. Establish early warning and monitoring systems: the reputation risk radar

A company must establish systems that can detect potential problems, which could arise from the commercial, political/regulatory, social, economic, and the technological, among other trends. The system should assess the likely impact of the identified risk issues. Companies must also manage information regarding stakeholders, so as to identify and assess their levels of interest, potential positions and influence (Larkin, 2003:58).

Companies should also prepare for problems by identifying possible issues that could affect the industry in which the company operates. Companies could also monitor websites and develop scenarios with outside consultants who are experienced in tracking such risks, and brainstorming with experienced managers who know their individual businesses (Argenti, 2005),

5.3.2 Identify and prioritise the risks.

The second step, as Larkin (2003:59) explains, provides the basis for developing and validating risk issue management strategies, for both short-term action and in taking a long-term strategic view on how to clarify and enhance understanding of a company's objectives, operations, values and behaviours.

The purpose here is to identify every risk issue, which could have a current or potential impact on the company according to:

- Cost to commercial operations and reputation through impact on stakeholder relations, and
- The likelihood of occurrences

Reputational risk must be gradually integrated into risk management and internal audit policies and procedures. This will ensure that reputation risks are included at operational and strategic planning levels. Recommended procedures would include: facilitating scenario planning, auditing and benchmarking, designed to highlight reputation risks, and obtaining both qualitative and quantitative data, which could assist in planning.

5.3.3 Gap analysis and identification of response options

The third step, as Larkin (2003:60) states, involves analysis of any gaps between current performance and stakeholder expectations. In order to provide a basis for determining anticipatory or response options that can contribute to closing the gap.

Companies must determine if there is a gap between performance and expectation. Once identified, this gap must be analysed and the company must determine whether or not its risk evaluation is effective, and whether or not it really delivers what it claims to deliver. Part of this analysis is to determine how the company behaves, and which stakeholders can influence the company's reputation and performance.

This action helps the company to identify differences between how it sees its own objectives, values, competitiveness and priorities, in relation to the perceptions of its key stakeholders, and to determine and confirm company policies, codes of practice, and other important positions. Understanding the need for a better response, opinion-formers and decision-makers can help determine the company's support base and potential for a stronger force.

5.3.4 Develop strategies and action plans

With this step, Larkin (2003:61) emphasises the importance of integration and cross-functional approach to reputation risk management. According to Malcolm Williams, Head of Global Issues Management and Resource Development for Shell International (in Larkin, 2003:61), planning, developing and implementing risk issue strategies must feature the following principles:

- Ownership is a line responsibility
- It is an integral part of normal business management, assessment and challenge processes
- A central co-ordinating function can add value in tuning the risk radar and intelligence gathering, providing issue management expertise to operating groups, thereby validating priorities for escalation, co-ordinating stakeholder contacts and monitoring effectiveness.
- It requires a systematic approach
- It is a strategic process: systematic, early warning, prioritising and objective setting
- Risk issues drive stakeholder engagement
- A 'prudent overreaction' policy is good practice
- Transparency can be balanced with a respect for confidentiality

Developing risk issue strategies, helps to determine what kind of response would be ideal, taking into account the position of the company, its resource assessment and approval, identifying every stakeholder that needs to be targeted, and developing an action plan which details the necessary steps that need to be taken, outlining the different responsibilities. A bullet-point template describing risk issue and assessment, with the related approach to be followed, can assist in the implementation process.

5.3.5 Implementation

This step, as Larkin (2003:62) points out, is about putting the strategy, which has been approved by appropriate management, into action, and consulting with and/or communicating the response effectively to relevant stakeholders. This should be done in a way that ensures that negative impacts to the company's position are avoided, and support - or at least acceptance - of operational policies can be secured.

Furthermore, consulting and testing positioning information and engagement techniques are important early steps. Companies must also build a support base and utilise researched information in order to help develop efficient strategies. In addition, a company must keep its radar tuned to track possible risk, which could influence company-related issues.

5.3.6 Keeping the radar tuned

Larkin (2003:63) stresses that this last step is simply evaluation and ongoing vigilance.

5.4 Managing a crisis situation

Another crucial step in maintaining reputation is to develop a crisis management for when things go wrong. There is always the chance of an unanticipated event taking place and affecting a company. A well-planned strategy can make the difference between prevention and disaster. The early stages of a crisis are marked with obvious corporate surprise, followed typically by wrong conclusions being drawn from insufficient or limited initial information, given a rapidly escalating flow of events, a siege mentality quickly develops, driven by short-term focus.

Management believes that it is solely its responsibility to manage a reputation crisis; however, no single person is ultimately responsible for managing reputation and assessing its risk on a daily basis. Therefore, nobody actually assumes the responsibility. In this fact lies the Achilles heel of managing reputation risk: when the reputation of a company is threatened, the company loses valuable time and opportunity, as it has to deal with an internal struggle to determine the state of its reputation, as well as who should assume responsibility to deal with the crisis. It is, therefore, important to have a contingency plan for dealing with an unexpected event. Following the recommended strategy for managing a crisis successfully, a company needs:

- Leadership
- Selected individuals who are able to make effective decisions under crisis conditions
- A crisis control group, outside the normal command structure, with clear lines of responsibility
- A crisis communications strategy with pre-identified and trained top-level spokespeople to deal with press and other enquiries
- Clear internal communications
- Scenario planning, including training and rehearsals to test plans and build confidence in the plans
- Flexibility (Turner, 2004)

The risk assessment and control phases help to develop a strategic response plan that can be initiated when a crisis hits. Immediately after a crisis of confidence occurs, the following should be triggered:

- The crisis management team deploys
- Emergency response teams deploy to the scene
- The crisis communications operations centre activates
- The crisis management plan is implemented
- Specialists are deployed and co-ordinated
- Investigations are initiated

A company's response phase of crisis management should include post crisis support, whereby lessons learned are shared and analysed. This helps to add to the crisis communication plans.

5.5 Managing Reputation Risk through Corporate Governance

Recent corporate scandals have shown that one of the primary causes of serious problems within companies is poor governance. Poor governance can help destroy the reputation of a business, in addition to the personal reputations of board members and management. The private sector is filled with numerous cases of boardroom casualties and tarnished personal reputations, for example, Enron, WorldCom, BCCI and Ratners. Corporate governance disasters take place because too much responsibility and emphasis is placed on the executive director.

Brotzen (in Veysey, 2000) stresses that it is important to set up a cross-functional team, in order to create and implement a reputational risk management strategy, because reputational risk cuts across the entire business. The board should set about identifying the threats to the company's reputation, including such factors as whistle blowing in the media, corporate responsibility, marketing failures and loss of regulatory approval. The board must then prioritise these risks, using traditional risk management strategies to rank the risks. The company must be able to respond to these risks as soon as they impact the company; for instance, if the company is vulnerable to a product recall, it needs to assess whether it has a comprehensive recall plan. The board has to determine whether or not it will retain, reduce or transfer all, or part, of the risk (Veysey, 2000).

An important factor in managing reputational risk is to develop a trusting relationship with the company's shareholders, thereby being able to salvage its reputation, should a disaster take place, as reputation is partly about a company's historical perception by its shareholders (Veysey, 2000). Companies must continually spend in order to maintain the perceived value of the company's products, and associated intellectual property. Good corporate governance requires protecting assets against all forms of risk, including counterfeiting and diversion. To do so, boards must identify all risks and ensure that policy, procedures and a plan of action will be in place to confront such risks (Hart, 2003).

Corporate governance is concerned with the way corporate entities are governed, and is distinct from the way businesses with those companies are managed. Corporate governance addresses the issues facing boards of directors, such as the interaction with top management, and relationships with the owners, as well as others interested in the affairs of the company (Cornford, 2003). Corporate governance includes the mechanisms by which the board exercises oversight with the enterprise (Chambers, 2001).

Thus, the board has an important function in monitoring the risks facing a company, and determining acceptable levels of risk. The board must consider both qualitative, as well as quantitative, risks. The board is ultimately responsible for determining how a company behaves. Reputation and risk are so pervasive and inter-linked that it is impossible for one individual to have full responsibility.

Companies that want to enhance their reputation must ensure reputation management is a priority, and that all employees should be responsible with the tone that has been, clearly, set by the board, as the overseer. The board must assess the impact of significant risks to reputation, and should ultimately:

- Take strategic decisions
- Provide specialist expertise, as well as breadth and depth of experience
- Protect and enhance its reputation (Turner, 2004).

The board is also responsible for implementing policies and procedures that will provide direction and determine the risk tolerance of a company. It must also establish a climate of trust and openness in which all employees:

- Understand their responsibilities for identifying risks, including reputation risk
- Provide early warning of any potential risks to reputation
- Recognise the value of their attitudes and behaviours, which could affect the company's reputation.

The board must, therefore, ensure that controls, which provide assurance that reputation risk is managed appropriately, are in place.

5.5.1 What is corporate governance?

Corporate governance is a system or process by which companies are directed and controlled. The aim of corporate governance is to address the inherent conflicts of interest between the owners and shareholders of a company and its managers: those who make decisions and those who execute decisions (Chapman, 2003).

Corporate governance also helps a company to attain its corporate objectives, and monitoring performance is a key element in achieving these objectives. Good corporate governance should ensure proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders. It should also facilitate effective monitoring, thereby encouraging firms to use resources more efficiently (Rayner, 2003:114).

The unethical behaviour of a chief executive can be damaging for corporate reputation. With corporate governance and the principle of accountability and transparency, shareholders can determine early signs of deterioration, and whether or not the directors, or the CEO, have any conflicts of interest. Good corporate governance is valuable not only to shareholders, but also to listed companies. It helps shareholders (particularly minority shareholders) to be confident that their interests are being protected and that the firms they invest in are well-managed (Zhang, 2003).

5.5.2 Dynamic Leadership

Recent scandals, such as that involving Regal Treasury Bank, have illustrated the importance of key individuals i.e. the chief executive officer. The leadership style – whether it is autocratic or dynamic leadership - has come under the spotlight: a distinction between styles must be made. Argenti (2005) states:

“An overbearing leader is frequently a prime trigger of corporate failure. Not because powerful personalities are anathema to success, but because strategic decisions become disproportionately risky when the decision-maker’s eyes or ears are closed. It is important to distinguish between an autocrat and a dynamic leader. The autocrat is the company. He does not listen to others and he does not share authority. Signs of this may be the merging of executive roles, the rise of passive directors and skewed skills at board level. As team input diminishes, the weaknesses of the individual at the top become the weaknesses of the entire company.”

President George Bush aptly described the accountable leader of a company: ”Our leaders of business must set high and clear expectations of conduct, demonstrated by their own conduct. Responsible business leaders do not collect huge bonus packages when the value of their company dramatically declines. Responsible leaders do not take home tens of millions of dollars in compensation as their companies prepare to file bankruptcy, devastating the holdings of their investors. Everyone in a company should live up to high standards. But the burden of leadership rightly belongs to the chief executive officer. CEOs set the ethical direction for their companies. They set a moral tone by showing their disapproval to other executives who bring discredit to the business world” (President announces tough new enforcement initiative for reform, 2002).

A Chief executive officer must have the vision to plan and strategise which way a company is moving. He must motivate employees to give the best of their ability to achieve the goals of a company. However, an overbearing leader can cause a company to falter because of his singular objective and selfish vision. A chief executive officer with a good reputation influences the reputation of the company, because he demonstrates a capable persona that can deal with different situations to avoid corporate failure, and this injects confidence in the shareholders (Rayner, 2003: 144).

5.5.3 Non-Executive Directors

Non-executive directors provide the main bridge between management and shareholders. They must command the respect and confidence of both sides, and be the ultimate custodians of the company's integrity and reputation. Their selection and appointment to a board must carry with it a transparent and proper test, demonstrating they have the skill, knowledge, experience and maturity to contribute meaningfully to the board's discussion and deliberations (Zaman, 2004: 166).

Non-executive directors should have a biased view, which is different to that of executive directors. However, Zaman (2004:167) states that there are problems which non-executive directors face:

- More emphasis is placed on non-executive directors to become all things to everyone, due to recent global corporate failures. However, non-executive directors cannot be auditors, because they do not have the obvious resources available to auditors to investigate independently, or to verify all the information that management provides them.
- Non-executive directors have time constraints which limits them, and for which they are not adequately compensated. Most non-executive directors spend only a limited time at the company; however if they worked on a full-time basis, that would equate to over 8 years.
- Non-executive directors also face financial risk, in addition to reputation risk, due to the possibility of being sued by shareholders.

The Higgs Report (2003) acknowledges that:
‘Corporate governance provides an architecture of accountability; the structure and processes to ensure companies are managed in the interests of their owners. But architecture in itself does not deliver good outcomes. The review, therefore, also focuses on the conditions and behaviours necessary for non-executive directors to be fully effective.”

Higgs’ Report (2003) further stresses that non-executive directors must continually maintain a focus on corporate reputation. In order for non-executive directors to be effective, they must demonstrate:

- Integrity
- The ability and willingness to challenge and probe
- Sound judgement
- Strong interpersonal skills

Effectively, one of the roles of the non-executive director is to satisfy themselves that financial information is accurate and that financial controls and systems of risk management are robust and defensible. This includes non-financial risks, such as reputation (Han, 2003).

Ultimately, in terms of the Companies Act, a director’s duty is to manage the company for the benefit of all shareholders. The director should manage the company so as to make it successful, by promoting business relationships with employees, suppliers and customers. Moreover, the director must be accountable for any impact on the environment, a specific community and, most importantly, business reputation. Furthermore, the types of people on the board of a company provide an insight into the company’s principles. Most importantly, from a South African perspective, where companies show a commitment to affirmative action requirements through board structure, this can enhance reputational image and show a commitment to reputational importance (Zaman, 2004: 188).

Good visible and measurable corporate governance is at the heart of investment decisions. In the Mckinsey Global Investor opinion survey of July 2002, an overwhelming majority of investors were reportedly prepared to pay a premium for companies exhibiting high governance standards.

Corporate failure globally has provided impetus to the area of corporate governance, especially with regards to transparency and disclosure, control and accountability, and to the most structured board that can prevent company failure or scandals from occurring (Shleifer & Vishny, 1997: 144).

As Dick and Anton (Andersen & Van Wyke, 2003) stress, whether rules specifying a board’s composition and structure are mandated or not, companies need to move beyond notions of compliance and conformance, in order to restore investor trust in their business. The court of public opinion is ultimately where a company’s corporate governance practices, and the business results they produce, are judged (Andersen & Van Wyke, 2003).

5.5.4 Remuneration

Paying huge packages to Directors and chief executive officers, irrespective of performance cannot be justified. Therefore, King (2002) made the recommendation that payments to directors should be performance-based; that is, the introduction of performance appraisals for the board of directors and board of commissioners, so as to ensure greater balance between directors and commissioners’ remuneration and their performance. This has appeased unions and employees in the face of huge unemployment.

Companies that pay remuneration on a basis equal to that of other companies, ensure a smaller disparity between employees at the top and those at the lower end of the corporate ladder. Most importantly, this ensures fully transparent disclosure of all remuneration made, and enhances the reputation of the company, because the company shows the shareholder the merit of rewarding companies based on performance. This is judged by shareholders through the transparency principle (Rayner, 2003:125).

The more transparent and open that the disclosures of company performance are, the more rational the investment decisions will be. The more rational the investment decisions the more wealth is created (Chambers, 2001). Sir Adrian Cadbury said that the foundation of codes of best practice for corporate governance is based on disclosure. Directors are trustees on behalf of both financial and non-financial shareholders. Coupled with their stewardship responsibility, is an accountability responsibility. Boards of directors, who are at the pivotal point in terms of corporate governance, have to consider laws, regulations, customs and practices, professional standards and even public opinion (Chambers, 2001).

Corporate governance practices should also contribute to business prosperity, not just accountability. However, a poor record for accountability will tarnish reputation and impair business prosperity, not least because a poor reputation amongst those who provide capital will increase the cost of that capital and act as a brake on business prosperity

5.5.5 Stock Options

Stock options were a key factor in the Enron debacle, contributing to its relevance. A Financial Times article stated the following: “At Enron, the scale of rewards generated for senior management by stock option plans beggars belief. Compensation plans so lightly geared to the share price risk provide an overwhelming temptation to manipulate it.” Stock options can motivate management to operate in the best interests of the company and its stakeholders, because management ultimately decides on the company’s objectives and goals through careful planning and strategies. However, management can, in some instances – such as with Enron - exploit and abuse the situation (Munzig, 2003). Management can abuse their power to exercise options at the apex of the company’s performance and then reap benefits, after which they then allow the company to slide and forget their responsibility to other stakeholders. This behaviour impacts the company’s image, and management is then perceived to be selfish in their motives of increasing profits only for their singular benefits.

King (2002), therefore, recommends that options can be given to non-executive directors and executive directors; however, a vesting period for non–executive directors should be applied, in order to dissuade short-term decision-taking.

5.5.6 Board Committees

Board Committees must be structured to be effective. They must be seen to add some value to the company, rather than be seen to be in a subservient position. Again, the transparency principle is paramount, whereby shareholders must be able to see what the different committees are doing, in order to contribute to shareholders’ wealth and return.

Globally, companies should address new developments. This has particular relevance in South Africa, because companies here have to address the social responsibility factors:

- Safety and occupational health objectives issues, including HIV/Aids.
- Environmental reporting and following the option with the least impact on the environment.
- Social investment policies, including black empowerment
- Human capital development, including
- Number of staff
- Progress towards equity targets
- Training
- Opportunities for women and the previously disadvantaged (Lake, 2003).

Boards that fail to, effectively, address the particular challenges facing their business in this arena may cost the company and its investors dearly, through direct factors, such as increased costs or damage to vital assets such as reputation (Lake, 2003).

5.5.7 Role of the Audit Committee

Another relevant and necessary committee is the audit committee. This particular committee will help give credibility to both internal and external auditors, and, thereby, raise confidence in investors. The King Report (2002) recommends that, at the very least, every board should have an audit and a remuneration committee.

The audit committee has to monitor the integrity of the financial statements of the company, and to review the internal financial control system. In addition, the audit committee has to review the effectiveness of the company's internal audit function. The audit committee also:

- Makes recommendations to the board, in relation to appointment of external auditor and the remuneration thereof.
- Monitors and reviews the external auditor's independence
- Develops and implements policy on the engagement of the external auditor, with regards to non-audit services (King: 2002).

Most importantly, in the absence of a risk committee, the audit committee has to assess the scope and effectiveness of the systems established by management in order to identify, assess, manage and monitor financial and non financial risks (Zaman, 2004: 193).

As Chapman (2004) stresses, risk management is interconnected with corporate governance, not only because of high profile business failures in the past, but also because of the need to respond to accelerating change. Change creates a long list of new and unprecedented risks, rapid growth, new technology, new legislation, changing customer needs, expanding foreign operations, new business lines and leadership, corporate restructuring and global communications systems. Good governance requires a feedback system that actively monitors and alerts management before a business risk escalates into unexpected consequences (Chapman, 2004).

5.5.8 Board and Control

PriceWaterhouseCoopers (2004) summarises eight steps as the most effective steps that a board of a company can take, in order to ensure effective management:

1. Strategy and Planning

Effective boards play a critical role by ensuring a sound planning process, providing strategic insights, and scrutinizing the plan itself with the rigor required determine whether or not it deserves endorsement

2. Risk Management

Boards at innovative companies view risk as a means of, not only controlling hazards and uncertainty, but also maximising opportunity

3. Tone at the Top

Companies that operate with integrity and high ethical values draw the best people and the most sought-after customer and supplier relationships, and find open doors to critical alliances, partnerships and merger candidates.

4. Measuring and Monitoring Performance

Leading boards look less at after-the-fact yardsticks, and more at non-financial leading indicators that drive value.

5. Transformational Transactions

The best boards uncover relevant operational, competitive, and related information in time to shape the deal terms, and also ensure that a post-deal integration process is well conceived and implemented.

6. Management Evaluation, Compensation and Succession Planning

Progressive boards establish clear-cut performance criteria and related metrics with the CEO, with performance targets linked directly to corporate strategy and encompassing both short- and long-term Company and personal goals.

7. Telling the world – External Communications

Successful directors ensure that their companies communicate reliable, relevant, and timely information - whether it is favourable or unfavourable - and see that neither technology nor the rumour mill improperly leaks sensitive information.

8. Board Dynamics

The best boards adopt a culture and operating style enabling them to operate effectively with management. CEOs keep directors fully informed and are receptive to their input.

5.6 Conclusion

Once companies experience the rewards showered by suppliers, business partners, and customers because of good governance practices, they will understand that governance can escalate a company's standing and provide a competitive edge over other companies. Corporate transparency and full disclosure must become part of the company's goal, because this will instil investor confidence. Good governance also reduces systematic market risks, thus promoting stability and shielding the company against financial crisis. Over the long term, good corporate governance will strengthen the competitiveness of the business and, enhance its ability to function well.

Corporate governance is a necessary part of a well-managed company. It helps to ensure that the company operates at optimum efficiency, and it also helps to maintain the company's reputation.

As Larkin (2003:75) so aptly concludes, corporate reputation management is not an isolated add-on located in the PR department, but a fundamental aspect of business performance. The value of reputation as an important intangible asset justifies integration with operational and risk management strategies (Larkin, 2003: 75).

The following chapter will introduce the methodology that is used for the empirical section of this dissertation.

CHAPTER 6

METHODOLOGY

6.1 Introduction

The previous chapter outlined the different factors that can affect the reputation of a company.

For the purpose of this research, a case study approach will be used to formulate a reputational risk management model to manage a crisis or unusual event, and, thereby, maintain the company's reputation. The case studies selected will demonstrate that, without a proper planned risk management model, a company's reputation can be severely impacted.

The initial intention was to use event study methodology, however because the sample reflected obvious results based on the share price, event study proved futile.

The primary objective of this research is to construct a model that can be used and implemented during a crisis or event to maintain the company's reputation, and, consequently, minimise any impact on shareholders' return. In order to achieve this, the Johnson and Johnson case study will be used to construct the model. Other companies will also be reviewed and compared to the Johnson and Johnson case study, in order to determine how they recovered from an event or crisis, and whether or not there was any impact to the company's reputation.

Reputation risk management is an important function, which, if managed effectively, can help minimise any negative returns should an event or crisis affect a company. Therefore, reputation risk management must be part of a risk management programme. Planned and prepared action by management reflects the company's internal culture, as this indicates that a company is pre-emptive. This characteristic assists in elevating the reputation of a company, because it appeases all shareholders, and this increased confidence helps to increase shareholders' return.

6.2 Methodology

6.2.1 The development of the model

The Johnson and Johnson case study was used as an exemplary case, due to the fact that the action of senior management demonstrated a level-headed approach to managing the crisis. Furthermore, they had the support of the board of directors, which, in turn, gave management confidence. This lead to a minimal impact on the share price of the company: the company retained its market share. Most importantly, there was no damage to the company's reputation.

The steps taken by management at Johnson and Johnson to retain market share and avoid reputation damage were, subsequently, analysed, and a step-by-step model was developed from the analysis of the management of the event.

Figure 6.1

A reputation risk management model of business reputation:

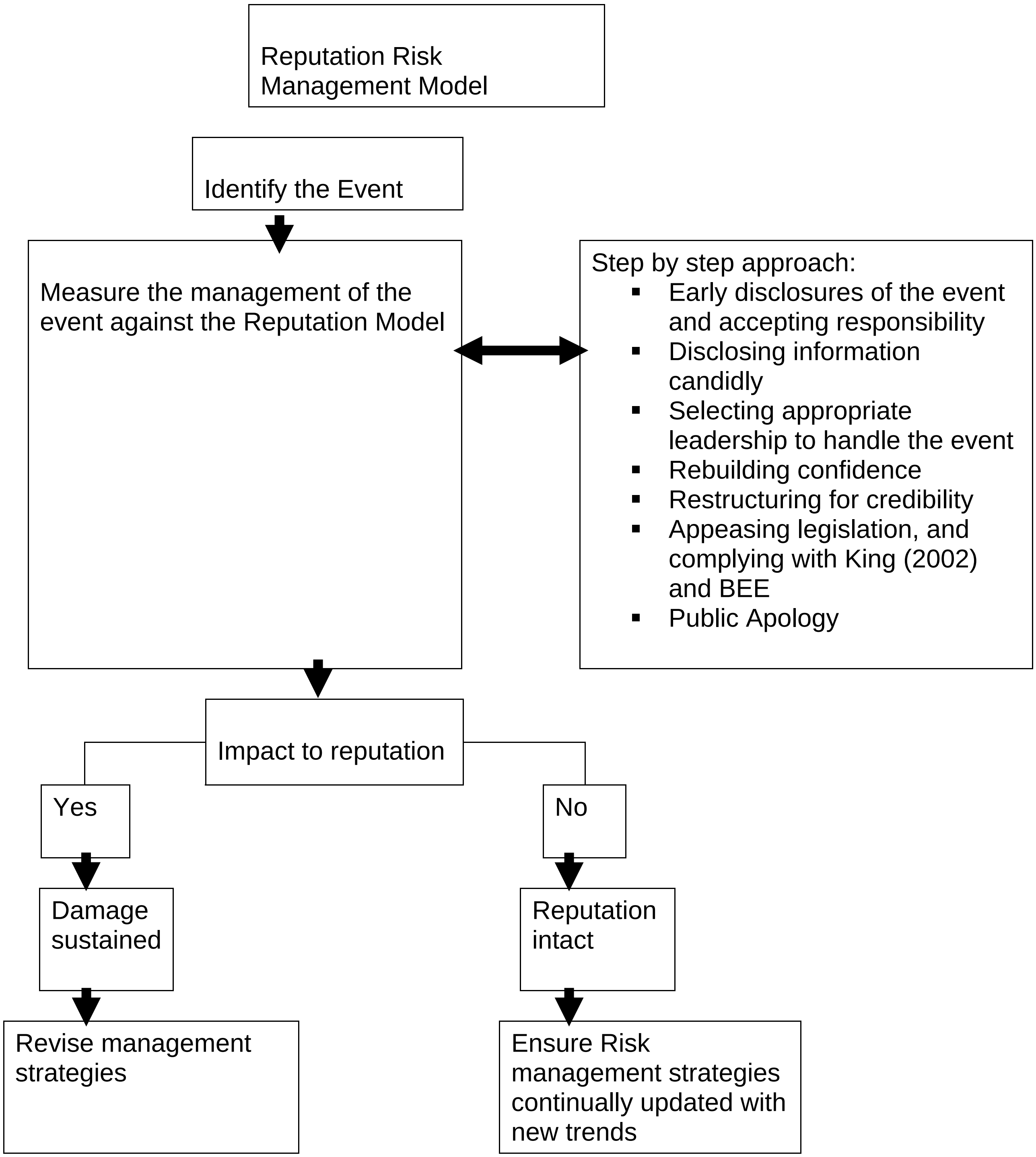
1. Identify the event

2. Measure the management of the event against the reputation model
3. Analyse and determine whether reputation was affected or not
4. Conclude whether event was damaging or sustaining

The step-by-step approach followed by Johnson and Johnson included:

1. Early disclosures of the event and accepting responsibility immediately
2. Disclosing information candidly (explaining the event)
3. Selecting appropriate leadership to handle the event
4. Rebuilding confidence
5. Restructuring for credibility
6. Appeasing legislation (Chambers, 2001; Fombrun, 1996:377).

Figure 6.1 Reputation Risk Management Model



The above steps are essential in maintaining the reputation of a company. These steps will be used to measure how management reacts to a specific event, and determine whether or not the company was successful in recovering from the event, without any damage to its reputation.

6.3 Practical application

A case study approach was used to develop the model for reputation risk management to maintain corporate reputation. Yin (1994:13) defines a case study as “an empirical enquiry that:

1. Investigates a contemporary phenomenon within its real life context, especially when
2. The boundaries between phenomenon and context are not clearly evident”

The case study approach helps to obtain data from the case, as well as determine commonalities for successful companies.

6.4 Selection of the case studies

The selection of cases is an important concept in building a theory from case studies. Eisenhardt (1989:537) stresses that, as in hypothesis testing research, the concept of a population is crucial, because the population defines the set of entities from which the research sample is to be drawn.

Multiple cases were used to increase the generality of the conclusions, which is also referred to as the external validity (Voss, Tsikriktsis & Frohlich, 2002). In studying multiple cases an important issue to consider is the selection of cases. Cases should be selected according to clearly specified criteria, using replication logic. Yin (1994:46) states that using replication logic means that the cases must be selected either to predict similar results (literal replication) or to produce contrasting results, but for predictable reasons (theoretical replication). Replication logic is used in this research. Each case was selected on the basis of variables assumed to influence the degree of formalisation (Meredith, 1998).

6.4.1 Criteria for using International reference cases

With regards to the international case studies, pharmaceutical giant Johnson and Johnson was used as the exemplary case. Johnson and Johnson's reputation was maintained and exalted, as a result of the managers' reaction to the tampering of one of the company's products, Tylenol tablets. The steps that management took to avoid reputational damage earned the company a reputation for caring about its customers. The company's actions set a model for creating a favourable reputation for itself (Fombrun, 1996:29). The selection of the other cases was based on the following criteria: firstly, on whether the company had experienced a crisis or event; secondly, whether or not the company had experienced extensive media exposure, and, lastly, whether or not the company had a solid brand name. Pettigrew (1988) provides assistance in this regard: he states that, given the limited number of cases that can usually be studied, it makes sense to choose cases demonstrating extreme situations and polar types, in which the process of interest is "transparently observable". Therefore, the goal of theoretical sampling is to choose cases that are likely to replicate the emergent theory (Eisenhardt, 1989: 537). The companies chosen for this study were extreme types – in other words, some were successful, while others were unsuccessful - so as to build theories of success and failure.

6.4.2 Criteria for selecting South African cases

Figure 6.1 illustrates the population of companies from which the sample was selected for the research, against which the research model was tested. The steps in selecting companies for the sample are outlined below:

Step 1

The first selection criterion involved determining whether the company was affected by a crisis or event. Any company that had been affected by a major event during the last five years was selected from the different sectors of the Johannesburg Securities Exchange. A total of twenty-five companies were initially identified.

Step 2

The second selection criterion was to ascertain whether or not the company had experienced an event that had impacted reputation: i.e. the cause of the event was analysed, in order to determine whether or not it had affected the company name. The event that was analysed was largely an unusual or crisis situation, which also helped to test the risk management strategies.

Step 3

The third selection criterion was based on the causes of the event or crisis situation. The companies chosen had experienced events, which were related to factors introduced in chapter 4:

1. Executive behaviour and ethics
2. Physical accident
3. By association
4. By reinvention or merger

5 The media

On the basis of these selection criteria, a total of twelve companies were chosen to help affirm the theory, and to act as cross-references for comparative purposes.

Table 6.1- Population of companies from which the sample was selected.

Company	**Event**	**Action after event**	**Recovery after event**
Anglogold Ashanti	Bribe paid to Militia Rebels	Admitted mistake and made press statement	Yes share price went up - reputation intact
Pick and Pay	Product tampering	Removed poisonous products and made press statement	Yes share price went up- reputation intact
Sasol	Explosion at plant and loss of employees	Ensured all workers receive proper medical treatment and made press statement	Reputation intact
CorpCapital	Lack of governance	Used an expert to investigate any governance weaknesses at company	Reputation was impacted
Metcash	Vat penalty	Settled with SARS and made press statement	Reputation was affected
Mercantile Lisbon Bank	Downgrade by Fitch and theft	restructured	Recovered with little damage to reputation.
Mccarthy	Accounting irregularities	Re-capitalised	Recovered but reputation was affected

Company	**Event**	**Action after event**	**Recovery after event**
LA Stores	Insider trading and lack of governance	Re-structured	Reputation was affected
Didata	Downgrade by Lehman	Re-structured	Reputation was affected
Elixir	Accounting irregularities	Re-structured	Reputation was affected
Beige Holdings	Accounting irregularities	No management action	Reputation damaged
Accord Technologies	Vat Fraud	Company did not admit wrongdoing	Reputation damaged
Spicer	Gross mismanagement	Admitted insider trading but reputation was tarnished therefore unable to obtain further finance	Reputation damaged
Paradigm	Failed due diligence	No management action	Reputation damaged
Macmed	Fraud and accounting irregularities	No management action	Reputation damaged
Regal Bank	Accounting irregularities and fraud	Public spat between management and CEO	Reputation damaged
Saambou Bank	Downgrade by Fitch and lack of governance	No press statement or action by management to calm investors	Reputation damaged
Leisurenet	Fraud and accounting irregularities	No management action	Reputation damaged

Company	**Event**	**Action after event**	**Recovery after event**
Mouldmed	Fraud and accounting irregularities	No management action	Reputation damaged
Profurn	Investigation by SARS	Settled with SARS but made a bad press statement	Reputation damaged
FBC Fidelity Bank	Inadequate bad debt provisions	No statement to the press and no management action	Reputation damaged
New Republic Bank	Failed due diligence	Public spat between NRB and Mawenzi	Reputation damaged
Bryant technologies	Lawsuit due to inferior product manufactured	No management action	Reputation damaged
Brait Bank	Downgrade by Fitch	Management decided to change business strategy	Reputation damaged

6.5 Research

There are four tests that are relevant to evaluating the quality of any research study: construct validity, internal validity, external validity, and reliability (Yin, 1994:43). Internal validity is only relevant to explanatory or causal studies, not to descriptive or exploratory studies, and is, hence, not relevant to this research. The three remaining tests are, however, relevant. These concepts will be discussed below, within the context of this research.

6.5.1 Construct Validity

Construct validity requires the researcher to select the correct tool or method for the concepts being studied. Yin (1994:44) also states that, in order to address construct validity, the tactic is to establish and maintain a chain of evidence, which would allow an external observer to follow the derivative of evidence, from initial research questions to ultimate case study conclusions.

In order to achieve construct validity, twelve listed companies were selected as multiple sources of evidence, using the Johnson and Johnson case study as a prelude. This helped to provide cross-validation, as well as a reference to the literature.

6.5.2 Research Instruments

Using various research instruments necessary in obtaining construct validity, multiple sources of evidence were used. The instruments used were relevant documents, such as media reports and journals. These documents were used to corroborate and augment evidence from other sources (Yin, 1994:47). Only recorded evidence could be used to determine the evidence of the different case studies.

6.5.3 Internal Validity

Internal validity demonstrates that the conditions being observed will necessarily lead to other conditions. This validity can be determined by triangulating various pieces of evidence that can be followed to these conclusions. However, internal validity is solely a concern for causal or explanatory case studies. It is not relevant to this study, as this study is exploratory (Leedy, 1989:27).

6.5.4 External validity

This refers to the establishing of the domain to which a study's findings can be generalised (Yin, 1994:33). Multiple cases were used in order to augment the generalization of the conclusions: this is also referred to as the external validity. (Meredith: 1998). Cases were selected according to clearly specified criteria using replication logic. Yin (1994:46) states that using replication logic means that the cases must be selected to predict similar results. For this study replication logic was used: each case was selected, carefully, on the basis of variables assumed to influence the degree of formalisation.

6.5.5 Reliability

Reliability refers to demonstrating that the operations of a study can be repeated, and still attain the same results (Yin, 1994:33),

By studying multiple cases, it was possible to confirm a logical chain of evidence (Yin, 1994:54). The cases were analysed similarly, in order to obtain recurring patterns, and to determine if factors - as proposed in earlier chapters - actually existed in the companies. In order to analyse the cases similarly, an elaboration of the research protocol, to account for the reliability and validity of the empirical research, was conducted. A research protocol contains the research instruments, the rules and general procedures for using the instruments, an indication of the sources of information, and a guide for case study report (Yin, 1994:94). The elaboration of the research protocol, in this study, was the extensive use of media reports.

6.6 Collecting Evidence

In order to support the theory, two collection methods were used, as the only appropriate alternatives: archival sources and documentation. Interviews and observations were not possible, due to the time frame of the case studies used.

6.6.1 Documentation

Newspaper clippings, and other articles appearing in the mass media, were obtained using the Lexis Nexus web page, as well as UNISA's online information resources. The information sought was corroborated and then used to confirm assorted evidence from other sources. Yin (1994: 84) stresses that documents play an explicit role in any data collection, when conducting case studies. Systematic searches for relevant documents are important in any data collection plans. During the data collection period, a wary attitude was undertaken, in order to avoid a potential over-reliance on documents. Reviewing the documentation that was written for a mass audience, and, therefore, the documentary evidence reflected therein, displayed communication among parties (Yin, 1994: 84).

6.6.2 Archival Records

Archival records were used, in conjunction with documentation, to produce the case study. Again, due to the limitations of archival records, these conditions must be fully appreciated in order to interpret the usefulness of any archival records (Yin, 1994:84). Most importantly, archival sources can produce both qualitative and quantitative information. Though, the terms ‘qualitative’ and ‘case study’ are often used interchangeably (Yin, 1994:83). Case study research can involve either qualitative data only, quantitative data only, or both - the combination of data types can be highly synergistic (Yin, 1994: 83). Quantitative evidence can indicate relationships, which may not be apparent, but also allows one to remain focused, without being influenced by impressions gained from qualitative data. Furthermore, it can help confirm findings from qualitative evidence. Eisenhardt (1989:538) states that qualitative data is useful for understanding the rationale or theory that underlies relationships revealed in the quantitative data; or it may directly suggest the theory, which can be strengthened by quantitative support. The synergy is as follows: “… for, while systematic data creates the foundation for our theories, it is the anecdotal data that enables us to do the building. Theory-building seems to require rich description - the richness that is synonymous with anecdotes. We uncover all kinds of relationships in our hard data, but it is only through the use of this soft data that we are able to explain these relationships (Mintzberg, 1979:583).

6.7 Analysis of the Data

The steps used by the model company, Johnson and Johnson, were compared to those used by the local listed companies in the sample. Moreover, additional steps were added for compliance with local business culture and legislation.

Cross-case search strategy was used to search for patterns. Categories or dimensions were used to look for within-group similarities, coupled with inter-group differences; these dimensions were introduced through the literature. Some categories were apparent, whereas others were elusive. Looking for similarities helped to highlight differences between cases. Also, the juxtaposition of seemingly similar cases can break simplistic frames. Eisenhardt (1989:537) further states that the search for similarity in a seemingly different pair can also lead to more sophisticated understanding. The forced comparisons create new categories or factors, which were overlooked.

In order to develop a model action plan during a crisis or event, i.e. a planned reputation risk management strategy, the literature was consulted to guide and perfect the strategy. The object of the study was to discover what steps had to be taken during an event or crisis. Using a scorecard, the steps were compared to the steps of the model company, Johnson and Johnson, in order to determine whether the model would have assisted the company to recover from the event or crisis unscathed, with reputation intact, and with minimal impact on shareholders' value.

A measure of success of the steps used by Johnson and Johnson will be the extent to which the companies implemented the steps. The primary concern is for the companies to act quickly during a crisis, so that the reputation of the company is not affected. Therefore, a review of the action plan will indicate whether or not the company recovered, after following an effective reputation risk management programme.

6.8 Conclusion

This chapter discussed the methodology used to complete this research. In addition, a means of measuring the extent of an effective planned reputation risk management was developed.

The following chapter uses international case studies, which measure performance, with regard to reputation risk management, against the reputation risk management model that was introduced in this chapter.

CHAPTER 7

IMPLEMENTATION OF A STRATEGY FOR MANAGING REPUTATION RISK DURING A CRISIS

7.1 Introduction

Companies must continually maintain their reputations. During an unusual event or crisis that impacts a company, the contingency plans must be utilised to ensure that a company only sustains a minimum impact, and that there is no long-term damage to the reputation of a company. Management must test the contingency plan effectively.

During a crisis, the chairman of the company plays the most important role in helping to defend a company's reputation. Prompt response by convincing figureheads can entirely head off negative publicity. If a crisis is handled well, the reputation of management may even be enhanced (Chambers, 2001).

The purpose of this chapter is to examine international case studies and to describe the different actions taken by the management of each of the companies. The starting point is the Johnson and Johnson Tylenol case, which demonstrates how managers skillfully maintained Johnson and Johnson's name during the crisis. The actions at Johnson and Johnson will be analysed and used as criteria to compare to the other case studies, and to determine whether or not the other companies were just as successful as Johnson & Johnson, by following similar steps in the process of managing reputation risk.

7.2 Johnson and Johnson

7.2.1 Background

This case was applauded for its effective crisis management.

Johnson & Johnson's subsidiary, McNeilab. Inc. introduced Tylenol, an aspirin-based medication, in 1961. Tylenol proceeded to become a very popular and profitable product for the company: it became the most popular pain reliever, thus monopolising a huge share of the market.

However, in 1982, seven people in the Chicago area died after taking Tylenol, because the tablets had been laced with cyanide. It took the company weeks to determine whether the capsules had been tampered with during the manufacturing process or after leaving the factory (Kaplan, 1998).

The company put on a massive corporate effort - from the chairman to marketing – in order to help resolve the crisis effectively. The company recalled 31 million bottles of Tylenol worth $100 million, and they sent 500 000 letters, outlining the situation, to physicians, hospitals and Tylenol distributors. They also set up a toll-free hotline for consumers, to help resolve any queries. The sceptics had a field day, predicting that the Tylenol brand would never recover. They were convinced that consumers would never see the name Tylenol in any form again, because the crisis had destroyed the Tylenol name. Eventually, a massive investigation revealed that the capsules had been sabotaged outside, and not during, the manufacturing process (Kaplan, 1998)

After the crisis, Johnson & Johnson was faced with quite a dilemma. They had to find the best way to deal with the tamperings, without destroying the reputation of their company, as well as that of their most profitable product, Tylenol.

The company decided to re-launch the tarnished product. Due to the tampering incident, the federal government of the United States of America required that manufacturers package all over-the-counter medicines in tamper-resistant packages. Johnson and Johnson's packaging subsidiary, Mcneil, repackaged Tylenol with glued-end flaps, a plastic-neck seal, and an inner-foil seal, with a label instructing consumers not to use the product if safety seals are broken. Although the government required only one of the three preventative measures, Johnson and Johnson did not want to take any chances, and decided to include all three of the precautionary measures. Thereafter, the company launched a massive production and distribution effort to make the newly packaged product available as soon as possible. This concept in packaging was innovative, and is now broadly used by food and pharmaceutical manufacturers globally (Govoni, Eng & Galper,1986:471).

Johnson & Johnson was praised by the media for their swift, but socially responsible actions. This incident provided the company with positive coverage for their handling of this crisis.

Johnson & Johnson had to re-attract customers who could have possibly strayed from the brand as a result of the tamperings. They also provided sales people from the company to make presentations to people in the medical community to reintroduce the product. Through the concerted effort of the company, Tylenol was re-entrenched as a favourite with consumers.

The success of the re-launch of the brand was based entirely on the quick actions of the corporation at the onset of the Tylenol crisis, and that they put public safety and interest first.

When the Tylenol crisis first started, and continued to become more serious as the hours went by, Johnson & Johnson’s top management turned to the basic corporate business philosophy for guidance. It was important for the company to be responsible in working for the public interest. The public and the medical community were alerted to the crisis, the Food and Drug Administration was notified, and the production of Tylenol was stopped (Neef, 2003:111).

The most important decision, that put Johnson & Johnson’s public relations program in the right direction, was for the company to co-operate fully with all types of news media. This was crucially important because the press, radio and television were imperative in warning the public of the ensuing danger. Without the help of the media, Johnson and Johnson’s program would have been completely ineffective (Rayner, 2003:253).

The media performed the legwork for the company. There were numerous queries from the press about the Tylenol crisis, and every newspaper carried a story about the crisis. The television and news coverage on the crisis was just as extensive. This widespread interest by the media exposed the vulnerability of the company’s reputation (Kaplan, 1998).

The media played a formidable role in Johnson and Johnson’s public relations campaign following the crisis. If the company had not fully co-operated with the media, it would not have received such positive media coverage. Negative publicity by the media could, easily, have destroyed Tylenol's reputation permanently (Kaplan, 1998).

The company created a public relations program that protected the public interest, and was, therefore, given full support by the media institutions. Johnson & Johnson was able to recover quickly from a crisis, which could have had a devastating permanent effect (Rayner, 2003:111).

Management at Johnson and Johnson took an uncontrollable event and succeeded in averting reputational damage, by using proper management principles, and responding to the disaster in a most professional and exemplary manner. However, what gave the company further impetus through the crisis was the lack of the following singular objective: the selfish drive towards earnings. Instead, the company incorporated a positive attitude by putting the interest of the consumer first. This enhanced the reputation of the company as an enlightened, concerned, and public-spirited corporate citizen.

Due to the new enhanced reputation of the company, the trade and the public re-marketed the Tylenol brand, which, in turn, re-established itself as a well-respected brand.

There are several key elements in the Johnson and Johnson case, namely: early disclosure and accepting responsibility, full acknowledgement of likely consequences, disclosing information candidly, selecting appropriate leadership to handle the event, rebuilding confidence, restructuring for credibility and appeasing legislation. These elements helped retain the Johnson and Johnson name as a reputable company.

7.2.2 The steps taken by Johnson and Johnson to deal with the event:

1. Early disclosures and accepting responsibility immediately (Chambers, 2001)

Johnson and Johnson acted immediately, by issuing a nationwide recall of 31 million bottles of aspirin, costing them $100 million, and instructed customers not to use Tylenol products until the issue was resolved. The nation was warned about the danger of Tylenol, as soon as a connection could be made. Police drove through Chicago announcing the warning over loudspeakers, while all three national television networks reported about the deaths from the contaminated drug on their evening news broadcasts. A day later, the Food and Drug Administration advised consumers to avoid the Tylenol capsules, until the cause of the deaths in the Chicago area could be clarified (Ross, 2001).

Johnson and Johnson advised consumers to destroy, or return for credit, all Tylenol capsules in their possession. The public and medical community was alerted of the crisis, the Food and Drug Administration was notified, and production of Tylenol was stopped.

2. Disclosing information openly and explaining the event (Fombrun, 1996:376)

When Johnson and Johnson were faced with the initial situation, it had to make some tough decisions that would severely impact the future of the company. However, rather than think in financial terms, CEO James Burke immediately turned to the company's Credo. Written by Robert Johnson in 1943, the document defines the focus of the company as its customers. With this as its inspiration, Johnson and Johnson used the media to promptly begin alerting people of the potential dangers of the product. It also despatched scientists to determine the source of the tampering (Hogue, 2001).

3. Selecting appropriate leadership to handle the event (Fombrun, 1996:376)

James E Burke, chairman of the board, was used as the spokesperson for the company. However, most importantly, the company used a corporate effort to resolve the crisis effectively, i.e. from the chairman to marketing.

4. Rebuilding confidence (Fombrun, 1996:376)

The company created a public relations program that protected the public interest and was, therefore, given full support by the media institutions

5. Restructuring for credibility (Fombrun, 1996:376)

The company repackaged Tylenol with glued end flaps, a plastic-neck seal and an inner-foil seal with a label instructing consumers to not use the product if the safety seals are broken.

6. Appeasing legislation

Due to the tampering incident, the federal government of the USA required that manufacturers package all over-the-counter medicines in tamper-resistant packages. Although the government required only one of the three preventative measures, Johnson and Johnson did not want to take any chances, and decided to include all three of the precautionary measures.

Result: Johnson and Johnson recovered from the incident with its reputation intact, because of the way the company handled the situation.

7.3 Another company that faced an unusual event was Ford, in conjunction with Firestone

7.3.1 Background

In 2001, car manufacturer Ford, and tyre manufacturer Firestone, badly handled a product recall in the United States, after it emerged that there was a fault with the Ford SUV Explorer. It was found that the treads on the firestone AT tyres, mostly manufactured for Ford Explorers, were prone to separate in hot weather. Ford claimed that Firestone had known about consumer dissatisfaction with these tyres since 1997 and had done nothing to rectify the error. Also, it appeared that Firestone only initiated the recall after more than 100 deaths had occurred. Due to the poor way in which the issue was managed and communicated, both companies suffered a setback because of their handling of the situation. This led to a dramatic fall in share prices and profits for both companies. Furthermore, both companies did not behave in a way that recognised the value of reputation or the importance of treating shareholders intelligently.

7.3.2 Analysis of the Ford Firestone Case

Using the 6 elements from the successful Johnson and Johnson case, we can determine what was lacking in the Ford/Firestone case in terms of managing reputation risk.

1. Early disclosure and accepting responsibility immediately (Chambers, 2001)

The treads on the firestone AT tyres, mostly manufactured for Ford Explorers, were prone to separate in hot weather. Ford claimed that Firestone had known about consumer dissatisfaction with these tyres since 1997 and had done nothing. Moreover, it appeared that Firestone only initiated the recall after more than 100 deaths had occurred. When the recall was announced, each company pointed a finger towards the other, and said in as many words: “It’s your fault”. They did not ensure customer safety first; instead, they resorted to mutual blame (Ackman, 2001).

There was evasiveness and denial from both companies. There was a defective product, for which neither company was prepared to accept blame, and both companies failed to act quickly and assure customers that the problem would be rectified.

Firestone was the first to make a move, by stating that the company had undertaken a tyre recall, but that the recall would take more than a year to complete, and certain States with colder climates might not see replacement tyres until the following summer. Moreover, the company made a highly callous remark by suggesting that the consumers, and not the company, were responsible for the tyre failures, because they did not maintain their tyres properly. Ford, on the other hand, announced that they would do whatever it would take to remedy the problem quickly, including using other brands to replace the recalled Firestone tyres (Greenwald, 2001).

Both companies later apologised about the deaths and inconvenience of the ensuing recall on consumers, but, to this day, neither company has accepted full responsibility for the problem.

2. Disclosing information openly and explaining the event. (Fombrun, 1996:376)

On 9 August 2001, both companies attended a news conference regarding the product recall. However, it was apparent that neither company prepared for the conference, as they were unable to address all the questions. Furthermore, consumers became sceptical, as a result of the absence of solid answers, as well as the slow response by both companies. Both companies were evasive and implemented the strategy of denial. Information regarding the product - the defective tyre - was slow and confusing.

3. Selecting appropriate leadership to handle the event. (Fombrun, 1996:376)

Ford chose CEO Jaques Nasser to handle the crisis. An advert was made using Nasser to reassure consumers; however, he came across as stiff and insincere in the advert. Jaques Nasser made another big mistake when he did not appear before house members for the first hearing on Capitol Hill, because he was too busy managing the recall. This enraged legislators (Dixon, 2001).

Firestone selected CEO John Lampe. Lampe did not feel that a tyre recall was justified, and he also terminated the 95-year-old partnership between Ford and Firestone.

4. Rebuilding Confidence . (Fombrun, 1996:376)

Firestone suggested they would close the Decatur plant, which was the source of the faulty tyres. Ford made the unprecedented promise that buyers could choose any brand of tyre they wanted on the next generation Explorer (Larkin, 2003:54).

5. Restructuring for Credibility . (Fombrun, 1996:376)

The only restructuring that was carried out was the closing of the Decatur plant by Firestone.

6. Appeasing Legislation

Jaques Nasser failed to appear before house members in the first hearing on Capitol Hill, and this angered legislators. Washington lawmakers publicly attacked the CEO of Ford, as well as the company itself. The company later stated that the CEO would be available for the second hearing, as the nature of the questioning had shifted from technical safety issues to the integrity of the company. At the second hearing, Jaques Nasser was forced to wait for hours, and, during the hearing, he was interrupted repeatedly.

Firestone made an apology at the first Congressional hearing through its Bridgestone/Firestone CEO, Masatoshi Ono (Larkin, 2003:56).

New Element: The Ford/Firestone event introduced a new element in managing reputation risk during a crisis: an official apology by the CEO of Bridgestone/Firestone. However, due to the public spat between the companies, the apology was considered insufficient. If the other elements had been dealt with correctly, the apology would, most likely, have succeeded in scraping and redeeming the company name.

7. Appropriate Apology

Public apology by CEO of Bridgestone/Firestone, Masatoshi Ono:
“I come before you to apologise to you, the American people, and especially to the families who have lost loved ones in these terrible rollover accidents. I also come to accept full and personal responsibility”

This apology did not, however, hold much significance, as it was not considered to be enough in the way of retribution.

7.4 Exxon Valdez

7.4.1 Background

Another company that displayed bad reputation risk management was Exxon Valdez.

An oil tanker named Exxon Valdez, which belonged to the Exxon Shipping company, struck a reef in Alaska in March 1989, causing the spillage of 11 million gallons of oil, and ruining an extensive area of natural habitat. However, Exxon offered no response to the disaster, until one week after the event. When the press statement was made, Exxon appeared ignorant and indifferent with regards to the extent of the damage that had occurred. This increased the reputation risk significantly.

7.4.2 Analysis of the Exxon Valdez Case

1. Early disclosure and accepting responsibility immediately (Chambers, 2001)

The moment the company became aware of the crisis, they should have established a 24-hour crisis management centre, in order to disclose facts to anyone concerned. The company should have made authorised statements and regular briefings. Instead, Exxon's response to the disaster was slow. With regard to addressing the actual problem - which Exxon claimed was its first priority - it took company officials nearly 10 hours after the accident to deploy booms to contain the spill. Company executives refused to comment on the accident for almost a week. CEO, Lawrence Rawl, waited six days before making a statement to the media, and he did not visit the scene of the accident until 3 weeks after the spill (Rubinstein, 1990).

Compounded with the slow response and lack of communication, the company blamed state and federal officials for the delays in containing the spill. To make matters worse, a company executive commented that, in order to clean up the spill, it would raise the price of fuel. The company's attempts to avoid responsibility tarnished its reputation (Smith, 2003).

2. Disclosing information openly and explaining the event . (Fombrun, 1996:376)

The media was ignored in the first crucial hours following the crisis. Exxon opted to communicate from Valdez, the town closest to the accident. However, this remote location proved inadequate due to communication limitations. An alternative was not considered, due to the stubborn insistence of the company, which stated: ”Valdez or nothing”. To make matters worse, contradictory statements were made by the senior executives, bringing into question Exxon’s credibility regarding the clean-up operation.

One week after the event, and after requests for better communication were ignored, the media became hostile. Exxon Valdez decided to utilise Frank Lorossi, the director of Exxon shipping, who flew to Valdez to hold a press conference. However, the statements made by Frank Lorossi, stating that the company had achieved some success, were contradicted by the locals in Valdez (Lucaszewski, 1993).

Finally, Lawrence Rawl, the company chairman, appeared live on television, and had to answer questions on the clean-up operation. He was, however, ill-prepared for the deluge of questions. For instance, he was asked about the reports regarding the clean-up operations, and he replied that it was not the job of the chairman to read such reports (Smith, 2003).

3. Selecting appropriate leadership to handle the event. (Fombrun, 1996:376)

Lawrence Rawl, Chairman of the Exxon Corporation, was chosen to manage the oil spill crisis at Exxon Valdez. He blatantly showed indifference to the crisis, by not visiting the site until 3 weeks after the incident. Furthermore, he did not set up the necessary liaison office to deal with media and consumer queries, and he also waited 6 days before he made a statement to the media. During the statement, he showed a lack of knowledge about the clean-up plans. Then he made a fatal error: he laid the blame for the crisis at the feet of the world’s media. The company showed a total lack of leadership after the crisis, and also gave no indication that it would ensure that this problem would not recur (Smith, 2003).

4. Rebuilding Confidence . (Fombrun, 1996:376)

The company was asked how it would pay for the clean-up costs, and a senior executive replied that Exxon would raise the price of fuel to pay for the incident. This statement obviously angered consumers. The company did not appear to care about the oil spill or consequent disaster. Exxon was seen to be entirely indifferent to the large-scale disaster and destruction of the environment (Secord, 2003).

5. Restructuring for credibility . (Fombrun, 1996:376)

The company did not carry out any major restructuring to improve its image.

6. Appeasing legislation

The government insisted on a full investigation into the reason for the oil spill. The company was forced to pay $5 billion dollars in punitive fines for corporate irresponsibility, ordered by the federal court in Anchorage:
Criminal restitution for the clean-up: $100 million
Criminal plea agreement: $150 million fine
Civil settlement: $900 million over 10 years to restore environmental resources.
In addition, the company had to pay out $1.1 billion in various settlements.
(Court puts Exxon Valdez punitive damages at $4 billion:2002)

The crisis also precipitated the 1990 Oil Pollution Act. This Act defines the elements of, defences to, and limits on legal liability of companies responsible for oil spills.

Furthermore, during the clean-up operation, Exxon dismissed offers of help from the environmental activist groups. Therefore, they wanted full restitution (Secord, 2003)

7. Appropriate Apology

The company took out a full-page advertisement in 166 newspapers, apologising for the incident, but refused to accept responsibility.

7.5 Coca Cola

7.5.1 Background

On 15 June 1999, the Belgian Health Ministry reported that 100 people, mainly school children, had fallen ill from drinking Coca Cola. Eight of the children had to be admitted to hospital. When the Belgian Health Ministry first broke the news, it took the Coca Cola Company (Coke) a crucial six hours before it reacted. On 16 June, Coke’s chairman in Belgium responded by making an apology. However, the apology was not very convincing, as it did not come from the parent company in the US. The chairman, Douglas Fuester, only made an apology one week after the event. On 17 June, Coke protested that there was no link between the illness and the, allegedly, contaminated coke. It later emerged that the bottling plant in Antwerp supplied bad Carbon dioxide. Therefore, Coke was forced to admit that there was contamination. Yet, Coke never gave an official explanation of the whole event. The share price fell from $64 to $63, and the company suffered a $37 million loss in sales (Roughton, 1999).

7.5.2 Analysis of the Coca Cola Case

1. Early disclosure and accepting responsibility immediately (Chambers, 2001)

When Belgian school children became sick, a Belgian Coca Cola executive arrived at the school in the afternoon after receiving a call from the school's headmaster. Samples were taken the next day, and the school received a fax from the company, acknowledging that the schoolchildren's illness was, in fact, due to the consumption of coke. A week later, more children were reported to have the same illness. Coke began withdrawing some of its products. However, after one week of incidents, government officials complained that Coke was neither sensitive to the government's position, nor forthcoming with explanations (Reid, 2004).

2. Disclosing information openly and explaining the event (Fombrun, 1996:376)

Much later, Coke explained that the bottles had become contaminated with sulphur-laced carbon dioxide gas, and the cans had come in contact with a fungicide on wooden pallets. Neither substance was found to have high enough levels to explain the symptoms. An official explanation for the contamination was given only a week later, and no media briefings were held to help answer consumer queries.

Coke failed to act quickly and resolve the situation, and appeared unconcerned that hundreds of children were made ill, and that its product was the probable cause of that illness (Roughton, 1999).

3. Selecting appropriate leadership to handle the event. (Fombrun, 1996:376)

Initially, a Belgian Coca Cola executive was used as the spokesperson. The executives in Atlanta were slow to cotton on to the extent of the actual crisis. It was only after the Belgian Government banned the sales of Coke in Belgium that Coke reacted with chairman Douglas Ivester arriving in Brussels, 10 days after the crisis. During an interview, Phillipe Lenfant admitted that Coke had underestimated the crisis, and they should have admitted their mistake (Public Relations Fiasco, 1997).

4. Rebuilding confidence (Fombrun, 1996:376)

The company did nothing to rebuild confidence. Nor did they indicate what steps would be taken to avoid the recurrence of a similar incident.

5. Restructuring for credibility (Fombrun, 1996:376)

Coke had to retrench 5200 people, due to huge losses from sales in Europe. In addition, the Chairman, Douglas Ivester, left the company (Reid, 2004).

6. Appeasing legislation

Coke ignored the Belgian government, and there was poor communication with Belgian officials. This angered government officials, and Deputy Prime Minister Luc van Bossche, subsequently, banned the sale of all Coca Cola products. Coke lost sales in Europe, and this gave the competition an opportunity to make inroads with their products (Reid, 2004).

7. Appropriate Apology

Coke issued a formal apology on 22 June, seven weeks after the first incidents of illness. The Chairman, Douglas Ivester, issued the apology.

7.6 Perrier

7.6.1 Background

In 1990, the company experienced a problem when a carbon filter, which was used at the source of the water to remove impurities, had become clogged and was, therefore, unable to remove impurities, such as benzene. The filter remained clogged for six months, and negligence on the part of the employees allowed the problem to remain undetected.

The company had to recall 160 million bottles of the benzene-contaminated Perrier water. Perrier was sold worldwide, and the company was unable to co-ordinate or deliver a standard message across the globe. Inevitably, the media carried reports of the contamination (Kurzbard & Siomkos, 1992).

7.6.2 Analysis of the Perrier Case

1. Early disclosure and accepting responsibility immediately (Chambers, 2001)

When confronted by the contamination scare, the company immediately reacted, and felt that a massive recall of all the bottles would help convince the consumers of the purity of the product. They accepted responsibility immediately (Kurzbard & Siomkos, 1992).

2. Disclosing information openly and explaining the event (Fombrun, 1996:376)

Perrier North America, France and UK each followed their own strategies in handling the crisis. North America recalled all 70 million bottles, and announced that it was solely the North American shipment that was affected. France followed the American strategy, and announced that the problem was exclusively with the bottling line destined for the American market. However, the UK reacted differently, by stating publicly that they did not know the cause of the contamination and, therefore, could not make an announcement until the cause was determined. Yet, they also recalled 40 million bottles. Furthermore, they took out full-page advertisements informing the public that there were no immediate dangers. The UK branch had a crisis management team, which had developed and tested a contingency plan: they, therefore, said nothing until an investigation had been undertaken. Thereafter, Perrier France was forced to admit that it had been wrong, and, consequently, lost all credibility. The public became sceptical, due to the conflicting reactions (Sandman & Lanard, 2004).

3. Selecting appropriate leadership to handle the event (Fombrun, 1996:376)

The company did not select one leader to handle the crisis; instead, the different countries selected their own spokespeople. This fact resulted in inconsistent messages being sent out by the company (Sandman & Lanard, 2004).

4. Rebuilding confidence (Fombrun, 1996:376)

The chairman of the company, Gustave Leven, Perrier's 75-year-old chief, insisted that "…we don't want the slightest doubt to weigh on Perrier". By recalling all the bottles, the image of purity was retained (Fombrun, 1996:204).

5. Restructuring for credibility (Fombrun, 1996:376)

The company did not carry out any restructuring.

6. Appeasing legislation

The company decided to recall all bottles in the North American market, after US authorities' tests of Perrier confirmed the South Carolina laboratory's results. South Carolina had used Perrier in its experiments because it found Perrier to be a cheaper alternative than making its own carbonated water. During testing, they found traces of benzene in the Perrier sample, and during the standard chemical analysis, benzene was found to have seeped in through unknown means (Fombrun, 1996:204).

7. Appropriate Apology

Perrier did not issue an apology.

7.7 Summary

Company	Event	Successful	Impact on reputation	Satisfied all 6 elements
Johnson and Johnson	Product tampering	Yes	No	6/6
Ford Firestone	Defective manufactured product	Yes	Yes	1/6
Exxon Valdez	Oil spill	Yes	Yes	1/6
Coca Cola	Contamination of product	Yes	Yes	3/6
Perrier	Contamination of product	No	Yes	2/6

7.8 Conclusion

Brotzen (in Veysey, 2000) stresses that companies need to invest in reputational risk strategies and establish credit in the bank, before they find themselves in situations where they will be forced to spend their way out of a crisis.

Johnson and Johnson bounced back without any major damage to the company's reputation. However, the other companies did suffer setbacks. McClenehan (2001) states that there are three broad indicators of a loss of reputation:

- An adverse movement in share price
- An increase in negative media coverage
- A loss of sales

Management behaviour is critical in avoiding catastrophic events, as well as handling them properly, should they occur. Coca Cola, Exxon, and Ford Firestone suffered by losing sales and having to witness their company names being sullied by the media, while the share price also took a dive during the respective crises. However, the companies managed to retain some credibility because of their previous building of name reserves. Chambers (2001) found that the shares of the ten most admired US companies recovered faster and suffered less during the 1987 stock market crash, while the shares of the ten least admired companies fell three times as far. Of course, the fundamentals of most companies with the highest reputations were the root causes for their better performance, and vice versa. However, the fundamentals alone would not be enough. Stakeholders' confidence depends crucially on reputation, which must be managed. Companies capitalise on their reputation in times of difficulty. Careful management of the crisis or incident may even enhance the reputation of the company, but poor management can be damaging. If the companies had followed the example of Johnson and Johnson in their management of the crisis situation, they would have suffered less damage to their names. Perrier was unable to capitalise on its reputation, as it was a fairly new company, and it, therefore, suffered dismally.

The following chapter will show the use of the reputation risk management model as a comparison, as well as its application to a sample of selected South African case studies.

CHAPTER 8

SOUTH AFRICAN CASE STUDIES

8.1 Introduction

The recent strike action by SAA employees was managed badly by the executives at SAA, leaving a damaged impact on the company's name. In their handling of the situation, SAA clearly showed that they did not have a proper contingency plan. SAA also showed a complete lack of concern for passengers worldwide, who sat in airport lounges, waiting for some form of action or response from SAA: none was forthcoming. Only one person spoke to the media, and this proved inadequate. SAA should have had managers all over the airport giving the required feedback to both passengers and the media. The chairman of the company should display appropriate leadership in a time of crisis; however, in SAA's case, the chairman was perceived as imperious, and was nowhere to be seen during the strike. Instead, it was later revealed that he was visiting an expensive game farm outside Johannesburg (Moerdyk, 2005). An SAA passenger was overheard saying: "I will never fly SAA again". A company's reputation is fragile, and, therefore, needs delicate handling, especially during a crisis or particular event.

The factors established in the previous chapter for international companies will now be applied to the South African case studies. However, bearing in mind, that each company develops a unique culture inherent from the country in which it operates and must adapt to the legislation required, certain unique factors become applicable when managing reputation risk in a South African context. Applying case study methodology, twelve listed companies from the Johannesburg

Securities Exchange were selected, and the factors for effective management during an event were applied.

8.2 Unique South African Factors

South Africa has an unusual historical past, and that is the adoption of the apartheid system. During this period, government policies, rather than market principles, determined many aspects of labour management relations. From the 1950's until the early 1990's, black workers suffered systematic discrimination. Apartheid legislation authorised the "reservation" of many skilled jobs and managerial positions for whites, and qualified blacks were legally excluded from most senior level jobs. In addition, black education standards were so inferior compared to those of whites that few blacks were qualified for well-paid jobs. Even in equivalent job categories, blacks received lower wages than whites. Although white workers were divided in their racial attitudes throughout the apartheid era, they often opposed benefits for black workers that could threaten their own economic standing (Employment and Labour, 2002).

The African National Congress (ANC), which is the current governing party in South Africa, came to power in 1994, facing massive economic inequalities that resulted from the policy of apartheid, including: an economy with a zero growth rate, rising unemployment, ageing and outdated industries, high debt, and very little direct foreign investment. Recognising the need to fundamentally restructure the economy, the ANC adopted the Reconstruction and Development program (RDP) in the same year. The program was designed to provide an overall economic framework, which would link reconstruction and development in a process leading to sustainable growth in all parts of the economy, with greater equity achieved through redistribution (Levitt, 2005). Black Economic

Empowerment (BEE) emerged as a central objective of South Africa's RDP. However, the government provided a statutory framework to promote BEE, particularly through the grant of Government and parastatal tenders, licences, concessions and contracts (South Africa, 1996).

The BEE Act now forms the primary statutory framework for the promotion of BEE in South Africa. The emphasis of the Act is on "broad-based" BEE, which is defined as the economic empowerment of all black people through various strategies, which include the following:

- Increasing the number of black people that manage, own and control enterprises and productive assets.
- Facilitating ownership and management of enterprises and productive assets by communities, workers, cooperatives and other collective enterprises.
- Human resource and skills development
- Achieving equitable representation in all occupational categories and levels in the work force
- Preferential procurement, and
- Investment in enterprises that are owned or managed by black people.

There is no 'hard law' requiring that any entity in South Africa must meet specific BEE targets or must implement a BEE policy within the entity. However, from a practical perspective, any company wishing to do business in the South African environment must consider and develop its BEE position as, in addition to the pressures from government discussed below, an entity that does not have a good BEE rating - or does not strive to improve its BEE rating - will be hampered in the conduct of day-to-day business with government organs of state and private sector customers. Most private sector businesses to which services are rendered or goods are sold will also have BEE procurement targets to meet, and so the BEE rating of entities from which goods and services are procured, will be a factor in determining with whom one should do business. Most importantly, a company that has a good BEE rating will enhance its reputation, i.e. add real commercial value to its business.

Another aspect of corporate reform comes in the form of guidelines from the King (2002) Report on Corporate Governance. Here, the emphasis is on issues of corporate governance and transparency. The report outlines certain fundamentals relating to corporate governance. The report also particularly focuses on social, ethical and environmental issues, in seeking an appropriate balance between the interests of shareowners and the interests of other stakeholders. However, conforming to corporate governance standards can bring about limitations to management. Boards must balance corporate governance principles with performance for financial gain and the sustainability of the company's business. However, good governance pays and enhances the reputation of the company. Compliance to King (2002) can enhance company performance and reduce the risk of business failure.

Risk management should be an integral part of the business process, and boards must be more forthright with investors and stakeholders about their risk management procedures. King (2002) stresses that directors should know what risk management is in place, how it works, as well as demonstrate its effectiveness.

Risk management has become more focused due to recent global corporate failures, and changes in the business environment. Change can bring about new risks, such as: rapid growth, new technology, new legislation, changing customer needs, new leadership, and restructuring. Good corporate governance structures help to maintain the corporate environment and alert management of any unusual events, which could give rise to an unprecedented crisis.

8.3 South African Case Studies

Using the factors identified from the international case studies, and adding the unique South African factors identified above, we can apply all these factors to the case studies, and determine whether or not they managed reputation risk successfully, and recovered from the incident or event unscathed.

8.3.1 Pick and Pay Stores Ltd (Pick and Pay)

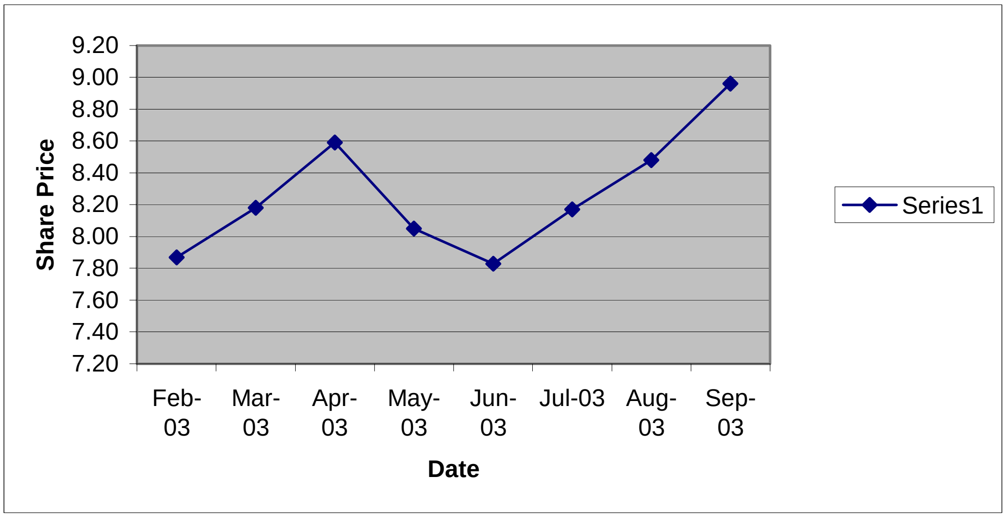
8.3.1.1 The event

On Tuesday, 13 May 2003, the company received a food parcel containing a 120g tin of No Name brand Portuguese sardines, one bottle of Pick & Pay Choice garlic flakes, and one tin of Lucky Star Pilchards in chillies. A letter accompanied the tins, which stated that the items had been poisoned and that, unless certain demands were met, similar items would be placed in stores (Mathews, 2003).

The extortionist had allegedly poisoned several items of food in stores in Gauteng and Kwazulu Natal. CEO, Sean Summers, claimed that the extortionist wanted to extort money from the company (Kemp, 2003).

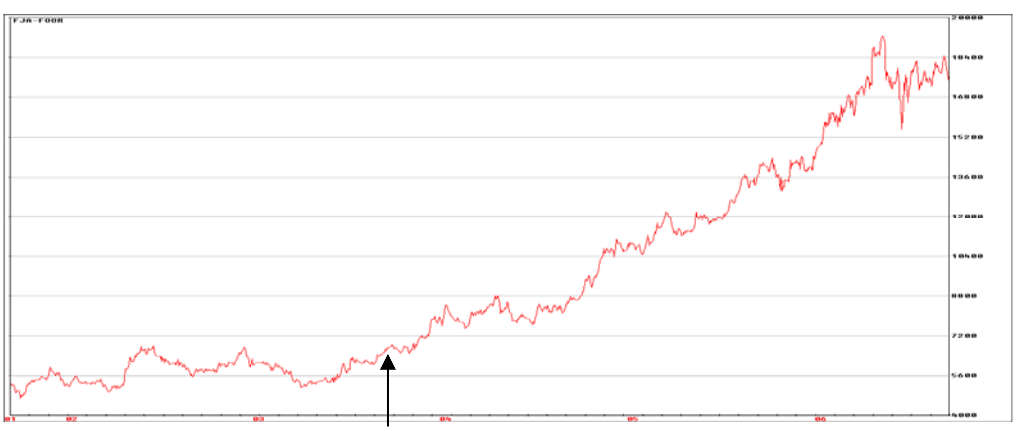
On Friday, 27 June, a consumer phoned in and informed the company that she had eaten a can of sardines that was marked poisonous. This prompted the company to recall all three of the affected products, in order to ensure customer safety. Customers were guaranteed full credit (Tagg, 2003). This incident impacted shareholders' value, the results of which are shown in Figure 8.1.

Figure 8.1 Impact on Investor confidence – Pick and Pay



The food and drug retail index for the period January 2003 to December 2003 is shown in the graph below. There was an upward trend for the period April 2003 to July 2003.

Figure 8.1.1 The Food and Drug Retail Index



8.3.1.2 Analysis of the Pick and Pay case:

1. Early disclosures and accepting responsibility immediately

After seven weeks of extortion, Pick and Pay had to make a media statement, alerting consumers of the extortionist's tampering with certain products. The CEO of Pick and Pay, Sean Summers, stated that the company had to make a public statement because the issue of customer safety must come first, while cost to the company should come second. The company removed all the products associated with the tampering, and urged all customers to return the items associated with the tampering for a full credit. The company also immediately extended the operating hours of its customer care line to 24 hours a day, seven days a week, and also stepped up its security and surveillance at all stores (Pick 'n Pay, 2005).

2. Disclosing information openly and explaining the event.

Pick and Pay explained in a statement to all customers that the company had been a victim of an extortionist for the previous seven weeks. The extortionist had targeted both the company and its customers. It was explained that the company had received three items, accompanied by a letter informing the company that these items had been poisoned, and if the company did not follow instructions, similar items would be placed in stores. The company followed the instructions so as to ensure the safety of the consumers. It, initially, appeared as though the public was not in danger, and the company avoided any statement that could possibly provoke the extortionist. However, due to the sporadic movements of the extortionist, the company decided to go public. It insisted on a policy of complete transparency (Tagg, 2003).

3. Selecting appropriate leadership to handle the event

The company chose Pick and Pay CEO Sean Summers to handle the crisis. He was chosen to make the media statement and disclose all information related to the crisis. Sean Summers shared empathy and appeared sincere. He further stated that ”this is an attack on all of us as South Africans”, and that he had been personally moved by the support that has been received from customers on the issue (Kemp, 2003).

4. Rebuilding confidence

The company recalled all tampered products immediately, and then wrote a letter to its shareholders, thanking them for their support during the extortion crisis. The company further assured its customers and shareholders that it would make every effort to track down the extortionist and bring him to justice (Kemp, 2003).

5. Restructuring for credibility

There was no restructuring done at Pick and Pay.

6. Appeasing legislation and complying with King (2002) and BEE

Pick and Pay co-operated fully with the SAPS, which carried out tests on the tampered products. The company also stressed its commitment to complete transparency with all involved (Mathews, 2003).

7. Public Apology

No public apology was made.

8.3.2 Anglogold Ashanti Ltd (Anglogold Ashanti)

8.3.2.1 The event

In April 2004, South Africa's Anglogold and Ghana's Ashanti Goldfields merged to form Aglogold Ashanti. The gold concession in the DRC formed part of Ashanti's portfolio in 1996, when the company bought a stake in a joint venture operation between mining development Internation and Okimo, called Kilomoto International Mining. The purchase gave Ashanti part of the rights to an area called Concession 40, which included 2000 square kilometres around the town of Mongbwalu in the province of Ituri. Local warlords and international companies, like Anglogold Ashanti, were among those benefiting from access to gold-rich areas, while local people suffered from ethnic slaughter, torture and rape (Anglogold Ashanti to stay on in DRC, 2005).

On 31 May 2005, a US-based Human rights organisation reported that Anglogold Ashanti, through its presence in the region of Ituri in the DRC, gave tacit support to militia groups and, in doing so, acted inconsistently with the company's business principles (Ryan, 2005).

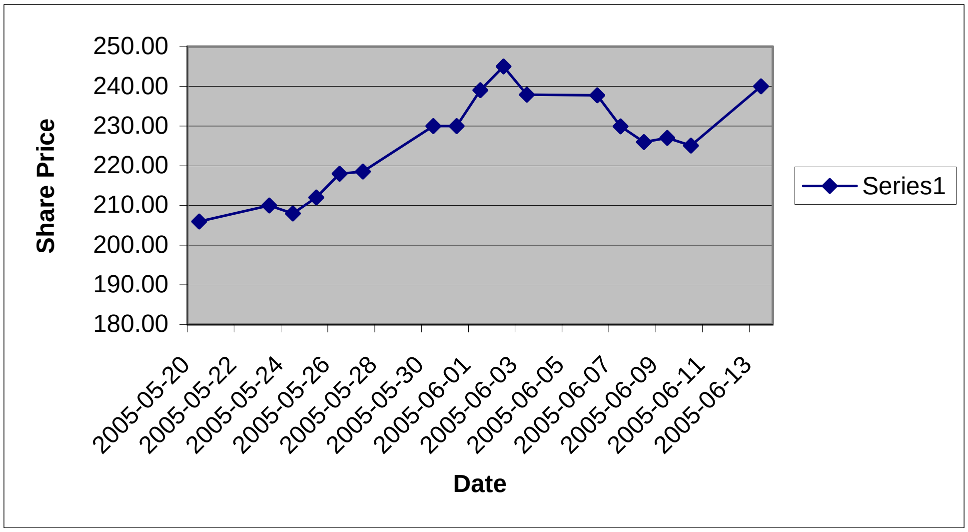
However, during a hastily convened press conference in Johannesburg on 2 June 2005, with Bobby Godsell as the spokesperson, the company retaliated, stating that it does not support militia, or any other groups whose actions constitute an assault on efforts to achieve peace and democracy. The company did, however, admit to a bribery payment made by the company to the FNI (a militia rebel group) in January 2005. The company made a payment of $8000, in addition to further sums totalling about $1000 in the previous year, in respect of an unauthorised arrangement related to cargo that had to be delivered to the local airstrip in the Ituri region. Furthermore, there was an allegation of contact between FNI members and employees of Anglogold Ashanti (Ryan, 2005). This incident impacted Anglogold Ashanti's share price as depicted in Figure 8.2.

Anglogold Ashanti stated that the company would not repeat a similar payment: it was a once-off payment. However, the human rights organisation stated that local armed groups fighting for control of gold mines use profits from gold mining to fund their activities and buy weapons. The group also reported that the gold is smuggled out of the DRC to neighbouring Uganda, where it is legitimised and sent to Europe, without the local communities benefiting from these transactions. The report also mentioned that FNI supporters lived in Anglogold Ashanti-owned houses, and were also offered lifts on company flights (Anglogold Ashanti, 2005).

Anglogold Ashanti had entered the Ituri region on the advice of the Transitional government and Manuc, and felt that their presence would contribute to the country's peace process. The company paid $1.5 million per year in lease payments for the right to look for minerals in the country. Once minerals were discovered the Kinshasha government would tax them (Anglogold supported DRC Rebels, 2005).

In a statement to the media, Anglogold Ashanti said that they had decided to continue operations in the DRC. They would, however, also regularly review their activities in the region, and should it become impossible to operate safely and with integrity, they would withdraw from the region (Anglogold Ashanti admits DRC bribes, 2005).

Figure 8.2 Impact on Investor confidence – Anglogold Ashanti



8.3.2.2 Analysis of the Anglogold Ashanti case:

1. Early disclosures and accepting responsibility immediately

On 31 May 2005, a human rights report entitled "The Curse of Gold" was published. This report stated that Anglogold Ashanti, through its presence in the Ituri region of the DRC, gave tacit support to militia groups and, thereby, acted inconsistently with the company's business principles. On 2 June 2005, Anglogold Ashanti made a public announcement, acknowledging that the company did give support to the militia; then proceeded to condemn that support, and, finally, gave assurance that it would not happen again. The company admitted there was a breach of the company's principles, because company employees had yielded to the militia group FNI's act of extortion (Ryan, 2005).

2. Disclosing information openly and explaining the event

The company explained in a statement made to the media that they acknowledged a payment made by Anglogold Ashanti Kilo to the FNI militia rebel group in January of that year, due to extortion. The amount paid was $8000, with an additional sum of $1000 paid for an unauthorised arrangement related to cargo delivered to the local airstrip. The company also stated that there were instances of contact between FNI members and employees on site, due to the fact that the company's operation was in close proximity to local communities, some of which comprised of FNI members (Ryan, 2005).

3. Selecting appropriate leadership to handle the event.

The company chose its CEO, Bobby Godsell, to handle the crisis. He bought credibility to the situation by stressing the company's objectives in the region, and if the company were faced with a similar situation - to yield to extortionate demands - they would consider that to be sufficient grounds for the company's withdrawal from the exploration project. The company also reiterated that if they succeeded in developing a mine in the area, the beneficiaries would be the government of the DRC, at both central and local levels, as well as the community, through subsequent employment (Anglogold admits bribes, 2005).

4. Rebuilding Confidence

The company conducted a review of the exploration activities in the DRC. The focus of the review was to determine whether or not the company could continue its activities in the region, within the company's values, and without compromising its integrity.

The company also held meetings with representatives of government, as well as the UN peacekeeping force Manuc, which confirmed that significant progress with the disarming of militia members has occurred, and the FNI rebel group has withdrawn from Mongbwalu, the town close to the company's gold exploration activities. Furthermore, the company gave its assurance that, due to the volatility of events in the DRC, the group would review its activities, and should it become impossible to operate within the company's principles, it will withdraw from the region (Ryan, 2005).

5. Restructuring for credibility

Anglogold Ashanti carried out no restructuring.

6. Appeasing legislation and complying with King (2002) and BEE

The company is considering an employee-share ownership programme; this is in line with its transformation programme, and in line with the BEE charter. This will help the company to promote its broad-based equity participation.

The company also made a decision to sell a stake in its South African mines to black investors and employees. This would also enable the company to secure the group's mining permits from government (Anglogold Ashanti, 2005).

7.Public Apology

No public apology was made.

8.3.3 CorpCapital Ltd (CorpCapital)

8.3.3.1 The event

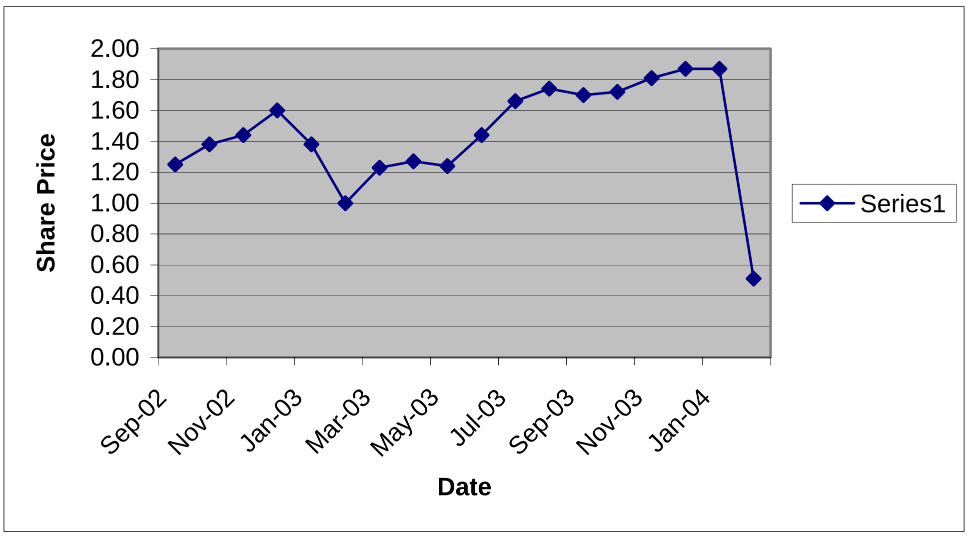
CorpCapital non-executive director, Nick Frangos, resigned from his position over issues of corporate governance at CorpCapital. Nick Frangos accused the company's board of serious lapses in corporate governance. He claimed that there was lack of disclosure on key issues, serious corporate governance concerns and the hefty pay packages allegedly given to senior management (Rose, 2003a).

Frangos also claimed that the true valuation of CorpCapital subsidiary Cytech was not properly disclosed to shareholders. Also, an amount of R37 million had been paid in restraint of trade agreements to management, allegedly with this information not being disclosed to the board or the committee (Rose, 2003b). The company was forced to allow an independent investigation by Nigel Payne, a member of the King committee on Corporate Governance, on the request of shareholders. This incident had an impact on shareholders' value as shown in Figure 8.3.

CorpCapital was cleared of corporate governance violations. In his report, Nigel Payne found nothing wrong with the financial services company, apart from a few minor recommendations. Nigel Payne also stated that Frangos had misled shareholders, by not stating the extent to which he participated in the proper governance processes. He also said that there were proper systems of checks and balances to safeguard shareholders' interests. He found no problems with the company's valuations. In addition, there was no undue or improper restraint of trade payments, and salary and bonus payments were made after due and proper process (Joffe, 2002a).

Within four months of the row with Nick Frangos over its corporate governance procedures, CorpCapital revamped the entire structure of its board. The company also divested its corporate finance business. In February 2004, the company decided to shut down without shareholder approval. CorpCapital's board decided to sell assets and close up, due to the fact that - as director Neil Lazarus stated – it was impossible to do business after the allegation made by former director Nick Frangos (West, 2004).

Figure 8.3 Impact on Investor confidence - CorpCapital



8.3.3.2 Analysis of the CorpCapital case:

1. Early disclosure and accepting responsibility immediately

No early disclosure was made.

2. Disclosing information openly and explaining the event

On 20 January 2004, CorpCapital came under attack from former director Nick Frangos. He had resigned from the board, and, subsequently, alleged that the company was in breach of corporate governance issues. As a result, he was unable to carry out his fiduciary duties.

The letter was released on Friday, 17 January. On Sunday, 19 January, the board responded, stating that it was 'outraged' by Frangos' actions, and claimed his letter was 'mostly untrue'. The company also said Frangos did not leave voluntarily, but was asked to resign. The company further stated that Nick Frangos was trying to justify his resignation "under pretext of being a champion of corporate governance". The allegations of corporate misconduct was deemed by the company when it responded to the media (CorpCapital, 2004).

3. Selecting appropriate leadership to handle the event

Neil Lazarus, an executive director, was chosen as spokesperson to deal with the crisis at CorpCapital, following the allegations by former director Nick Frangos. Lazarus, however, appeared aggressive in his stance against the allegations. This sparked the shareholders' interest into the allegations. Neil Lazarus did not show any empathy or sincerity with regards to the management of the crisis. Instead, he entered into a public row with the former director Nick Frangos. Neil Lazarus, as quoted in The Business Day, had said that the company would sue Frangos, as "we've had enough" (Bridge, 2004).

4. Rebuilding confidence

Nick Frangos accused CEO Jeff Liebersman of lying to an Old Mutual analyst when he was asked about his 2002 remuneration details. His reply was fraught with lies.

Based on this allegation CorpCapital's board met with representations of Old Mutual asset managers, in order to discuss the structure of an independent review of the company's corporate governance (Rose, 2003a).

Nigel Payne, an independent auditor, was appointed by CorpCapital to investigate the allegations. Payne served on the King Committee and chaired its subcommittee on risk management, internal control and internal audit. He is a former KPMG partner and, presently, general manager of Transnet's group audit services, in addition to being a director of the JSE, and chairman of its risk committees. However, apart from a few minor misdemeanours, he found no serious corporate governance offences, and stated that the executives had not conducted business that had, in a way, favoured their interests over those of their shareholders (Engelbrecht, 2003).

5. Restructuring for Credibility

Within four months of the disagreement with Nick Frangos over its corporate governance procedures, CorpCapital revamped its board of directors. Although cleared of any corporate governance grievances, the company hired more non-executive directors (Rose, 2003a).

6. Appeasing Legislation and complying with King (2002) and BEE

After the CEO of CorpCapital resigned due to a disagreement among CorpCapital’s directors, the Minister of Trade and Industry, Mr Alex Erwin announced that an investigation would be conducted by specially appointed inspectors into CorpCapital’s affairs, in terms of section 258 of the Companies Act. The inspectors were advocate John Myburg, and Professor Keith Prinsloo. The company later filed a high court application for the release of the report commissioned by the Department of Trade and Industry into its governance practices. This was done because the executive director believed that the report would vindicate him and his fellow directors against the allegations made by Nick Frangos (Faure, 2003).

7. Public apology

No public apology was made.

8.3.4 Sasol Ltd (Sasol)

8.3.4.1 The event

On 1 September 2004, an explosion at Sasol killed 11 people and injured more than 300 workers. The gas explosion took place at Sasol’s Secunda plant.

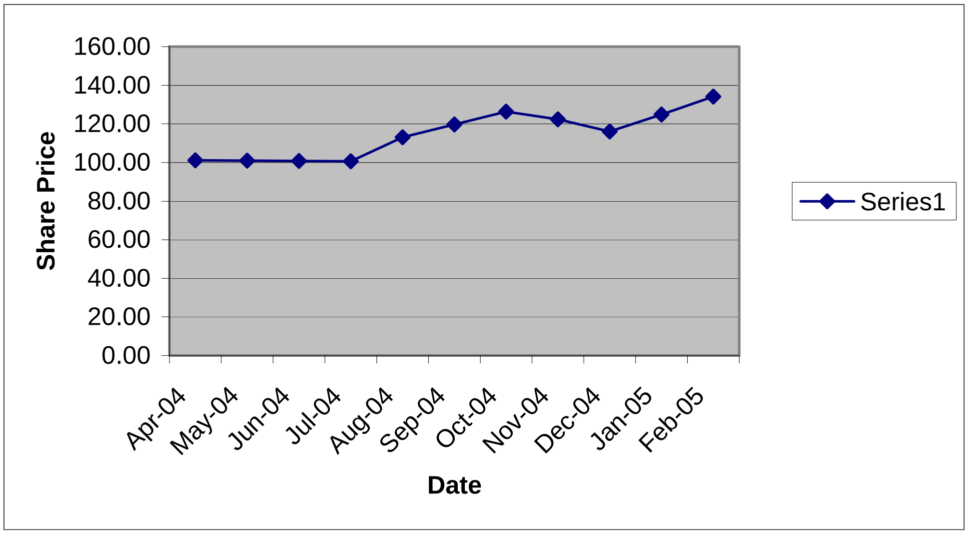
Spokesperson Johann van Reede made the official press statement, and stated that 14 people were missing, but he could not commit to the accuracy of this figure. He further commented that after an explosion, people are in shock, and, therefore, run away from the scene, making it difficult to attain an accurate picture. More than 500 people were working at the ethylene plant when the blast occurred. Sasol alerted the Highveld Medi Clinic near Secunda, so that the hospital could be on full alert by the time the patients arrived (Sasol blast, 2004).

Spokesperson Johann van Reede stated that the plant was undergoing planned maintenance, and there were several contractors at the plant when the blast occurred. Indications were that the incident was caused when a gas cloud, due to a gas leak, ignited. The plant is part of Sasol's polymers chemical production division. The managing director of the Plant, Director Terry Bates, said that the ethylene plant produced chemicals, and fuel production was, therefore, not affected. The labour department, the police, as well as Sasol, investigated the explosion (Probe going to take a while, 2004).

On 13 June 2005, Sasol and the leaders of its three major labour unions signed a safety charter in Johannesburg. This followed a string of accidents that had seen a total of 23 people die. The charter put safety as the highest priority at Sasol, and the signatories said that they believed all safety-related incidents were preventable and that they were committed to reach a point where all workers were safe.

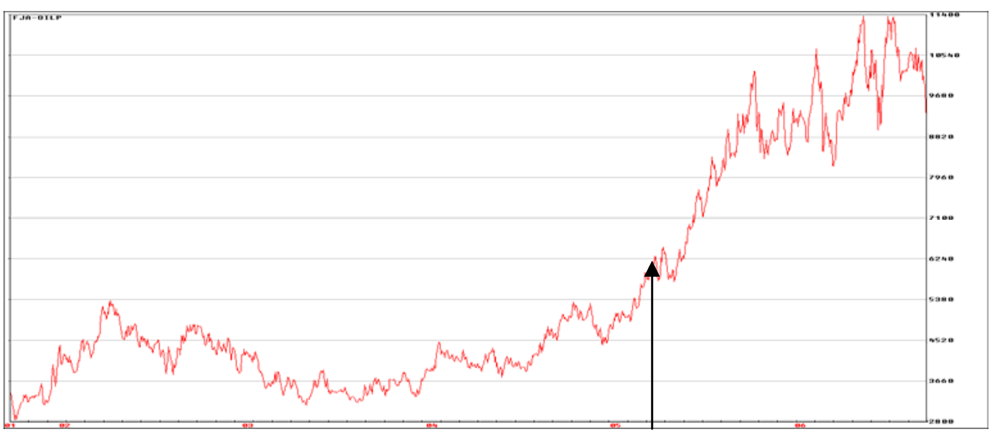
The parties also agreed to thoroughly investigate all incidents, eliminate the causes of accidents and share the results of investigations in a transparent way (Sasol unions sign safety charter, 2005). Figure 8.4 depicts the drop in shareholder confidence in Sasol due to the incident.

Figure 8.4 Impact on Investor confidence - Sasol



The oil and gas producer index for the period July 2004 to September 2004 is shown in the graph below. There was an upward trend in the sector for this period.

Figure 8.4.1 Oil and Gas producer index



8.3.4.2 Analysis of the Sasol case:

1. Early disclosures and accepting responsibility immediately.

A gas explosion at Sasol on 1 September 2004 killed 11 people and injured more than 300 workers. Sasol made an official press statement regarding the incident; however, the company could not comment on the accuracy of the number of people missing (Lubisi, 2004).

2. Disclosing information openly and explaining the event

The company gave a press statement confirming that the plant was undergoing planned maintenance, and that there were several contractors on site when the blast occurred. A gas leak caused a gas cloud, which, in turn, caused the blast (Lubisi, 2004).

3. Selecting appropriate leadership to handle the event

Johann van Reede, a senior employee was chosen as the spokesperson for the crisis. He displayed a cool composure, which helped minimise the status of the crisis. Being a veteran at handling crisis further enhanced his persona as a reliable spokesperson. He also showed empathy towards the workers involved in the blast. He managed to convey the company's empathy simultaneously (Lubisi, 2004).

4. Rebuilding confidence

On 13 June 2005, Sasol and the leaders of its three major labour unions signed a safety charter in Johannesburg. The charter places safety as the highest priority at Sasol, and the signatories said that they believed all safety-related incidents were preventable and that they were committed to reach a point where all workers were safe (Sasol unions signs safety charter, 2005).

5. Restructuring for credibility

The company undertook no restructuring.

6. Appeasing legislation and complying with King (2002) and BEE

On 14 September 2004, the company announced that it wished to accelerate plans to introduce BEE ownership into their liquid fuels business. Furthermore, a BEE liquid fuels retailing venture, Excel, was integrated into Sasol Oil. The company also announced the signing of two additional equity participants, thus showing a commitment to the transformation process. With regards to its employment equity, the company stressed that it would not ‘window-dress’, but had made a committed investment with a long-term view to meet the company’s obligation (Union not part of inquiry, 2004).

7. Public Apology

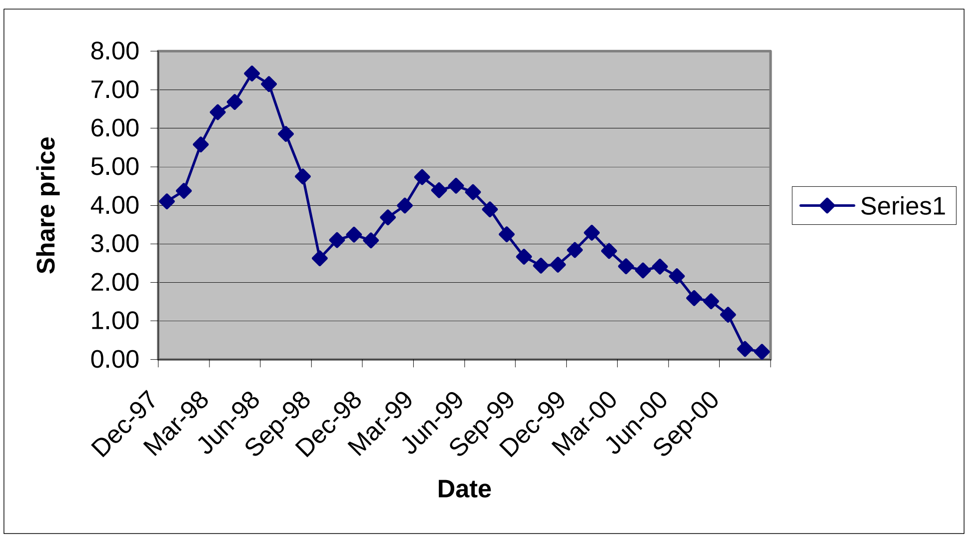
Sasol made an official apology, whereby they stated that the company deeply regretted the loss of life during the blast incident, and offered sincere condolences to the loved ones of the deceased and to those who were injured (Sasol, 2005).

8.3.5 Leisurenet Ltd (Leisurenet)

8.3.5.1 The event

In March 2000, Leisurenet's fortunes were prompted by an incident, which started a chain of events that caused the company huge financial losses. Fitness Holdings Worldwide (FHW), the multinational club chain based in San Francisco, had indicated it was interested in purchasing Leisurenet. However, a black economic empowerment group, which holds an 18% interest in Leisurenet, was unwilling to consider the offer; thus, FHW never placed the offer. Following this, the company had to concede to changes in its accounting policy. This related largely to the recognition of revenue (Lowe, 2000). The change in policy affected shareholders' value, as is evident in Figure 8.5.

Figure 8.5 Impact on Investor confidence - Leisurenet



8.3.5.2 Analysis of the Leisurenet case:

1. Early disclosures and accepting responsibility immediately

There was no disclosure to stakeholders explaining the current position of the company.

2.Disclosing information openly and explaining the event

No information was given regarding the crisis at the company.

3. Selecting appropriate leadership to handle the event

Peter Flack of Coronation FRM, which specialises in turnarounds, was brought in as interim Chief Executive Officer. He tried to find a buyer for the loss-making subsidiary, Healthland, which was draining the company financially. He openly acknowledged that the company's overseas expansion had put a strain on the company (Closer look at Leisurenet exposes more than a little muscle, 2003).

4 & 5. Rebuilding confidence and Restructuring for credibility

Before the release of its midyear results, the company announced that it had reshuffled its board, ostensibly to position the group for a listing on an international stock exchange (White collar grime at Leisurenet, 2001).

6. Appeasing Legislation and complying with King (2002) and BEE

The Directors breached corporate governance rules, because they had realised that they could get away with it. Directors used company funds to pay for personal expenses. There was, therefore, a complete transgression of King (2002) compliance.

8. Public apology

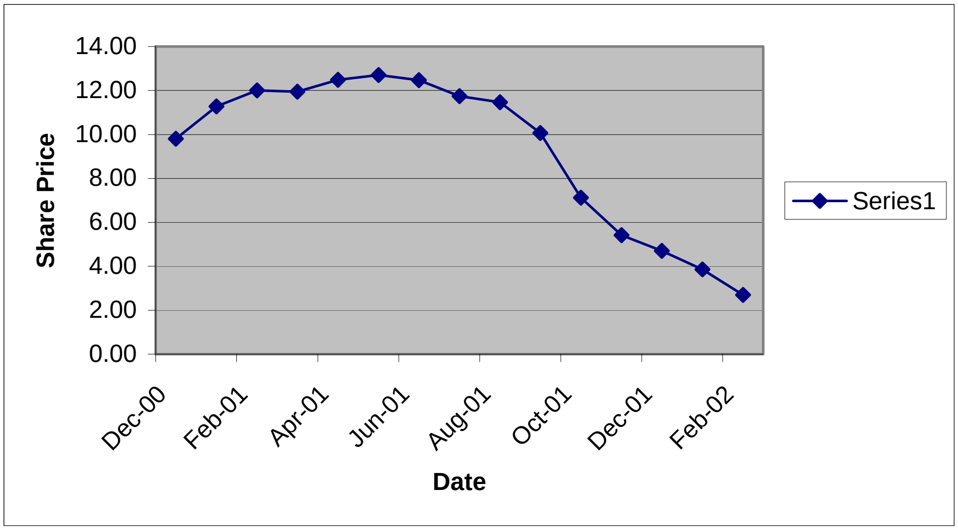
No public apology was made.

8.3.6 Saambou Holdings Ltd (Saambou)

8.3.6.1 The event

On 11 February 2002, after rumours of insufficient bad debt provisions and a downgrade in Saambou's credit ratings by Fitch - a credit rating agency, which assesses the financial viability of banks - Fitch lowered its short- and long-term ratings for Saambou (Cameron & Dasnois, 2000). This incident had a dramatic impact on the share price, as shown in Figure 8.6. There was a run on the bank, whereby depositors withdrew R1 billion in 2 days (Stovin-Bradford &Klein, 2002).

Figure 8.6 Impact on Investor confidence - Saambou



8.3.6.2 Analysis of The Saambou case:

1. Early disclosures and accepting responsibility immediately

The Saambou story made headlines over the weekend. When retail clients stormed the bank on Monday, they were met with closed doors, and all telephone lines had a pre-recorded message, stating that the bank was experiencing technical problems (Van Niekerk & Joffe, 2002). The appointed curator, John Louw of KPMG, was the only person who reassured Saambou clients who feared that they had lost their lifetime savings. Even though the run on the bank was splashed across every newspaper, Saambou management did not come forward with any explanation; instead, they hid behind closed doors (Gebhardt, 2002).

2. Disclosing information openly and explaining the event

After the downgrade by Fitch, no-one at Saambou made a statement to the media explaining the reason for the possible rumour, or attempted to allay investor fears (Van Niekerk & Joffe, 2002).

3. Selecting appropriate leadership to handle the event.

Saambou executive, Hennie Dreyer, made a statement claiming that the Reserve Bank was happy with provisions for bad loans at Saambou (Steyn, 2001).

4. Rebuilding confidence

Saambou undertook no confidence-building strategies.

5. Restructuring for Credibility

On 2 January 2002, after a threat of a downgrade by ratings agency Fitch, the company had to admit its mistake: the personal loan business Thuthukani had lost its direction (Stovin- Bradford, 2001b). On 21 January 2002, Saambou embarked on a restructuring programme whereby 140 jobs were shed at Thuthukani (Steyn, 2001).

6. Appeasing legislation and complying with King (2002) and BEE

The finance ministry pulled the plug on two proposed ‘lifeboats’ for Saambou, thus preventing the Reserve Bank from assisting Saambou in averting curatorship. The first plan was a subordinated loan supported by the Reserve Bank; the second package involved a re-capitalisation plan. However, the ministry explained that the reason for not bailing Saambou out was that the government was averse to using taxpayer’s and public pension funds to save ailing companies (Hogg, 2001).

7. Public Apology

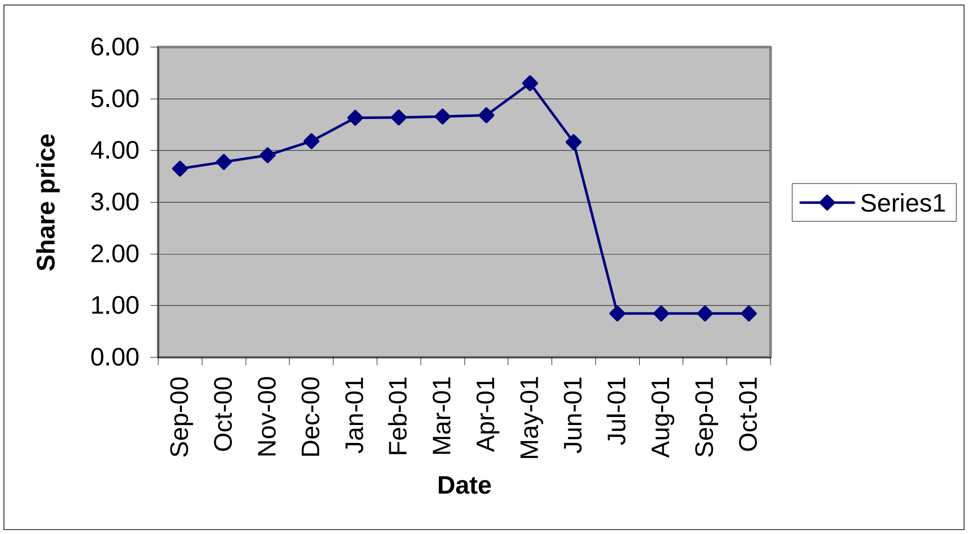
No public apology was made.

8.3.7 Regal Treasury Bank Holdings Ltd (Regal Bank)

8.3.7.1 The event

When the media relayed serious breaches in corporate governance by Regal Treasury Bank, the JSE confirmed that an investigation into possible share price manipulation was underway (Joffe, 2002b). Shortly thereafter, on 26 June 2001, there was a run on the bank. The auditors had previously withdrawn their support for the 2001 financial statements. Furthermore, 45% of Regal's shares were cancelled by certain trusts and other entities (Wessels, 2001a). This resulted in a total lack of confidence in Regal Bank by the shareholders as is evident in Figure 8.7.

Figure 8.7 Impact on Investor confidence – Regal Bank



8.3.7.2 Analysis of the Regal case:

Factors 1-5 were not applicable in this case.

6. Appeasing Legislation and complying with King (2002) and BEE

Jeff Levenstein, CEO of Regal, repeatedly ignored orders by SARB to institute proper corporate governance structures. Levenstein acted as chairman and chief executive officer of the bank for 19 months (Whitfield, 2002). This was in contravention of direct orders from SARB, which stated that the chairman should be seen as being independent. Regal directors were charged with fraud because annual corporate governance statements were not taken seriously; instead directors paid lip service to the market (Steyn, Van Niekerk & Thole, 2001).

The non-executive directors stated that they did not know what was going on. Advocate John Myburg states that they should have known what was going on, as it was their duty as directors of the company (Wessels, 2001b). Non-executive directors' duties were no less onerous than those of executives, and their priority was to monitor and review the performance of executive management, with more objectivity than the executive directors (Stovin-Bradford, 2001a). In order to ensure the requisite checks and balances, a chairman who was not the CEO, should have lead them on the board (Wessels, 2001c).

7. Public apology

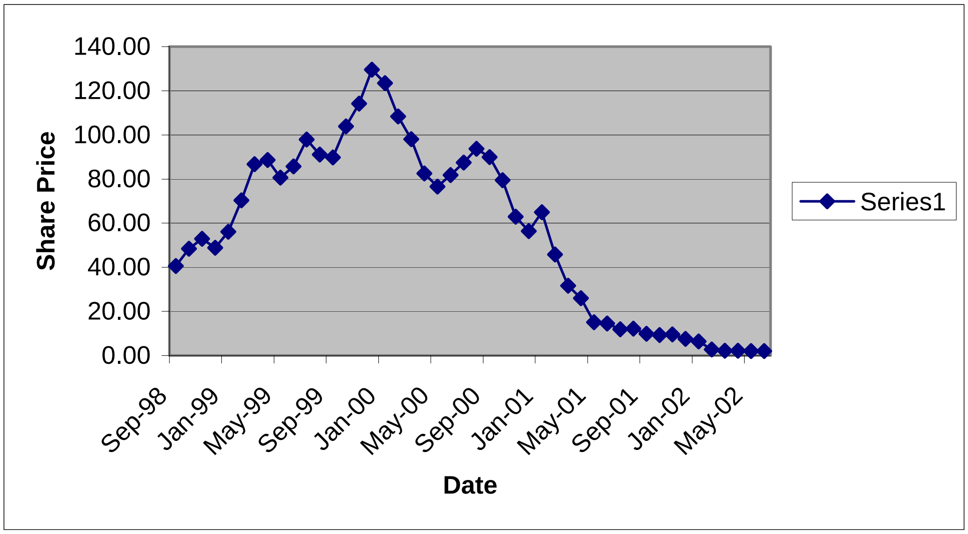
No public apology was made.

8.3.8 Profurn Ltd (Profurn)

8.3.8.1 The event

In November 2000, a rumour started in the market place that the South African Revenue Service was investigating the electronics sector. Due to the fact that Hi-Fi Corporation is a subsidiary of Profurn, this investigation had a negative impact on Profurn's share value. However, during January 2001, the company had to pay SARS R26 million in settlement of unpaid duties on imported merchandise. The market took the settlement payment as an admission of guilt. The SARS investigation into Hi-Fi Corporation released information asserting that agents were not paying total custom duties. This finding tarnished the company's image as a whole (Profurn Ltd, 2003).

Figure 8.8 Impact on Investor confidence – Profurn



8.3.8.2 Analysis of the Profurn case:

1. Early disclosures and accepting responsibility immediately

No disclosure of the problem was made to stakeholders.

2. Disclose information openly and explaining the event

No explanation was given to stakeholders

3. Selecting appropriate leadership to handle the event

No appropriate leader was chosen to handle the event

4. Rebuilding confidence

The company undertook no confidence-building strategies

5. Restructuring for credibility

No restructuring was carried out.

6. Appeasing legislation and complying with King (2002) and BEE

There was a tax settlement agreement between SARS and Profurn. The directors accepted no wrongdoing, but reached an agreement with SARS to restore assurance to the company's shareholders (Profurn Ltd, 2003).

7. Public apology

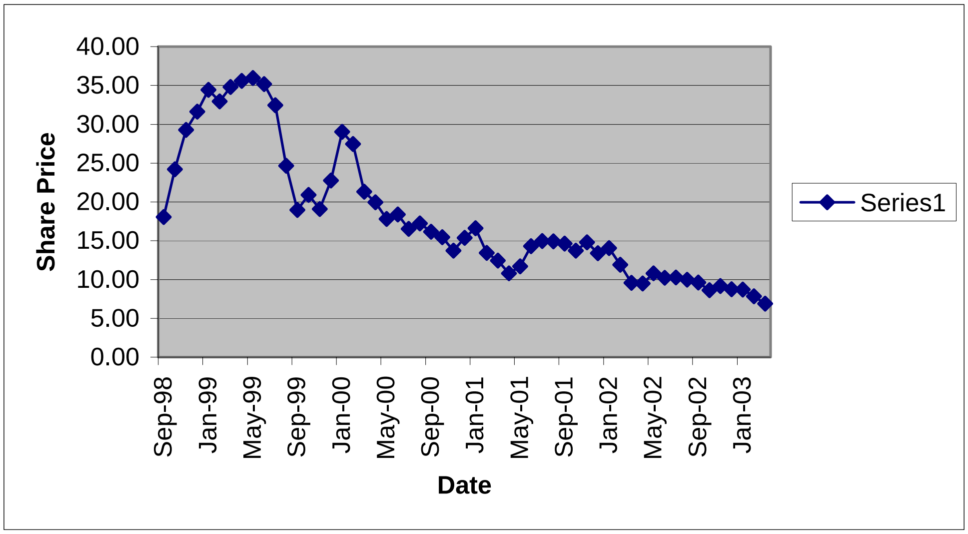
No public apology was made.

8.3.9 Brait S.A (Brait Bank)

8.3.9.1 The event

On 11 February 2001, Fitch ratings issued a negative watch on six banks, one of which was Brait Bank. The ratings agency then withdrew the statement after it met each of the institutions and satisfied itself with regards to their liquidity; it came to the conclusion that the bank was, in fact, able to meet its obligations. (Brait SA, 2003).

Figure 8.9 Impact on Investor confidence – Brait Bank



8.3.9.2 Analysis of the Brait case*:*

The company did not implement factors 1-4 and 6-7.

5. Restructuring for credibility

Brait announced plans to wind down its banking operations and cancel its banking licence. The company would continue with its strategy of running a first class investment bank (Brait SA, 2003).

8.3.10 NRB Holdings Ltd (NRB)

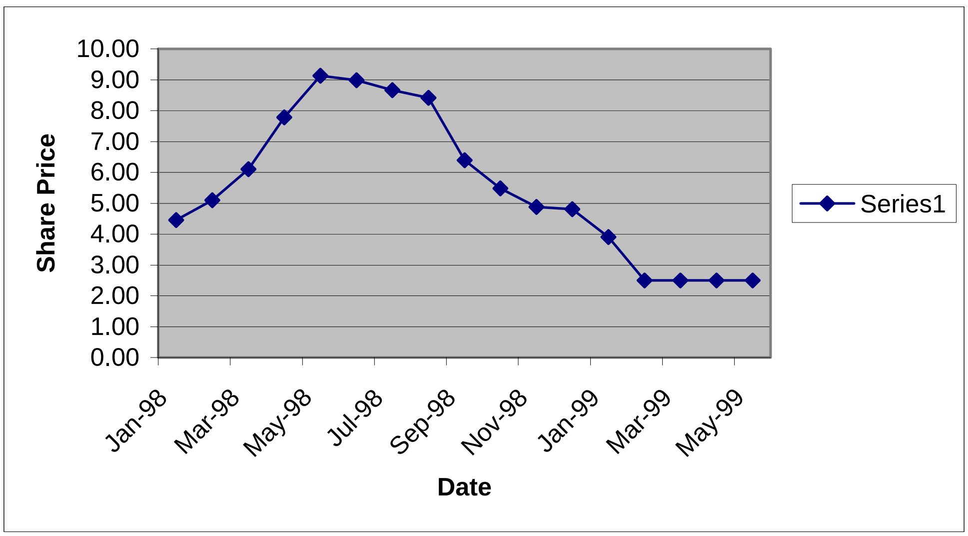
8.3.10.1 The event

In December 1998, the NRB entered into a deal with Mawenzi Resources, whereby Mawenzi purchased operating companies to the value of R490 million. However, the deal was subject to a due diligence, as well as the achievement by the acquired companies of profit after tax of not less than R40 million. During January

1999, fallout occurred between NRB and Mawenzi Resources. Mawenzi's reason for withdrawing from the deal was due to irregularities highlighted from the due diligence review carried out by KPMG. Samsuddin alleged that Mzi Khumalo of Mawenzi Resources failed to come up with the cash (Jones, 1998).

Aspects of the KPMG due diligence report compiled for Mawenzi were leaked to a financial newspaper, raising questions about NRB's liquidity because of a non-performing loan to NRB subsidiary Merchant Trade Finance (Jones, 1998).

Figure 8.10 Impact on Investor confidence – NRB



8.3.10.2 Analysis of the NRB case:

The company did not follow factors 1-2 and 4-7.

3. Selecting appropriate leadership to handle the event

Jonathan Scott, NRBH's chief executive, was chosen to handle the event. In terms of Mawenzi's failure to honour the contract, Scott stated that the deal whereby

Mawenzi would purchase all NRBH's operating subsidiaries - including its flagship, New Republic Bank - had been tightly structured. SMG Holdings and NRBH were confident that it catered fully for Mawenzi's consistent failure to meet its obligations. Scott further stated that the Reserve Bank's support shows that allegations that the bank was in financial trouble was "absolute rubbish'. The bank was liquid enough to support any losses from its own resources (Salgado, 2002). However, after the run on the bank, Scott hinted at the possibility of a hidden agenda, which emerged once NRB holdings and SMG (its holding company) resisted attempts by Mawenzi Resources (the black empowerment vehicle headed by Mzi Khumalo) to withdraw from the R490 million deal to buy NRB (Smith, 1999).

Scott also argued that the most basic business principles, including confidentiality, had been violated. He said that NRB had bared its soul to KPMG as it was compiling the due diligence, and, because it was a reputable company, had given it carte blanche to investigate the bank (Salgado, 2002).

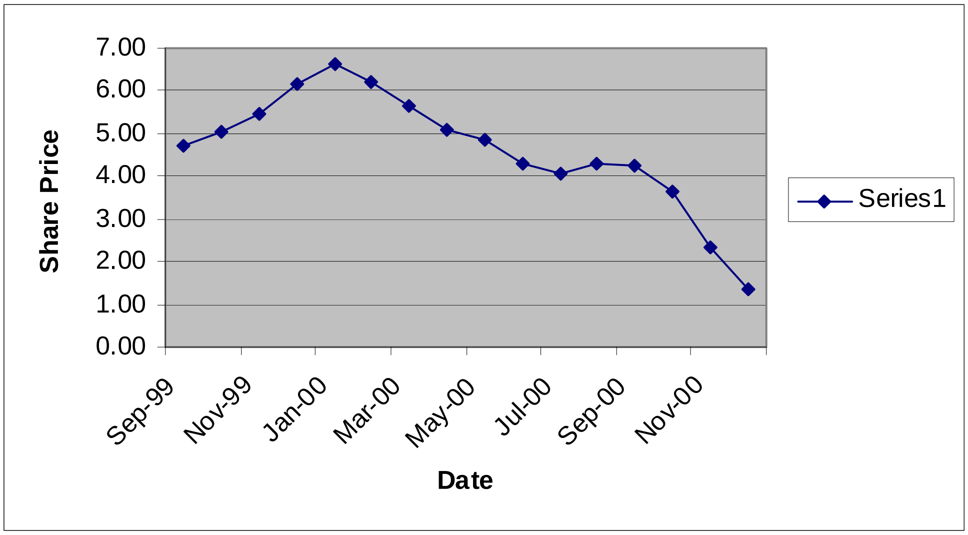
"We were entitled to expect the due diligence to be kept in absolute confidence, but it was not. You can't do business if this kind of trust is violated" (Jones, 1999).

8.3.11 Metro Cash and Carry Ltd (Metcash)

8.3.11.1 The event

On 15 September 1999, Metcash made a statement stating that SARS officials had confiscated documents and files during a recent raid on Metcash's internal audit offices, in spite of full co-operation by the company. The investigation related to a R266 million charge, levied against one of the Metcash subsidiaries in respect of VAT claims, between June 1996 and July 1997. The company assured investors that the claim would be contested (Metro Cash and Carry Ltd, 2002).

Figure 8.11 Impact on Investor confidence – Metcash



8.3.11.2 Analysis of the Metcash case:

The company did not follow factors 1-3.

4. Rebuilding confidence

Metcash won its case against SARS, as aspects of the VAT Act were declared unconstitutional. The court resolved that Metcash had a constitutional right to have the case heard by a court or impartial forum or tribunal, and should not have been required to settle an outstanding amount prior to a decision by these forums (Metro Cash and Carry Ltd, 2002).

5. Restructuring for credibility

Metro is to raise R692 million by way of a rights offer of new ordinary shares in Metro. This will provide additional capital for Metro's continued expansion of its trade centre division, liquor operations and additional distribution facilities to service its Foodies and IGA Friendly Grocer franchises. Subject to approval from the SARB, a portion of the funds raised will be utilised to reduce the offshore debt incurred for the acquisition of Davids Ltd in Australia. The funds will recapitalise and strengthen Metro's balance sheet (Metro Cash and Carry Ltd, 2002).

6. Appeasing legislation and complying with King (2002) and BEE

Metcash entered into an agreement with SARS, whereby Metcash would divulge information on clients suspected of fraudulent acts to SARS.

7. Public apology

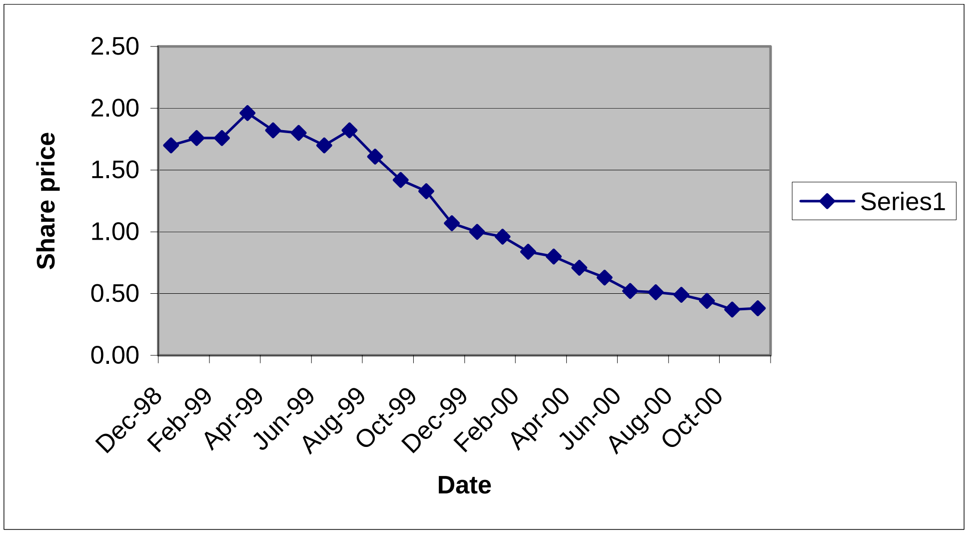
No public apology was made.

8.3.12 Mercantile Lisbon Bank Holdings Ltd (Mercantile Bank)

8.3.12.1 The event

Calypso Trading laid a criminal charge against Mercantile Lisbon Bank, and against its merchant bankers, over the theft of R2 million from Calypso's account. Civil proceedings for recovery of the capital, plus interest, were also instituted. The bank stated that it had complied with all written instructions, and opposed the action (Mercantile Lisbon Bank Holdings, 2003). Mercantile was placed on credit watch in June 2001 after a loss of R84.2 million for the year ending March 2001. The loss was chiefly the result of bad debt provisions, as well as higher operating costs (Mercantile Lisbon Bank Holdings, 2003).

Figure 8.12 Impact on Investor confidence – Mercantile Bank



8.3.12.2 Analysis of the Mercantile Bank case:

The company did not follow factors 1-4.

5. Restructuring for credibility

The asset finance division has, for some time been, been identified as non-core to the future of Mercantile and, as such, a major portion of this division was disposed of to Citibank.

- The disposal by Mercantile of its custodial, registry and share dealing/brokering business to Computershare Services Ltd and Computershare Custodial Services Ltd.
- The injection of R120 million of new capital by Caixa Ceral de Depositos, SA, a major shareholder of Mercantile, by way of a specific issue of shares for cash (Mercantile Lisbon Bank Holdings, 2003).

6. Appeasing Legislation and complying with King (2002) and BEE

An agreement was reached between SARB and Caixa General de Depositos (CAIXA), whereby CAIXA guaranteed to undertake the recovery of certain specifically identified non-performing advances in Mercantile's advance book, against which provisions have been made for the financial year ending 31 March 2002. The effect of the guarantee was to render the provisions raised - in respect of the underlying advances - unnecessary. Such provisions may, therefore, be reversed by the effective date of the guarantee, thereby increasing the reserves of Mercantile by R265 million and restoring the company's capital to a level of 11.95%, which exceeds the SARB's requirement (Mercantile Lisbon Bank Holdings, 2003).

7. Public apology

No public apology was made.

8.4 Results

Company	Event	Share Price before event	Share Price after event	Share price 1 month after event	Action after event	Recovery after event
Anglogold Ashanti	Bribe paid to militia rebels	21405c	20667c	23669↑	Admitted mistake and made press statement	Yes share price went up
Pick and Pay	Product tampering	1512c	1460c	1562c↑	Removed poisonous products and made press statement	Yes share price went up
Sasol	Explosion at plant	10067	11301	11975↑	Ensured all workers receive proper medical treatment and made press statement	Yes share price went up

Company	**Event**	**Share Price before event**	**Share Price after event**	**Share price 1 month after event**	**Action after event**	**Recovery after event**
Corp - Capital	Lack of governance	138c	100c	123c↑	Used an expert to investigate any governance weaknesses at company	Yes share price went up
Metcash	Vat penalty	424	363	233	Settled with SARS and made press statement	Recovered eventually
Mercantile Lisbon Bank	Downgrade by Fitch and theft	196	182	180	Restructured	Recovered eventually
Regal Bank	Accounting irregularities and fraud	530	416	85	Public spat between management and CEO	No recovery
Saambou Bank	Downgrade by Fitch and lack of governance	470	386	270	No press statement or any action by management to calm investors	No recovery

Company	**Event**	**Share Price before event**	**Share Price after event**	**Share price 1 month after event**	**Action after event**	**Recovery after event**
Leisurenet	Fraud and accounting irregularities	216	159	116	No management action	No recovery
Profurn	Investigation by SARS	7952	6299	5639	Settled with SARS but made a bad press statement	No recovery
NRB	Failed due diligence	481	391	250	Public spat between NRB and Mawenzi	No Recovery
Brait Bank	Downgrade by Fitch	1405	1191	957	Management decided to change business strategy	Delisted

8.5 Summary

8.5.1 The Recoverers

The companies that recovered and experienced an increase in the share price are:

- Anglogold Ashanti
- Pick and Pay Retail
- Sasol
- CorpCapital

Pick and Pay followed Johnson & Johnson's Tylenol case approach:

1. They recalled all products related to the poisoning
2. Advised consumers to destroy or return all fish cans
3. Responded fully to all press enquiries, and made public statements to inform the public.

There was a lack of any selfish objective on the part of the company, but rather a caring approach was displayed by putting the consumer first.
This strategy immediately showed that Pick Pay aligned leadership, company vision and business strategy to effectively manage reputation risk.

Anglogold Ashanti made a press statement and admitted that they had paid the bribe, and responded fully to all press enquiries. The victims were their employees who worked in the ITURI region, and for whom the company paid the bribe, in order to ensure their security. Here they displayed a facet of the company that cares about its employees.

Sasol followed a similar approach. They too issued a press statement following the explosion at the plant, and, immediately, ensured that the safety of the workers came first and that they would receive immediate medical care. Both companies then carried out restructuring in terms of BEE legislation, in order to appease government and legislation effectively.

CorpCapital had to react to an allegation made by former Director Nick Frangos regarding improper governance at the company. The company reacted by using an expert in corporate governance, Nigel Payne, who was asked to review the corporate governance of the company. Nigel Payne then issued a statement stating that he did not encounter any improper governance problems at the company. This strategy helped the company to retain its reputation. However, internal problems resulted in the eventual dissolution of the company.

The reason that the share price went up for the above companies is because management followed some form of contingency plan. If a company takes immediate, responsible action in the aftermath of an event, it enhances the company's overall image. Two days after an event occurs is considered a critical time, as this is the period during which the media covers the story and determines whether it is considered front-page news. If a company is perceived to be responding inadequately, journalists will be motivated to dig deeper and scrutinise closer, looking for other motives. Similarly, if a company is seen to be doing everything right, in terms of handling the situation effectively, then the story ceases to hold the same attraction to the media and falls from "front page news". Therefore, it is essential that a company communicates immediately after a crisis has emerged, and selects the appropriate leadership to add credibility to the managing of the situation.

8.5.2 The Non-Recoverers

The following companies were unable to recover from the event:

- Regal bank and NRB followed the four failure techniques that were used by Ford/Firestone:

1. Unable to identify the risk early
2. When they did finally recognise that they had a problem, they did not share information or acknowledge the problem. The event was managed behind closed doors.
3. When the story broke, there was no evidence of responsible behaviour or of working in partnership. Instead, they blamed each other.

The other non-recoverers followed the Exxon Valdez case study, which includes the following:

1. Failure to take quick and decisive action
2. Reluctance to take responsibility
3. Poor, or no communication with the media, e.g. Saambou and Leisurenet

8.6 Conclusion

Corporate reputation risk management is not an isolated add-on located in the PR department, but a fundamental aspect of business performance. The value of reputation as an important intangible asset justifies integration with operational and risk management strategies. Management must actively engage and co-ordinate relations with shareholders.

As Mitchell (1999) states, corporations are often so focused on making short- term profits for their stockholders that they behave in ways that adversely affect their employees, the environment, consumers and even the long-term well-being of the corporation.

By implementing the right strategies to manage reputation risk, the reputation of a company is left unscathed. Most importantly, in the South African context, where companies show empathy with wage earners, and show a commitment to the transformation process in terms of BEE legislation, this enhances the company's reputation. King (2002) compliance also retains investor confidence during a crisis: this confidence translates into support, whereby the investor holds onto the share of the company, confident that the company will manage the event to the best of its ability.

The following chapter will provide a summary of the study.

CHAPTER 9

CONCLUSION

9.1 Introduction

The corporate reputation of an organization is an asset, and should be treated as such. This study has focussed on factors that are able to maintain reputation. However, it is as important to implement strategies to protect the reputation when an event occurs, because this becomes a form of reputation insurance (Haywood, 2002: 173). Companies should, therefore, have an action plan in place, in order to protect reputation, should a crisis or event occur. As Haywood (2002:173) specifies, you can pollute half a town, poison most of the residents, turn the hair green of those who use your products and kill half your workforce without much damage to your reputation, as long as you follow some form of a reassuring crisis plan.

This chapter will attempt to conclude the results of the research, in light of the literature discussed in previous chapters and from the experiences depicted in the case studies. This will include consideration of the factors referred to in chapter 7, which contributed to the successful recovery of the companies concerned. A reputational management strategy, i.e. a step-by-step approach for both the international, as well as the South African environment, is, therefore, proposed, in order to maintain reputation in the event of a crisis. For the local companies, one of the steps was tailored to incorporate the unique factors of both King (2002) and BEE. At the end of this chapter, the necessity for further research in this area will be considered.

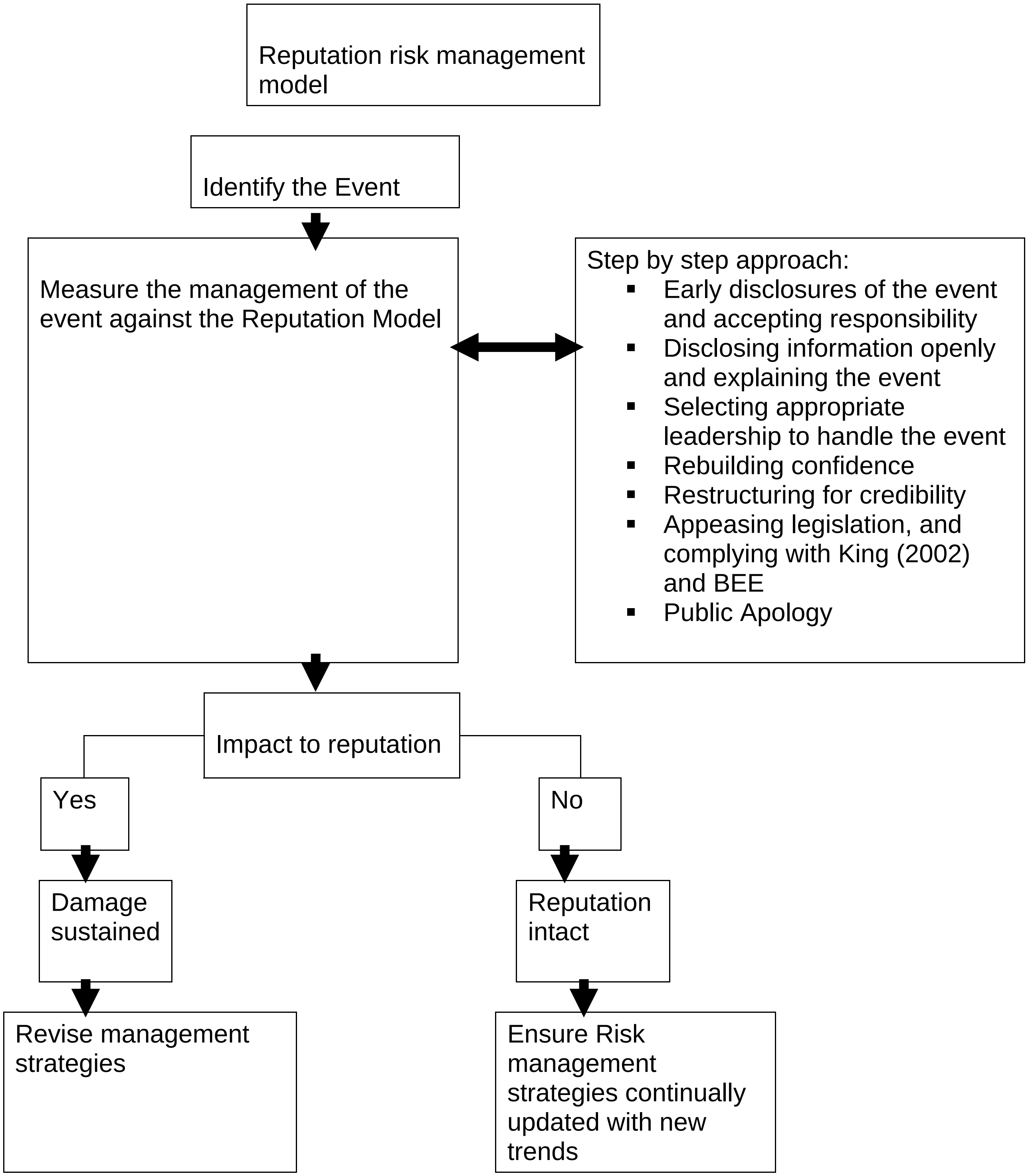
9.2 The Reputation risk management model

A model or framework has been compiled for managing reputational risk, based on the findings of the study. The study has established that companies that managed reputational risk successfully followed the following step-by-step approach, as presented by the model in Figure 9.1:

1. Early disclosures and accepting responsibility immediately
2. Disclosing information openly and explaining the event
3. Selecting appropriate leadership to handle the event
4. Rebuilding confidence
5. Restructuring for credibility
6. Appeasing legislation and complying with King (2002) and BEE
7. Public Apology

This model can be illustrated diagrammatically: Figure 9.1 depicts the flow that should be followed by the management of the company to manage an event or crisis.

Figure 9.1 Reputation risk management model



It is obvious, from the diagram, that the management of the event or crisis can be measured against the step-by-step approach, which is proposed and identified in this research. The impact to reputation is assessed and, based on the steps followed, negative reputation to the company can be averted. If it is not averted, the company must formulate strategies to address this impact.

9.3 Application of the model

In this study, various case studies of companies that have experienced some type of crisis or event were selected to help test the model. The study used both international and local case studies.

9.3.1 International Companies

The incident or event, whether it was external or internal, did not diminish or increase the impact to reputation; however, the fact that the companies had established names helped to soften the blow from the impact. Chapter 7 of this dissertation showed that Ford/Firestone and Exxon Valdez suffered damage to their reputation because they only satisfied one of the steps of the model. However, due to the fact that these were companies with huge capitalization and established names, they managed to avert total bankruptcy. Coca Cola’s event was due to both external and internal factors: contamination of the product and management’s disregard towards the situation. Coca Cola suffered a dent to its reputation, but, once again, because of its well-established name, it managed to bounce back and regain its reputation. Perrier, on the other hand, satisfied only two of the steps, and, as it was a fairly new company that had not established itself, it suffered the hardest blow to its reputation. Perrier experienced an event due to external factors, and had to sell its business to Nestle, because it could not regain a good reputation.

9.3.2 South African Companies

Twelve South African companies were selected; however, the selection was biased, due to the fact that prior knowledge of an incident affecting all the companies was known. The seven steps of the step by step approach from the reputation risk management model - including the modified step 6 with the unique South African factors - were used. These steps were applied to analyse management's actions during a particular event or crisis.

Anglogold Ashanti Ltd displayed the typical symptoms: i.e. there was a downward movement in the share price, and an increase in negative media, but one month after the incident, the company was able to recover comfortably, with the share price showing an upward trend. The company also satisfied 5 of the 7 steps. Two other established companies - Pick and Pay and Sasol - also managed to avert damage to their reputation, as they satisfied most of the steps: Pick and Pay satisfied 5 of the seven steps, and Sasol satisfied 6 of the 7 steps. However, both companies suffered negative setbacks when the incident occurred, in the form of a negative movement in the share price and an increase in negative media coverage. Both companies later experienced a surge in the share price after the event, because they displayed astute management skills in handling the crisis and, thereby, managed to avoid any major impact to reputation.

CorpCapital, on the other hand, applied 4 of the 7 steps, but the finger-pointing and internal fighting within management displayed a lack of stakeholder interest; instead, it showed complete indifference. Therefore, the company suffered damage to its reputation and was unable to rebuild confidence. Metcash applied 3 of the 7 steps, but it displayed confidence in being able to challenge a decision by SARS, and this helped to prove that the company was right, thereby managing to sustain consumer confidence, and minimise the impact of the crisis on reputation. Mercantile Lisbon Bank's event was an internal factor, but the company was forthright in its actions to remedy the situation. It also restructured so that the company's major shareholder, a respected Portuguese Bank, helped to maintain the company's image. This assisted Mercantile in avoiding liquidation, which, in turn, would have led to the ultimate destruction of its reputation.

The other companies, Regal Treasury Bank Ltd, Saambou Bank, Leisurenet Ltd, Profurn Ltd, New Republic Bank and Brait Bank, applied a maximum of only 2 of the seven steps. None of these companies were able to avert damage to reputation, because they did not display an astute management performance during the incident. Therefore, these companies suffered dismally: Regal Bank and Saambou Bank, Leisurenet, NRB Bank and Brait Bank did not survive the consequences. Profurn, however, managed to hold on, as it received assistance from major stakeholders.

Local companies that showed empathy with employees, as well as a commitment to BEE legislation, elevated their reputation; for instance, Anglogold Ashanti and Sasol. This is also apparent from the share price of the respective companies one month after the incident or event.

Again, companies with established names were better suited to deal with an event or crisis. The action that was taken appeared to be more responsibly handled by the more established companies, and there was evidence that the companies concerned had an action or contingency crisis recovery plan. Prompt and open disclosure with effective action also limits damage. This enabled the companies to respond swiftly, and by applying the same factors as used in the Johnson and Johnson case, they were, therefore, able to recover unscathed from the crisis or event.

9.3.3 Summary

Company	**Event**	**Successful**	**Impact on reputation**	**Number of the 7 steps satisfied**
Anglogold Ashanti	Bribe paid to militia rebels	Yes	No	5/7
Pick and Pay	Product tampering	Yes	No	5/7
Sasol	Explosion at plant	Yes	no	6/7
Corpcapital	Lack of governance	Yes	yes	4/7
Metcash	Vat penalty	No	yes	3/7

Company	**Event**	**Successful**	**Impact on reputation**	**Number of the 7 steps satisfied**
Mercantile Lisbon Bank	Downgrade by Fitch and theft	No	yes	2/7
Regal Bank	Accounting irregularities and fraud	No	yes	0/7
Saambou Bank	Downgrade by Fitch and lack of governance	No	yes	2/7
Leisurenet	Fraud and accounting irregularities	No	yes	2/7
Profurn	Investigation by SARS	No	yes	1/7
New Republic Bank	Failed due diligence	No	yes	1/7

9.4 Secondary Objectives

In chapter 1, the secondary objectives of depicting how internal, as well as external, factors have an impact on the reputation of the company were introduced. However, it is evident from the results analysis of paragraph 9.3 that the external factors display a, purely, secondary role in terms of impact on reputation. Rather, it is management's role that is primary in averting any negative consequences to reputation. However, this research does require further consideration.

9.5 Reputational management

A key element in reputational management is the development of an effective reputation risk management model. A company must have a contingency plan to deal with specific types of risk, should they occur. Therefore, management that deals with this kind of emergency must be on standby with a tried-and-tested model. An event can be sudden and totally unexpected, or it can gradually develop into a crisis situation. A reputational event is defined as any situation that can interfere with normal operations, attract close external scrutiny, damage the bottom line, escalate in intensity, and jeopardise the positive public image of the company or its leaders.

As Chambers (2001) states, reputation management is about avoiding and deflecting the negative, and about cherishing and projecting the positive. It entails the pro-active management of reputation risk, as well as appropriate reactive responses to reputational opportunities and threats.

9.6 Limitations and areas for further research

Avoiding damage to reputation requires further consideration, because reputation is an asset and must be treated as such. A good reputation is also beneficial to the company and all its stakeholders. Although a model to reduce reputation risk has been discussed above, it is not a flawless model.

The factors discussed above need further study and research, in the form of questionnaires aimed at the individual companies. This will attain an exact analysis of the actions followed by management during the event. The research to garner solutions in this study was based on archival records.

9.7 Summary

The factors, which led to the recovery, or non-recovery, in implementing a reputation risk management model, were discussed in the previous chapter. In addition, a recommendation was submitted, on a proposal basis, for the implementation of a reputation risk management model.

Important steps in risk management include the following: companies must make early disclosure and accept responsibility for the event; all information should be disclosed and the event should be explained fully; appropriate leadership must be selected to handle the event, and the company must rebuild confidence. Another recommended factor is to restructure, in order to enhance credibility. Lastly, the company must satisfy all requirements related to legislation.

These steps taken from the model will assist the company in recovering from the crisis/event with minimal damage. Further research should, however, be considered, as this research is exploratory.

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