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The value of a good reputation

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Terrorist strikes and the fallout of war may be uppermost in the minds of risk managers. But the loss of corporate reputation, potentially far harder to plan for and manage, is causing almost as much concern.

A recent survey by Aon, the insurance broker, of more than 100 European companies found that loss of reputation was seen as the second biggest threat after business interruption. Yet few are dealing with the threat. Only 22 per cent had a formal strategy to manage brand and reputation risk, leaving the others "seriously exposed to the unexpected", according to Aon.

Patrick Thomas, Aon's European development director, says companies should audit their risk profile across their business, not just in the areas where the law, or their insurers, require them to. "Risk management should be part of a company's radar, identifying both emerging threats and opportunities."

Reputation requires constant attention, especially in the internet age and after scandals such as those of Enron, Andersen and Ahold, which have battered trust in public companies and the systems meant to regulate them. The continuing fallout from these scandals highlights the devastating impact on shareholder value, as well as jobs and pensions, when reputation is lost.

A few high-profile companies such as General Electric seem to endure through thick and thin with their reputations unsullied. But even these fortunate few cannot afford to be complacent. BP's Alaskan oil well accidents and a pollution lawsuit against it in California have raised uncomfortable questions about the group's painstaking efforts to establish itself as a leader in environmental concerns.

Enterprise risk management - the term used for prioritising and managing risks across the business with the aim of improving shareholder value - has been much talked about but slow to take off. A survey last year by accountancy firm KPMG, focusing on US companies with revenues of more than \$500m, found that only 28 per cent used it.

It is probably no accident that GE was the most frequently cited example in the survey of a company that was good at enterprise risk management.

Too often risk management takes place piecemeal in separate departments, says Ted Senko, KPMG's national partner in charge of management assurance services. "The board has to take a strategic overview. Corporate governance in America maybe lost touch with that."

Managing reputational risk across the business is time-consuming. Half the 25 multinationals surveyed recently by Environmental Resources Management, an international consultancy, spend more than 500 working days a year tracking environmental and corporate social responsibility issues. Nearly 30 per cent allocate more than 1,000 days to this.

These companies, arguably in the vanguard, use electronic news updates, media tracking and participation

in industry working groups as their main ways of keeping abreast of developments in their sectors. Even so, the study finds that 60 per cent are not managing potential risks in a systematic way and 36 per cent feel they are not on top of the big issues affecting their sector.

Companies in risk-strewn sectors such as energy and mining tend to be well versed in managing such issues. Other sectors are less amenable. When Business in the Community, the UK charity, published its first Corporate Responsibility Index rankings this month, companies including Reuters, the media group, were furious they had been marked down on issues they saw as irrelevant to their business. "To assess us in terms of global warming and solid waste is farcical," said Reuters.

The index is a web-based tool for companies to measure how well they translate their values and strategy into responsible practices in the workplace, the community, the environment and the marketplace. The premise is that companies are no longer judged on one activity, such as employee volunteering, separate from wider issues including corporate governance.

Institutional shareholders are becoming increasingly vocal about risks to the reputation of companies in which they invest, adding to pressure for greater disclosure from campaign groups and governments.

The Association of British Insurers, whose members account for more than 20 per cent of investments in the London stock market, is achieving some success with its disclosure guidelines. These call on companies to state in their annual reports that they have assessed the business and reputation risks arising from the way they manage social, environmental and ethical issues.

Just under 30 per cent of FTSE 100 companies made full disclosure and 37 per cent adequate disclosure in the first year. The best performers were in high-risk sectors such as tobacco, chemicals and utilities.

However, sectors such as information technology, distribution and leisure have not sufficiently acknowledged their risks, says the ABI. "This includes the retail sector, where supply chain management can have a large impact on a company's reputation."

Peter Montagnon, the ABI's head of investment affairs, says constructive engagement with companies is not always easy. "A lot were happy to produce lengthy CSR reports with glossy pictures but were less happy to put in their annual reports that the board had considered these risks, because then there's accountability."

One UK retailer that has adopted an integrated approach to risk and reputation management, to plaudits from the ABI, is Marks and Spencer. The company, which also emerged at the top of BITC's corporate responsibility rankings, has had its share of reputational difficulties, notably over the handling of its French store closures in 2001.

The M&S structure includes a corporate governance department. This provides information and guidance to the group operating committee, chaired by the chief executive, and to the board's remuneration, nomination, audit and corporate social responsibility committees. Each of the group's businesses assesses its risks - including social and environmental ones - according to how likely they are to materialise and how painful their impact on the brand's reputation. Red is for danger, amber for "keep watching" and green for insignificant. Twice a year Roger Holmes, the chief executive, formally presents the group's risk profile to the board.

Mike Barry, sustainable development manager, says the company's main reputational concerns are product safety, sustainable raw materials, animal welfare, ethical trade and communities. He says reputation risk management extends not only "upstream" to the companies' suppliers but also "downstream" into what consumers do with M&S products - for example, how much energy they use in washing a pair of M&S trousers.

Mike Morley-Fletcher, head of risk assessment, says the aim of the strategy is not to avoid risks -

impossible in business - but to ensure that they are taken intelligently and managed properly and are transparent to stakeholders. It is also about gaining a competitive edge by being in control of risks and securing a "licence to sell".

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