

## REPUTATIONAL CRISIS: SAVING THE MOST VALUABLE A COMPANY'S ASSET

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### Abstract

The paper deals with presenting the concept of reputational crisis as an issue in its own rights rather than just one of subsequences of any other crisis. Growing interest in reputation crisis management is determined by acknowledging a company's reputation to be a valuable corporate asset that has to be managed and protected, as well as growing environmental pressure to a company to be best and reliable player. Growing power of media should be acknowledged as one of the most important factors determining reputational crisis' run and outcome. Despite growing concern in protecting ones reputation, there is still more case studies of reputational crisis than theoretical conceptualizing of crisis in a company's reputation.

The *paper aims* at revealing the construct of reputational crisis. The following four *questions* presented below are being discussed in the paper: *how* can be a company's reputational crisis defined? *what* are the possible sources of reputational crisis? *what* are the possible consequences of reputational crisis? *what* should be a company's response to reputational crisis? The *research method* of logical, systematic and comparable analysis of scientific literature was applied.

In the paper the definition of reputational crisis is generated; the possible sources (from social irresponsibility, too aggressive and shocking marketing, inadequate behaviour of leaders, up to failure to comply with regulatory obligations, defamation, etc.) highlighted and possible subsequences of reputational crisis are presented. Additionally, a company's response to reputational crisis is discussed and some guidance for dealing with reputational crisis presented.

*Keywords:* corporate reputation, reputational crisis, reputational capital.

### Introduction

Corporate reputation is an asset of immense value. It has a great potential to impact a company's competitiveness and performance results through influencing stakeholders' decisions and actions towards the company. The benefits of positive reputation are widely presented by number of researchers (Fombrum, 1996; Dowling, 2001; Dalton and Croft, 2003; Jackson, 2004; Eccles, Newquist and Schatz, 2007; etc.). Yet, acknowledging the value of reputation always goes along with perceiving a company's limited abilities in managing reputation and difficulties in protecting it. Due to its intangible and social-psychological nature, and dynamic environment it takes long to create ones strong positive reputation, but it may be destroyed very rapidly. Furthermore, usually the value of corporate reputation is ascertained only in crisis when a company faces negative publicity, negative stakeholders' perceptions and all the subsequence related to it.

Risk managers and researchers agree that any type of crisis – technological, ecological, product failure, etc. – might cause a decrease in reputational capital of a company. Moreover, due to growing importance of corporate reputation, researchers emphasize the necessity to treat reputational crisis not only as a subsequence of any other crisis but “an issue in its own rights” (An Economist Intelligence Unit white paper, 2005). Already in 1986 while presenting nine types of crises in business, Meyers and Holusha discuss crisis in public perception as number first of all the crises (today this issue can easily be called reputational crisis).

Despite growing interest in corporate reputation management and infinite public relations' advice for crisis communication, the reputational crisis as a research object still lacks conceptualizing. Most often reputational crises are being analyzed presenting case studies from business practice. The case of Arthur Andersen's fall in 2002 and Tylenol of Johnson&Johnson poisoning case in 1982 are being presented oftentimes as good examples illustrating the magnitude of damage reputational crisis may bring. Such cases demonstrate necessity to cognize better the phenomenon of reputational crisis both in theoretical and empirical levels. And the first start should be defining what reputational crisis is, presenting insights where it may come from, and what the possible outcomes are.

The *paper aims* at presenting the construct of reputational crisis. The following four *questions* presented below are being discussed in the paper: *how* can be a company's reputational crisis defined? *what* are the possible sources of reputational crisis? *what* are the possible subsequences of reputational crisis? *what* should be a company's response to reputational crisis?

Seeking answers to the problem questions highlighted above, the following *research method* was applied: logical, systematic and comparable analysis of scientific literature.

## Defining reputational crisis

Reputational risk management and reputational crisis management are the matters of great concern. And this might be easily illustrated by growing number of case studies of well-known companies' reputational crises presented in academic literature (Johnson&Johnson Tylenol poisoning case, Arthur Andersen fall, Coca-Cola employment related lawsuits, etc.). The survey report presented by the Economist Intelligence Unit white paper (2005) points out reputational risk to be the most significant threat to business (on the survey 269 senior executive for managing risk made choice out of 13 categories of risk).

There might be indicated two interrelated reasons for growing interest in reputational crisis management: 1) acknowledgement a company's reputation to be a valuable corporate asset that has to be managed and protected (Ashcroft, 1997; Fombrum, 1996; Dowling, 2001, Dalton and Croft, 2003, etc.); 2) growing environmental pressure to a company to be best and reliable player. The first goes along with understanding that cost of losing trust in some stakeholder groups can be very high (Zaman, 2003); and you may never restore lost reputation. The second – growing pressure to a company – is determined by the following reasons:

- *Increasing stakeholders' sophistication and calibre.* This determines that stakeholders' expectations to a company, its products, behaviour, etc. are bigger and more sophisticated.
- *Sharpening competition* that gives more choice opportunities for stakeholders.
- *Increasing public awareness* of the impact that business has to a society (Freeman *et al.*, 2007) and rise of social responsibility (Dalton and Croft, 2003).
- *The emergence of environmentalism* as one of macro changes in business (Freeman *et al.*, 2007).
- *The rise in NGOs and pressure groups* such as Greenpeace, etc. (Genasi, 2002; Dalton and Croft, 2003). Or reference to Davies *et al.*(2003), pressure groups specialize in 'emphasizing the emotional aspects of an issue, leaving company management floundering with their more factual platform'.
- *Advance in technology* (eg. Internet). For instance, 'consumers now have instant access to vast amounts of data and knowledge: the internet allowed access to people who previously had no effective way of gaining such data and at hardly any cost or effort' (Dalton and Croft, 2003).
- *Growing power of media:* media's 'insatiable appetite for scandal' (Dalton and Croft, 2003), media's 'scrutiny and speculation' (Dowling, 2001), media's aggression (Genasi, 2002), media's escalation of an incident into crisis (Dowling, 2001, on reference to Nash T., 1990), etc.

The statements presented above lead to acknowledging reputational crisis to be not only a subsequence of other – technological, ecological, product failure, etc. – crises but a "an issue in its own rights" (An Economist Intelligence Unit white paper, 2005). Reputational crisis indicates possible damage to a company's reputation: decrease or significant loss of trustworthiness, reliability, esteem and favourability among stakeholders. Reputational crisis can be defined as a non-routine, build up gradually or occur suddenly event (not necessarily a catastrophic one) or series of events that cause significant reputational damage due to failure to meet reasonable stakeholders' expectations. Reputational crisis usually goes hand in hand with high publicity and intense media involvement.

## Possible sources of reputational crisis

The reputational crises may come step-by-step or may appear unexpectedly; they might be caused by one incident or serious of events. Brown (2007) indicates that some reputational crises might be either accidental (caused by careless talk, etc.) or deliberate (caused by sabotage of others, etc.).

The sources of reputational crises vary: from emitted pollution, industrial actions, and failure to comply with regulatory obligations (An Economist Intelligence Unit white paper, 2005), product failure up to unacceptable marketing actions (eg. too intensive or shocking promotion) or employee disputes, etc. Most of them are caused by a company's failing to act in a way stakeholders' expect company to act or think it should act in some particular situation due to existing norms in the company's environment. However, one more some different kind of sources of reputational crisis might be identified – possible sabotage, aspersion and other issues far from being real but having much potential to cause reputational damage. This is due to socio-psychological nature of reputation, and information's powerful impact on ones reputation.

Dowling G. (2001) claims that many crisis are caused by two interacting sets of failures:

- RIP (Regulatory, Infrastructure, and Preparedness) failures in the organization's operating environment;
- HOT (Human, Organizational, and Technological) factors inside the organization.

On the reference to Atkins *et al.* (2006), Jackson (2004), Neef (2003), Dalton and Croft (2003), Davies *et al.* (2003) and Genasi (2002), the following sources of reputational damage and crisis might be identified:

failure in management decisions, employees and employment related issues, marketing and customer related issues, health and safety issues, unacceptable environmental impact of corporate practice, other unacceptable corporate behaviour (social irresponsibility, unethical behaviour, etc.), technological failure, reverse financial results of performance (*see table 1*). All these sources are tightly related to an organization’s practice and behaviour, and each of them might be escalated and discussed widely. For instance, Neef (2003) presents employment-related issues that may evolve to huge reputational crisis. These are: layoffs and downsizing policies, discrimination and disregard of equal opportunities at work, sexual harassment, etc. that lead to lawsuits, strong media involvement and publicity, and reputation damage.

**Table 1.** Possible sources of reputational crises

| Sources of reputational crises                 | Explaining sources of reputational crisis on reference to scholars |                         |  |                                  |                                     |  |
|--|--|-------------------------|--|----------------------------------|-------------------------------------|--|
|  | Atkins <i>et al.</i> (2006)  | Jackson (2004)          | Neef (2003)                                    | Dalton, Croft (2003)             | Davies <i>et al.</i> (2003)         | Genasi (2002)                            |
| <i>Failure in management and governance</i>    | Executive performance  | Misdeeds of leaders     | Corporate governance                           | Management decisions             | Disasters caused by bad management  |  |
| <i>Employees and employment related issues</i> | Employees  |                         | Employment<br>Human rights<br>Workplace safety | Human error                      | Disasters caused by employees       | Employee disputes                        |
| <i>Customer and marketing related issues</i>   | Customer relations<br>Products and services                        | Marketing gaffes        |  |                                  | Product boycott                     | Consumer complaints<br>Recalled products |
| <i>Health and safety issues</i>                | Health and safety  |                         | Product safety issues                          |                                  |                                     |  |
| <i>Unacceptable environmental impact</i>       | Environmental policies   |                         | Environmental policies                         |                                  |                                     | Pollution emitted                        |
| <i>Unacceptable corporate behaviour</i>        | Unacceptable behaviour   | Social irresponsibility |  |                                  |                                     | Lawsuits                                 |
| <i>Technological failure</i>                   |  |                         |  | Mechanical or technology failure |                                     |  |
| <i>Financial performance results</i>           | Financial performance  |                         |  |                                  | Restatement of a financial position |  |
| <i>Others</i>                                  |  |                         |  | Acts of God                      | Sabotage<br>Fraud                   |  |

*Note: white boxes indicate that sources of reputational crises indicated and presented left might be not pointed out by the referred scholars.*

On reference to The Economist Intelligence Unit white paper (2005), the biggest threats to corporate reputation are ‘failure to comply with regulatory or legal obligations’, ‘exposure of unethical practice’ and ‘security breaches (eg. sensitive data leaks, hacking of customer financial data)’. Additionally, Jackson (2004) presents some more sources of reputational damage in more wider context of multinational corporations: exploiting people, being unfair competitors, purveying harmful products, disrupting local economies, contaminating cultures, etc.

The source of reputational crisis definitely makes an impact on the run of the crisis; but this factor is not the single one that determines the consequences of it.

### Consequences of reputational crisis

The consequences of reputational crisis are not the same at any situation. On reference to Dowling (2001), the impact of a crisis on reputation is determined by the following three factors:

1. The level of favorability (or unfavorability) of the reputation before crisis;
2. The type and magnitude of crisis.
3. The amount and tone of media publicity.

According to Davies *et al.* (2003) crises are often expensive in the short-term but rarely appear to damage companies in the long-run if they are handles well. The insight based on this statement should be presented as the fourth factor determining the consequence of crisis: level of damage to reputation is also determined by a company’s actions and behavior during the crisis.

The importance of all the fourth factors might be illustrated by Johnson&Johnson Tylenol poisoning case. On reference to Murray and Shohen (1992), Davies et al. (2003) points out that Johnson&Johnson survived Tylenol crisis for the following reasons: (a) a strong and positive reputation before crisis; (b) being open with media; (c) the chairman took clear and public command; (d) the media presented position that Johnson&Johnson were not to blame.

Genasi (2002) do also claim that reputational crisis do not necessarily lead to a company’s crash. On reference to him, a company crisis can bring ‘your company a standstill, but handled well it can build you reputation back up to a higher level than before the incident’. Yet, if not handled well, the outcome of reputational crisis leads to decrease in reputational capital that evidences in significant lost of stakeholders’ trust and confidence in a company and its abilities to keep the expected obligations to consumers, employees, community, business partners, investors and other stakeholders. And it is not just damage to reputation; this negatively will impact a company’s abilities to attract material and non-material resources, as well as initiate and affiliate, and maintain relations with stakeholders (*see table 2*).

**Table 2.** Possible consequences of reputational crisis among stakeholders

| <b>Stakeholder group</b>       | <b>Consequences of reputational crisis</b>   |
|--------------------------------|--|
| <i>Customers</i>               | <ul style="list-style-type: none"> <li>• Few abilities to attract new customers;</li> <li>• Discourage of loyalty of current consumers;</li> <li>• Loss of sales;</li> <li>• Less acceptance of new products;</li> <li>• Less abilities to charge additional prices;</li> <li>• Less support while entering new markets.</li> </ul>  |
| <i>Business partners</i>       | <ul style="list-style-type: none"> <li>• Worse access to the best professional service providers (eg. ‘the best advertising agencies want to work for the best clients – so they can ‘rent’ their clients’ good reputation’; Dowling, 2001)</li> <li>• Limited abilities to attract new business partners;</li> <li>• Limited abilities to maintain current business partners;</li> <li>• Loosing important relations with suppliers, distributors, etc.</li> <li>• Decrease in bargaining power.</li> </ul> |
| <i>Employees</i>               | <ul style="list-style-type: none"> <li>• Less opportunities to attract and recruit top employees;</li> <li>• Failure to retain good staff;</li> <li>• Discourage of employees’ loyalty (for the future of the company’s survival and development is not clear);</li> <li>• Decrease in employee motivation and satisfaction.</li> </ul>  |
| <i>Investors</i>               | <ul style="list-style-type: none"> <li>• Less opportunities to attract investors</li> <li>• A company is perceived as risky for investments.</li> </ul>  |
| <i>Shareholders</i>            | <ul style="list-style-type: none"> <li>• Loss of share price.</li> </ul>   |
| <i>Community</i>               | <ul style="list-style-type: none"> <li>• Less community support.</li> </ul>  |
| <i>Regulatory institutions</i> | <ul style="list-style-type: none"> <li>• More attention and supervision of coordinating institutions.</li> </ul>   |

Doorley and Garcia (2007) point out that organizations suffering the same crisis can ‘experience dramatically different outcomes’ due to quality of their respective response. According to the authors, the outcomes of reputational (as well as any other) crisis is determined more by a company’s response than the underlying event – severity of the crisis. This naturally leads to seeking an answer to a question of what a company’s response to reputational crisis should be.

### **A company’s response to reputational crisis**

In the context of managing a company’s reputational crisis most scholars agree that ‘primary success comes from prevention, preparation and intervention’ (Kash and Darling, 1998). Thus, the following three phases in reputation crisis management should be indicated:

- 1) *Prevention* comes from shaping positive corporate reputation among stakeholders before crisis. Positive reputation settled among stakeholders over a long period of time plays a role of shield during the crisis and softens negative impact of crisis. On reference to Dalton and Croft (2003), positive reputation communicated to required stakeholders give much better opportunities to 'ride out a storm'. Coombs and Holladay (2006) do also consider prior reputation as a factor helping to facilitate reputation's repair.
- 2) *Preparation* includes measuring and monitoring changes in corporate reputation (the results might be a good indicator for step-by-step coming crisis) and creating various scenarios for possible reputational damage (the scenarios allows to be prepared for sudden and accidental crisis), analyzing scenarios, choosing communicational team and strategies. Preparation is essential for some issues might be fixed before evolving into crisis. Haywood (2005) stresses the necessity for having a reputation protection plan as a form of reputation insurance. Though, it should be admitted that in practice 'too often companies become aware of such reputational issues only when it is too late – when a scandal looms or a crisis has already hit' (Fombrum, 1996).
- 3) *Intervention* includes a company's actions and communication during the crisis.

Thus, dealing with reputational crisis tree parallel reactive responses should be undertaken: 1) timely and effective communications to stakeholders and mass media; 2) operational responses (eliminating causes of reputational crisis), and 3) behavioural responses (accepting responsibility, demonstrating remorse, etc.). Nonetheless, it should be admitted that discussing a company's intervention activities most researchers focus on communicational issues: crisis communicational programs and strategies, choose of appropriate communicational instruments and channels, etc. Ashcroft (1997) points out that during crisis effective information management is vital, and basic rules are: appropriate apologies and speed of media coverage. Dowling (2001) do also suggest step number one to be an immediate communicational response explaining what happened, why, and what the company is going to do about it (Dowling, 2001). The need for quick and well-prepared communicational response during reputational crisis can be explained significant increase of a need for information among stakeholders during any crisis. Necessity of communicational response might be illustrated with the help of following insights:

- 1) 'The extent to which a person blames a company results largely from how the person perceives the cause of the incident' (Dowling, 2001). Therefore, a company must present what has happened and deliver reasons of the event.
- 2) Stakeholders contact each other for outrage, debate and information. A crisis can therefore easily become a time of chaos (Fjeld and Molesworth, 2006).
- 3) If the company do not deliver its position and explanation, the media will find someone else to interview, such as an eyewitness or an independent expert (Dowling, 2001);
- 4) If the company procrastinate talk to the media, management is perceived as incompetent, confused or as withholding information (Dowling, 2001);
- 5) In internet people, rather than just passively read information, actively discuss such an events, (Fjeld and Molesworth, 2006), spread their interpretations and perceptions (no matter if they are reality or not).

The strategies for crisis communication may vary from keeping your head down to blaming risky business or someone else, etc. Yet, on reference of Dowling (2001) communicational response should go along with demonstrating remorse and even taking some punishment which stakeholders consider should be handled out to the guilty party. This highly illustrates that communicational response should include both rational and emotional elements. Some stakeholders might do not understand rational explanations (especially in technological crisis), but they certainly do understand a company's emotional appeal. Nevertheless, Davies *at al.* (2003) points out that many organizations 'appear to ignore the emotional aspects of a crisis'.

In summary, saving ones reputation or seeking to minimize possible damage to reputation, tree parallel reactive responses should be undertaken: timely and effective communications to stakeholders and mass media; operational responses, and behavioural responses. Beyond reactive actions, proactive reputation risk management plays great role in reputational crisis; for past reputation acts like a protecting shield and softens striking negative impacts during a crisis.

## Conclusions

1. Reputational crisis can be defined as a non-routine, build up gradually or occur suddenly event (not necessarily a catastrophic one) or series of events that cause significant reputational damage due to

failure to meet reasonable stakeholders' expectations. Reputational crisis usually goes along with high publicity and intense media involvement. Reputational crisis indicates possible damage to a company's reputation: decrease or significant loss of trustworthiness, reliability, esteem and favourability among stakeholders. Corporate reputation's value, limited abilities to shape it easy way, as well as environmental pressure to a company lead to acknowledging reputational crisis to be an issue in its one right rather than subsequence of other crisis.

2. The sources of reputational crises vary: from failure in management decisions, employee related issues, marketing and customer issues, health and safety issues, other unacceptable corporate behaviour, reverse financial results of performance, etc. Most of them are caused by a company's failing to act in a way stakeholders' expect company to act or think it should act in some particular situation due to existing norms in the company's environment. However, causes of reputational crisis might be far from being real: possible sabotage, aspersion, etc.
3. The consequences of reputational crisis are not the same at different situations and vary accordingly to a company's prior reputation before crisis, type of crisis, a company's response, and the media's involvement and position. If not handled well, the outcome of reputational crisis leads to decrease in reputational capital that evidences in significant lost of stakeholders' trust and confidence in a company and its abilities to keep the expected obligations to consumers, employees, community and other stakeholders.
4. The company's responses to reputational crisis should be: timely and effective communications to stakeholders and mass media; operational responses, and behavioural responses. Proactive reputation risk management plays great role in reputational crisis; for past reputation acts like a protecting shield and softens striking negative impacts during a crisis.

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