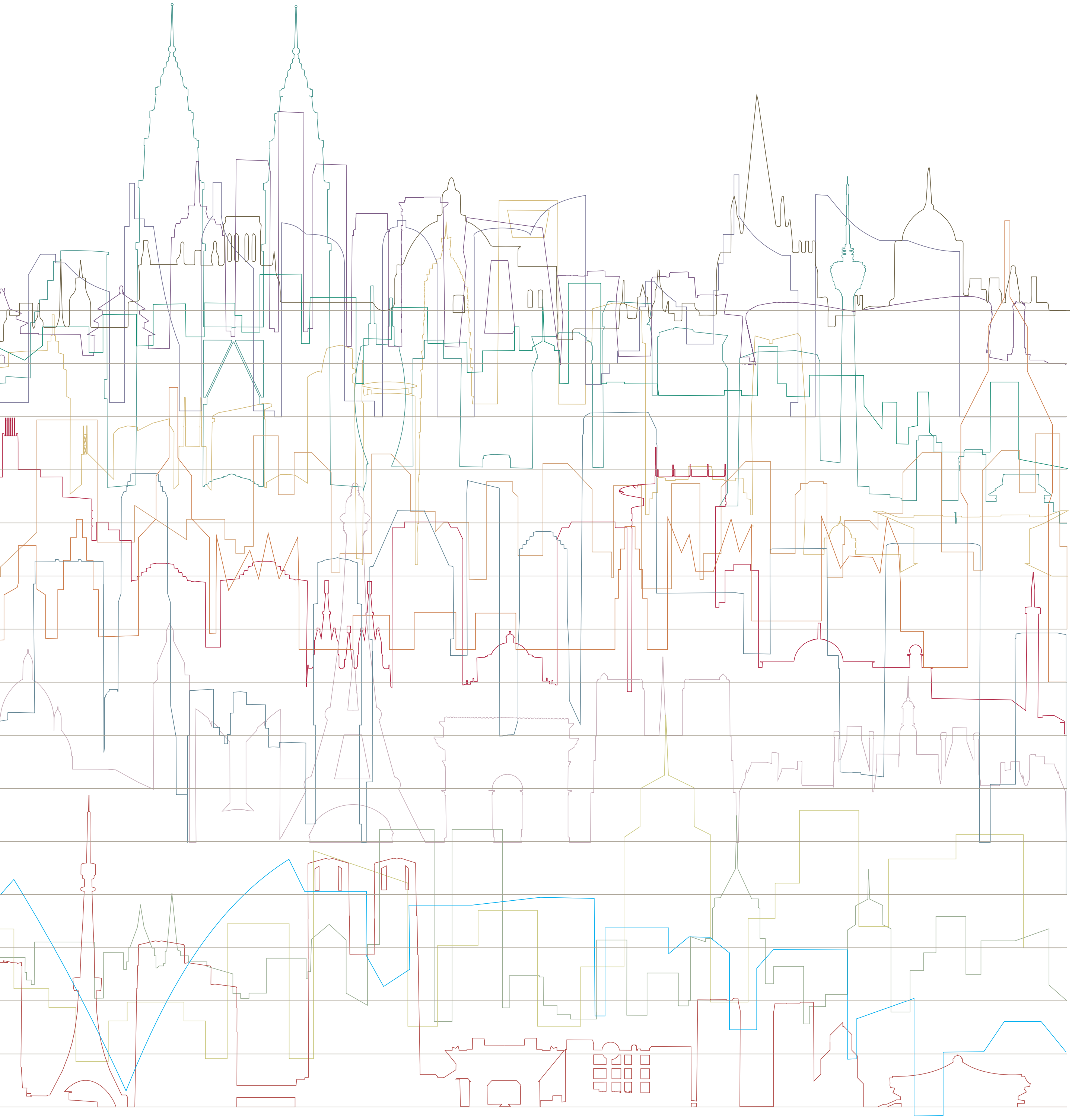
CORPORATE REPUTATION IN CRISIS: THE IMPACT ON SHAREHOLDER VALUE



Introduction

Over the past three decades there has been a succession of high profile, man-made, corporate disasters across a spectrum of industries, each involving their own environmental, human and social costs. These crises have come in all manner of forms - airline disasters, financial and other high level leadership misconduct, oil spills, product recalls and, most recently, cybersecurity breaches.

The chances that a company's senior management will have to overcome a corporate crisis at some point during their leadership are now extremely high. *PwC*[1] found that 69% of leaders experienced at least one corporate crisis in the past five years. That study also found that a variety of causes can trigger a corporate crisis, ranging from operational and technological issues to humanitarian and financial problems.

REPUTATION HAS A MAJOR IMPACT ON SHARE VALUES

Therefore, understanding how such events impact a firm's reputation and ultimately translate into a loss or gain in shareholder value is vitally important. The insights from our research are intended to help management view reputation as a strategic asset and enable them to manage their reputational risk so that that they are better prepared in times of crisis.

Our research reveals that the impact of reputation on shareholder value is far broader and more complex than previously thought. However, destruction of shareholder value is avoidable, and a reputational crisis can paradoxically provide an opportunity for a company to enhance shareholder value. Ultimately, recovery depends on how swiftly and effectively management responds.

Winners and losers

Firms emerging from crises, as Figure 1 shows, fall into two clearly distinct groups: those that recover well after the crisis and ultimately go on to increase value, "winners" and those that suffer long-term, "losers". As one would expect, all crises have immediate negative effects on value. However, this initial loss is lower for "winners". These lose less than 5% in value at first, in contrast to a loss of over 11% among "losers". Furthermore, after approximately thirty trading days "winners" start to show sustained recovery in value. After 250 trading-days they even add a further 10% in value. The value added measured is alpha, representing the risk adjusted return over market movements. By contrast, the "losers" suffered a 15% reduction in value.

CRISIS IS OPPORTUNITY

FIGURE 1. **The impact of crises on share prices**

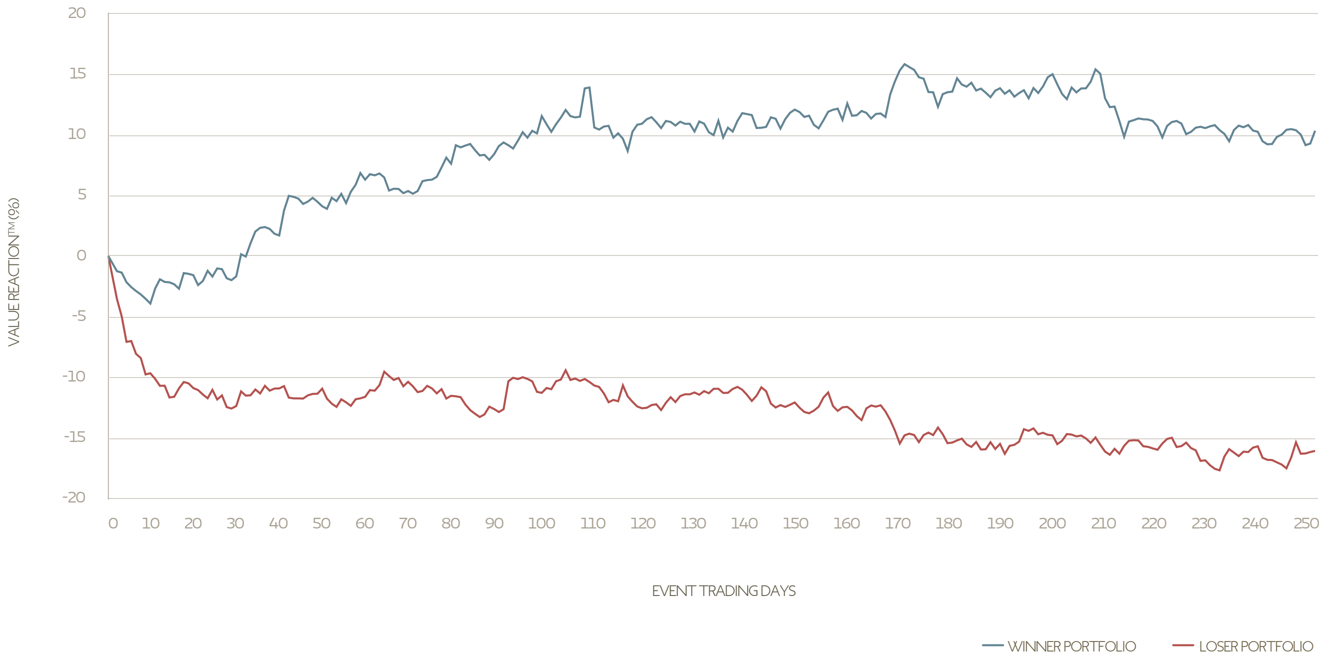
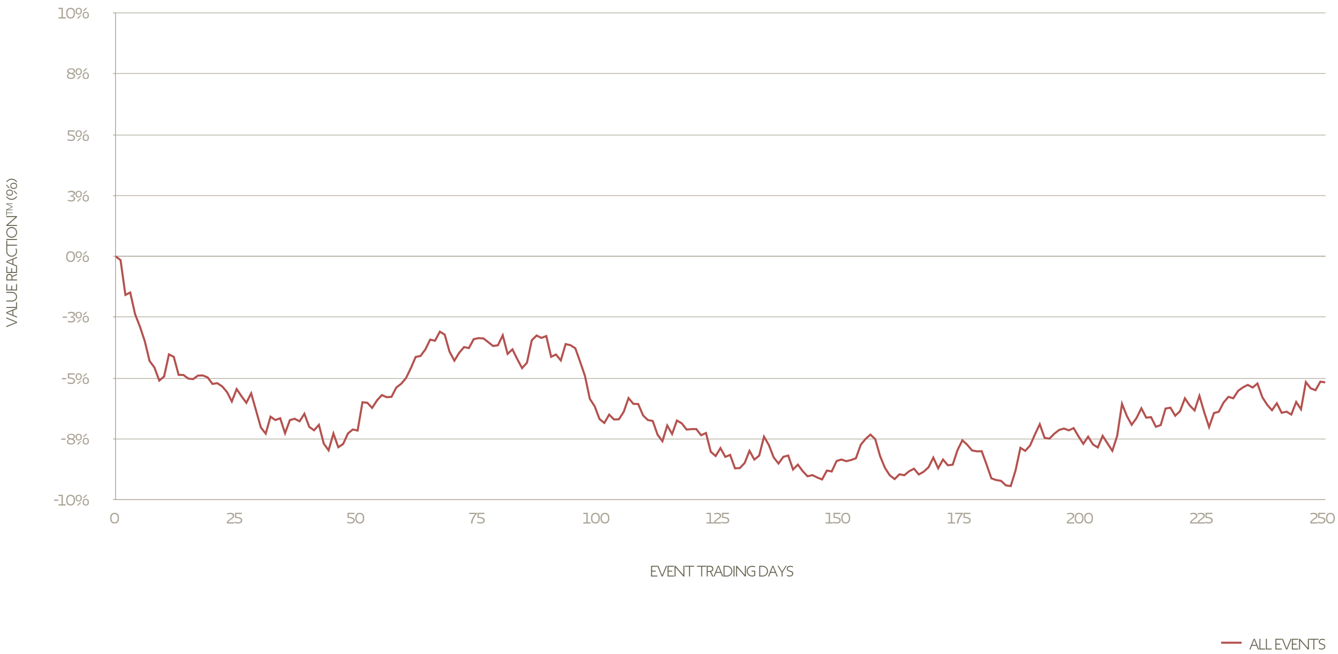


FIGURE 2. **The impact of events since 2008**



It is clear that in the aftermath of a corporate crisis all is by no means lost for a firm and its shareholders. Several factors determine whether a firm emerges with a positive or negative impact after a crisis. One is the nature of the financial loss incurred in the crisis, for instance how far insurance limits a reduction in the firm's cash flow. However, our research shows management responsiveness is the key determinant of whether value is created or lost. The market's evaluation of the effectiveness of management's response to the event, together with its assessment of the scale of, and confidence in, the company's future cash flow, determines whether shareholder value is lost, regained or even enhanced.

MANAGEMENT RESPONSIVENESS IS KEY

Our analysis identified some common traits among those firms which emerge as winners and those which do not. Table 1 lists the key attributes respectively of winning and losing companies.

Wide ranging impact

Our research has analysed the shareholder impact of major reputational crises since 1980, with particular emphasis on high profile corporate disasters since the 2008 financial crisis. Three criteria provided the basis for inclusion in the study:

- The disaster should be man-made
- The company should be publicly listed at the time of the event
- The crisis should attract significant public and media attention

We gathered a wide range of data from airline, retail, financial, industrial and technology industries across North America, Europe and Asia Pacific. The impact of the event on shareholder value was measured using a Value Reaction™ metric which captures the specific impact on shareholder value of the firm while controlling for market-wide effects, external risks and currency fluctuations. The dates at which the events occurred have also been aligned, again to rule out the impact of contingent factors. The large size and diversity of the international companies sampled over this extended period ensure the results have particular statistical validity and significance.

2008 changed the landscape

In order to investigate the changing nature of reputational risk our study next analysed major corporate crises since the financial crisis of 2008. Forty-five such events fell into this category. The results highlighted a number of important trends. Firstly, market reactions have become far harsher, and proportionately fewer firms are able to avoid a loss of value. Secondly, cybersecurity has emerged as a significant risk to corporate reputation. Thirdly, social media increasingly amplify the negative effects of a crisis.

Figure 2 shows that since 2008 more corporate crises have on average destroyed shareholder value, implying that management is now struggling to find responses that protect shareholder value. It reveals that that in the 250 trading days after a crisis the value lost was on average over 5%. This reflects that since the financial crisis there has been a far greater emphasis on company accountability and corporate governance. Markets have become far less forgiving of man-made crises. And in an age when information travels further and faster and is far more readily available, especially via social media, management has far fewer hiding places at its disposal when disaster strikes.

SOCIAL MEDIA LEAVE CRISIS MANAGERS FEW PLACES TO HIDE

FIGURE 3. **The impact of crises on share price since 2008**

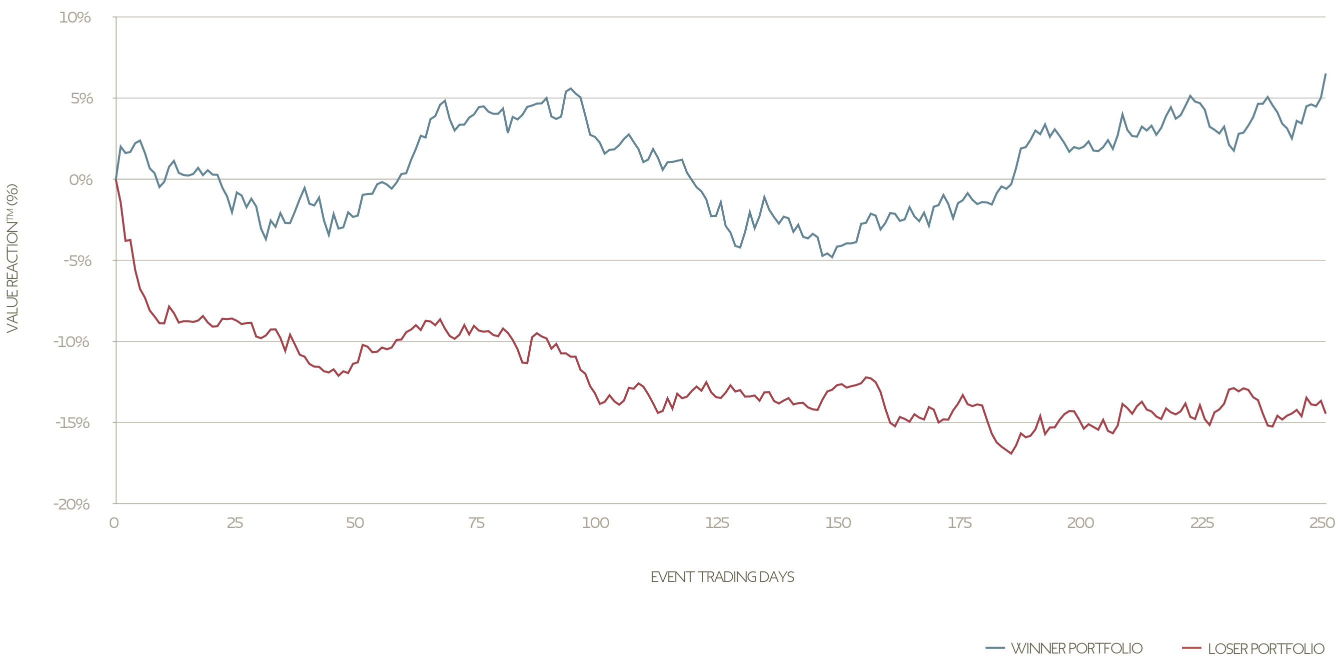


Figure 3 provides a comparison between "loser" and "winner" firms since 2008. While there continue to be two distinct groups of such firms, it is now harder to avoid a negative response. The figure highlights two other significant findings. First those that emerged positively experienced a smaller increase in value than in the period before 2008, with only 6% of value created on average compared to 10% previously. Second, the gap between the winners and the losers was narrower. These findings underline that it is now more important than ever for management to respond in a manner that turns a corporate disaster into a situation that drives shareholder value. Reputation has become a strategic asset that is increasingly crucial to manage.

REPUTATION IS AN INCREASINGLY CRUCIAL STRATEGIC ASSET

Value creators and destroyers

More detailed analysis identified some of the factors that can create or destroy shareholder value. Figure 4 shows that, since 2008, if the crisis caused loss of human life the damage to shareholder value was much more significant. On average, events involving fatalities lost 13.5% against 1.7% where no lives were lost.

Cybersecurity now a leading issue

Finally, our study analysed different types of corporate crisis to see whether certain categories were relatively more conducive to value creation or destruction in the aftermath of a crisis. Figure 5 highlights that since 2008, leadership misconduct and product failures are two types of corporate events that have been relatively well-handled in terms of impact. On the other hand, crises like cybersecurity and airline disasters are linked to significant destruction of shareholder value. It appears that if rapid and decisive action is taken - e.g., if the CEO or leader is promptly removed in the wake of leadership misconduct - the stock market reacts favourably. Thus, this swift response creates value for shareholders. The most value-destructive events have been airline disasters, losing 10.9% of value 100 trading days after the disaster. Since most airline disasters result in loss of life, this underlines previous findings that crises involving fatalities have a significant greater detrimental impact on value.

Cybersecurity breaches have occurred with increasing frequency since 2008 and have attracted growing attention reflecting mounting concern over data privacy. As a result, the market reacts markedly and negatively to firms that suffer a data hack or other breach of cybersecurity, with such firms typically losing over 6% in value 100 trading days after the breach. This result, incidentally, empirically substantiates PwC research finds that of those that expect to experience a crisis in the future, 38% expect a crisis of cybersecurity, making it the top concern[1].

CYBERSECURITY IS NOW A LEADING SOURCE OF REPUTATIONAL DAMAGE

FIGURE 4. **Impact of fatal and non-fatal events since 2008**

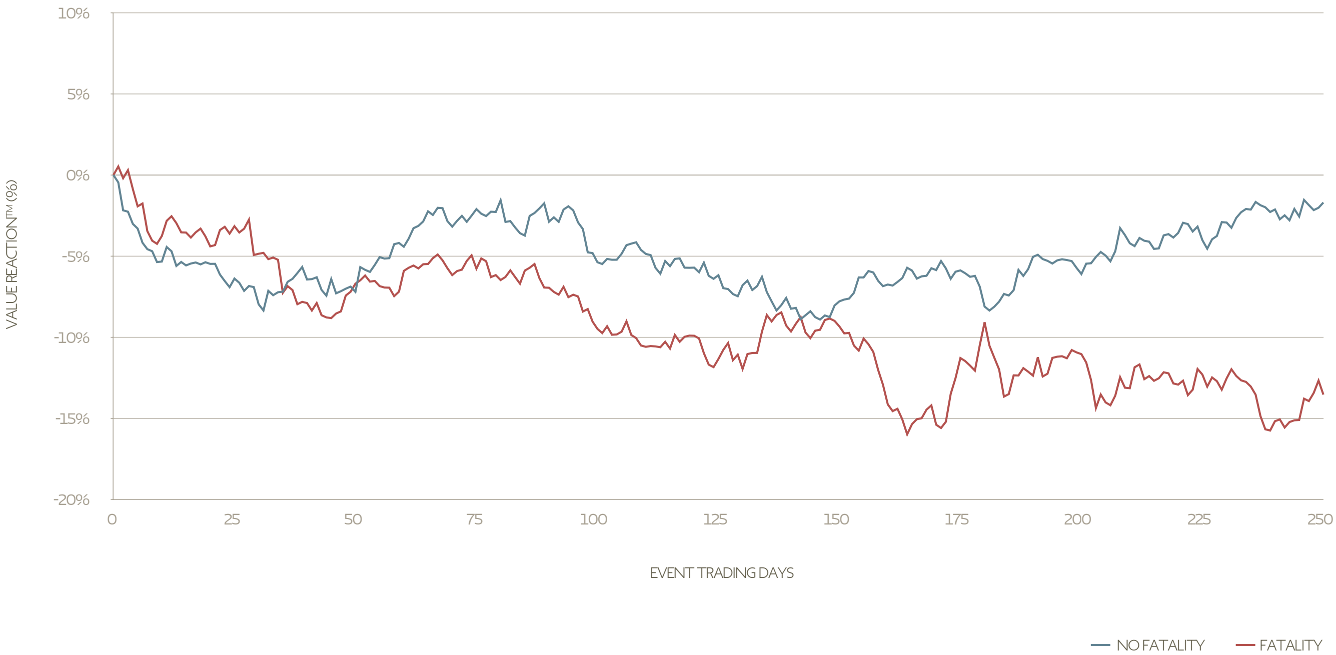
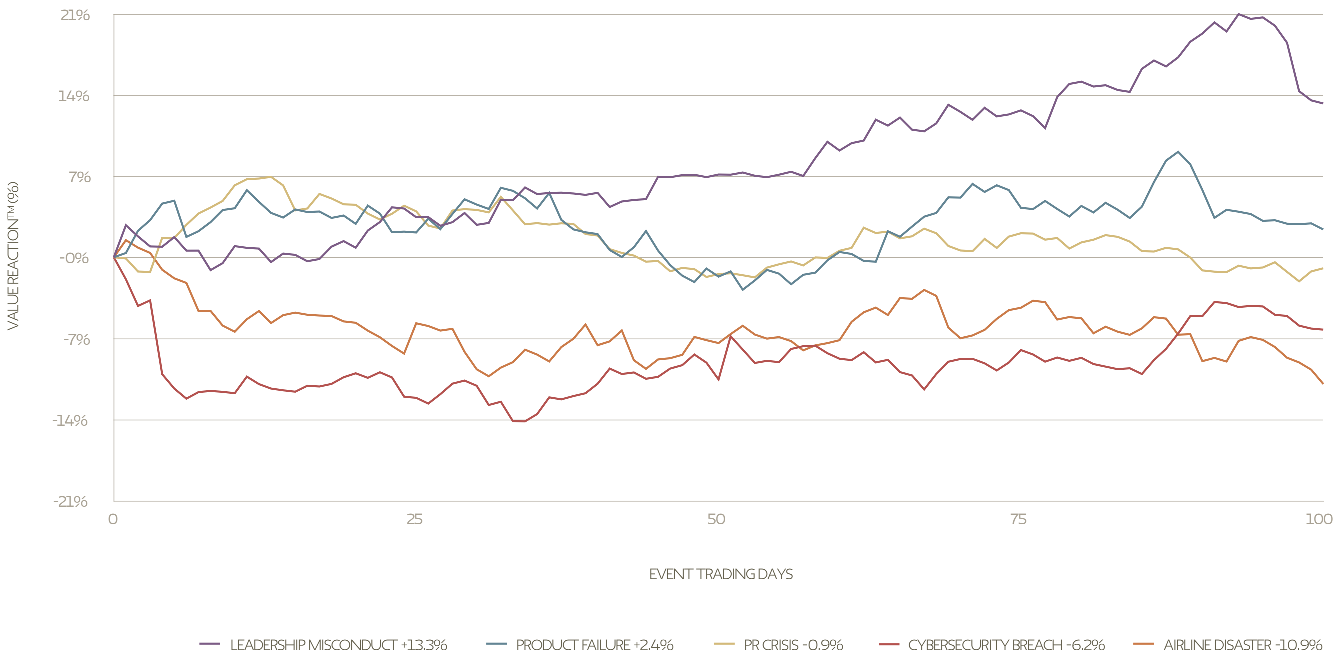


FIGURE 5. **Impact by type of crisis events since 2008**



Organisational implications and potential actions

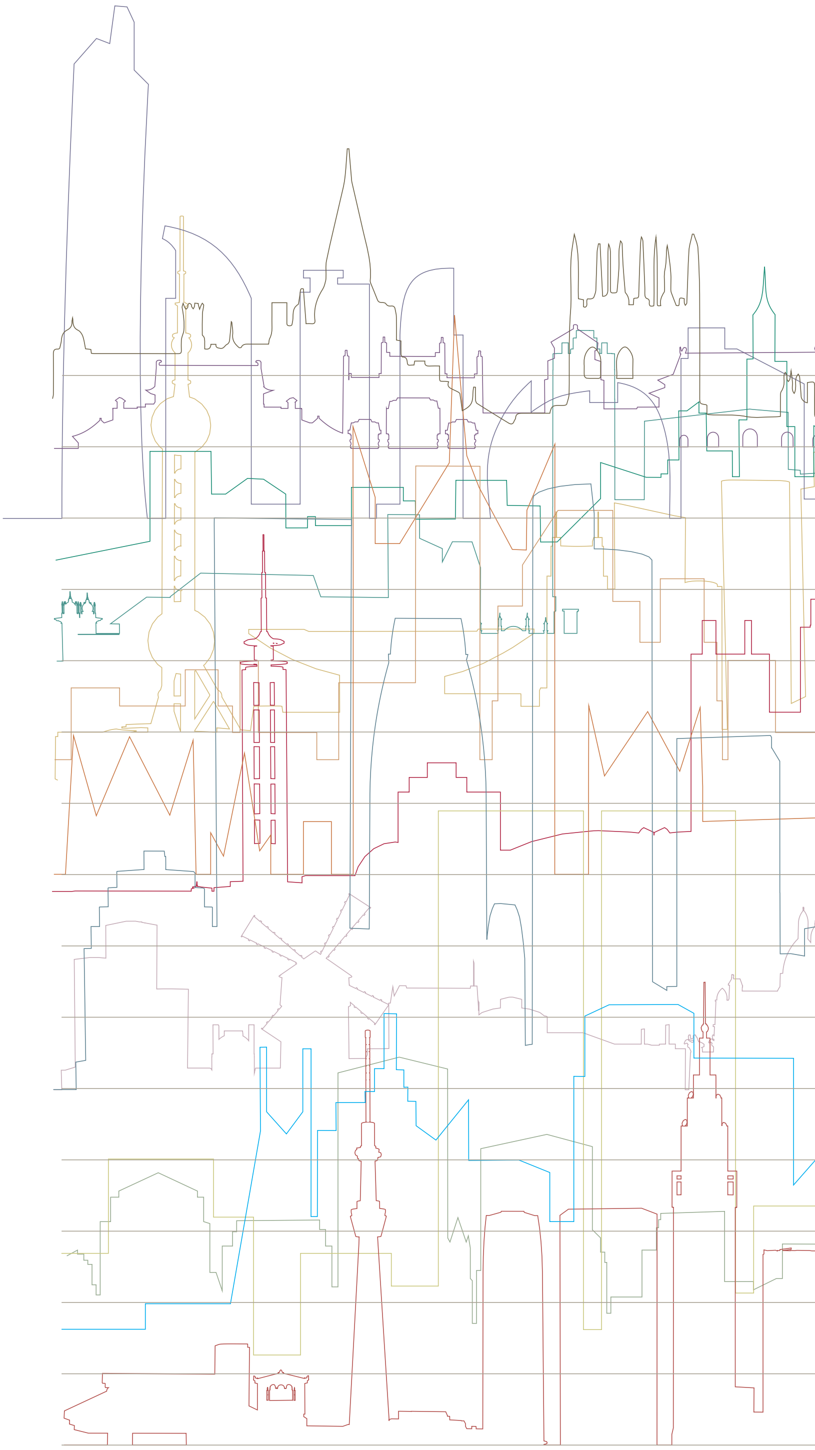
Our research presented in this paper shows that how a company responds to a crisis may have a significant impact on its shareholder value, and in fact, if the company responds in an effective manner shareholder value may even increase over time. In a world where stakeholder expectations are rising, management's responsiveness to a crisis is the key to determine whether the company can emerge stronger. As the frequency of crises across the globe rises, the good news is that there are key steps and techniques that management can employ to emerge as a "winner". Table 1, highlights the different responses that have lead firms to fall into either the "winners" or "losers" cohort. Therefore, management being prepared and understanding the strategy that best fits its firm is key. Furthermore, PwC report[1] that companies that self-identified as *emerging stronger* from a crisis had in common the following characteristics:

1. Allocated budget to crisis management before the event
2. Had a tested crisis plan in place
3. Set a fact-based approach that included all key stakeholders
4. Performed a detailed post mortem and acted on the findings

TABLE 1. **The hallmarks of winner and losers**

WINNERS - COMPANIES WHERE SHAREHOLDER VALUE INCREASED POST-CRISIS	LOSERS - COMPANIES WHERE SHAREHOLDER VALUE DECREASED POST-CRISIS
1. Disclosed promptly	1. Either delayed communication responses or failed to respond entirely
2. Effectively communicated with stakeholders	2. Issued opaque or partial responses
3. Took responsibility for their actions or their agents' actions appropriately	3. Failed to take responsibility or express contrition
4. Demonstrated credible follow-up behaviours	4. Attempted to shift blame

[1] PwC's Global Crisis Survey. PwC, 2019



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Oxford Metrica has been analysing the impact of corporate reputation over the last two decades, creating an extensive data set of international corporate disasters. Our report, compiled in conjunction with research from PwC, presents its latest findings on the relationship between corporate reputation and shareholder value.

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