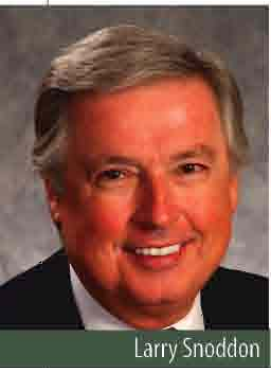


The Role of Boards in Corporate Reputation

By Larry Snoddon

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One of the most important and least understood areas of director responsibility today is corporate reputation. "Headline risk" has become part of the vernacular among professional investors.

Yet many corporate boards continue to see their role in terms of financial and strategic control. In a McKinsey survey of 250 corporate directors, the writers noted that non-financial risk "only gets anecdotal treatment" and, as one director stated, "boards absolutely do not understand the risks their companies face." Only when a crisis threatens the company's reputation are boards placed in a spotlight, forced to take action and communicate on their own behalf.

It has become critical that boards understand what unique factors drive their company's reputation and the risks to that reputation. Their role must be to minimize the gap between these drivers and the company's actions. They must be effective monitors of reputation as they are monitors of the firm's financial status.

The investment community has recognized that non-financial factors, collectively determining corporate reputation, have become increasingly

important in determining corporate value as well as risk. The California Treasurer's Office has stated "shareholders need to send a clear message: company conduct counts. Too often, institutional investors have tried to construct a wall between their investment decisions and corporate responsibility." In an Ernst & Young study, institutional investors said non-financial value drivers, such as the factors that create corporate reputation, were fully 35 percent of the rationale in rating a company's stock. They also said they are more important than financial factors in an IPO's success. When he was CEO of General Electric, Jack Welch said it was clear how to value corporate reputation—it is the difference between book value and a company's stock price.

Increasingly, business interests can no longer be separated from society's interests and expectations. And major corporations have to view themselves as virtual political institutions—constituency based, founded on trust, existing only by public consent (to paraphrase L.L.L. Golden).

In this environment, boards and managements are held equally accountable for the corporation. This has created a fundamental change in the way sophisticated boards see their priorities, how they must operate and communicate in the future.

What Factors Make Up Corporate Reputation?

Research conducted in more than 45 countries shows that expectations for major multinationals have indeed changed. Stakeholders, from government regulators to customers, expect companies to move from a compliance mode to affirmative and proactive interaction with their various audiences. This requires socially responsible companies to go beyond what they are required to do under the new rules. Companies that will be among the most respected and trusted will do just that.

What is Corporate Reputation?

To understand the expectations for well-respected corporations, opinion research was conducted throughout North America, Latin America, Europe and Asia over the past three years. This research examined the expectations of the general public (including the most attentive and active segments of the public) and senior officials in government, media, NGOs and financial institutions.

What resulted was a paradigm of corporate reputation asserting that a society's expectations of good corporate behavior define the specific attributes of corporate reputation; in other words, a company's reputation is based upon what society expects

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of it. Furthermore, while many have tried to 'fit' standard measurement tools to assess corporate reputation, in reality, what defines a company's reputation is unique for each and every company. It is essential that directors understand these unique drivers for their companies.

There are, however, some commonalities. Research for a wide range of companies in major industries, such as packaged goods, pharmaceuticals, oil, public utilities and financial services, identified several broad areas that are consistently cited as societal expectations. One of these was surprisingly consistent across geographies and segments of society.

What is heard across the world is that transparency, which includes honesty and ethical behavior and is a part of good corporate governance, is a critical element of reputation. It is not limited to publishing financial reports, but is expected to infuse the full range of actions and policies of a company, everything about how a company is governed and operates—from products and services and employment practices to philanthropy.

Beyond Disclosure

Furthermore, transparency includes an affirmative obligation for corporations to openly and honestly talk about their corporate social responsibility initiatives in a proactive and responsible way. This means it is not enough to provide complete and honest information—there is also an obligation to “find me and tell me”. Thus, the need for consistent, open and relevant communication is essential to building or rebuilding trust.

Obviously, one cannot proactively communicate about corporate responsibility in a transparent manner unless it is a fundamental

part of how business is conducted. So what role does the board play in building trust and determining corporate reputation? When and how must the board use its position to protect the company's reputation, and ensure both its ROI and its ROR (Return on Reputation)?

The board's role in approving corporate policy and assuring compliance is very clear. The board, however, also needs to be the standard bearer—and at times the arbiter—of ethics for the company. The board must make as much effort in this area as in finance—ensuring that the company has a culture of ethics (a sharing of values of people who want to do the right thing), not just a culture of compliance, shaped by lawyers.

Boards will find that they must establish their own public positions on these and other issues including the long-term sustainability of the company; the position of the firm within the body politic (to include issues, such as environment, safety, workers' rights); the “ethics” of decision-making as well as legality (e.g. moving offshore for to avoid taxes). These positions must guide their decision making and, at times, their communication.

To establish and maintain trust and credibility in this new environment, directors will have to act outside the company as well as inside. They must communicate on their own behalf with key constituencies. At times, they will have to represent their own and key shareholder interests publicly and separately from management. They must weigh in publicly on matters of ethical decision-making and corporate social responsibility.

Along with management, they on occasion must speak on the issues of long-term sustainability of the

corporation. One consideration would be a periodic report from the board to shareholders and other key constituencies, explaining the guiding principles of the board. This might include how the board operates and determines priorities, provide comment on issues addressed in the past year, explain how the board balances financial and non-financial demands, review the ethical framework guiding the company, as well as social and business missions.

Increasingly, boards will have select involvement in public communication by the company on strategy and issues. They must seek new ways of working with management teams to support objectives by speaking to media and audiences on important issues (as a cadre of advisors to the country's President might explain certain positions of an Administration).

Views of corporate purpose and the roles of boards are indeed changing. It is not the failures of companies that have increased expectations, but their significance to modern life and society—constituency-based, founded on trust, existing only by public consent.

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