

One bright summer day a few years ago, I had breakfast with Dipak Jain, then dean of the Kellogg School of Management. During the conversation, Dean Jain asked me to become the academic director of the new CEO Perspective Program. I had just returned from a lovely vacation, and I agreed. The program is now going strong in its seventh year and has taught me many invaluable lessons, one of which became the seed for this book.

A defining component of the program is the sessions taught by the CEOs of some of the world's leading companies. Perhaps the most striking characteristic of these sessions is the enormous variety that can be seen among these individuals—differences in personal style, management approach, corporate culture, strategy, and company challenges. Despite these differences, however, there are also striking commonalities. Ask CEOs what items are at the top of their agenda, and you'll find that the top two issues are common across companies and industries, and that they rarely change. The other issues vary tremendously across time and industries; "innovation" is currently a core concern, whereas "survival" was very popular in 2008 and 2009. However, the two leading items on the CEO's agenda are constant. Item number one is "people." The other issue was a surprise—at least to me: "reputation." Some CEOs even stated that it was their company's reputation that most distinguished it in the marketplace—its most important asset.

Surveys of CEOs and corporate boards report a similar list of priorities.² For boards, "reputation" is as important as "people" issues such as CEO selection and compensation, succession planning, and oversight. Indeed, many board members view the board as the ultimate guardian of the company's reputation. Of course, for board members (as for CEOs), the company's reputation and their personal reputation are intimately linked, further elevating the issue's importance.

Recent events confirm this perspective. Almost every day, another company faces a battle for its reputation, and the costs of losing that battle can be severe. During its recent crisis triggered by the sudden acceleration issue, Toyota's stock price dropped by as much as 24 percent, wiping out about \$33 billion in shareholder value, close to the total market value of Time Warner. In its battle with the U.S. government in the aftermath of the 2008–2009 financial crisis, Goldman Sachs lost \$24 billion of its market capitalization, a 26 percent drop in share price that exceeded the entire value of American Express.³ Finally, there is the BP

oil spill disaster in the Gulf of Mexico, which at one point cut the stock price in half and destroyed about \$90 billion in shareholder value, more than the market value of Procter & Gamble.⁴

Of course, some of these effects are transitory; companies can and do recover from reputational harm. Also, a company's stock price is affected by more than just the company's reputation. Indeed, establishing the exact cost associated with reputational damage is a difficult challenge requiring careful analysis. That said, these are massive events in the life of a company, comparable to a big acquisition gone wrong or the collapse of an entire market segment. Perhaps CEOs and their boards are right to be concerned.

One may think that this is all a coincidence, a temporal disruption of the normal business environment. *Reputation Rules* will demonstrate that there will be no return to a "normal" business environment; instead, the intense scrutiny that companies have been facing over the last decade is the new normal. The underlying forces that elevate reputational concerns are not transitory, but instead will increase in importance and will shape global business environments for years to come. It is true that reputational concerns take center stage in the context of a crisis, but crises are merely the tip of the iceberg of significant changes in the global environment of business.

From this perspective, one fact becomes painfully obvious: most companies have shockingly underdeveloped capabilities to manage their reputations effectively. This becomes evident when one directly compares "reputation" with the other leading item on the CEO's agenda, "people." Not only do companies have entire corporate functions (human resource management, "chief people officer") devoted to this issue, but managers have a host of tools and concepts at their disposal—from compensation strategies to evaluation and development approaches to the management of culture and change. Most important, CEOs have learned that they need to own the people process.

What about reputation? For the most part, you would find an

When it comes to reputation, many companies face a mismatch between assets and capabilities. Reputation is widely considered a core asset, and its protection is near the top of the CEO's agenda. Yet most companies have woefully inadequate reputation management strategies and processes. The result is one reputational crisis after another.

underfunded initiative in the communications department matched by nervous questions from the board—in other words, a striking lack of awareness, skills, and capabilities.

Underdeveloped capabilities in an environment of growing reputational risks will inevitably lead to an increase in reputational crises. Perhaps it all started with Enron and the accounting scandals at the beginning of the decade, but this era of reputational crises has not stopped since. Business, it seems, has entered the age of crisis, with the demolition of the global financial industry as its most recent pinnacle. Venerable companies and institutions continue to find themselves in the headlines, usually not in a flattering context. Entire industries have seen their reputational capital eroded at a shockingly rapid pace, such as the global banking and financial services industry, ratings agencies, the U.S. auto industry, the U.S. health insurance industry, and the global pharmaceutical industry.

Consider some data from a sequence of polls conducted by Harris Interactive. In the survey, respondents were asked the following question: “Which of these industries do you think are generally honest and trustworthy—so that you normally believe a statement by a company in that industry?”

The results are given in Table P.1.⁵

Notice the overall erosion of trust across industries, with the particularly striking collapse in the banking sector.

Losing the battle for public perception has dire consequences. Erosion of customer trust is only the most obvious example. Regulators and politicians may feel public pressure to take decisive action, changing market environments and the rules of competition. The history of the tobacco industry is perhaps the best-known example, but many others exist. Consider the effect of Sarbanes-Oxley on accounting practices and corporate governance, the fate of genetically modified food in Europe, changes in global labor standards after Nike’s child labor scandals, health-care reform, and the proposed levies on financial institutions. Clever lobbying and legal strategies can stem the tide for a time, but companies have been put on the defensive and find themselves fighting a rearguard battle that occupies substantial management time and effort.

Table P.1 **Industries I Can Trust**

Industries	2003 %	2006 %	2009 %
Hospitals	34	28	28
Electric and gas utilities	n/a	14	16
Packaged food companies	23	14	16
Online retailers	n/a	11	16
Banks	35	31	12
Airlines	20	16	10
Life insurance companies	11	11	10
Pharmaceutical & drug companies	13	7	9
Car manufacturers	14	9	8
Health insurance companies	7	7	7
Managed care companies such as HMOs	4	4	5
Oil companies	4	3	5
Tobacco companies	3	2	3

n/a = industry not asked about that year

Source: Harris Interactive (2009)

Four main factors are responsible for the increase in reputational risk.

The first is straightforward; media coverage has increased dramatically, as has its global reach. On the one hand, we have the birth of the Internet as a communicative and connecting medium and the rise of user-generated content, from blogs to Twitter and YouTube. On the other hand, we now live in an ever-faster-moving news cycle, driven by intense competition between 24-hour news channels, wire services, and online news providers.

This increased media scrutiny has many dramatic consequences for companies. First, they have less and less control over their messages. A YouTube video shot from the cell phone of an unhappy customer or disgruntled employee, a negative tweet, or a Facebook campaign can dramatically damage a brand, and once it is on the Web, it will stay there

forever. The rise of the Web has dramatically shifted the balance of power from companies to customers and other stakeholders. When this is combined with the global reach of the media, it is virtually impossible for a company to hide. Transparency is increasingly in demand.⁶

The second factor is the unintended consequence of globalization, the “dark side of living in a flat world.”⁷ The globalization of activist organizations has matched the global reach of companies. Today, a nongovernmental organization (NGO) that tries to make an impact on human rights will not protest in front of a foreign consulate or the UN

The dramatic rise in reputational risk is no accident or passing fad. It is driven by sustained forces, from 24-hour media coverage to higher expectations of acceptable business conduct in a globally operating economy.

headquarters; instead, it will target a multinational company with global operations.

Shell experienced this over its oil extraction operations in Nigeria and the connection to the Nigerian government’s execution of human rights leaders. Nike had similar experiences involv-

ing its global labor standards.⁸ My collaborator, David Baron, and I have used the term *private politics* for these phenomena.⁹ Regulation, for example, is usually understood as the result of government action, exercised and implemented by legislatures, agencies, and the courts. Public institutions, however, are no longer the sole source of constraints on commerce. Instead, political activists and NGOs have increasingly succeeded in forcing *private* regulation: the “voluntary” adoption of rules and standards that constrain certain forms of company conduct without the involvement of public agents. In many cases, the mechanism driving change is the creation of reputational crises for companies that, when effective, leave the companies with no choice but to change their business practices.

The third factor is not usually considered in the context of reputation management, yet it is a critical multiplier and enabler of the previous two factors, considerably amplifying their effects. Various observers have noticed some marked generational differences between older and newer population segments. Frequently discussed as a “Generation Y” phenomenon, commentators have pointed out an increase in concerns

about the moral dimensions of businesses, especially among young people.¹⁰

Evidence for these trends can be found in the explosive growth of areas such as corporate social responsibility, sustainability, and socially responsible investing. Some critics have dismissed these trends as passing fads that lack impact, but this assessment may be premature. In addition to typical business issues such as quality and product safety, reputational concerns are increasingly arising out of moral or ethical concerns. Child labor, dolphin-safe tuna, and fair trade coffee are just some of the best-known examples. NGOs and the media coverage that follows them will be particularly attuned to these issues, but in order for such issues to have a real impact, at some point somebody has to care, and has to demonstrate it by changing behavior. A customer may decide to buy a different product, an employee may leave, or an investor may divest her holdings. A gradual shift in value orientations provides the needed motivation.

The first three factors were changes in the environment of business, while the last one is a complementary shift in business strategy: the rise of business models based on trust. Over the last decade, marketing scholars have pointed out the importance of creating customer-focused organizations. Practically speaking, this means a shift from selling products and services toward selling experiences or selling a solution. In the consumer segment, these trends are well understood, as in Starbucks's focus on the customer experience. We find similar developments among industrial companies. For example, Caterpillar makes repair parts for broken equipment available to customers anywhere in the world within 48 hours, a critical differentiator from its low-cost competitors. To develop unique experiences and solutions, companies need to understand their customers even better, and they need to get closer to those customers' unarticulated—perhaps even unconscious—desires and needs. Building these relationships and maintaining them requires trust, and trust has both rational and emotional components.¹¹

This surely provides new opportunities for value creation, but only if a company maintains the relationship of trust. In other words, if brands are promises, then even the mere perception of a broken promise will elicit strong negative emotions of mistrust and betrayal. In many

cases, a company can fix the problem directly. A Starbucks customer who is unhappy with the preparation of his café latte may be appeased by being given a new one, plus a free cookie as a little apology.

What about a customer who is concerned about the labor conditions of workers on coffee plantations? Combined with sufficiently evocative images from the media, such concerns can quickly undermine a pleasant experience for even the most loyal customer. Building the brand is not enough; it must also be defended.¹² The more business models are based on reputation, the higher the stakes.

Recent surveys provide further evidence for these trends. In the 2010 trust survey by the public relations firm Edelman, transparency and trust surpassed product quality in determining corporate reputation. Financial performance was at the bottom of the list.¹³

To summarize, recent developments have dramatically increased the need for effective reputation management. On the one hand, companies are increasingly basing their business models on trust. On the other hand, the threats that may undermine that trust have grown rapidly, driven by new media technologies, globally operating advocacy organizations, and the relative growth of population segments that care about the moral dimension of business. CEOs and boards have begun to appreciate the importance of this challenge, but feel unsure about the capabilities and strategies needed to respond to it.

The gap between needs and capabilities is untenable. *Reputation Rules* will help companies close this gap. As with any capability, doing so requires the proper mindset and processes, and the values and culture to support them.