INHERENT NEGATIVES:
MANAGING REPUTATION THROUGH THE WINDSHIELD, NOT THE REARVIEW MIRROR

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The most successful companies today have learned how to manage strategically both the ups and the downs. No company can eliminate the negative, but the best businesses anticipate, address and even embrace potential problems before they explode.

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What is most frustrating for many corporate executives is the clarity with which they can see trouble spots in retrospect or through the rearview mirror, rather than anticipate them. Yet most issues that mushroom into crises can be anticipated. In fact, two-thirds of headline-level crises in 2002 were small, internal, smoldering and could have been avoided, according to the Institute for Crisis Management. And contrary to conventional wisdom on crises being generated from external factors, the Institute found that only 20 percent or fewer of crises start from people or forces outside the organization.

OBSTRUCTING THE VIEW

The advantages of anticipating emerging issues or crises are significant. A company with an advance view of trouble spots – seen through the windshield – has the time to plan how to address the issues, without the glare of media and before critics have become polarized and unreceptive to dialogue. This buys some breathing room, air space for mitigating the negatives while also advancing positive messaging on brand or corporate positioning.

The view through the rearview mirror, however, is not as attractive. Since the media loves a conflict, stakeholders most impacted by the issues of concern quickly become typecast as visible critics or even victims starring on the evening news. With the media spotlight turned on high, the time to plan degrades into the time for damage control, and the opportunity for quiet, constructive dialogue with critics disintegrates into an above-the-fold debate.

So if the advantages of seeing emerging trouble spots through the windshield are so obvious, and if most crises begin as small but manageable smoldering issues generated from internal factors, what is obstructing the view?

Line-of-sight obstructions are often self-inflicted. The immediacy of a business's competing visible urgencies usually will trump the proactive idea of setting aside resources to manage emerging issues. The issues might be rationalized as a temporary blip on the radar screen that should not be legitimized through any proactive planning or engagement. Critics, who could be seen as the proverbial canary in the mine shaft, are instead dismissed as gadflies without credibility. Thus a business could substantially underestimate their potential impact.

Fundamental to all of these obstructions is typically a lack of sustained corporate engagement with external stakeholders. This would allow a company to step outside of its mindset and see emerging issues from the other end of the business telescope – from the perspective of the consumers or stakeholders impacted by such issues.

Finally, companies that engage in monitoring emerging issues too often focus almost exclusively on external trends and factors rather than systematically examining their own business operations. This self-examination can identify internal smoldering issues early in their cycle – at the time they can be constructively managed.

INHERENT NEGATIVES: A FOUNDATION FOR SYSTEMICALLY EXAMINING BUSINESS OPERATIONS

In today's climate, reputation has become more than the expression of a coherent message. While managing the pluses remains an important part of sustaining a positive reputation, accentuating the positive through branding and positioning is no longer enough. A critical element to sustaining a positive reputation is thoroughly understanding and anticipating potential negative stakeholder impact from the company's business.

In a 2003 survey conducted by the World Economic Forum, many CEOs and CFOs emphasized the increasing convergence of corporate citizenship and performance. "Since much of the justification for giving the corporate responsibility agenda a high priority relates to the maintenance of goodwill and relationships with stakeholders," said Anthony Traher, outgoing CEO of the mining resources company Anglo American, "it is clearly helpful for management that investors increasingly see the value of such intangibles and, at the very least, see the downside risks to value from failing to uphold high standards."

So if the advantages of anticipating emerging issues that could morph into crises are clear, and if investors are increasingly willing to penalize companies for failing to anticipate those issues, how can an organization improve its line of sight for anticipating emerging issues, shifting its perspective to the windshield rather than the rearview mirror?

The first step begins with a comprehensive understanding of the impact its business has on stakeholders, regarding not only its core operations but also its upstream impact from suppliers and its downstream impact on consumers or end users.

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Every business is hardwired with the potential for problems. These inherent negatives are elements inherent to a company's business model that have the potential for negative impact on stakeholders. The more successful the business, the more the inherent negatives are multiplied. In other words, inherent negatives are a byproduct of an enterprise's success, making the company a particularly ripe target for criticism or even outrage, depending on the severity of the negatives' impact.

How a company manages its inherent negatives helps set its strategic tone: ignore possible troubles and face potential crises, address them and unlock new opportunities. Dealing with inherent negatives even can lead the way to innovation and fresh methods of stakeholder interaction.

So how does a company go about examining sources of inherent negatives? They can be found all along the production chain of a company's products or services, both upstream in its supply chain management – how a product or service is produced – and downstream – how customers use the product or service. Companies also should examine their place-of-business footprint – where the product is produced – and how it is marketed, including advertising, promotion and distribution.

The spirits industry provides a good example of the importance of managing potential inherent negatives both in product development and marketing and in downstream operations. Diageo is the world's leading premium drink business. Its brands include Smirnoff, Johnnie Walker, Guinness, Baileys, Tanqueray, and Beaulieu Vineyard and Sterling Vineyard wines. Despite, and perhaps helping to explain the excellent reputation of the Diageo brand, the company has taken special care to recognize and address the potential downstream impact of its inherent negatives. Misuse of alcohol, underage drinking, socially inappropriate behavior and alcohol-related accidents are just some of the threats to Diageo's reputation if they were to become associated with any of its brands.

Rather than brush off or downplay these inherent negatives, Diageo has institutionalized certain business practices to address them constructively. For example, the company has institutionalized a marketing code that governs the advertising, promotion, marketing and public relations of its brands. The code addresses the prohibition of marketing to underage consumers, drinking and driving, cultural sensitivity and alcohol education. Diageo has gone one step further to align its product development process with this marketing code, to ensure, for example, that its product development process does not generate new products for which the primary market would be underage drinkers.

Diageo also addresses the potential for downstream inherent negatives generated from the inappropriate uses of its products, well after those products have left its direct control. For example, Diageo provides downstream bartender training for responsible serving, as well as teacher and parent education. The company also has developed partnerships with industry, with nonprofit organizations and with other public-private initiatives to promote appropriate consumption.

Nike's well chronicled issues with worker conditions in its contract manufacturing operations provides a case study for the importance of understanding and constructively addressing the upstream impact of inherent negatives. The world's leading designer, marketer and distributor of athletic footwear, apparel, equipment and accessories, Nike's brands include Nike, Cole Haan, Bauer Nike Hockey, Jordan, Starter, Hurley International and Converse. Nike does not manufacture these products. Instead, it contracts manufacturing from a global network of manufacturers, many of which operate in developing countries. Building on lessons learned from a sustained, highly visible multiyear campaign from activists and nongovernmental organizations critical of the working conditions in some of those contract manufacturers, Nike has taken extensive constructive actions to mitigate the potential inherent negatives in its upstream supply chain. For example, it has institutionalized policies and processes that govern those upstream contract manufacturers with which it will conduct business.

Nike uses three levels of monitoring tools to evaluate its suppliers' factories. Its oldest and most basic tool – its so-called SHAPE assessment – has been in place since 1997. The SHAPE assessment examines a factory's safety, health, attitude, people and environment.

The company also performs a risk assessment for factories to determine their likelihood at being out of compliance with accepted conditions. The risk assessment takes into account the country of manufacture, the size of the worker population, the nature of the manufacturing and the factory's past compliance performance. Should the factory warrant further auditing, Nike's internal auditing team performs a more in-depth M-audit ("M" for management.) The M-Audit team grades factory processes and policies and

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may perform one-on-one confidential interviews with workers. Nike also participates in external monitoring through the Fair Labor Association (FLA), which posts summaries of the audits on its Web site.

In addition, Nike requires a multistep process any time one of its business units seeks to add a new factory. This approval process, among other requirements, includes a profile of the potential factory, inspections for quality and a third-party labor audit.

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Finally, a fundamental element to its monitoring and auditing processes has been transparency. Nike openly reports actual factory conditions through the FLA and through its own corporate responsibility report, which has included the name and address of each of Nike's 800+ contract manufacturers.

While it is important to identify and address the inherent negatives, both upstream and downstream, a company's degree of involvement often extends beyond its individual business model. Failure to mitigate potential negatives can have an impact on an entire industry.

In December of 1984, catastrophe hit the chemical industry. A deadly chemical leak at a Union Carbide plant in Bhopal, India resulted in more than 3,000 deaths, tens of thousands of injuries and an environmental disaster of extreme proportion. Three years later, the reputation of the entire industry still wallowed in disrepute. A 1987 survey by the chairman of the then-Chemical Manufacturers Association found American CMA members listed "the negative public perception of the industry" as one of their top two problems. To make matters worse, the public did not seem to distinguish among chemical manufacturers, viewing the entire industry as unreliable, untrustworthy and even dangerous. The industry would have to take drastic measures to win back the public trust.

Through their national industry associations, chemical manufacturers worldwide began to sign on to a 1985 Canadian initiative called Responsible Care®, in which companies collaborate to improve the health, safety and environmental concerns of the industry. In short, Responsible Care addresses the inherent negatives in the chemical industry, focusing on improving performance in environment, health and safety, security, product management issues and value chain. This volunteer initiative now embodies 52 countries, accounting for 90 percent of the world's chemical production.

Responsible Care features a number of elements that directly address the chemical industry's inherent negatives. First, it draws its authority from a guiding coalition at the CEO level. In addition, every Responsible Care company undergoes a mandatory certification process by independent auditing firms, which certify a company's performance in the areas of environment, health, safety and security. There are consequences for nonperformance. And the coalition stresses the importance of transparency, requiring public reporting on results by its member companies and the industry as a whole.

The idea behind the creation of Responsible Care reinforces the idea that mitigating negatives is an ongoing process, not a one-time event. As such, the process requires continual upgrades, reevaluation and review, and these procedures must be institutionalized actions as part of the overall business system, with third-party validation as a fundamental element of the system.

In all of these examples, we find that the more time and resources a company invests in anticipating and mitigating risk, the greater the benefit. Companies generally take the importance of brand enhancement and differentiation as necessary and self-evident. But equally as important is proactive protection of the company and its brands.

Critical to this process is identifying and understanding the impact of an organization's inherent negatives before the critics do. Companies who can define constructive actions to address those inherent negatives, institutionalize them and monitor and upgrade over the long term will be a step ahead. Equally important is engaging those who could be impacted by a negative, always with an eye toward the spirit of transparency, communicating the benefits to internal and external stakeholders while simultaneously acting on the negatives.

In addition, the risk of not proactively managing inherent negatives is becoming more visible to the investment community. More than 70 percent of global corporations surveyed by the World Economic Forum in 2003 expected an increasing interest from mainstream investors in corporate citizenship. And for the years 2001 to 2003, socially screened funds in the United States were up 6.5 percent, while professionally managed portfolios were down 4 percent, according to the Social Investment Forum.

"[The] risk aspects of corporate responsibility are as important as bottom line impacts," stated the Association of British Insurers in a 2004 report titled "Risk Returns and Responsibility." "Many companies are not yet managing these systemic risks adequately, posing threats to shareholder value which investors need to take into account."

Clearly, investor trends are driving an expanded definition of business risk to include inherent negatives. Effective risk management requires excellent business practices, well communicated to all stakeholders. As we have seen, today's ignored, low-visibility, inherent negative is tomorrow's high-visibility, costly crisis. It is communication that sits at the intersection of multiple stakeholders' relationships with the enterprise.

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