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The Importance of Reputation for Investor Relations

Ask anyone who works in investor relations about the importance of reputation management and they'll probably roll their eyes, and respond that it's a "no-brainer". That's reassuring, however, despite the widespread acceptance that reputation is important, very few IROs are able to describe the tangible role that the IR function plays in corporate reputation management, let alone how IR supports the Board's approach to reputation risk. This is despite 76% of Chartered Global Management Accountants saying that their organisations are prepared to lose profit in the short term to protect their image over the long term.[i]

Why does corporate reputation matter?

Oxford University Press defines reputation as the beliefs or opinions that are generally held about someone or something. Simple enough, but why is reputation important specifically to companies? Among others, the Chartered Institute of Management Accounting's 2010 study identifies corporate reputation as affecting share value, operational costs and market opportunities.[ii] Oxford Metrica, a university spin-off, concludes in its 20 year research that companies that are clear about what they stand for typically enjoy high levels of trust, and are worth more. Its analysis also shows that companies which open up more following a crisis are valued more highly, benefitting from share price increases of 10 per cent on average, over a year.

Why is this the case? Because the market has greater confidence that a business with a stronger reputation will deliver higher future earnings than one that doesn't. Law firm Freshfields conducted a similar exercise in 2012, analysing 78 global company crises over five years, categorising them into behavioural, operational, corporate and informational events.[iii] Among other things, Freshfields found that behavioural crises are the only type of crisis to see immediate share price falls of 50 per cent or more. [iv] In my experience with IR, spanning four continents, it's a behavioural crisis that most damages the trust of stakeholders; be they employees, customers, regulators, partners or shareholders.

Why does this affect the IRO?

This body of evidence supports the case for the value of corporate reputation, but why does this matter to the IRO? Because reputation acts as a form of equity, and thus it should be considered as a source of shareholder value. In working with listed companies – both with 'good' and 'poor' reputations – I have found that the IR function is vital in telling the investment story to financial stakeholders, and gaining recognition for what reputational equity exists. Oxford Metrica's research shows that the element of market capitalisation in excess of book value, which is not represented by the brand, is a 'reputational premium' that reflects leadership, innovation, intellectual property, and global reach – all reputational assets, so to speak. As components of reputation, these are sources of sustainable competitive advantage and enhance long term shareholder value.[v]

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How do I measure it?

For the purposes of supporting the Board's oversight of reputation risk, some form of metric is useful. There are a number of potential metrics that can be used, for example, adjusted share price can be used to measure reputation equity as it removes market-wide influences and the returns are risk-weighted. This provides a clean measurement of impact from reputational events, specific to the company and unencumbered by broader market movements. Beyond an adjusted share price, measurement can also be through an analysis of errors of omission and commission – in plain English that means opportunities lost to competitors due to your relatively weaker reputation, and business that was in hand but was lost due to failures within in your business.

In summary, reputation is a vital part of competitive advantage, which enhances sales, customer satisfaction and retention. It attracts talent, which drives innovation and effectiveness. It improves access to scarce resources and reduces operating costs. For those with weaker reputations, the reverse is true. An enlightened IRO will seek to understand their management's and Board's approach to reputation risk and management, and their desired role for IR. In terms of the IR function's enduring role, an IRO should play an active part in their company's wider communications effort, as well as related leadership development, corporate crisis planning and management, and counselling corporate leadership on reputational risks as they relate to value creation and destruction.

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[i] "*Reputation, why it matters and how you can manage it*", Chartered Institute of Management Accountants, November, 2010

[ii] Ibid

[iii] Behavioural (illegal or questionable conduct of the company or its employees), operational, corporate (affecting corporate and financial well-being) and informational (IT and data infrastructure).

[iv] *Crisis Management Study"*, Freshfields Brukhaus Derringer, 2012

[v] "*Reputation Review 2012*", Oxford Metrica Press, 2012