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Research by Wharton Professors **HOWARD KUNREUTHER** and **MICHAEL USEEM** found a reputational hit can cause a 20 percent drop in share price and take 80 weeks to recover. Brunswick's **LIZ DAHAN** reports.

LOOKING AT S&P 500 COMPANIES BETWEEN 2001 and 2011, professors Howard Kunreuther and Michael Useem, who both teach at the University of Pennsylvania's Wharton School, found more than 2,100 instances of a share-price crisis – where a stock fluctuated by at least 20 percent within a 10-day trading period, compared to industry peers. The most frequent driver of these crises? Reputation and marketing.

It's no secret that reputation is valuable – variations of that phrase have become tired truisms – but the professors' research brings new precision to the traditionally nebulous topic, using a decade's worth of data to establish how valuable it can be to a company's bottom line. "We found companies can lose 15 to 20 percent of their market value," Professor Useem says. "It's obviously well worth investing against that potential, which would be a fraction of 20 percent of your market capitalization."

The professors' research also measured how long it took for companies, on average, to recoup the losses. Of the 22 areas that drove a share-price crisis, only two – "international" and "intellectual property" – saw share prices recover in less than a calendar year. Those caused by marketing and reputation required 80 weeks. "Analysts and investors have come to put a price on failing to avert significant risk," says Professor Kunreuther. "And there's clearly a wait-and-see attitude by the equity market on whether a company has actually taken steps to not only repair itself, but also prevent the next disaster."

Their recent book, *Mastering Catastrophic Risk: How Companies Are Coping with Disruption*, offers a numbers-driven assessment of a crisis' price tag and a 15-step framework for companies to better prevent them. Professors Kunreuther and Useem discussed their findings with Brunswick's Liz Dahan, and explained why they're optimistic about Corporate America's ability to navigate these turbulent times.

If you had every Fortune 500 CEO in the same room, what would your message to them be?

HK: We actually did something close to that; we interviewed 100 people who had a leading role in their organization on dealing with adverse risks and disruption – from Chief Risk Officers to CEOs – to complement their insights with our data.

So what we would tell those 500 CEOs is that there's a tendency to think short term, to feel that low-probability events are not going to happen to you – until after they do. It's time to think about a checklist of how you can prepare for disasters and disruptions well in advance of them actually happening.

MU: I would say, first of all, look around you. Ten, 15 years ago – and we documented this in the book – many companies paid little attention to enterprise risk management. Many are paying attention now. The second message would be: The human condition being what it is, we tend to be relatively short term in our thinking and myopic in our behavior. I think we'd urge CEOs to engage in more analytic, more deliberative thinking – and expect that not only of themselves, but also of their middle managers, too. Even the board can be, sometimes, not so focused as they should be.

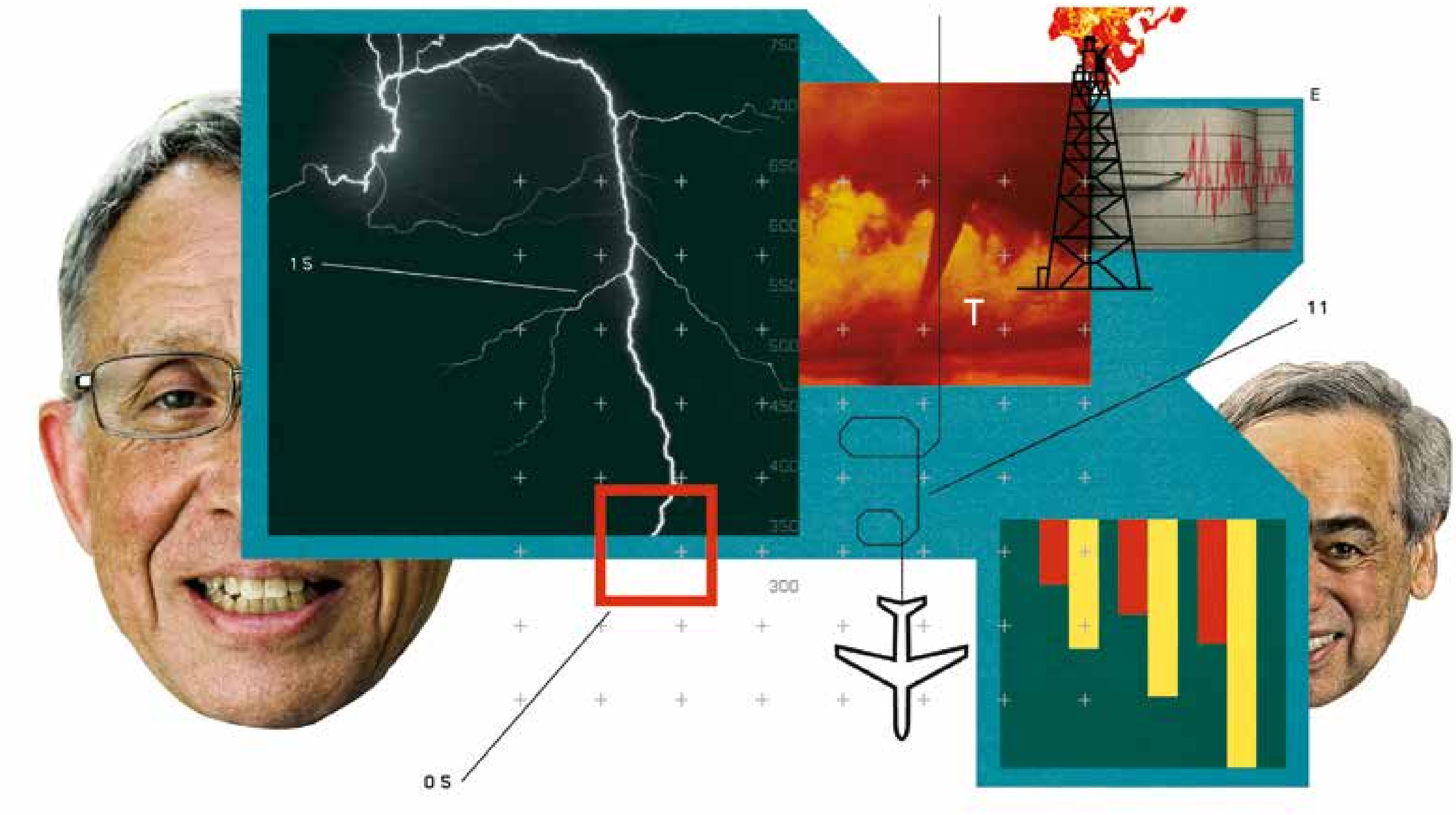
HK: There's a human element but also a structural one. Companies have processes and procedures that lead to short-termism: quarterly reports, annual bonuses. Things of that nature push employees to think short term because they're being judged on the short term. There's a challenge for firms to recognize that and consider things like contingent bonuses.

You've highlighted some biases that are hardwired into our brains and incentives that are built into modern businesses. Are you optimistic there's going to be real change any time soon?

MU: I would have been more pessimistic until we actually conducted these interviews with those 100 leaders. For a host of reasons – 9/11, Hurricane Katrina, the BP oil spill, Wells Fargo, Volkswagen – I think many companies and leaders have become much savvier about the downside risks. We often heard, you know, "There but for the grace of God go I."

One reason we wrote the book is to provide examples of how other companies have done it. Many companies that have been through a crisis become much better at managing risk the next time. But that's not a great way to learn how to deal with the world. Better to prepare for it before you have to live through it.

HK: I share Mike's optimism. We came out of our interviews feeling that a lot of these companies were trying to take the right steps. But I would also be a little bit cautious. For how long will they do this? Will they be motivated to go back to their old ways of thinking if nothing bad happens in five, 10 years?



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Your research found how expensive reputation can be; what are some investments a company can make to safeguard it?

MU: The state of the world is that sometimes these enormous setbacks come from natural disasters. So in parallel with strengthening their internal risk-management schemes and protocols, companies have also become more involved in helping the communities where they operate recover from setbacks.

Virtually all large, publicly traded companies, in the wake of major disasters, intervene today. Our research found that for a company's reputation, it's important to become involved in disaster relief – not your own disaster, but that of others, if you operate in the region. That's the key point: If you've got a footprint there, then you become involved. If you provide services, products and cash – and this has to be handled well, obviously – then your local revenues will actually be enhanced. There's unequivocally a reputational advantage.

ILLUSTRATION: STUART BRADFORD

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One of the 15 steps toward mastering catastrophic risk is to be unsurprised by surprise. How can leaders actually do that?

HK: Start thinking about their risk appetite and risk tolerance. The minute you ask, "What are you willing to tolerate?" you have to figure out what would happen and how you'd deal with it. It has often taken a BP oil spill or a financial crisis for companies to do that.

MU: Another way is to draw on the amazing intelligence you've already got in your company – both at the board level and at the front line, managerial level. The data's there. It's just a matter of pulling it up from the ranks.

Deutsche Bank, for example, is headquartered in Frankfurt. Who would've guessed that the Japanese 9.0 earthquake of 2011 and the resulting tsunami could affect Deutsche's operations? At one point, Deutsche almost shut down its Tokyo operations, since the Fukushima power plants looked like they might explode. Fortunately, Deutsche had already put in place a risk-management system. They had people trained and ready to go. It still was a surprise to Deutsche, like everybody else, but their people were prepared and empowered to respond to the unthinkable – in this case, evacuating 1,000 Deutsche employees in Tokyo and all their families.

We're always going to be surprised by the particulars of a disaster – they tend not to repeat themselves exactly. But chance favors the prepared mind. ◆