

FYI

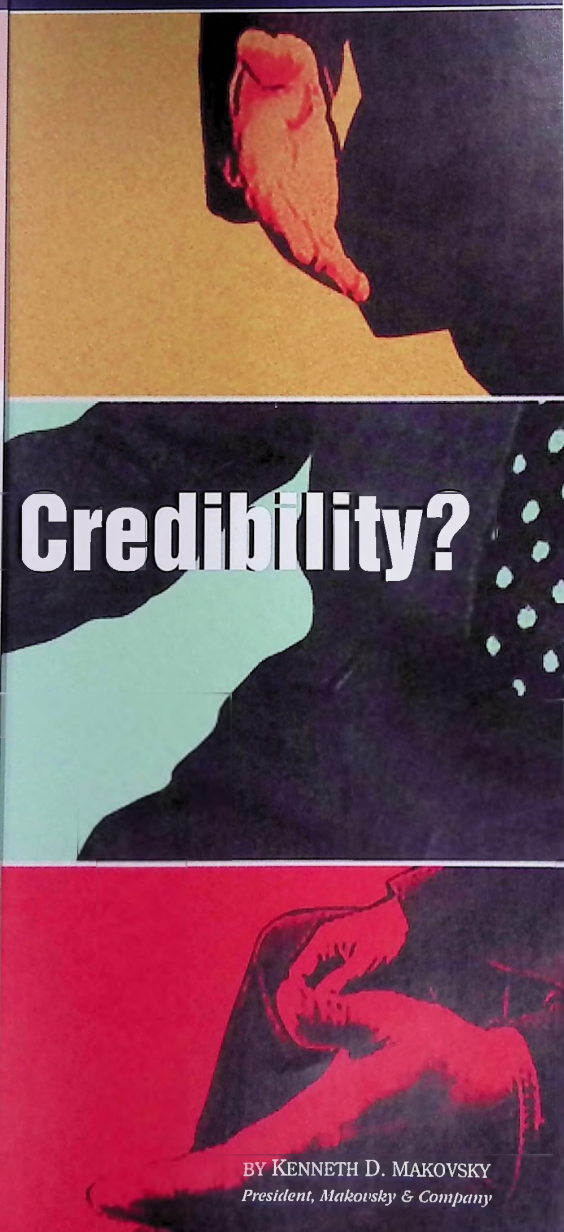
Investment strategist Warren Buffett once advised, "If you lose dollars for the firm by bad decisions, I will be understanding. If you lose reputation for the firm, I will be ruthless."

In fact, 35 percent of a company's value is attributable to intangibles such as public trust and management credibility, according to research conducted by Ernst & Young.

In the enclosed article, "What Price Credibility?", published recently in the communications leadership magazine, *The Public Relations Strategist*, Kenneth D. Makovsky provides valued insights and a credibility action plan – a necessity to review in this post-Enron environment. Please send your comments and questions to kmakovsky@makovsky.com or call Ken at 212-508-9601.

Paul A. Holmes
Paul A. Holmes,
Editor, *The Holmes Report*

www.makovsky.com



Credibility?

BY KENNETH D. MAKOVSKY
President, Makovsky & Company

What Price Credibility?

BY KENNETH D. MAKOVSKY, APR, FELLOW PRSA

President, Makovsky & Company

Creating value is the essence of business.

But credibility is the foundation upon which value is built.

The corporate scandals of the past two years have made it abundantly clear that loss of credibility equals loss of value. The loss of credibility has been widespread — not only with corporations, but also with institutions as diverse as government, the Catholic Church and Little League baseball.

This ripple effect has fostered a pervasive feeling of distrust among the public, thereby damaging reputations that have taken years for institutions to build.

For example, fewer than three in 10 Americans (27 percent) feel that most large U.S. corporations are trustworthy, according to a recent RoperASW survey. A Gallup poll reveals that business leaders and stockbrokers have joined used car dealers and HMO managers in the category of “least trusted” professionals. Gallup also indicates that 82 percent of the public believes the phenomenon of top executives of larger corporations taking improper actions to help themselves at the expense of the corporation is “very” or “somewhat” widespread.

Greed, insider trading, questionable accounting practices and outright fraud have rocked boardrooms, decimated employee pension funds and devalued or destroyed investments, as

well as some of the nation’s largest corporations.

Now the legal profession is grappling with this issue. The American Bar Association approved a change in its code of conduct that allows lawyers, when they learn of an employee’s illegal act that may injure a client company, to disclose client confidences to protect that company. The old “inside/outside” paradigm — that a company could conduct its business internally without fear of any

Credibility is the foundation upon which value is built

information getting out — is dead. The Internet has opened a window on virtually every aspect of our business.

The Value Equation

The value of a brand, whether it is a corporation or a product, is a promise that, if kept, delivers trust. It is real and quantifiable.

Companies with highly credible reputations, for example, have a 12 percent higher price/earnings ratio than those with lower profiles, according to a Yankelovich/*Fortune* survey. Coca-Cola, the world’s most valuable

brand, is an asset worth more than \$70 billion, says Interbrand. The top 10 global brands account for nearly \$387 billion in value — equivalent to the entire gross domestic product of the Netherlands.

Credible brands, therefore, are one of the intangibles that create company value. In fact, 35 percent of a company’s value, says Ernst & Young’s classic “Measures That Matter” study, is attributable to various nonfinancial intangibles. In addition to brand image, the others include:

- management credibility and experience;
- the quality of corporate strategy and organizational vision;
- innovativeness, and
- CEO leadership style.

So what is the value equation?

People come to trust what they believe, and believability is a function of personal experience. If you provide me with accurate information or you tell me something and it’s consistent with my experience, then I believe you and trust you. You become credible.

Every single individual in a company, therefore, represents a point of credibility with the outside world.

Everyone — from the CEO to the receptionist, from the head of human resources to the accounts payable person — is critical in establishing the trustworthiness of a company. A failure of credibility on the part of a sin-

gle individual can help derail the public's trust in an entire institution.

Two recent studies, one by RoperASW and the other by InsightExpress, show that 48 percent of a company's reputation is attributed to the CEO's reputation, and 95 percent of business influentials report that the CEO reputation impacts their investment decisions. Ninety-two percent of the same group says that the CEO's reputation helps maintain confidence in a company when its share price is lagging.

The Martha Stewart Story

Let's consider the case of Martha Stewart. To briefly recap the facts: The issue of insider trading first became public when a House Committee announced that Stewart had sold almost 4,000 shares of ImClone Systems on Dec. 27, 2002, the day before a devastating Federal Drug Administration ruling sent the stock price plummeting.

While Stewart and her company, Martha Stewart Living Omnimedia, Inc. (MSO), had already taken steps to differentiate the company from the individual — and despite the fact that her alleged ethical lapses had nothing to do with the company — MSO shareholders are feeling the effects of the scandal.

The company's revenues fell nearly 15 percent in the first quarter of 2003 versus 2002, with a reported operating loss of \$7.5 million against last year's \$5.8 million gain. Eight months after the scandal, the share price was 30 percent less than it was when news of the investigation broke;

sales of Martha Stewart Everyday products were down, and the Magazine Publishers Association estimates that revenue from advertising in the company's flagship publication, *Martha Stewart Living*, fell nearly 40 percent in July. MSO reported its third straight losing quarter — all the result of a stock sale that netted Stewart less than \$50,000.

The Martha Stewart story is a prime example of the fragility of trust.

Stewart never ignored the importance of image. She worked hard to earn the title "doyenne of domesticity." But because the public company she led did not have sufficient reserves of goodwill to cushion her

83 percent of
Americans are
more likely to
give companies
they trust the
benefit of the
doubt...

fall, the initial crack in the façade of perfection that was integral to her image rapidly became a major credibility gap. One of the best ways to avoid this risk is to build a history of trustworthiness that can overcome the vagaries of individual managers, as Citigroup has done.

Credibility Over Time Maximizes Trust

A financial colossus with 200 mil-

lion customer accounts in more than 100 countries, Citigroup Inc. traces its history back to 1812. In more recent years, Citigroup's stock has traded at a premium because of the quality of its management, including its larger-than-life chairman, Sanford I. Weill.

Last year, however, the company was required to make settlement payments totaling \$400 million after being implicated in a conflict-of-interest scandal. More headlines detailed allegations that Weill had helped the children of star telecom analyst, Jack Grubman, get into a prestigious Manhattan preschool in exchange for a positive research report on AT&T. As a result, Citigroup took \$1.3 billion in charges for the cost of the regulatory settlement and estimated litigation costs in the fourth quarter. Citigroup's stock fell 25 percent.

But you can't keep a trustworthy company down. Eighty-three percent of Americans are more likely to give companies they trust the benefit of the doubt and listen to their side of the story before making a judgment about corporate behavior, according to a study conducted by InsightExpress earlier this year.

This summer, Citigroup announced a 5 percent gain in second quarter earnings and record net revenues of \$19.4 billion. The company's stock is up 40 percent from its February low. Since 1986, shareholders of Citigroup and its predecessor companies run by Weill have enjoyed annual returns of 22 percent, double those of the S&P 500.

So why has Citigroup recovered so quickly, and why does MSO continue to stumble?

Lessons Learned

One reason is time. Trust is a commodity that needs to be refreshed continuously. Citigroup, in all its previous incarnations, has spent nearly two centuries nurturing the values necessary for a credible and trustworthy reputation. It has done this through extensive employee, community and corporate PR programs. Martha Stewart Living Omnimedia, on the other hand, while a much younger company, has spent the last four years burnishing its founder's image as a guru of style, rather than communicating the values of the company she created.

The other reason is the power of the brand itself. Under the arc of its red umbrella, Citigroup shelters Citibank: ranked No. 13 among the world's top brands and No. 1 among financial services companies. Citigroup takes every opportunity to leverage the brand awareness, values and emotional bonds with its customers that Citibank has painstakingly forged over a long period of time.

On the other hand, Martha Stewart is the MSO brand. Her ad in *USA Today* (an open letter proclaiming her innocence) and her new Web site (MarthaTalks.com) may help build support among her fans, reinforcing the idea that she's being singled out because she's a powerful woman who's successful in business. If she can win over the public — and ultimately, clear her name in court — her victory will undoubtedly be reflected in the company's bottom line.

There are several lessons to be learned from both the Weill and

Stewart situations.

A company is bigger than its CEO, and therefore the institution as well as the executives need to live up to the highest standards through their deeds, both public and private. These values reflected through those deeds — externalized — are the values of the company.

The organization, no matter how big or small, how old or new, must build a reservoir of goodwill that supports it over time.

We all need to add "fostering

The organization must build a reservoir of goodwill that supports it over time

honesty, accountability and transparency" to our list of job responsibilities. We have to behave as if our every action were subject to public scrutiny — because it is.

Looking people in the eye and telling them the truth is the quickest and surest path to credibility, but it's just the beginning. Other actions you can take to help maximize credibility include:

• Pre-empt the whistleblowers.

Cynthia Cooper, Coleen Rowley and Sherron Watkins — *TIME* maga-

zine's "Persons of the Year 2002" — had the exceptional courage to blow the whistle on the massive failures at Worldcom, the FBI and Enron. They did what they felt was right.

Each of us should try to strive for the same standards. We should be alert to potential areas of operational vulnerability, calling management's attention to them and working to fix them, immediately, before they escalate into full-blown crises.

• Establish a "credibility budget."

The USC Annenberg Strategic Public Relations Center's Generally Accepted Practices Study (2002) found that:

- The use of PR firms among *Fortune's* "Most Admired Companies" was nearly universal (more than 90 percent).
- There was a correlation between the "Most Admired Companies" and their PR budgets.
- The more a PR function is designed, practiced and evaluated in close alignment with an organization's strategic business goals, the greater its support from top management in terms of budget, and the greater its perceived contribution to the organization's success.

To protect your brand and build and sustain a credible presence for your company, it is important to establish a "credibility budget." It does not have to be huge, but it should be proportionate to revenues. A good rule of thumb is a public relations-to-revenues ratio of 0.75 to 2.5 percent.

- **Be unfashionable: Apologize.**

Don't dodge responsibility when you have made a mistake. Ken Blanchard, author of "The One Minute Apology," says corporations should realize "the longer you wait to apologize for a wrongdoing, the quicker a weakness is seen as a wickedness." Not publicly apologizing puts off customers, employees and others. The apology helps restore value. But true atonement — and credibility — is won through future deeds that demonstrate that the same mistake is not repeated.

- **Act as if the media were embedded in your organization.**

We can learn a lesson from the conflict with Iraq, the first war in which journalists were embedded in various military units, gaining access to the buildup of military operations and the war itself.

Imagine if the media were embedded in your organization — what might they report? It's a useful test to undertake. Even though there are privileged matters in every company, a shared perspective and an open

and honest approach can help increase credibility — but only if you have nothing to hide.

- **Look at the quality of your corporate governance.**

The root of credibility is in good corporate governance. In the wake of the corporate scandals, governance guidelines have been developed for public companies under the Sarbanes-Oxley Act of 2002, and both public and private companies can reference the American Institute of Certified Public Accountants' new fraud audit standards. Private companies should also check state legislation. Seventy-nine percent of investors contacted in a recent Harris Interactive survey said they now want to know about a company's governance.

But it takes more than independent directors and audit committees to build a relationship of trust with your most important constituencies. Quality governance also means a company's board or other leadership must articulate, "role model" and implement the values (including ethical behavior) that will drive the culture. Open and honest communications are a constant.

- **Provide a feedback loop to management.**

One of the most important responsibilities of PR practitioners is serving as a channel for the free flow of information, back-and-forth, between the corporation and its many constituencies. You need to have the research systems in place to capture vital intelligence. The PR function then becomes a conduit for the office of the chairman, and thus the most senior PR professional should be part of the executive committee in order to effectively manage credibility from the top.

A great many organizations continue to earn the admiration and respect of their shareholders, customers, employees, business partners and the media. Among the key factors in their success are an understanding of the link between trust and value, a corporate commitment to transparency and accountability, and a PR program designed to foster credibility.



Kenneth D. Makovsky, APR, Fellow PRSA, is president of Makovsky & Company, a Top 25 global independent public relations & investor relations firm.

