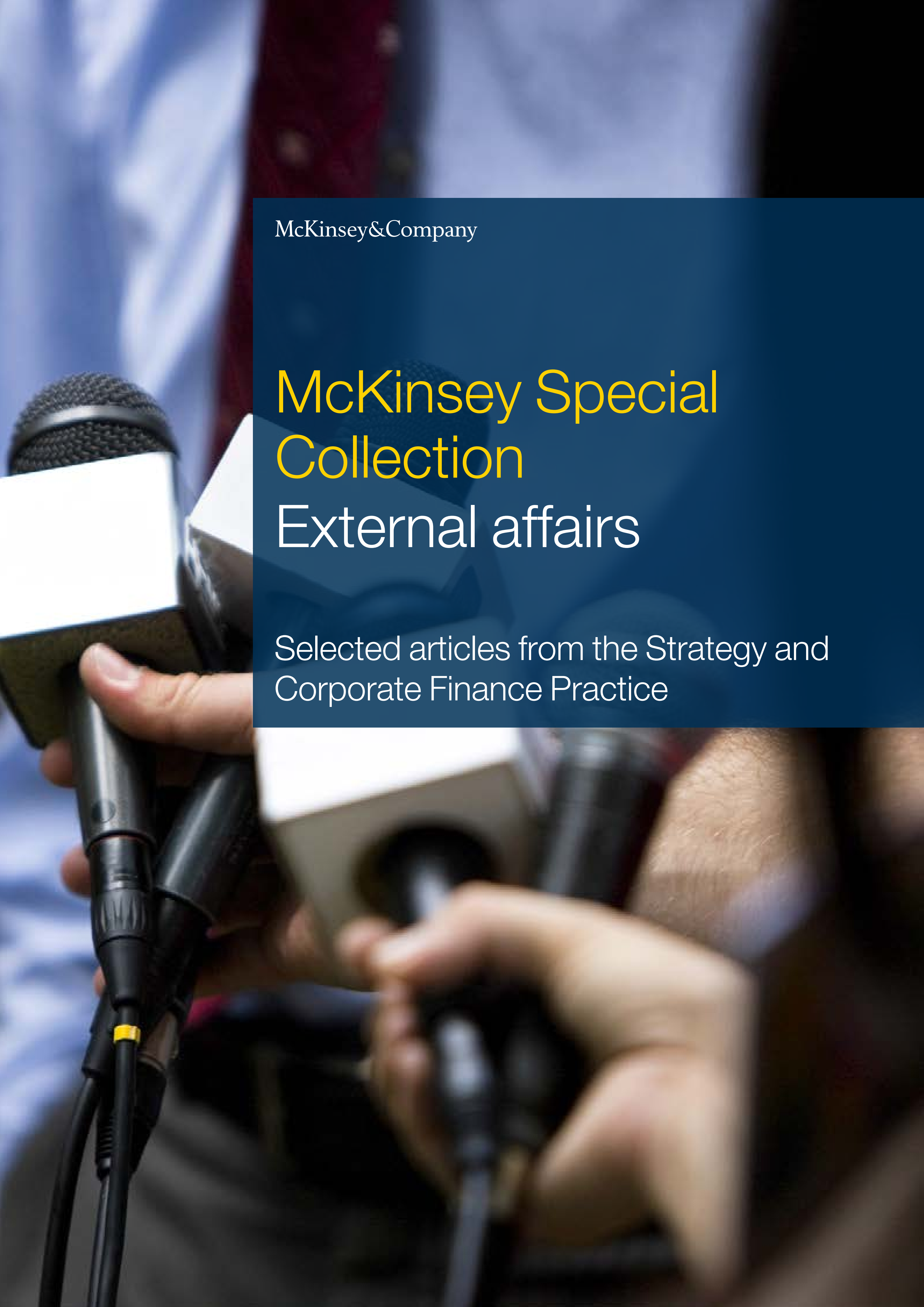

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How to reinvent the external-affairs function

Working with outside stakeholders is a rising priority for company leaders. But in a new survey, most executives say their organizations still lack the external-affairs capabilities they need to succeed.

Engaging with external stakeholders is more important than ever to company leaders, according to the fifth McKinsey Global Survey on external affairs.[1] Yet while most executives believe outside stakeholders will be increasingly involved in their industries in coming years, few say their companies have taken an active approach to engaging with stakeholders or that they have found success in their external-affairs efforts. The results suggest that to step up their game, companies should start by strengthening their capabilities—many of which aren't any stronger now than they were a few years ago. The companies that, according to respondents, are most successful at external affairs not only have better overall capabilities than their peers but they also are particularly skilled at organizing their external-affairs functions.

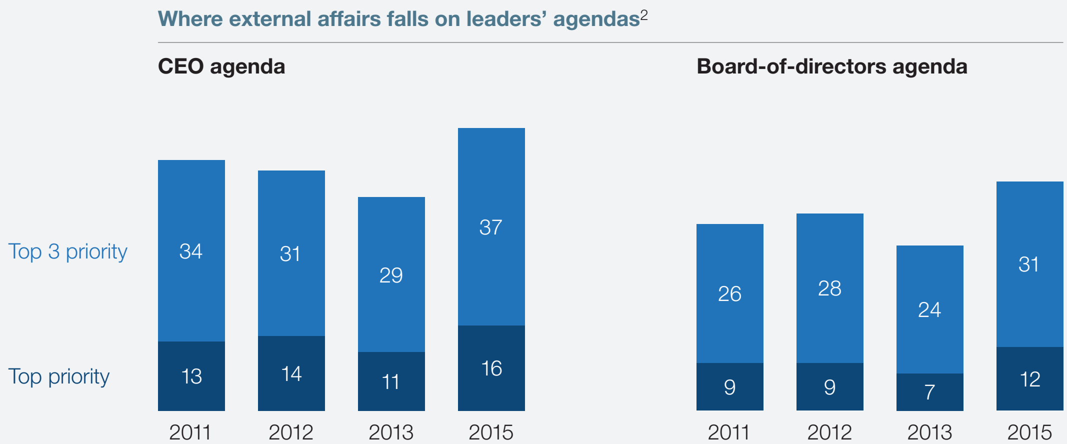
A rising role for stakeholder engagement—and the business value at stake

After several years of surveys on engaging external stakeholders, respondents now say the topic is a higher priority than ever before for their companies' leaders (Exhibit 1). External affairs now ranks as a top or

Jean-François Martin

Exhibit 1 **External affairs is a rising priority for both CEOs and boards.**

% of respondents[1]



[1] Respondents who answered "top 10 priority," "not a top priority," "not on the agenda," or "don't know" are not shown.
[2] In 2011, n = 1,396; in 2012, n = 3,525; in 2013, n = 2,186; and in 2015, n = 1,334. In the 2009 survey, these questions were not asked.

top three priority for more than half of CEOs, and boards also are paying more attention than they have in past years.

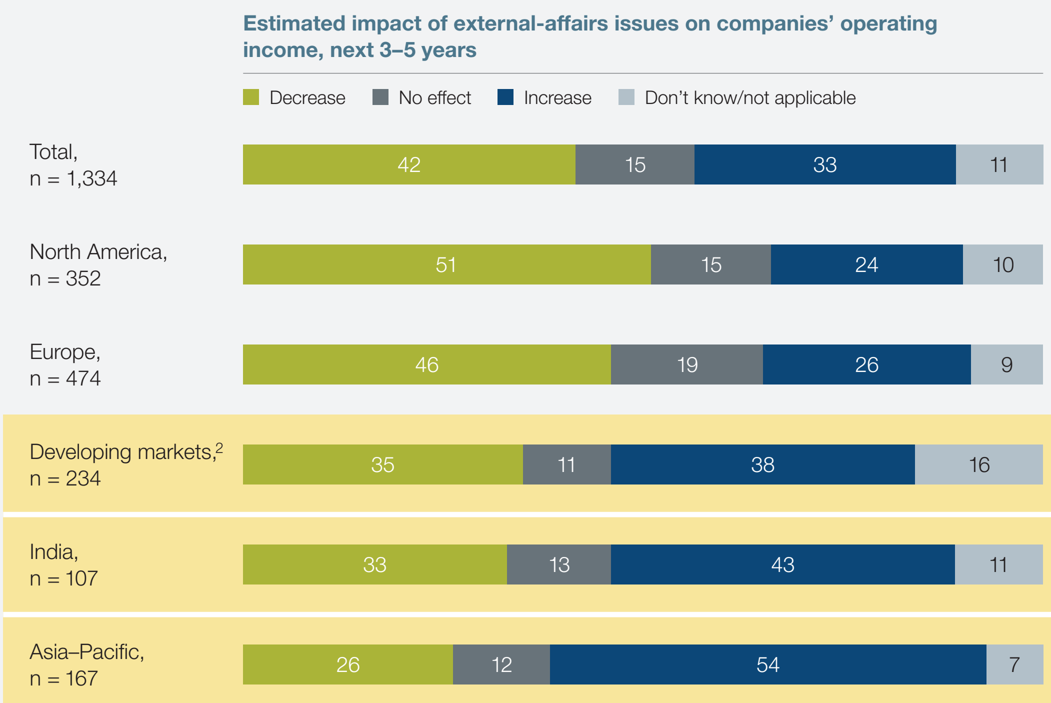
When asked about the most influential stakeholders, executives expect government entities and regulators—as well as customers—will have the greatest effect on their companies' value. Even outside the financial sector (where, in earlier surveys, executives have consistently ranked regulators more often than their peers as an important group), growing shares of respondents note the impact of this group. Among all respondents, 42 percent cite regulators as an important stakeholder, up from 30 percent in the previous survey. What's more, about two-thirds of all executives predict that government and regulator involvement will increase in the coming years. In financial services, in energy, and in healthcare and pharma, more than 80 percent of respondents say the same.

On average, respondents tend to expect the impact of this involvement will be negative. More than 40 percent (and a plurality) say the actions of governments and regulators will hurt their companies' future operating income.[2] Across regions, executives in Europe and North America are even more bearish than their peers. Some, though, view external-affairs issues as an opportunity for growth rather than a threat to income. In developed Asia and in developing markets, executives are more likely than others to believe external-affairs issues will boost their operating income in the coming years (Exhibit 2).

Exhibit 2

Executives in developing markets and in Asia are likelier than others to see external affairs as an opportunity rather than a risk.

% of respondents,[1] by region



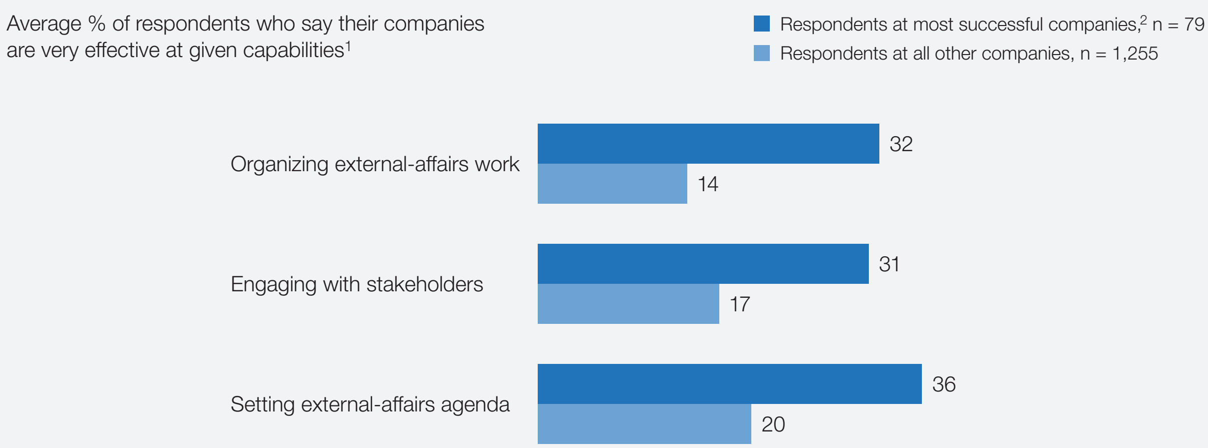
[1] Figures may not sum to 100%, because of rounding.
[2] Includes China and Latin America.

The struggle to succeed

Despite the growing focus on external relations and the recognition of the value at stake, responses suggest that success is rare. Only 11 percent of executives say their companies frequently succeed at shaping government and regulatory decisions, and there are no regions or industries where more than one in five respondents report success. Managing the corporate reputation is challenging as well: just 22 percent of respondents say they frequently succeed at this.

Even among the most successful companies that excel at both shaping decisions and managing their reputations,[3] many have a long way to go toward strengthening their capabilities in three areas: organizing the company's external-affairs work, engaging with stakeholders, and setting the external-affairs agenda (Exhibit 3). Overall, respondents report little progress—and even some declines—in the strength

Exhibit 3 **The companies that are most successful at external affairs have stronger capabilities than others, but even they have room to improve.**



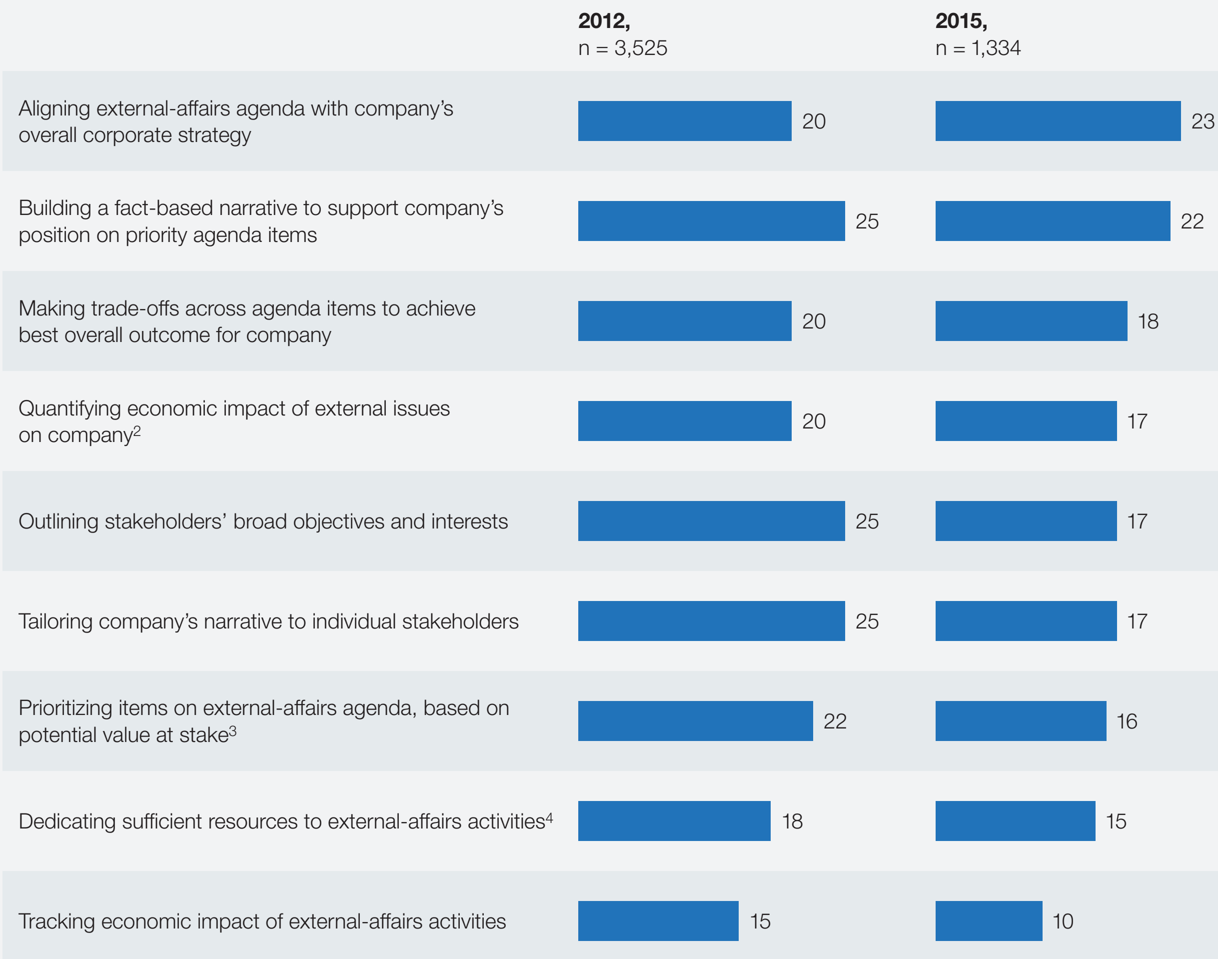
[1] Respondents were asked about 10 organization-related capabilities, 8 stakeholder-engagement capabilities, and 9 agenda-setting capabilities and how effective their companies are at each one. The figures above are the average percentages of "very effective" responses within each set of capabilities.
[2] Respondents who say their companies are frequently successful both at shaping government policy and/or regulatory decisions and at managing their corporate reputations among civil-society groups.

of their organizations' external-affairs capabilities since the 2012 survey (Exhibit 4). When asked how well their companies tailor their narratives to individual stakeholders, only 17 percent of respondents say they are very effective, down from one-quarter of respondents in 2012.

Exhibit 4

On average, respondents report little progress—and even declines—in the strength of their companies' capabilities since 2012.

% of respondents who say their companies are very effective at given capabilities[1]



[1] In the 2012 survey, respondents were also offered an "extremely effective" option for each capability. This was not offered as an option in 2015.
[2] In 2012, the option was "rigorously quantifying the potential economic impact of external issues."
[3] In 2012, the option was "assigning resources to external issues according to the value at stake."
[4] In 2012, the option was "dedicating sufficient talent and resources to external-affairs activities."

Other results may explain why, exactly, so many companies are struggling to break through. While external engagement has risen on the board agenda in recent years, few respondents say their board members oversee these activities well. Only one in five say their boards are very effective at setting a framework for how their companies manage stakeholder relationships, at balancing stakeholder interests in their decision making, or at interacting regularly with the most relevant stakeholders.

What's more, few executives report that their companies are actively engaging with stakeholders. Just one-quarter say that in the past year, their companies have taken a very active approach to engaging with governments and regulators; 30 percent, by contrast, say their approach is either very or somewhat passive. Both in energy and in healthcare and pharma, where respondents are much likelier than average to expect increasing involvement from these groups, executives are also likelier to report more active strategies. Yet even those executives report room to improve and be more active: respondents in these industries are no likelier than their peers to say they're successful at managing their reputations.

The nature of a company's engagement matters because, according to respondents, organizations that take a more active approach are much likelier than others to connect directly with stakeholders, instead of hiring lobbyists or relying on industry associations to engage on their behalf. The most active companies

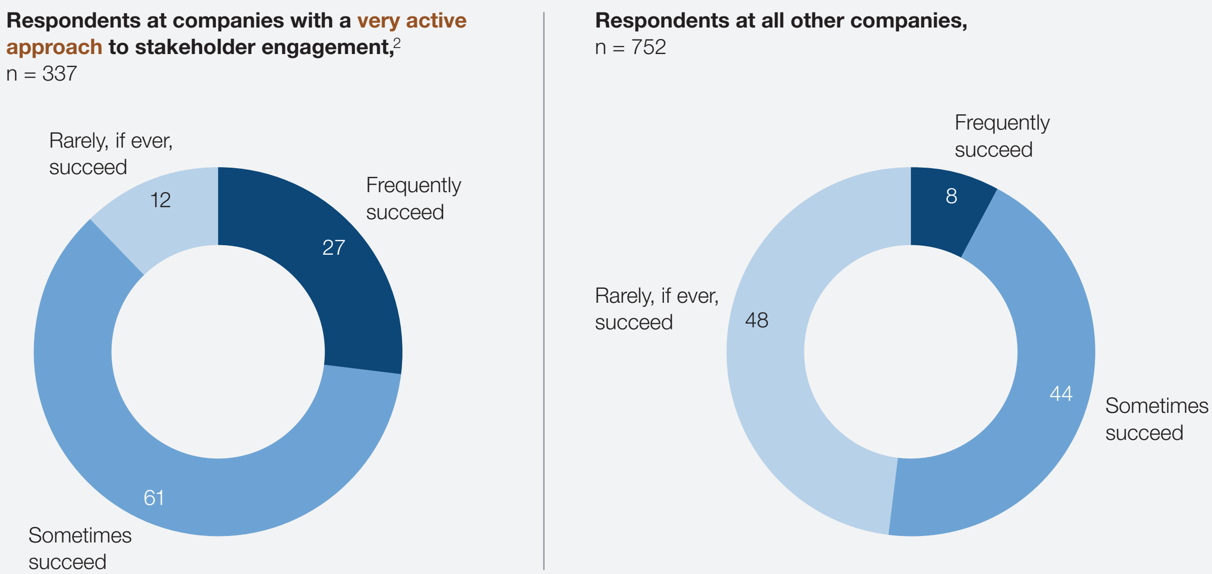
According to respondents, the companies that take the most active approach to engaging with governments and regulators are more likely than all others to see success from their overall external-affairs efforts.

Exhibit 5

Companies that take an active approach to stakeholder engagement report higher rates of overall success at external affairs.

% of respondents

Companies' success at shaping government policy and/or regulatory decisions that could affect their business environments[1]



[1] Respondents who answered "don't know/not applicable" about their companies' success are not shown.
[2] Specifically, engagement of governments and regulators in the past 12 months.

are also much likelier than others to succeed at external-affairs management overall (Exhibit 5). Of those reporting an active approach, 27 percent of executives say their companies frequently succeed at shaping policy and regulatory decisions. Among all other respondents, 8 percent say the same.

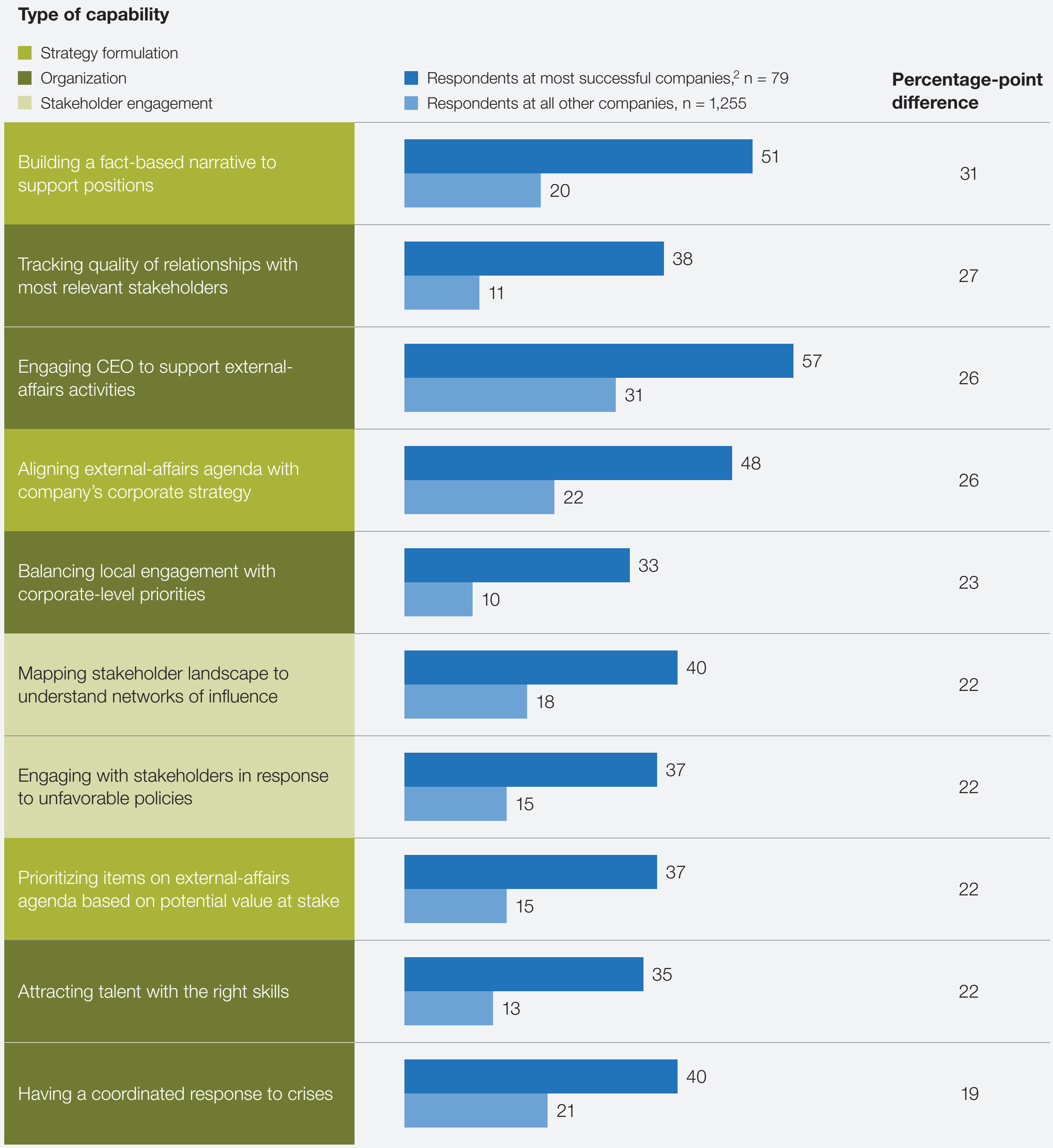
The capabilities that drive success

While success in external affairs is rare, it's not impossible—and it depends on more than just active engagement. We looked at 27 specific external-affairs capabilities in an effort to understand exactly how and where the most successful organizations are excelling. Executives at these organizations are more likely than other respondents to report effectiveness at each capability, and the gaps between their responses are especially pronounced in ten of them.

Half of these ten standout capabilities relate to the ways companies organize their external-affairs functions (Exhibit 6). For example, 57 percent of respondents at successful companies say they are very

Exhibit 6 **Of the ten capabilities where successful companies most outperform their peers, five are organization related.**

% of respondents who say their companies are very effective at given capabilities[1]



[1] Out of 27 capabilities the survey asked about. The 10 capabilities shown represent the biggest percentage-point differences between respondents at the most successful companies and those at all other companies.
[2] Respondents who say their companies are frequently successful both at shaping government policy and/or regulatory decisions and at managing their corporate reputations among civil-society groups.

effective at engaging their CEOs on the external-affairs agenda, compared with 31 percent of all others. And while only 35 percent of high performers say their companies are very effective at attracting the right talent, they're almost three times likelier than their peers to say so. When asked how their external-affairs functions are organized, those at the most successful companies also report a different approach than others do. The best companies are likelier than others to have a mix of central and local management and, relatedly, to effectively balance local needs with corporate-level priorities.

Of course, not every standout capability is organizational in nature. When setting the external-affairs agenda, respondents at the most successful companies are 2.5 times likelier than their peers to say they're very effective at building fact-based narratives to support their positions. They are also much likelier to report effectiveness at tracking the quality of their relationships with stakeholders. Other data suggest that digital tools have a role to play here. Although a whopping 82 percent of all respondents say their organizations use digital tools (such as social media) for business reasons, those at successful companies use these tools differently. When asked about their main goals for using digital tools, for instance, they most often cite promoting their companies' priorities and engaging with specific stakeholders, rather than driving website traffic or increasing their companies' media visibility—which respondents at other companies cite more often.

Looking ahead

- *Take an analytical approach*. Most survey respondents expect that governments and regulators will grow more involved in their industries over time—and that there are real implications for company value. Consequently, organizations can no longer afford to take a qualitative approach to engaging with these stakeholders and hope for the best. Regardless of their industry or location, organizations should think of external relations as an extension of their business and apply the analysis-based management practices they use in other areas of their companies. This means, for example, tracking the economic impact of their companies' external-affairs activities (and the quality of their stakeholder relationships) and using that information in specific tactics for engagement, such as the development of fact-based narratives that will resonate with external stakeholders.

- *Reimagine the organization*. To succeed in external affairs, organizations need the right structure and people to support it. For many companies, this requires a rethinking of the function's setup, so its work is more visible in the organization and more strategic, too. To start, companies should focus on developing the standout capabilities (especially those in the organization category) that have helped the most effective organizations succeed. The leaders of external-affairs functions should also seek to play a more active role in shaping strategic decisions that could be affected by external forces. They will also need strong talent in their functions—people who can act as thought partners to other functions and build long-term relationships with external stakeholders. ■

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[1] The online survey was in the field from November 5 to November 15, 2015, and garnered responses from 1,334 executives representing the full range of regions, industries, company sizes, functional specialties, and tenures. To adjust for differences in response rates, the data are weighted by the contribution of each respondent's nation to global GDP.

[2] When asked about the expected impact that external-affairs issues will have on their companies' income in the next three to five years, 42 percent of respondents believe their income will decrease, 15 percent believe it will stay the same, 33 percent believe it will increase, and 11 percent say they don't know or it's not applicable. Figures do not sum to 100 percent, because of rounding.

[3] We define a most successful company as one that, according to respondents, is frequently successful both at shaping government policy and/or regulatory decisions and at managing their corporate reputations among civil-society groups.

The contributors to the development and analysis of this survey include **Alberto Marchi**, a senior partner in McKinsey's Milan office; **Robin Nuttall**, a partner in the London office; and **Ellora-Julie Parekh**, a specialist in the Brussels office.

External affairs at a crossroads

While executives continue to agree that external affairs will affect their companies' business, few report having the internal capabilities or pursuing the actions that support effective outcomes.

For a third consecutive McKinsey survey on managing external affairs, a majority of executives say external-affairs issues will affect their companies' income.[1] But even those reporting successful outcomes say their companies struggle to quantify the impact these issues will have on their business. These are among the key findings from the fourth McKinsey Global survey on the topic, which asked global executives about the relative value created by external-affairs activities, the specific actions companies pursue, and the strategies companies use to interact with stakeholders.[2]

While respondents largely agree that governments' and regulators' involvement will grow in the coming years—and that these groups' decisions will affect operating income—few report that their companies have put in place the right organizational capabilities, such as adequate resources or systematic measurement of outcomes. The executives reporting more robust capabilities are likelier than others to say their companies take key external-affairs actions on a regular basis. And these more "active" companies are likelier than others to see successful results: that is, frequently succeeding at managing their reputations and shaping policy and regulatory decisions. There's no single strategy for stakeholder engagement that works best

[1] "External affairs" includes, but is not limited to, activities performed by departments such as external affairs, public affairs, corporate affairs, government and regulatory affairs, corporate communications, public relations, and corporate social responsibility.

[2] This survey was in the field from January 29 to February 8, 2013, and received responses from 2,186 executives representing the full range of regions, industries, company sizes, tenures, and functional specialties. To adjust for differences in response rates, the data are weighted by the contribution of each respondent's nation to global GDP.

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for all companies, respondents say, and the ways in which companies interact with stakeholders vary among geographies, sectors, and even within our "success" group. But the results and our experience suggest that *not* engaging isn't an option; neither is neglecting the organizational capacities and resources that support meaningful action.

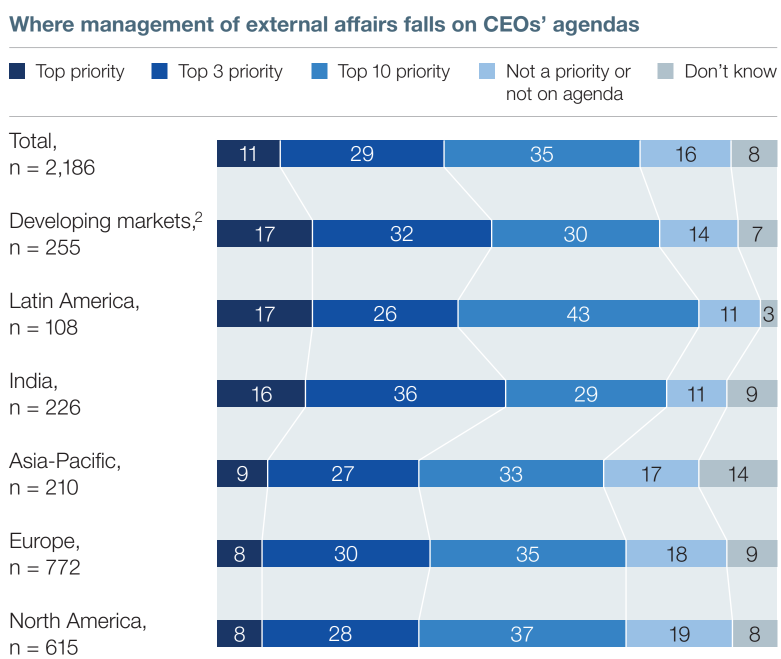
Steady views, stalled success

This year's responses indicate that executives have reached a consistent view on how—and by how much—external issues matter. First, respondents agree that, among stakeholders, customers (followed by governments and regulators) will have the greatest impact on company value. They also tend to assert that these issues will decrease operating income as government and regulator involvement in their industries will keep increasing.

Exhibit 1

Prioritizing external issues in emerging markets

% of respondents,[1] by office location



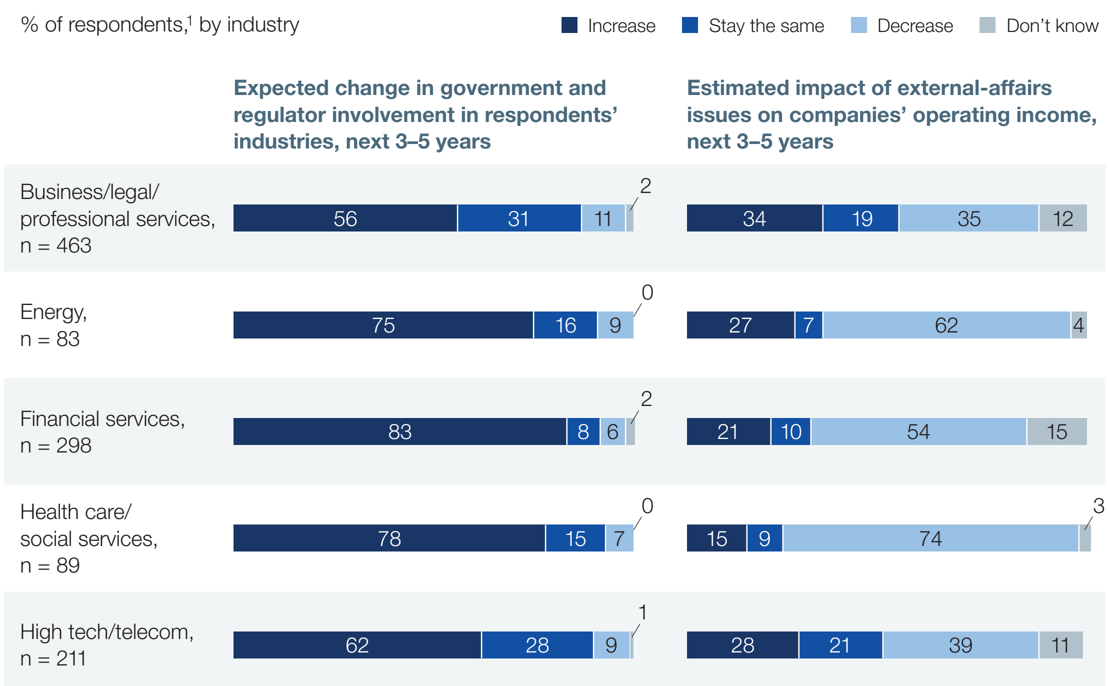
[1]Figures may not sum to 100%, because of rounding.
[2]Includes China.

[3] Pluralities of respondents in every region (including Latin America) say external-affairs issues will have a negative impact on their companies' operating income. This year, half of executives in North America say so, down slightly from 52 percent who said the same last year. The smallest shares expecting increased income from external-affairs issues are in North America and Europe (24 percent and 25 percent, respectively), which was also true in the 2012 survey.

The importance of external affairs continues to be more acute in certain regions and industries than in others. A growing share of executives in Latin America (39 percent, up from 31 percent last year) expect income will increase as a result of external-affairs issues, while those in other regions are still wary of the financial impact.[3] And respondents in emerging markets are more likely than those in developed economies to say their CEOs consider external affairs a top priority (Exhibit 1). Across industries, much larger shares of respondents in health care and energy than in other sectors expect external-affairs issues will reduce income (Exhibit 2). Meanwhile, financial-services executives are still the most likely among their peers to expect increased government and regulator involvement, to rank these two as the stakeholders with the greatest effect on company value, and to say external affairs is a top CEO priority.

Exhibit 2

Varied industry effects



[1] Figures may not sum to 100%, because of rounding.

Despite the general consensus on the significance of stakeholders and these issues, respondents say efforts to mitigate risk or create value through external affairs have stalled. In line with results from the past two surveys, just 21 percent say their companies frequently succeed at shaping government policy or regulatory decisions. A larger share than before report success at reputation management, which may owe partly to this year's rewording of the question: we asked respondents how well their companies manage reputation among civil-society groups, and 45 percent say they frequently succeed at doing so.[4]

A need for more action

Overall, the results suggest that this struggle to influence policy and manage reputation links back to a lack of organizational capabilities and actions taken. While most respondents (69 percent) say their top-management teams or CEOs become directly involved in strategy if needed, much smaller shares report capabilities related to decision making, sufficient talent and resources, cross-functional buy-in, skill development, and the systematic measurement of outcomes.[5]

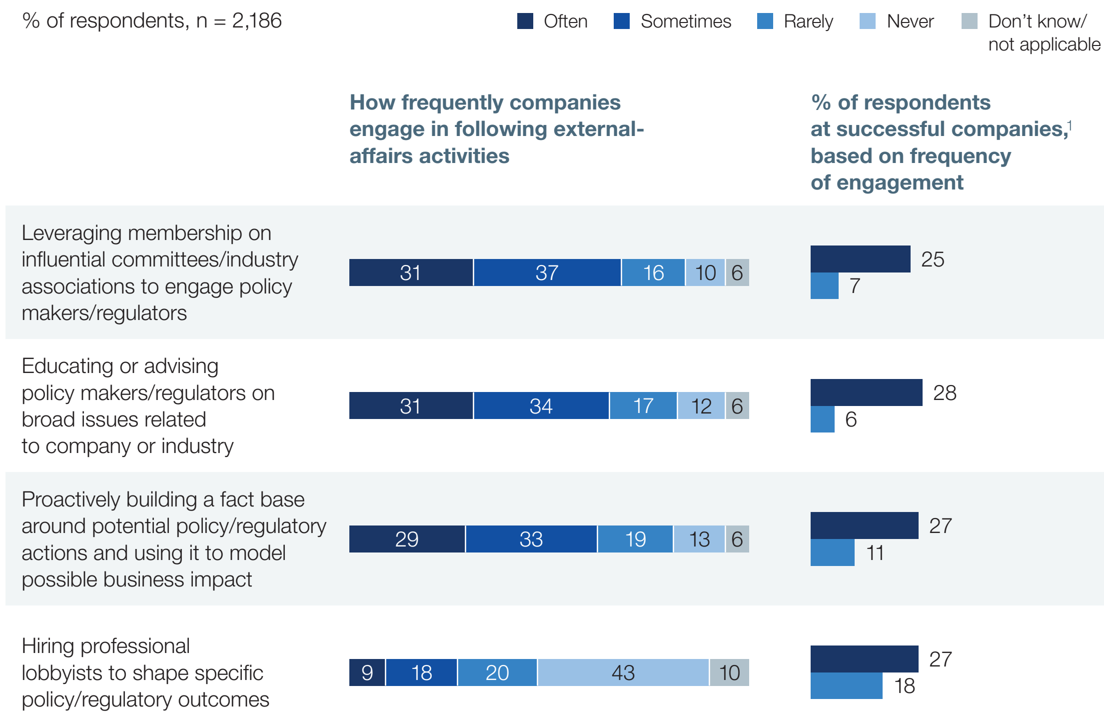
At companies with stronger capabilities, more executives say they are pursuing four activities that, in our experience, make up the foundation of an external-affairs program: educating policy makers and regulators on industry issues, engaging these stakeholders on committees or industry associations, modeling the impact of potential policy actions, and hiring lobbyists to shape policy or regulatory outcomes. Nearly one-third of executives say their companies often engage in the first three, while 9 percent report hiring lobbyists—but across actions, these shares are much larger if the company has established any of the six capabilities we asked about.

[4] In the previous two surveys, we asked respondents how effectively they managed their corporate reputation to mitigate risk or create value. Last year, 27 percent answered "very effective, so it was a significant source of competitive advantage" (while 61 percent said "somewhat effective, mostly by actively managing risks and handling crises as they arise," and 6 percent said "not at all"). In 2011, 30 percent of respondents said "very effective," 58 percent said "somewhat," and 7 percent said "not at all."

[5] After top-management and CEO involvement, equal shares of respondents (27 percent) say their companies have processes to ensure that external-affairs issues are considered in daily decision making and that they have sufficient in-house talent and resources to build an economic fact base for external-affairs activities. This is followed by having a formal, cross-functional strategy process that involves both internal functions and external partners (24 percent), developing external-engagement skills across the organization (21 percent), and systematically measuring external-affairs outcomes (16 percent). Ten percent of executives say their companies have none of these capabilities.

Exhibit 3

More action, more success

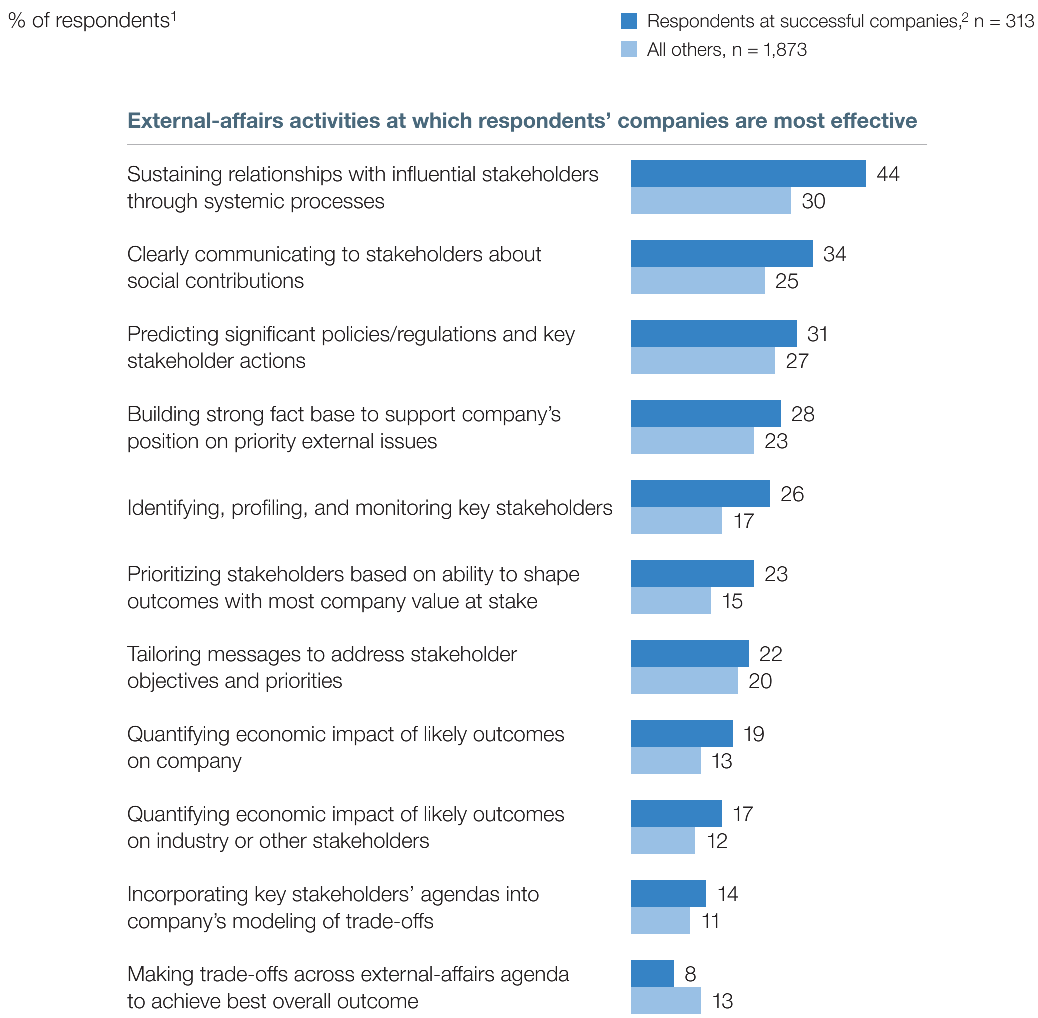


[1] Respondents who say their companies frequently succeed at shaping policy and regulatory decisions and at managing their corporate reputation among civil-society groups, such as nongovernmental organizations and consumer groups, that could affect their business environment.

In turn, respondents at companies that often pursue each of these activities are much more likely than those who don't to report successful reputation and policy outcomes (Exhibit 3). Larger shares at the "success" companies say each of the six capabilities we asked about is in place at their organizations. They also are likelier than others to rate their companies as effective at a range of related practices, including the activity that all respondents most often cite: maintaining stakeholder relationships (Exhibit 4). But even successful companies struggle when it comes to quantifying the economic impact of external-affairs outcomes for themselves and their industries.

Exhibit 4

Strength in relationships



[1] Respondents who answered "other" or "don't know/not applicable" are not shown.
[2] Respondents who say their companies frequently succeed at shaping policy and regulatory decisions and at managing their corporate reputation among civil-society groups, such as nongovernmental organizations and consumer groups, that could affect their business environment.

Reputational strengths and weaknesses

Consistent with the findings from a September 2012 survey[6] on reputation, executives are quite confident about their companies' standing: 62 percent say their reputations are significantly differentiated from or better than their competitors'. One tool companies can use to stand out is social media. Among respondents who say their companies use social media to track reputation-related stakeholder concerns, 58 percent say they successfully manage reputation, while only 44 percent of those not using social media report frequent success.

Still, respondents note a few weak spots. When asked to identify their companies' reputational strengths, respondents most often select high-quality products and services, trustworthy leadership, and values-driven business conduct. When asked about their vulnerabilities, the largest shares cite innovation, strong financial performance, and societal contributions (Exhibit 5).

[6] In the survey, 61 percent of all respondents said their overall reputations were either significantly differentiated from or better than those of competitors in their industries.

Exhibit 5

Reputational assets and weaknesses

% of respondents,[1] n = 2,186

Areas where companies' reputations are strongest and most vulnerable, compared with competitors

	Strengths	Weaknesses
High-quality products and services	47	10
Trustworthy CEO and top-management team	34	10
Values-driven, transparent business conduct	31	13
Innovation	31	31
Operational excellence	28	24
Strong financial performance	25	31
Fair treatment of employees	22	16
Sustainable business practices	20	20
Societal contributions	19	25
Fair pricing practices	13	23

[1] Respondents who answered "other" or "don't know/not applicable" are not shown.

Strategic engagement

When asked to identify the strategy their companies use to engage with governments and regulators, respondents tend to report either a proactive or an improvement-focused approach, though there is no single strategy that leads the way. Even respondents at successful companies report using a wide variety of strategies, though they do engage more often than others in the first place.

Likewise, the approach varies by geography (Exhibit 6). Executives in Latin America are most likely to report a defensive stance toward engagement, even though they're most likely to

Exhibit 6

Diverse approaches to engagement

% of respondents,[1] by office location

Companies' strategies for engaging with governments and regulators in home countries, past 12 months

	Asia-Pacific, n = 210	**Developing markets,**[2] n = 255	**Europe,** n = 772	**India,** n = 226	**Latin America,** n = 108	**North America,** n = 615
Defensive Aim primarily to amend existing regulation	9	10	11	9	22	8
Improvement-based Identify new business opportunities and/or redefine business models	30	25	19	17	29	17
Breakthrough Take leadership position to shape outcomes for company's sustained economic benefit	9	6	8	8	17	12
Proactive Engage consistently and in a collaborative way that yields both wins and losses for company's business	25	29	20	23	13	22
Offensive Proactively propose and shape new regulations with notable impact on company's business	7	8	14	12	3	13
No engagement in past 12 months	13	13	18	15	9	19

[1] Respondents who answered "other" or "don't know/prefer not to answer" are not shown.
[2] Includes China.

expect governmental and regulatory involvement will increase in the next few years. Still, they engage more often than average; only 9 percent say they have not engaged at all with these stakeholders in the past year, compared with 16 percent of the global average who say the same.

Looking ahead

- *First and foremost, engage.* It's good news that so many respondents say their companies are engaging with stakeholders—and doing so with a positive, proactive mind-set—because a lack of engagement is not an option. To get ahead of potential challenges, executives need to assess their specific context (that is, their countries and industries) before deciding on the best strategy.

- *Determine the value at stake.* Even the most successful organizations are struggling to quantify how external-affairs outcomes will affect their companies: only 19 percent of executives at these companies say they do this well, which is an even smaller share than all respondents in 2009 who said their companies quantified the potential impact of government actions very or extremely effectively. All companies would do well to build capabilities that can enable more rigorous measurement, especially since majorities of respondents expect external issues to have some financial impact (either positive or negative) in the coming years.

- *Build skills.* The results affirm that the strength of a company's skills and resources is linked to the success (or failure) of its outcomes. Even with goodwill and CEO support, companies cannot make real progress on their external-affairs agendas unless they develop and professionalize the underlying capabilities, especially the ones much more likely to be found at successful companies: sufficient talent and cross-functional processes. ▢

About the contributors

The contributors to the development and analysis of this survey include **David Dyer**, a principal in McKinsey's Melbourne office; **Robin Nuttall**, a principal in the London office; and **Ellora-Julie Parekh**, a specialist in the Brussels office.

The McKinsey Quarterly

STRATEGY PRACTICE

JUNE 2009

Rebuilding corporate reputations

A perfect storm has hit the standing of big business. Companies must step up their reputation-management efforts in response.

Sheila Bonini, David Court, and Alberto Marchi

McKinsey&Company

As governments respond to the financial crisis and its reverberations in the real economy, a company's reputation has begun to matter more now than it has in decades. Companies and industries with reputation problems are more likely to incur the wrath of legislators, regulators, and the public. What's more, the credibility of the private sector will influence its ability to weigh in on contentious issues, such as protectionism, that have serious implications for the global economy's future.

Senior executives are acutely aware of how serious today's reputational challenge is. Most recognize the perception that some companies in certain sectors (particularly financial services) have violated their social contract with consumers, shareholders, regulators, and taxpayers. They also know that this perception seems to have spilled over to business more broadly. In a March 2009 *McKinsey Quarterly* survey of senior executives around the world, 85 and 72 percent of them, respectively, said that public trust in business and commitment to free markets had deteriorated.[1] According to the 2009 Edelman Trust Barometer, those executives are reading the public mind correctly: 62 percent of respondents, across 20 countries, say that they "trust corporations less now than they did a year ago."

The breadth and depth of today's reputational challenge is a consequence not just of the speed, severity, and unexpectedness of recent economic events but also of underlying shifts in the reputation environment that have been under way for some time. Those changes include the growing importance of Web-based participatory media, the increasing significance of nongovernmental organizations (NGOs) and other third parties, and declining trust in advertising. Together, these forces are promoting wider, faster scrutiny of companies and rendering traditional public-relations tools less effective in addressing reputational challenges.

Now more than ever, it will be action—not spin—that builds strong reputations. Organizations need to enhance their listening skills so that they are sufficiently aware of emerging issues; to reinvigorate their understanding of, and relationships with, critical stakeholders; and to go beyond traditional PR by activating a network of supporters who can influence key constituencies. Doing so effectively means stepping up both the sophistication and the internal coordination of reputation efforts. Some companies, for example, not only use cutting-edge attitudinal-segmentation techniques to better understand the concerns of stakeholders but also mobilize cross-functional teams to gather intelligence and respond quickly to far-flung reputational threats.

One key to cutting through organizational barriers that might impede such efforts is committed senior leadership, including leadership from CEOs, who have an opportunity in today's charged environment to differentiate their companies by demonstrating real statesmanship. The stakes demand it; an energized public will expect nothing else. At a moment when capitalism seems flat on its back, CEOs have an obligation to bolster the reputations of their companies and of free markets.

A rapidly evolving reputation environment

The financial crisis has underscored just how ill-equipped companies can be to deal with two important changes in the reputation environment. First, the influence of indirect stakeholders—

[1] See "Economic Conditions Snapshot, March 2009: McKinsey Global Survey Results," mckinseyquarterly.com, March 2009.

such as NGOs, community activists, and online networks—has grown enormously. The number of NGOs accredited by the United Nations, for instance, has grown to more than 4,000, from less than 1,000 in the early 1980s. These proliferating indirect stakeholders have tasked business with a broader set of expectations, such as making globalization more humane and combating climate change, obesity, human-rights abuses, or HIV.

Second, the proliferation of media technologies and outlets, along with the emergence of new Web-based platforms, has given individuals and organizations new tools they use to subject companies to greater and faster scrutiny. This communications revolution also means that certain issues (such as poor labor conditions) that might be acceptable in one region can be picked up by "citizen journalists" or bloggers and generate outrage in another.

As a result, what formerly were operational risks resulting from failed or inadequate processes, people, or systems now often manifest themselves as reputational risks whose costs far exceed those of the original missteps. In banking, for example, data privacy has become a reputational issue. In pharmaceutical clinical trials, Merck's experience with Vioxx showed that anything less than full transparency can lead to disaster. And as risk-management problems in the financial sector have generated astronomical losses that taxpayers are helping bear, it's little wonder that the reputational fallout has been enormous.

An outmoded approach to reputation management

In this dispersed and multifaceted environment, companies must collect information about reputational threats across the organization, analyze that information in sophisticated ways, and address problems by taking action to mitigate them. That can involve developing alliances with new kinds of partners and coordinating responses from a number of parties, including governments, civil-society groups, and consumers. All this requires significant coordination and an ability to act quickly.

Many companies, though, rely primarily on small, central corporate-affairs departments that can't monitor or examine diverse reputational threats with sufficient sophistication. Moreover, traditional PR spin can't deal with many NGO concerns, which must often be addressed by changing business operations and conducting two-way conversations. Managers of business units have a better position for spotting potential challenges but often fail to recognize their reputational significance. Internal communication about them may be inhibited by the absence of consistent methodologies for tracking and quantifying reputational risk. Accountability for managing problems is often blurred.

As a result, responses to reputational issues can be short term, ad hoc, and defensive—a poor combination today given the intensity of public concern. And therein lies a problem that companies must solve quickly: even as reputational challenges boost the importance of good PR, companies will struggle if they rely on PR alone, with little insight into the root causes of or the facts behind their reputational problems.

A better, more integrated response

A logical starting point for companies seeking to raise their game is to put in place an effective early-warning system to make executives aware of reputational problems quickly. In our experience, most companies are quite good at tracking press mentions, and many are beginning

Assuming responsibility

Stanley Greenberg and Howard Paster are political consultants and public-relations experts with a long history of advising companies and individuals, including former US president Bill Clinton. Paster also formerly served as chairman and CEO of Hill & Knowlton, a PR firm owned by the WPP Group. The conversation that follows, in which the two reputation gurus reflect on the challenges facing business leaders and the steps they should take to rebuild trust, is a compilation of interviews that McKinsey's Sheila Bonini and Allen Webb conducted separately with Greenberg and Paster in March 2009.

The *Quarterly*: *The reputation of big business has waxed and waned over the years. Do you see anything exceptional in attitudes toward business today?*

Stanley Greenberg: What's special now is that corporate behavior is seen as being central to the most severe economic crisis since the Depression. This is being identified as a crisis produced by bad decisions and irresponsible behavior. That makes reputation issues more dramatic than in any prior period.

Howard Paster: We've also got a larger set of reputation issues here: trust, confidence, wondering whether unfettered capitalism is a problem.

The *Quarterly*: *How can companies dig out?*

Stanley Greenberg: Responsibility is critical. I don't mean *assigning* responsibility, but people in positions of responsibility *assuming* responsibility. There is probably nothing more important to get right than conveying that the leaders of companies recognize this is a special moment.

I also think this is uniquely a time when the answer to the reputation problem lies less in what you are doing externally and more in what kind of company you run—the way you deal with your employees and consumers, the behavior and compensation of leaders. I don't think you address this problem by doing more work in food banks or in neighborhoods; I think this is really about business practices. If you're a bank, people think you have walked away from your essential functions. So you have to highlight how you are resuming business and expanding lending, if you are.

Howard Paster: The first thing you have to do if you're in financial services is explain to people that you weren't part of the problem, assuming you weren't. You need to come up with specific ways to put distance between you and the bad guys. For example, the public face of a company is a big deal. Companies in trouble are wise to change their chief executives.

You've also got to announce, all the time, how you're doing things differently. You have to devise ways of reiterating this again and again—preaching and living integrity internally, having codes of conduct, having the right kinds of staff briefings, making integrity a basic premise of your operation, building it into your business. At a time when you have less money for philanthropy, for environmental initiatives, or for your employees, you'd better run a place with a lot of integrity.

The *Quarterly*: *How important are symbolic actions, such as Goldman Sachs's recent announcement that employees will stay at a lower-cost hotel when they go to New York?*

Stanley Greenberg: I think it is a big deal. It may look like symbolism, but it is an important new tone. Executives have seemed tone deaf.

The *Quarterly*: *What else can help?*

Howard Paster: When a company gets into trouble, we always say, "Who is there that you can bring in, whose reputation is such that he or she, by virtue of being your independent auditor or your independent investigator, can become part of the cleansing process—identify problems, be believed by the media, authenticate changed behavior?" People like to use former attorneys general or someone like former senator Warren Rudman, a man of great probity: strong willed, but God he's honest and he'll tell you what he thinks. That's worth a lot.

The *Quarterly*: *One reason reputation is important is that it will influence regulations and policies. How should companies approach this debate?*

Stanley Greenberg: We are going to move to re-regulating a whole range of markets as a result of all this. I think companies, understanding that the public views them as having produced a global crisis of unheard-of proportions, need to be thinking about how they reenter the debate. The perception I see among many companies is that government is overreaching. But I do not think pushing back is the best way to reenter the public discussion about the proper balance of regulation. Right now, I assume CEOs are not a very legitimate voice on how to regulate properly. One of the greater challenges will be how business gets the right voice for a momentous debate. I think responsibility is the critical piece. People are looking for responsibility to be a much stronger value on an individual, corporate, and political level. The companies that get this, that seem to be part of this, are in a much better position to have a voice in re-regulation.

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to monitor the multitude of Web-based voices and NGOs, whose power is beginning to rival the mainstream media's. However, doing these things effectively, while an important prerequisite for stepping up engagement with stakeholders, isn't the toughest task facing organizations.

Far more of a challenge is preparing to meet serious reputational threats, whose potential frequency and cost have risen dramatically given the greater likelihood that stakeholders—including regulators and legislators—will lash out in an atmosphere that's become less hospitable to business. These threats might take a variety of forms: issues related to a company's business performance, like those that financial companies have recently experienced (see sidebar, "Assuming responsibility"); unexpected shocks along the lines of Johnson & Johnson's Tylenol scare, more than two decades ago; opposition to business moves, such as expanding operations; or long-standing, sector-specific issues, for instance climate change (industrials and oil and gas), obesity (the food and beverage industry), hidden fees (telecom providers), "e-waste" (high tech), and worker safety (mining).

To prepare for and respond to these threats, our experience suggests that companies should emphasize three priorities. First, they need to assemble enough facts—most important, perhaps, a rich understanding of key stakeholders, including consumers—and not only the product preferences but also the political attitudes of consumer groups. Second, companies should focus on the actions that matter most to stakeholders, something that may call for an exaggerated degree of transparency about corporate priorities or operations. Third, they must try to influence stakeholders through techniques that go beyond traditional PR approaches, with an emphasis on two-way dialogue. Underlying these priorities is a willingness to participate in the public debate more actively than many companies have in the past. Instead of allowing single-issue interest groups to control the conversation, companies should insist on a more complete dialogue that raises awareness of the difficult trade-offs they face.

Understanding stakeholders and their concerns

Companies should first develop a deeper understanding of the reputational issues that matter to their stakeholders and of the degree to which their products, services, operations, supply chains, and other activities affect those issues. A company trying to improve its environmental reputation, for example, needs to document, catalog, and assess its sustainability efforts and then to benchmark them against those of its competitors and industry standards. The facts should be presented objectively and, if possible, quantitatively—for example, the amount of carbon emitted or water used. Quantitative measurements promote effective comparisons and help companies avoid ignoring potential issues or performance gaps.

Such an analysis may lead a company to conclude that it has a good story that should be told more vigorously—or that it should refrain from doing so until it takes real action. The analysis also is the starting point for an objective quantification of reputational risks. The company can prioritize them and the measures needed to keep them at bay by assessing the probability and financial cost of potential reputational events, such as consumer boycotts or the forced closure of operations.

Reputations are built on perceptions, however, so issue analysis isn't enough. Companies must also know if they are meeting the expectations of key stakeholders—those in the best position to influence sales and growth. To identify these centers of influence, companies should cast a wide net, scrutinizing not just traditional stakeholders (consumers, employees, shareholders, and regulators) but also indirect ones, such as NGOs and the media, that help shape attitudes. Even for companies that don't deal directly with consumers, it's important to understand public opinion. People have unprecedented access to information now and may therefore concern themselves with a surprisingly wide array of issues, potentially providing the impetus for regulatory or legislative action.

Each kind of stakeholder has unique perceptions and concerns. Shareholders might ask if reputational issues will affect a company's long-term growth prospects. Regulators could worry that the public thinks they should curb the company. The media might wonder if it could be an example of how business exploits society. There are different ways of identifying the perceptions of each kind of stakeholder and their root causes (Exhibit 1). A detailed press analysis can help companies to understand the positions of columnists and editors on key issues. Interviews with regulators can clarify their concerns. Focus groups and market research are important for understanding consumers and the wider public.

If consumer research is required, companies must understand that an analysis of how different consumers feel about them differs from typical segmentations: one for reputation management

Exhibit 1

Understanding the stakeholders

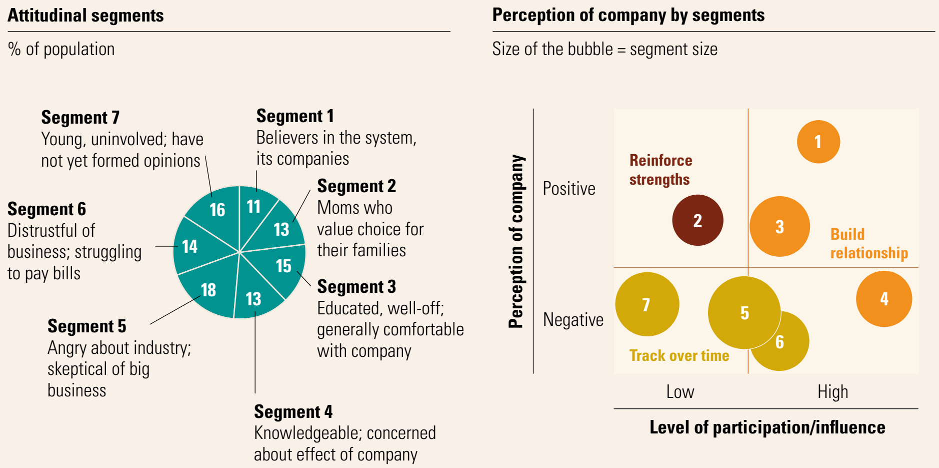
A company can employ methods specific to each type of stakeholder in seeking to understand its position on reputational issues.

	Consumers and partners	Media, including Internet, newspapers, TV	Shareholders, analysts, investors	Regulators	Civil society—eg, activist groups, nongovernmental organizations (NGOs), labor unions
Key issues	• Avoiding purchases, because of negative perceptions of company	• Portraying big business issues in a negative light • Lacking the in-depth reporting required for a balanced view of the issue	• Effect on share prices • Changing investments	• Shaping policy and regulation • Monitoring impact on consumers, environment, and society	• Advocating environmental, social, governance, and economic standards
Key questions asked by stakeholders	• Limited; if any, probably through investment conferences	• Limited, usually through telephone discussions with investor relations unit	• Multiple in-depth meetings with executives at all senior leadership levels • Follow-up conversations, if necessary, with investor relations unit	• Occasional meetings, calls with investor relations unit • Semiannual or annual senior-management meetings	• Occasional meetings, calls with investor relations unit • Semiannual or annual senior-management meetings
Actions company can take	• Past financials, consensus estimates, trading information, implied valuation	• Web site, press releases, management press, sell-side analyst calls and reports, industry reports	• Past operations and unit-level information, management's future strategy and forecasts, industry outlook, management's background • Detailed follow-up information from company	• Quarterly updates on performance, significant changes in outlook	• Quarterly updates on performance, significant changes in outlook
Questions company should ask	• Limited; if any, probably through investment conferences	• Limited, usually through telephone discussions with investor relations unit	• Multiple in-depth meetings with executives at all senior leadership levels • Follow-up conversations, if necessary, with investor relations unit	• Occasional meetings, calls with investor relations unit • Semiannual or annual senior-management meetings	• Occasional meetings, calls with investor relations unit • Semiannual or annual senior-management meetings

Exhibit 2

Whom to target

For disguised European consumer company



resembles a dissection of voters in a political campaign rather than a parsing of customers who prefer different types of products or services. There might, for example, be a group of consumers who care deeply about social issues and will weigh in aggressively on regulatory ones affecting a company's operations. Others, such as swing voters, might be undecided about whether, or how, to become involved. Some could be uninterested and unlikely to take action. Still others may be so anti- or probusiness that their positions are set in stone. One consumer company facing regulatory challenges used this type of "social attitudinal" segmentation to analyze consumers (Exhibit 2). After identifying people who were both influential and open-minded, the company focused on addressing their needs, and the public's attitudes toward it improved.

Transparency and action

Reputations are built on a foundation not only of communications but also of deeds: stakeholders can see through PR that isn't supported by real and consistent business activity. Consumers, our research indicates, feel that companies rely too much on lobbying and PR unsupported by action. They also fault companies for not sharing enough information about critical business issues—for manufacturers, say, the content of their products, their manufacturing processes, and their treatment of production employees. Transparency in such matters is crucial. Sometimes it highlights a mismatch between consumer expectations and a company's performance and therefore calls for action. In other cases, transparency can convince key stakeholders that the company is headed in the right direction.

After the director of the US Food and Drug Administration voiced reservations about the side effects of the high-cholesterol treatment Crestor, for example, AstraZeneca not only placed ads in the national press to present its case but also took the unusual step of providing raw clinical-trial data on its Web site, allowing completely independent researchers to draw their own conclusions. This was a high-risk strategy, since it's always possible to draw different statistical inferences from the same data. But the strategy reestablished public trust and stabilized Crestor's market share.

Consider also the efforts of the US plastics industry to overcome a consumer and regulatory backlash, in the late 1980s, over plastic packaging's environmental impact. The CEOs of leading companies joined forces to reframe the public debate not just through an award-winning ad campaign illustrating positive applications of plastics (in child safety, for example) but also by committing the industry to recycling and thus to solving environmental problems. The industry could do so credibly because it undertook real actions, such as spending $1.2 billion on recycling research and developing a standardized plastics-coding system.

Such actions need not take place only in response to reputational concerns; at other times, they help build goodwill that may provide some degree of cover against future bad news. A willingness to tackle climate change has helped companies like Toyota Motor and GE, for example, build strong reputations that are holding up better than those of many other major automotive and financial-services players. Sometimes, reputation-oriented actions may even have a direct impact on sales. In 2008, for instance, Best Buy began inviting customers to bring their old electronics into its stores for recycling. The program has not only generated positive press and helped position the company as an environmental leader but is also increasing foot traffic in stores.

Engaging a broad group of influencers

Formal marketing and PR do play an important role in managing the reputation of a company, but when it responds to serious threats it must use many other means of spreading positive messages about its activities quickly (Exhibit 3). In general, credible third parties speaking for

Exhibit 3

No time to waste

Using a number of communication channels, beyond the typical public-relations approach, can boost awareness of a company's activities effectively.

	Purpose	Examples	Desired outcomes
War room	To ensure opportunity to refute critics and deliver messages in daily news cycles	Media professionals' war room, responsible for monitoring, responding to news	No attack left unanswered; respond to every reporter
Free media	To deliver messages through low-cost, high-trust channels	Speeches, events, press conferences	Regularly create new stories showing company in favorable light
Paid media	To deliver messages with maximum control of message and targeting	Television, print ads, brochures, Web sites, mailings	Ensure everyone hears, sees, reads message
Networking	To develop relationships with broad set of stakeholders; listen and deliver messages to them	Meetings with politicians, organizations (eg, unions), media, other stakeholders	Wide network of influential supporters; better understanding of detractors
Giving	To reinforce messages through charitable contributions	Timberland's charitable focus on environmental causes	Positive associations from working on good causes
Operations	To reinforce messages and reduce reputational risks through activities within business	Starbucks's fair trade–certified coffee; Nike's supplier policies	Seamless integration between company's actions and reputational consequences
Partnerships	To gain credibility by working with others to solve industry-wide reputation issues	Labor certification standards in textile industry	More friends to help in shared reputation battles
Surrogates	To use high-credibility people to reinforce strategic messages	Placing prominent people on board, in executive positions	People with star power speaking up for the company
Grassroots	To leverage energy of current supporters	Bumper stickers, blogs, interactive Web sites	Support for company is highly visible

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the company can boost its reputation more effectively than its own PR or marketing department. Leveraging existing grassroots support—through blogs, bumper stickers, and interactive Web sites, for example—is one method. Another is to have people with high standing reinforce key strategic messages. Partnerships between the company and NGOs can be important not only because of their credibility but also because they can alert it to performance gaps early in the game. A network of positive relationships with credible third parties (such as journalists and NGOs) can also help the company get out its side of the story when crises do hit.

One company worried about what it saw as the dangerous inaccuracy of its portrayal in the press targeted opinion leaders with concise facts to dispel misunderstandings and gave regulators a scientific paper outlining the possible negative consequences of proposed regulations. A broader communication program describing recent and forthcoming changes in the company's business practices was released to the general public. This approach was effective, but even more nuanced forms of impact are possible: influencing specific bloggers, using company blogs to start conversations with consumers (a tactic Cisco, HP, and Intel, among others, use), and reaching scientists through research discussion boards.

Increasingly, two-way dialogue is critical. Consider, for example, Chevron's "Will you join us?" campaign, which addresses many of the oil industry's most difficult questions, such as the developing world's energy needs, the role of renewables, environmental protection, and the problems that will get worse if we go on using oil as we do now. The campaign not only embodies a new level of openness about the industry's challenges but also asks the public to join the conversation on a Web site with a moderated discussion board and interactive tools providing information about conserving energy.

In this more complex world of influence strategy, no single kind of approach is likely to be sufficient to deal with fast-moving situations. Companies must instead initiate a multidisciplinary, cross-functional effort that can quickly identify reputational issues and plant responses in broader strategy, operations, and communications. The groups involved might include regulatory affairs, the general counsel, PR or corporate communications, marketing, corporate social responsibility, and investor relations.

To achieve the necessary coordination, a senior executive should be accountable for such efforts. A strong understanding of customers and marketing might make the CMO appropriate to play this role.[2] But it's the CEO who must lead a company's overall reputation strategy, ideally with the support of a board committee focused on it. This may seem like a lot of firepower, but in today's climate, with reputational issues threatening both shareholders and a company's ability to achieve broader goals, that degree of high-level attention and integration is essential. Q

[2]See David Court, "The evolving role of the CMO," mckinseyquarterly.com, August 2007.

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