BusinessWeek

What Price Reputation?

Reprinted from the July 9 & 16, 2007
issue of **BusinessWeek** magazine.

This reprint provided
compliments of:

CCW
A Global Consulting Unit of Fleishman-Hillard

What Price Reputation?

Many savvy companies are starting to realize that a good name can be their most important asset—and actually boost the stock price

BY PETE ENGARDIO AND MICHAEL ARNDT

A RECENT PRINT AD BY United Technologies Corp. looks deceptively like an assembly diagram for a model helicopter. Study it more closely, however, and you'll notice that the color schematic of UTC's Sikorsky S-92 copter is embedded with messages aimed at Wall Street (page 5).

Text near the engine trumpets 40% lower maintenance costs than comparable helicopters and a "health and usage system" that ensures the S-92 "always operates at peak performance." Next to a view of the cockpit, you learn that the thermal imaging system lets rescuers find people they can't see. Other text notes fuel efficiency that allows "more rescues per gallon" and paint with few compounds that harm the environment. "You don't have to understand everything we do to profit from it," crows the tagline. The underlying theme: UTC is a great investment because it is a leader in innovation and eco-friendly technologies that help the bottom line.

More research went into crafting those messages than you might imagine. The $49 billion Hartford conglomerate has long been frustrated that the strengths of its individual brands may be well known, but as for the publicly traded parent, investor surveys showed "most view us as some sleepy Northeast company," says UTC Communications Vice-President Nancy T. Lintner.

ECO BOOST

SO IN LATE 2005, UTC turned to a tiny consulting firm named Communications Consulting Worldwide, led by sociologist Pamela Cohen and former Ernst & Young strategist Jonathan Low, pioneers in the nascent study of how public perceptions affect a company's stock price. A CCW team spent months processing a bewildering amount of assorted data UTC had amassed over the years. It included studies tracking consumer perceptions of its brands, employee satisfaction, views of stock analysts and investors, corporate press releases, thousands of newspaper and magazine articles, and two years' worth of UTC financial information and daily stock movements. After feeding the data into an elaborate computer model, Cohen and Low concluded that 27% of UTC's stock market value was attributable to intangibles like its reputation.

The duo determined the way to drive up the stock was to make investors more aware of UTC's environmental responsibility, innovation, and employee training—points the company had not stressed publicly. To make sure investors got the message, UTC plastered the Sikorsky S-92 ads and others like it featuring an Otis elevator, a Pratt & Whitney jet engine, and a hybrid bus with UTC Power fuel cells, on four commuter train stations in Connecticut towns with high concentrations of financiers. "The work we did with CCW guided the development of our ad strategy," says Lintner. "We're very happy with the results."

Call it the new science of reputation management. Corporations have long used sophisticated statistical models to predict everything from how much a new production process would hike efficiency to how much more soap can be sold with an additional $100 million in advertising. But a company's reputation among investors, customers, and the general

PIONEERS Cohen and Low study what intangibles are worth

public traditionally has been regarded as too squishy to measure with hard numbers or manage with any precision, let alone to prove cause and effect.

Many investment pros scoff at suggestions they can be influenced by image manipulation. And to most CEOs, corporate image is not something to fret about—at least, not until a crisis erupts, like an options scandal, employee class action, or ecological disaster. Even when execs try to be proactive, it's often by gut. Want to be viewed as a good corporate citizen? Order up a PR blitz on your charity work or efforts to go green. Eager to land on a magazine's most-admired list? Gin up a strategy to game the selection process.

But a more sophisticated understanding of the power of perception is starting to take hold among savvy corporations. More and more are finding that the way in which the outside world expects a company to behave and perform can be its most important asset. Indeed, a company's reputation for being able to deliver growth, attract top talent, and avoid ethical mishaps can account for much of the 30%-to-70% gap between the book value of most companies and their market capitalizations. Reputation is a big reason Johnson & Johnson trades at a much higher price-earnings ratio than Pfizer, Procter & Gamble than Unilever, and Exxon Mobil than Royal Dutch Shell. And while the value of a reputation is vastly less tangible than property, revenue, or cash, more experts are arguing it is possible not only to quantify it but even to predict how image changes in specific areas will harm or hurt the share price.

Of course, spin alone can't create a lasting public image. A company's message must be grounded in reality, and its reputation is built over years. And if there is a negative image based on a poor record of reliability, safety, or labor relations, "please don't hire a PR company to fix it," says strategy professor Phil Rosenzweig of Switzerland's International Institute for Management Development. "Correct the underlying problem first." The biggest driver of a company's reputation and stock performance is, after all, its financial results, notes Rosenzweig, author of *The Halo Effect*, a book that details how quickly reputations can turn.

NOT JUST SPIN
A company's message must be grounded in reality—and its reputation built up over many years

Smarter communications can, however, help companies with good stories to tell. By most metrics, such as return on equity, profit growth, and product quality, companies like UTC, Southwest Airlines, and United Parcel Service may compare well with top rivals. But unless the message gets through to Wall Street, their stocks may trade lower than they could.

The trick is to decide where to focus amid dozens of factors defining a corporate image. As reputation expert Sandra Macleod of London's Echo Research Ltd. puts it, there are "threshold expectations" that every company must deliver and reinforce, such as good service and financial performance. Beyond that, priorities get fuzzy. Sure, it looks great to tell the world about your innovative culture or that you are the greenest company in your industry. But do these

JORDAN HOLLENDER

issues really move the needle with your target customers or investors?

That's why companies are trying to get more scientific about reputation management. Many big companies now shell out $2 million a year on image research. This will be a tiny slice of the $4.2 billion spent on PR this year, but such research is growing fast. To get a fix on how companies are seen publicly, they are hiring firms like Factiva and Delahaye that use powerful search engines to track databases of all print, broadcast, and Internet coverage and to search for trends. For around $100,000, for example, Factiva can plow through a database that includes 10,000 mainstream media sources from 150 countries and 14 million blogs and tell clients whether their press is positive or negative on key issues.

MINE OF DATA

A HOST OF SMALL consulting firms including CCW, a subsidiary of Omnicom Group's Fleishman-Hillard PR agency, and KDPaine & Partners, a Durham (N.C.) boutique, mine this data with remarkable precision to steer client corporations to the most effective messages and away from those that should be ignored. "Not long ago, there wasn't much science behind media tracking," says Warren Weeks, CEO of Australian reputation analysis firm Cubit Media Research, whose clients include Microsoft, SAP, and Ford. "With today's technology, we can find every scrap of information on what is said about a company, second by second, and correlate that to movements in the share price."

Work done by Echo Research for SABMiller PLC provides an illustration of the process. The South African beer giant had enjoyed a great reputation among investors for its ability to acquire and manage brewers in fast-growing emerging markets. But SAB's stock suffered a year after its $5.6 billion takeover of Miller Brewing Co. in 2002. First, Echo turned to providers like Factiva and CyberAlert, which tracks Internet news and blogs, to collect all articles on SAB appearing in financial media in Britain, the U.S., and South Africa over a one-year period. From the company, Echo secured all stock analyst reports. Echo staff read and analyzed each piece and determined whether the articles or analyst comments were positive, negative, or neutral on key points, such as SAB's financial performance, leadership quality, and ethics. It compared this data against moves in the stock of SAB and its top competitors.

Echo pinpointed which journalists had the most influence on daily stock movements—and which analysts they talked to. It also found a strong correlation between a 57% increase in unfavorable articles in the spring of 2003 and SAB's weak stock price. Digging further, it learned the biggest factor was continuing weakness at Miller. The market expected a faster turnaround, raising doubts about SAB'S U.S. expansion.

Echo recommended that SAB change its communications strategy to talk more consistently about gradual but steady progress at Miller, and thus restore confidence in SAB's leadership. Since mid-2003, SABMiller's stock has soared from around 6 to 24. But the brewer says the stock gains reflect its stronger financial performance: Revenues have doubled since 2003, while operating profits have more than tripled. "Echo's research was considered an expensive expression of what was abundantly obvious to anyone with eyes in their head," says Nigel Fairbrass, SABMiller's media-relations chief. "While I would acknowledge that an ability to specifically evaluate PR activity in stock value sounds seductive, it betrays a misapprehension of the complexities and inefficiencies of equity markets." Macleod agrees such analysis alone doesn't explain stock moves but says many clients find outside analysis helpful.

Now reputation wonks are trying to take this to the next level—to enable companies to hone their message to attain specific financial outcomes. Procter & Gamble Co., one of the first companies to do consumer research and test marketing, applies statistical tools developed to guide its marketing of soaps and shampoos to promote the P&G corporate brand. Other companies such as UTC, Southwest Airlines, UPS, and AT&T are

The Value of Perception

IF A COMPANY COULD BOOST ITS REPUTATION among investors, what would be the effect on its stock? One way to get an idea is to compare companies in similar industries but with different reputational strengths and weaknesses. Communications Consulting Worldwide Inc. agreed to do a quick analysis of several major corporations to predict what would happen to their stock price if they could switch reputations with a peer.

CCW CALCULATED RATINGS of three different aspects of each company's reputation on a scale of 1 to 100: its reputation for operational performance, management quality, and financial performance. For this exercise, CCW used media data provided by Factiva and various publicly available rankings appearing in business publications, such as lists of the "best managed" companies or the best places to work. According to CCW's formula, for example, Pepsi scored 70 for operations reputation, 71 for management, and 70 for finances. Overall, it received a reputation score of 76. That compared with an overall tally of 62 for Coke, which scored lower in all three categories.

NEXT, CCW ESTIMATED HOW THESE FACTORS relate to stock price. It determined how much of the movement in a stock is due to the company's financial performance and economic conditions. After controlling for these factors, it assumes the remaining portion of stock value is due to aspects of its reputation. So if Coke were able to match Pepsi's overall score, its stock would be worth $1.73 per share, or 3.3%, more. For clients, CCW analyzes many other data that can give managers an idea of which aspects of reputation need the most improvement.

IF...	...HAD THE REPUTATION OF...	...ITS STOCK WOULD RISE...	...BOOSTING MARKET VALUE BY
Coca-Cola	Pepsi	3.3%	$4 BILLION
Wal-Mart	Target	4.9%	$9.7 BILLION
Colgate	P&G	6.2%	$2 BILLION
CVS	Walgreens	6.9%	$3.9 BILLION
Wachovia	Wells Fargo	3.5%	$3.5 BILLION

Data: Communications Consulting Worldwide turning to consultancies like CCW.

CCW's Low and Cohen have spent more than a decade developing ways to measure intangible corporate assets, especially reputation factors, that can affect the bottom line. "There are plenty of data measuring the visibility and credibility of a company," says Low. "But there have been no data showing how communications adds value to a company." Says corporate communications professor Paul A. Argenti of Dartmouth's Tuck School of Business, also a CCW partner: "If we can get this right, we have found the holy grail of communications."

The method works like this. Cohen first takes data on a company's daily stock movements for a certain period, say two years. She then collects data on its financial disclosures and economic conditions at both the national and industry level. She runs a statistical model to determine how much of the stock movement is due to financial performance and how much to outside factors such as the economy.

After adjusting for these influences, she loads in less obvious factors. Drawing on reams of data on media coverage, opinion surveys, investor interviews, the company's public statements, reputation rankings in magazines, and other sources, she runs through several dozen reputation-related issues to see if they move the stock. Do messages about the company's employee relations, governance, or environmental efforts have impact, for example? If so, how many cents per share can be explained that way?

SKEPTICISM

OPINIONS ARE MIXED about how much credence to put in such predictions. UTC is thrilled with CCW's work. Since launching its ad campaign in September, the number of financiers viewing UTC as an innovation leader has leaped by 10 percentage points, says an annual survey by researcher Lippincott Mercer. UTC thinks this may have contributed to the 16% rise in UTC's stock, far outpacing the Standard & Poor's 500-stock index and rival General Electric Corp.

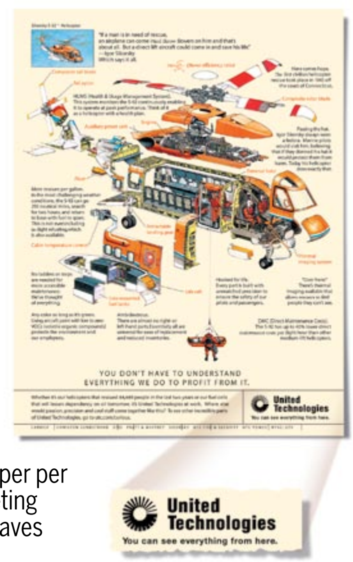
Message Behind The Message

Text in this ad pointing out cool features of the Sikorsky S-92 helicopter actually is designed to make key points to Wall Street

HEALTH MANAGEMENT
This system constantly monitors the S-92, assuring peak performance
MESSAGE UTC is an innovation leader

GREEN PAINT
The S-92 uses paints with few or no volatile organic compounds, protecting the environment
MESSAGE UTC is eco-friendly

MAINTENANCE
The S-92 is up to 40% cheaper per flight to service than competing helicopters **MESSAGE** UTC saves buyers money



CORPORATE LOGO The name of the Sikorsky division is in small print, while parent United Technologies gets big type
MESSAGE Buy this stock

Other companies say it's too early to tell whether their new communications strategies have had any impact on sales or their stock. But investment pros, not surprisingly, are dubious. "Very little, very little," said stock analyst Raymond F. Neidl of Calyon Securities when asked how much he thinks PR influences his investment decisions on Southwest Airlines, which he covers. "The markets are smarter than that."

Perhaps. Yet the fact that corporations are commissioning such intricate work shows image management has come a long way. Just a decade ago, it largely meant crisis management or tracking media references through news clippings. But by the late 1990s, investors began to recognize reputation was in part responsible for the sky-high market values of the likes of Cisco Systems Inc. and Amazon.com Inc., companies with relatively few brick-and-mortar assets such as factories, machines, and real estate.

Interest really took off after the tech bust and accounting scandals of 2001, which made investors more aware of risks if a company's reputation is trashed by governance and leadership lapses. Companies also realized their shares were increasingly vulnerable to negative publicity over employee and social practices.

This may explain why many once-cagey companies are returning more reporters' phone calls. By shunning the media, P&G realized in the late '90s that it had little influence in the way journalists framed its corporate identity. Now the consumer-products giant says it uses the same approach in crafting its messages to the media that it has used to market its consumer brands. To learn how it's being perceived, P&G commissions surveys of journalists and tests key messages with focus groups. It also makes sure its messages are parlayed to suppliers and employees, and carried in ads and PR. Then it tracks media pickup to adjust its talking points.

Southwest also leaves little to chance. The Dallas carrier already enjoys one of the industry's best reputations, and Wall Street rewards it accordingly. Its $11.4 billion market cap is bigger than the combined value of the two biggest airlines, American and United, a gap that differences in assets like planes and routes don't begin to explain. Still, when Linda Rutherford, Southwest's vice-president for public relations and community affairs, heard Low's pitch at a PR meeting two years ago, she decided to hire CCW to assess whether it was stressing the right points.

After crunching years' worth of data, Cohen and Low flew to Dallas last August with results that were eye-opening. CCW estimated public relations alone could move Southwest's stock up or down by 3.5%, equal to $400 million in market value today. The data also indicated Southwest was getting little return by stressing its budget fares—a familiar story. Instead, there was more upside potential for shares if Southwest stressed its extensive routes and schedules. "We had a bit of an 'Aha!'" Rutherford recalls.

So Southwest has begun emphasizing

long-haul flights and frequent service between many cities, points that seldom had gotten press. It also plans a third-quarter ad campaign based on CCW's advice. The effect so far: While airline stocks have fallen more than 15% overall in 2007, Southwest's shares are down only 5%, to about 14.80.

While these experiments are intriguing, the real test of faith in the new science of spin will come when somebody risks serious money on it. Suppose a hedge fund really does unravel the secret that can boost a company's value simply by turning around its reputation—and uses that information to buy and reshape that company's image?

The idea isn't completely far-fetched. Fashion and fragrance companies have long built successful businesses largely on brand image. That's why CCW President and Senior Partner Peter J. Verrengia thinks it's inevitable companies will one day manipulate their images with some of the same precision they use to optimize operating performance. "Just as people reengineer corporations, they will reengineer reputations," he predicts. "The tools are becoming available." The question is whether companies are ready to bet their reputations on them.

Wal-Mart Without The Warts

What would the mass retailer be worth if it sharpened its PR?

It might be hard to believe, but Wal-Mart Stores Inc. once was a stock market rocket. Between 1997 and 2000, the company's share price soared sevenfold. Wal-Mart stock could probably take off again if the company recaptured the growth rates it used to log so reliably. Then again, the discount retailer might also raise its share value by simply doing a sharper job at PR.

By attaining Target Corp.'s reputation in three key areas—finances, management, and operations—Wal-Mart's stock price would increase 4.9%, according to a study by public-relations advisers Communications Consulting Worldwide. That works out to more than $2.35 a share at Wal-Mart's current price, or enough to lift the mass merchant's market cap by nearly $10 billion.

Digging deeper, CCW's analysts identified a half-dozen issues that most affect Wal-Mart's share price and another half-dozen that barely matter at all. Among topics that Wal-Mart should talk up more: revenue growth, entrepreneurship, and cost control. Meantime, it has said enough about suppliers, community, and the strength of CEO H. Lee Scott Jr.: Wal-Mart has generally received favorable media coverage on these points, but investors have heard those messages so often that they tune them out.

CCW, a 12-employee boutique within Omnicon Group's Fleishman-Hillard Inc. PR agency, evaluated Wal-Mart's image-shaping at the request of *BusinessWeek*. Although the report drew from fewer information sources than does CCW's usual work—its $75,000-to-$300,000 projects typically include internal data from customer and supplier surveys—the method was essentially the same.

COURTESY WAKEUPWALMART.COM

CCW started by scoring tens of thousands of news stories about Wal-Mart from 2004 through 2006 based on tone and prominence, among other criteria, and sorted by subtopic. An article judged to be entirely favorable earned a score of 100, while one completely negative got a 0. CCW then compared a chronology of the ups and downs in these scores by subject to daily movement in Wal-Mart's share price to quantify impact. The consultancy also stacked up Wal-Mart's numbers against those of archrival Target to get another perspective.

The exercise revealed that, despite frequent knocks by unions and other critics, Wal-Mart garnered good press overall, with an average score of 59.5. But its image deteriorated over the study's span. During

DRAWING FLAK Low costs turned sour after the media equated them with offshoring

those two years, Wal-Mart had an average 66.4 score, for instance, when it came to fostering a corporate culture of entrepreneurship, but that number plunged to 0 at yearend 2006. Another high-impact topic, cost control, also went negative as the media started to equate Wal-Mart's tightfistedness less with low prices and more with offshoring.

Wal-Mart, which is advised by PR agency Edelman, one of Fleishman-Hillard's largest competitors, declined to comment on CCW's analysis. But David Tovar, the company's director of media relations, said: "We're focused on a long-term effort to proactively tell the Wal-Mart story."

–Michael Arndt and Pete Engardio