The Food and Beverage Industries Need a Reputation Risk Management Overhaul

By Denise Williamee and Nir Kossovsky

There's ample soul searching by risk management within the food industry strata. How many were prepared with governance, operational, communications, and financial contingencies addressing disruptions caused by the global pandemic? How many customer-facing businesses had effective contingency plans for contactless services or were prepared for the explosion of social justice issues that have required rapid public corporate governance and communications actions? How many had meaningful business interruption insurances?

Failure to foresee and plan for a multitude of 21st century enterprise scenarios is another stuck fork in an obsolete 20th century notion of enterprise risk management. The entire current apparatus—governance, leadership, processes and insurances—is not engineered to mitigate the greatest risk to the value of an enterprise, which is reputation risk.

And what exactly is reputation risk? It is the widespread economic damage from a maelstrom of frightened, mistrustful and angry stakeholders triggered by a real or perceived corporate failure of ethics, safety, security, sustainability, quality or innovation.

For companies failing to manage this risk adequately, reputational crises will be painful. Board members will see plaintiffs' lawyers becoming increasingly successful in holding companies and boards liable under the standards set by the landmark Caremark decision. These cases will be followed by substantial Directors & Officers liability settlements. Financial executives will struggle with perils of liquidity and solvency. Leaders at the helm of the risk management controls will suffer humiliation and disgrace.

All this pain comes from sudden reputational impairments because when stakeholders are emotionally charged, they boycott, disengage, increase credit terms, reduce credit limits, dump equity shares, demand guarantees, vigorously litigate, turn to regulators and publicly protest. The Blue Bell Creameries case, whose derivative litigation settled pre-trial for $60 million this spring, is illustrative of this outcome.

In 2015, a food safety crisis (Listeria outbreak) at ice cream producer Blue Bell Creameries resulted in three deaths. The operational crisis triggered a total product recall, shutdown of plants, and layoffs of employees. But the greatest damage was the go-forward national consumer fear of the product—a reputational crisis. In August of 2015, The New York Times claimed the company faced an "uphill battle to win over consumers" who stopped buying from the company after the first recall and then in January of 2016, The Houston Chronicle acknowledged that Blue Bell was attempting to calm their loyal customer base after finding more possible Listeria. Blue Bell's reputational crisis (reduced revenues and increased expenses) triggered a liquidity crisis that was resolved only through a dilutive private equity investment.

A Blue Bell shareholder filed a derivative suit alleging that directors failed to make a good faith effort to implement and monitor an appropriate oversight system for food safety; a key area of risk to the business. The Defendant's Motion to Dismiss was granted but on appeal it was reversed, with the Delaware Supreme Court recognizing that Blue Bell's business relied on consumers trusting that the product was safe. It was found that Plaintiff's allegations that Blue Bell had "no committee overseeing food safety, no full board-level process to address food safety issues, and no protocol by which the board was expected to be advised of food safety reports and developments" were credible.

Prior to the crisis, safety was implicitly assumed. The crisis shook consumer (and investor) confidence. Plaintiffs produced evidence showing weak controls, most critically, an absence of board-level oversight and monitoring. Plaintiffs effectively demonstrated the harm they experienced arising from the operational failure and the cash flow impairments from the reputational crisis.

Let's unpack this case for general lessons. In the past, the standard for protecting against issues related to food safety were executive level operational control processes and insurances for recall and products liability. But today, the peril emerges from the fact that various stakeholders—investors, customers, regulators, and employees—have an expectation of governance-level oversight, monitoring, and a reasonably accurate anticipation of future risks. These expectations create reputational value, which executives surveyed recently believe now comprises on average 76% of enterprise value.

Most companies currently disclose in their public filings that their reputation is a critical asset and that reputational risk is a material peril. The Board is responsible for protecting the assets of a firm. It is also responsible for overseeing and monitoring mission critical operations. Under both the duty of care and the duty of loyalty, boards therefore have a duty to oversee and monitor reputational value and all that creates a threat to reputational value.

In the past two years, dozens of legal cases have cited reputational damage as grounds for litigation with board members increasingly being singled out. However, the legal arena is not the only place board members are being targeted; the court of public opinion is perilous, as well. Tarnished personal and professional reputations, lost board seats and lost future opportunities are now the potential consequences of not overseeing and monitoring reputation value and the subordinate enterprise reputation risk management apparatus.

Reputational risk can be understood and properly managed only through an enterprise risk management process that extends beyond the outmoded way of thinking and begins by capturing intelligence on stakeholder expectations. The most effective way to accomplish this is to establish an enterprise-wide strategic intelligence gathering and analysis system: customer intelligence from sales, investor intelligence from investor relations, bond market intelligence from treasury, compliance intelligence from legal and corresponding operational intelligence from respective line operations. This task should be owned by corporate and functional silo leaders who understand the true nature of reputational risk.

Because reputation risk is a behavioral economic peril, among the leaders comprising this Integrated Reputation Group (IRG) should include professionals who appreciate behavioral science. Operationally, it must have the authority to gather enterprise-wide intelligence, determine the potential costs of upsetting stakeholders, identify material risks and coordinate with executive leadership to deploy departmental resources to meet and manage expectations. An educated IRG will also evaluate the benefits of financing the costs of loss with captives and insurance.

An empowered and forward thinking IRG will foresee potential enterprise-level risks posed by future cultural shifts (#MeToo, #BlackLivesMatter), and evolving societal expectations related to corporate brands. While it may be difficult to predict future shifts, an Integrated Reputation Group is empowered to form and activate a rapid response mechanism for evaluating and responding to threats – as PepsiCo recently did, for example, in connection with its Aunt Jemima brand.

Companies who adopt and embrace Integrated Reputation Groups will be signaling to stakeholders that they aren't "following the herd over the cliff" with the traditional ERM model: they are going above and beyond the industry standard to identify and anticipate enterprise-wide risks. It is a powerful, authentic story that stakeholders can appreciate and value that lends to preferential equity investment allocations, bond ratings, and liability insurance costs. It is a story told in executive summary form by reputational value insurance.

A consumable goods company's ERM processes and how its board oversees them can be the difference between creating a reputational asset or a reputational liability.

Denise Williamee is Steel City Re's Vice President of Corporate Services, where she heads client relations and education for integrated reputation groups.

Dr. Nir Kossovsky is CEO of Steel City Re, which employs principles of informational and behavioral economics to provide reputation risk management and insurance solutions for companies, their officers and directors.