

# News



ECRS News Issue | March 31 2008

## Editorial

**Dear Readers,**

The first quarter of the new year, again, is marked by the global financial market crisis. Deficient risk management is threatening ever more companies with billions in losses, a loss of reputation and, ultimately, also a massive loss of trust. Increasingly, the question is asked: who can be held responsible for the crisis? Particularly from the perspective of business ethics, this question assumes new relevance. We asked Christoph Luetge, an expert in business ethics, for his assessment, and spoke with him about the importance of corporate reputation in times of crisis. Crisis is also the topic addressed by our guest author Daniel Künstle: he analyses why the debate about executive compensation is revisited with such vigour in difficult economic times especially. Also, we present you once more with the latest results of scientific studies and explain, among other things, why companies' social commitment often does not help improve their reputation.

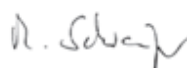
**We hope you enjoy reading this issue!**



Dr. Mark Eisenegger



Ralf Langen



Prof. Dr. Manfred Schwaiger



Robert Wreschniok

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## Reputation Agenda: Trends & Topics

**Executive compensation: A public outcry years in the making**

**Reputation management of global companies in the face of the scandalisation of bonuses**

*Guest article by Daniel Künstle, Managing Director of commsLAB – Corporate Profile Management.*

Those seeking a vivid illustration of the dynamics of reputation in media societies will find it rewarding to analyse the issue of executive remuneration and bonuses. One can use this example to illustrate the functional and social expectations of a company or an individual, as well as their emotional significance.

From a functional standpoint, high salaries are usually at least accepted when they can be linked to a clearly successful business story. As for their social acceptance, this requires – apart from a high degree of moral integrity on the part of the agent concerned – first and foremost the fulfilment of socially accepted or legally applicable standards. Finally, to successfully stake out a position in the emotional dimension, one must distinguish oneself from the mass of society with an identity that is authentic but comprehensible.

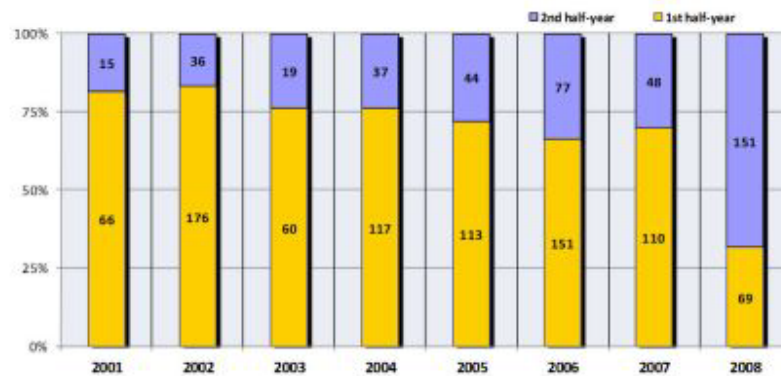
### **Debates about executive remuneration as seasonal events**

As regards the effect on the reputation of the companies and executives concerned, debates about salaries and bonuses were, until recently, characterised by a high degree of moral and emotional stigmatisation, yet imbued with an astonishing level of tolerance when it came to fundamentally questioning high salaries in the face of economic success. In other words: as long as a company yielded sufficient profits (so that there remained the prospect of economic prosperity for broad sections of society), reputational damage was usually containable. This is underscored by the fact that until 2007, the executive pay debate was seasonal. Public discussion of the issue peaked in the first half of each year – when annual reports and accounts were issued –, while in the second half of the year, it was of more marginal importance (see figure). From the standpoint of the companies concerned, this was a communications event that could be planned for. It was also one that was manageable as far as their reputation was concerned, since it was largely confined to the time around the publication of annual results.

Politicians and regulators must therefore, in the context of the unfolding economic crisis, stand accused of only having half-heartedly tackled an issue that now has become an emblem of this crisis, even though the main arguments and options for action have been known for years. Those monitoring today's debates on excessive executive remuneration and exorbitant bonus payments, particularly in the financial sector, feel as though they are in a time warp: back in early 2002, in the aftermath of the accounting scandals at Enron and the burst of the dotcom bubble, there erupted, first in the USA and later in Europe, a debate about executive pay more ferocious than anything seen before.

**Resonance Issue 'Salaries Top Executives'  
Swiss Lead Media (2001-2008)**

commsLAB /  
fög - Universität Zürich



*Figure: Until 2007, the executive pay debate was seasonal, meaning it could be planned and contained by the companies affected from the perspective of reputation management. This pattern only changed in 2008, as a consequence of the massive financial and economic crisis and the emerging deep recession.*

“Outrageous executive compensation practices are a symptom of the failure of checks and balances that led to a crazed ‘anything goes’ mentality at some companies during the recent financial bubble”, wrote the New York Times, for example, in May 2002. And the Washington Post even proclaimed, at the same time, a sea change of historical proportions: “Corruption on Wall Street is undermining the world’s most successful economy and giving democratic capitalism a bad name for the first time since the demise of the Soviet Union.” Yet the debate about executive remuneration was, even in 2002, not new, but had itself been preceded by a number of related regulatory proposals. For example, in 1992, the USA’s Securities Exchange Commission (SEC) had already called for the disclosure of salaries for the top management and executive boards of listed companies. After this, similar initiatives and draft legislation surfaced, particularly in Great Britain, France, Germany and Switzerland.

**Economic necessity versus moral culpability**

Certainly, it would be wrong to claim nothing has been done towards resolving this issue since the last stock market crash in 2001/2002. There were adjustments made, in particular, to statutory requirements for transparency. Thus, disclosing the individual salaries and bonuses of top management and executive boards is now standard in many countries. There remained, however, an unwavering belief in the doctrine that greater transparency alone would automatically lead to greater self-regulation of the market. The view that exorbitant salaries, as a result of disproportionate risks, could even be extremely dangerous from a functional standpoint – both for individual companies and the whole economy – remained largely undeveloped.

There are no indications, however, that transparency in fact tempered the level of compensation. On the contrary: competitiveness and international competition were used to justify ever higher levels. These increases were regularly criticised, but until the current financial crisis and the recourse to state assistance, the criticism had few consequences politically or in terms of regulation, meaning it was ultimately of secondary importance for the companies concerned.

In terms of reputation, the pressure confined itself, especially for global players, to the moral component – or, the social dimension of reputation mentioned above. While this detracted from the reputation of the companies affected and their top managers, it never really did lasting damage. What really mattered for reputation overall was always a company's economic position. If this was robust, high executive salaries were criticised in the sense of social injustice, but never cast as the problem many see it as today: namely, as the root of the greed that appears to be responsible for this crisis of a century.

From the standpoint of company-specific reputation management, this gave rise to an almost rhetorical question: should my company voluntarily forego a relatively comfortable, economically justified and state-endorsed element of competition, when its communicative impact is limited to seasonal peaks (see figure)?

### **Remodelling by the state versus 'going it alone' as reputation drivers**

It is barely surprising, against this economic and social background, that a rethink could only be put into practice once the whole system had run aground and once a new public opinion prevailed: namely, that exorbitant executive salaries had crucially encouraged the assumption of unduly high risks, thus making them one of the central causes, from a systemic viewpoint as well, of the financial crisis.

What does this mean now for reputation management in the companies affected? The same applies as before: avoid getting into the headlines on this issue, carefully observe the appropriate regulations and act demonstrably in line with applicable social norms. However, acceptance will continue to turn on the functional dimension of reputation: major banks such as Goldman Sachs, Deutsche Bank and Credit Suisse have set a strategic course for a future without state aid – and are determinedly speculating on a competitive advantage over those competitors who have accepted state aid and are therefore quite constricted in their freedom to act.

For example, the current reputation profile of UBS, the biggest Swiss bank, is contaminated by the issue of bonus payments, clearly illustrating its limited freedom to act (especially communicatively) as a bank under state influence. Those who can position themselves with the 'go it alone' alternative are now

able to profit – at least in the short term – from an improvement in reputation. This can be shown with the example of Deutsche Bank, which, despite billions in losses in 2008, yielded an astonishing amount of goodwill due to its strategic position.

This completes an arc back to the discussion in 2002: criticism of the virulent salary excesses, in the financial sector especially, could hardly be sharper in the face of the billions in losses. But the way out of this reputation trap is, as before, a belief in a company's positive economic future – and not, for example, its new-found commitment, under regulatory coercion, to new business conduct or fundamentally changed business activities.

To be continued.

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### Reputation in times of crises: Interview with PD Dr. Christoph Luetge



*Dr. Christoph Luetge works as an associate professor for the disciplines philosophy and economics at the Ludwig Maximilians University of Munich. He is focussing on diverse aspects of business ethics.*

#### **ECRS: What role plays reputation in times of crisis?**

CL: In times of crises, reputation plays a similar role as in stable times. The point is to establish moral standards directly on the market. In times of crises, reputation not only offers new business opportunities but also helps companies to survive in markets, which others already had to leave. Therefore, reputation mustn't be neglected in hard times, in the contrary!

#### **ECRS: Since the fall of stocks, investors lost confidence in companies. To which extent do executives bear the blame for the loss of confidence? Is it the fault of the so called "greedy managers"?**

CL: Of course stocks didn't fall without cause. But I wouldn't approach the problem as it is tackled by the general public at the moment. Not the greedy managers are guilty of the crisis. Guilt implies that managers could have taken other decisions. That means they could have invested in more stable assets. However, they couldn't. A manager who didn't invest in assets that promised at least 10 percent rate of return would have been a manager for the longest time.

#### **ECRS: So the fault is/has been within the system...**

CL: Yes, that was a whole system, in which a single manager hadn't got a leeway for decisions. Therefore not the greedy managers are responsible for the crisis, but the incentives that have been set wrongly respectively the system of rules. For example the supervision of banks that ignored early economic expertises or the system of international rating agencies to name just a few problems of rules.

**ECRS: Which possibilities do companies have to regain the trust of their clients and partners?**

CL: In my opinion we are not confronted with a global economic crisis, but with a financial crisis. And the mistrust in banks can't be that deep, since private clients aren't massively withdrawing their money from the banks. The problem is rather, that the banks lost confidence amongst each other.

**ECRS: What do you think of voluntary renouncement of bonuses? Is it only window-dressing?**

CL: Regarding the effect on public opinion, it's likely inevitable to shorten bonuses. Therefore the cutbacks serve a purpose. Regarding the confidence among the banks, of course the renouncement doesn't play a role. In the contrary: it is questionable if with lower salaries we will get the right managers to solve the real problem.

**ECRS: Thank you very much for this interview, Dr. Luetge.**

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### **The role of reporting on companies in the stock market**

Until now, communications science has examined the media's role in the stock market either in an purely theoretical way or by using a variety of investor surveys. Financial science aspects, by contrast, have played a less significant role. But in an analysis published in 2008, authors Bertram Scheufele and Alexander Haas adopt a combined approach, drawing on both communications and financial science. The authors did not focus on media effects at the level of individual investors (micro), but on the wider impact of media, as reflected in measurable movements in share prices or trading volumes (macro). Their study combined a primary analysis of reporting in selected newspapers, TV stock market broadcasts and online finance portals with a secondary analysis of the trading volumes and stock prices of ten German listed companies. These variables were analysed over time. The print media used were the Frankfurter Allgemeine Zeitung and the Süddeutsche Zeitung, since these papers reflect the political spectrum and are considered opinion leaders. For online media, the finance portals Onvista and Finanztreff were chosen, and for television, the stock market programmes Börse im Ersten and Telebörsen. At the same time, the stock market performance of prominent companies such as DaimlerChrysler, Deutsche Telekom, Infineon, Lufthansa, Evotec Mobilcom, Solarworld, T-Online, Consumer Electronics and EM.TV was examined. The results show quite clearly that media effects penetrating to the macro level of share prices or trading volumes are rare. Although one cannot rule out the possibility that individual investors are influenced by the media, the study found

barely any indication of measurable reactions by the stock market itself to media reporting. On the other hand, media reporting definitely responded noticeably to the reality on the stock market: the higher a company's trading volume on a given day, the more strongly and positively the company seemed to be present in the media.

**Reference:** Scheufele, Bertram; Haas, Alexander: Die Rolle der Unternehmensberichterstattung am Aktienmarkt. Eine Zeitreihenanalyse des Zusammenhangs zwischen Print-, Online- und Fernsehberichterstattung sowie den Handelsvolumina und Kursen ausgewählter deutscher Aktien. In: M&K. 56. Jahrgang. Baden-Baden, 2008. S. 347-367.

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## ECRS News

### **The 7 Commandments for companies: A study by the communications agency Pleon analyses society's expectations of business**

Social commitment is now, almost self-evidently, considered one of the traditional core elements of the social market economy, and it is seen as an important part of corporate strategy. In this sense, responsible company behaviour (or: corporate social responsibility, CSR) has long since become a key value for any successful company. According to the Edelman Trust Barometer, in 2007 as many as 96 percent of German companies made contributions to society. Be it sponsoring educational projects, committing to protecting the environment or sponsoring sports – most CSR activities seek to sustainably strengthen a company's reputation. Yet many of the projects do not achieve the desired success, since 58 percent of German citizens suspect business, despite their various social commitments, of having a mainly negative impact.

A study by communications consultancy Pleon from October 2008 now offers some hints for understanding this divergence: the low impact on corporate reputation, it concludes, is due to the fact that CSR activities are, in many cases, not aligned with the expectations society has of companies. This was the result of a survey of a total of 204 social stakeholders from politics, NGOs and research. Also however, the study was able to identify the demands social stakeholders actually have of companies, and what their priorities are. To successfully implement their CSR activities, then, companies should observe the following '7 Commandments':

**1. The operative business should be conducted in such a way that it can be regarded, in society's terms, as responsible: here, companies should pay special heed to aspects like human dignity when outsourcing production to foreign countries, or the protection of labour and the environment.**

- 2. Society's expectations of the company must be fulfilled: at the moment, most companies are committing, of all things, to areas least called for by society.**
  
- 3. Although many companies stress arts sponsorship in their CSR portfolio, hardly any lasting improvement to reputation could be found here.**
  
- 4. A central aspect of sustainable CSR activity is that a company acts responsibly in its overseas operations.**
  
- 5. In foreign markets, therefore, companies should stress responsible behaviour all the more, since their overseas activities are under particular scrutiny.**
  
- 6. Different social groups have different expectations of companies and of their social commitment.**
  
- 7. When communicating with political parties, companies should take account of the differing perspectives of those with whom they are dealing. For example, the issue of human dignity weighs much more heavily for the SPD (Social Democrats) than for the CDU (Christian Democrats).**

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### **The importance of reputation for brand equity**

New findings about the relationship between corporate reputation and brand equity– two empirical studies support the importance of the intangible asset reputation: Evaluating corporate brands with brand equity models, the consideration of corporate reputation leads to a significant improvement of consumer orientated prediction power.

For product brands an experiment shows that a change of a company's reputation results in a change of a company's product brands' equity in the same direction – therefore, the integration of marketing and corporate communication is indispensable.

For more details, the study is forthcoming in March in Gabler Verlag (in German): Sebastian Fuchs: Unternehmensreputation und Markenstärke. Analyse von Wechselwirkungen und Ansätzen zur Prognose des Konsumentenverhaltens. Mit einem Geleitwort von Prof. Dr. Manfred Schwaiger. ISBN: 978-3-8349-1504-7

For further information: [http://www.gabler.de/index.php;do=show/sid=1686730504499955dfd4039523598835/site=g/book\\_id=18282](http://www.gabler.de/index.php;do=show/sid=1686730504499955dfd4039523598835/site=g/book_id=18282)

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## ECRS Events

### ECRS Symposium 2009

In 2009, we will again host an international symposium on reputation management. The date and location will be advertised in due course.

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## Impressum

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