Moving crisis management from war room to boardroom
Tony Jaques says that many directors and CEOs would prefer not to think about crises. But the truth is that every executive and director should be concerned about crisis prevention and reputation.

Organisations that suffer a major crisis have a more than one in four chance of going out of business. Yet despite this level of risk, many companies continue to leave crisis management in the hands of operational middle managers or technicians with little expertise beyond how to recover when things go wrong.

Corporate crisis management traditionally has a strong emphasis on tactical elements such as crisis manuals, cross-functional teams, table-top simulations, communications procedures and a well-equipped ‘war room’. However, leading companies are now taking a more proactive role in crisis planning and issue management, shifting from reactive crisis response to proactive crisis prevention, and moving the focus from the war room to the boardroom.

The global financial crisis helped accelerate reassessment of the broader scope of crises that can pose a threat. For many managers, this meant understanding what steps can and should be taken to prevent corporate crises before they happen in the first place. It often also meant starting to switch attention from simply operational tactics to the involvement of senior executives and the board.

But progress is slow. A global survey of board members, published early in 2016, found that fewer than half of the non-executive directors questioned reported they had engaged with management to understand what was being done to support crisis preparedness. And only half the boards had undertaken specific discussion with management about crisis prevention.

The other key factor driving increasing senior executive involvement has been acknowledgment that most crises which threaten a company are not unexpected events but are, in fact, preceded by clear warning signals, which are frequently ignored. Together, these two factors—that most crises are not truly unexpected and that many are avoidable—fuel the move from the operational emergency context of the war room to strategic planning in the boardroom.

Moreover, these factors are reinforced by a growing recognition that the impact of a crisis is not just operational. Crises threaten not only the financial success of the company, its reputation and the personal reputations of management and directors, but can also threaten its continued existence. A major study of crises in Australia across a ten-year period showed that one in four crises cost the organisation affected over A$100 (668, $76) million, and more than 25 per cent of the organisations concerned did not survive the event.

At the same time, studies in North America and Europe have demonstrated that companies with well-established crisis plans in place suffered less impact on their share price, and recover more quickly. For example, one well-respected study at Oxford University showed that for companies without effective crisis plans in place, the share price initially fell twice as far, and a year later the organisation's market value was on average 22 per cent less than for well-prepared companies.

Yet, in the face of such reality, many organisations still fail to prepare properly and continue to treat crisis management as an operationalised part of the emergency or security function. That may provide adequate response to an incident when it happens, but contributes little to crisis prevention, long term value or reputation management. If crises are to be prevented before they occur, issues and problems need to be identified early, and acted upon at the highest level.

A high profile example of failure to link information to action is the collapse of Barings Bank, a British financial institution for more than 200 years. While the bank was effectively destroyed by the activities of a single rogue trader, it was revealed that Barings’ internal control systems failed to catch signals such as increased trading activity, the extensive use of leverage and escalating volume of trades.

The failure cost Chairman Peter Baring his bank and his job, but it is not clear whether the lesson was learnt by others. In an eerily familiar scenario a decade later, Société Générale reported about €4.9 billion ($7 billion) lost on unauthorised transactions by a single rogue trader. An independent panel found the French bank failed to act on 75 red flags or early warnings over a period of 18 months. In this case the bank survived, but CEO Daniel Bouton had to step down soon afterwards, and later also resigned as Chairman.

Or more recently, consider the ‘London whale’ trading scandal in 2012, which JP Morgan Chase CEO Jamie Dimon initially dismissed as: “A tempest in a teapot.” However, it cost the bank a €6.2 billion loss and its market value fell €40 billion in a matter of weeks. In addition, JP Morgan eventually paid over $1 billion in fines to regulators in the United Kingdom and United States. Most importantly, a US Senate Panel investigating the fiasco reported that bank management had: “disregarded multiple warnings,” including the fact that internal risk limits were breached more than 300 times.

Joining the dots

Of course this problem is not confined to banks. We need look no further than the crisis that stricken New Zealand dairy giant Fonterra in 2013 when reported botulism contamination of milk powder led to a global product recall. The scare soon proved to be a false alarm, but not before it had directly affected the entire country’s economy and reputation, and the value of the NZ dollar.

The investigation that followed identified a catalogue of shortcomings, but perhaps most damning was the failure at the top to recognise and act on what was happening. The official report concluded that Fonterra failed to join the dots between botulism, infant food products, consumer sensitivities and the company’s global reputation; and that Fonterra’s crisis management planning was inadequate for a crisis of that kind and scale. Critically, these were matters that needed to be dealt with not by operational managers down in the war room, but at the highest levels of management and the board.

The current evolving perception towards strategic recognition and prevention rather than a reactive response has, in turn, expanded the crisis management role of top executives and directors. The idea that crises are typically sudden, unexpected events that you cannot really plan for is now well and truly obsolete.

The Institute for Crisis Management (ICM) in Denver, Colorado, has been tracking business crises in the media for well over 20 years and its conclusion from analysing tens of thousands of crises is that about two thirds are not sudden, unexpected events at all. They are what the ICM categorises as ‘smouldering’

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> crises’, in other words events which should – and could – have prompted prior intervention. Worryingly the Institute also records that, in fact, management – either through action or inaction – causes more than half of all corporate crises.

Given these stark numbers, and some of the examples listed here, there’s no doubt that responsibility for early identification of potential crises lies right at the top of the company, as does responsibility to provide leadership and resources to develop proper prevention and planning.

The link between information and action lies at the heart of effective signal detection mechanisms, and there is an obvious close relationship between systemic causes of failure to recognise potential crises and not detecting warning signals. The prolific crisis expert Ian Milroth has even claimed that in every crisis he ever studied there were always a few key people on the inside of an organisation, or on its edge, who saw the early warning signs and tried to alert their superiors. And in every case the signals were either ignored, blocked from reaching senior management, or stopped from having any effect.

At a practical level, this challenge of upward communication to senior management and directors was highlighted by Andy Grove, the legendary founder and CEO of Intel, in the wake of the notorious Pentium chip crisis. After a faulty computer chip problem was initially downplayed, the resulting recall crisis eventually cost Intel a $475 (€428) million charge against earnings and serious damage to its reputation. Writing in the New York Times later, Grove conceded: “Most CEOs are in the centre of a fortified palace, and news from the outside has to percolate through layers of people from the periphery where the action is. For example, I was one of the last to understand the implications of the Pentium crisis. It took a barrage of relentless criticism to make me realise that something had changed and that we needed to adapt to the new environment.”

Such failure to keep top executives and the board fully informed is hardly new. But the impact is seldom as great as when a resulting crisis can threaten the very existence of the entire enterprise.

It’s clear that the greatest danger from a crisis can often occur after the triggering event is over, at a time when inquiries and investigations begin to consider where the buck really stops. A striking example arose after Victoria’s Black Saturday bushfires in February 2009, when one of Australia’s worst natural disasters saw 173 people killed in a single afternoon. In the protracted legal proceedings that followed, it was revealed that power distributor SP AusNet had received warnings about allegedly inadequate maintenance of power lines, which caused at least some of the fires, and blame was sheeted home at the top of the organisation. By 2015 the power company had agreed to pay out close to A$500 (€343; $380) million “without admission of liability”.

A few years earlier the BP Texas refinery fire provides another brutal instance of where the buck stops, both in terms of management shortcomings and in terms of the specific role of the board in crisis prevention. BP was an organisation with an enviable global reputation for environmental innovation and corporate leadership. Then, on March 23, 2005, an explosion and fire at the Texas City refinery near Houston killed 15 and injured 170. The official inquiry found six underlying causes, all of which had been known to management, and BP was eventually fined over $21 (€18) million. In addition, an inquiry into all five of its American

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