REPUTATION PROTECTION

The aftermath of BHS: reputational risk in M&A

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YOUGOV

Recent research by YouGov showed that 92% of the CEOs surveyed believe that the management of their corporate reputation affects the bottom line by either a "reasonable" (24%) or a "large" (68%) amount. Interestingly, this view was not wholly shared by their colleagues. Essentially, the further down the organisational hierarchy, the lower the value placed on the management and protection of the company's reputation.

Of course, YouGov's survey was of opinions rather than actualities. Also, it was commissioned by the PR Consultants Association, whom (some may say) has a vested interest in encouraging companies to take an interest in the management of their reputations.

Even so, it would be surprising if those numbers are not significantly higher than they would have been 10 or 20 years ago. For all sorts of reasons, the importance (including the financial importance) of the reputation of a business is much higher up the board agenda than ever used to be the case.

It's not just about the 24 hour news cycle and the impact of social media. Regulatory investigations, activist shareholders, sensitive litigation, operational issues, pressure groups, aggrieved customers and disaffected employees can all put the reputation of a business, its brands and its directors at risk. People tend to expect more of a business these days - and not just of big business. The media and other stakeholders can be less forgiving when things go wrong.

Indeed, the way a company responds to a crisis may itself say more about the business than the circumstances which gave rise to the crisis in the first place. Stonewalling legitimate enquiries with a 'no comment' statement or a failure to apologise for, or be transparent about, any shortcomings can back-fire.

Increasingly, journalists, politicians and others are much more likely to look further up the chain with a view to pinning blame on the chief executive or owner of a business (or even, as in the case of BHS, a former owner), who is not considered by the commentariat to have run, bought or sold the business in an appropriate manner.

Learnings from BHS

Indeed, the fall out from the collapse of BHS tends to suggest that those disposing of a business may now need to ensure that they carry out much more thorough and wide ranging due diligence on potential buyers and think much more carefully about the implications of a deal. While there may be no general legal requirement (other than in specific sectors) to ensure that the buyer of a business satisfies in effect a 'fit and proper person' test, it is plain that a buyer who turns out, for example, to be an asset stripper, to treat employees badly, or to make business decisions contrary to the national interest, may very well cause serious reputational blowback for the seller.

So **what steps can a seller take to manage this reputational risk**? Here are a few examples:

- We are increasingly seeing sellers place material disclosure obligations on bidders entering into an auction process, in a bid to avoid a BHS style blame game – this may well include detailed requirements around known associates and other investments, their tax residence and group structures and their activity in sensitive territories (e.g. where sanctions are in place), and corporate intelligence providers are reporting increasing demand for their services from sellers in such scenarios.

- Where a company with a defined benefit pension scheme is being sold, the seller risks being on the receiving end of the Pensions Regulator's anti-avoidance powers, which can bring its own unhelpful publicity as well as liability risks (including for directors). To manage both the financial and reputational risk, the seller and its directors will need to satisfy itself that the sale will not leave the company in a materially weaker position and to engage proactively with the trustees and may well have to consider ensuring that appropriate post-sale mitigation is in place.

- Risk for the seller might also be heightened if it continues any substantial trading (or transition or migration) arrangements with the buyer/target post-completion.

- Clearly, there is a direct correlation between size of workforce and level of reputational risk, particularly where there is significant unionisation.

- As we have seen from the Soft Bank takeover of ARM Holdings, the buyer was obliged by the Takeover Panel, pressed by Greg Clark, the Business Secretary, to give legal commitments about the future of the ARM business (including a commitment to double the UK employee base) – sellers might also consider specific and binding reassurances from bidders where they have reputational concerns about the future of the divested business.

- Most bid processes will ask each bidder to confirm its funding arrangements: in certain cases this scrutiny may need to be stepped up, to ensure 'certain funds', especially if there is a delay to completion and if there are any post-completion obligations about how the target business is run.

- Ultimately, of course, there is only so much that can be done: for example when the Southern Cross Blackstone healthcare group failed, Blackstone had to deal with considerable adverse publicity, even though it had sold it two years earlier and the business had been run quite differently post-sale. Damage limitation may be the most that can be achieved (see *Managing the crisis* below).

And **an afterthought for buyers**: aside from the usual scrutiny of financial, tax, legal and compliance risks, do you need to consider any reputational risk from any acquisition, for example through association with the seller (or any known associates of the seller) or with how the target grew its business? Particularly relevant in emerging market transactions, this is often one of the triggers for detailed forensic diligence on the seller, its associates and the target and its business practices.

Managing the crisis

Also highlighted by the BHS saga is the importance of strong crisis management where any such reputational storms blow up.

A business that understands the importance of protecting its reputation, and its information, will generally be better prepared to deal with any threats to either, whether low level or a full-blown crisis. An organisation which already has a crisis response strategy in place is likely to be able to respond more rapidly and effectively than one which does not.

40% of EMEA based companies did not have a crisis plan

PR AGENCY BURSON-MARSTELLER, SURVEY OCTOBER 2015

A survey last October by PR agency Burson-Marsteller across a wide selection of EMEA based companies revealed that 40% of them did not have a crisis plan. Of those that did, just over a third had not updated it in the last two years.

A crisis management team should be identified. Lines of command should be kept short and roles clear. Team members should understand the importance of deadlines – there is rarely time for leisurely debate or extended chains of approval.

The team needs to be trained and tested, for example, by undertaking a crisis simulation exercise. External advisers need to be introduced to the business before the crisis hits, when time will be short and it may be too late properly to get to grips with the economics and dynamics of the business.

Employees should know who is authorised to communicate with the press. Journalists are often adept at eliciting information from those inexperienced in dealing with them. Likewise, staff should be trained routinely to report potential trouble spots to the crisis team. This is a separate issue to ordinary compliance. What may be of interest to the compliance team may be of little interest to the media, and vice versa.

Every case will be different, but the strategy will need to be updated even if no crisis erupts. As markets develop, as investor profiles change, and as the focus of regulators shifts, different strategies will be required. Inevitably, it is easier to develop a sustainable reputation protection strategy, with or without the assistance of external professionals, when all is calm, rather than when fire-fighting.

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- media crisis management
- social media and online
- misuse of information
- defamation and harassment
- privacy and confidentiality
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