MARSH

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To Survive or Thrive: How Crises Impact Company Value

Corporate crises can be highly damaging. They erode trust, destroy company value, and for some, can ultimately lead to the organisation's failure. However, these impacts are not inevitable outcomes; in fact some organisations are able to thrive post-crisis.

Marsh set out to understand why this was the case with a research project delivered in partnership with Cranfield University. The study explored share and stock price volatility over a 250 trading-day post-incident timeline (see Figure 1) of 23 globally listed companies that had experienced high-profile incidents in the past 10 years. All of our selected case studies had received significant business and financial media coverage as a result.

Our research findings show that post crisis some companies can benefit from a sustained 5% increase in share performance, while others lose on average 12% of their value. And the main reason for the difference? A good crisis response, which is the significant driver between simply surviving or thriving.

By our calculation we can expect to see a large corporate crisis somewhere in the world four times per year. Ignoring the risk or assuming it will not or cannot happen to you is simply not an option. Recent high-profile corporate crises have brought into sharp focus how a well-orchestrated response to a crisis can pay dividends to a company's value.

FIGURE 1

Sum of differences between expected returns on stock and the actual return on stock and the impacts of resilience on shareholder value

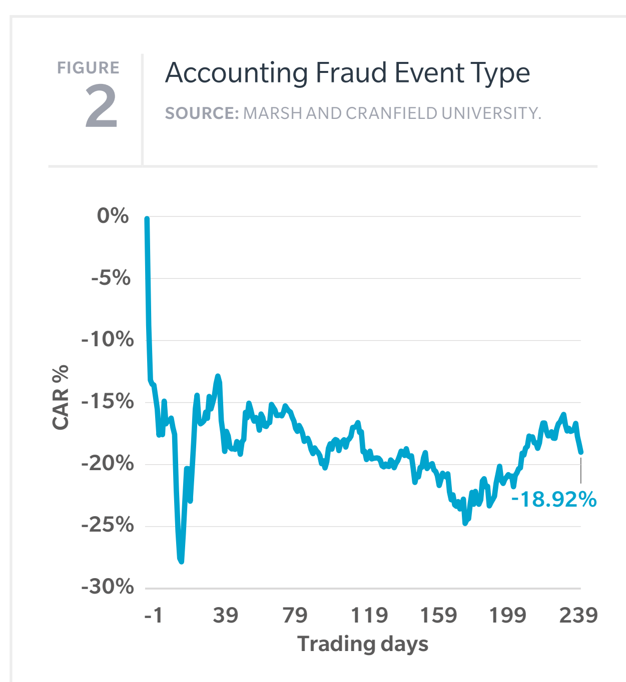
SOURCE: MARSH AND CRANFIELD UNIVERSITY.

Different types of crisis lead to different impacts

Our findings show stark differences between crisis types. By far the worst crisis event to suffer is an accounting fraud, which can lead to around an 18% loss in share price performance (see Figure 2). Given share price is a market's measure of trust in an organisation, this is not too surprising. If investors cannot trust management and the numbers they report, the level of investment risk is clearly going to be greater. In one example where the CEO himself was found at fault, the losses were even greater (-30%).

FIGURE 2 Accounting Fraud Event Type

SOURCE: MARSH AND CRANFIELD UNIVERSITY.

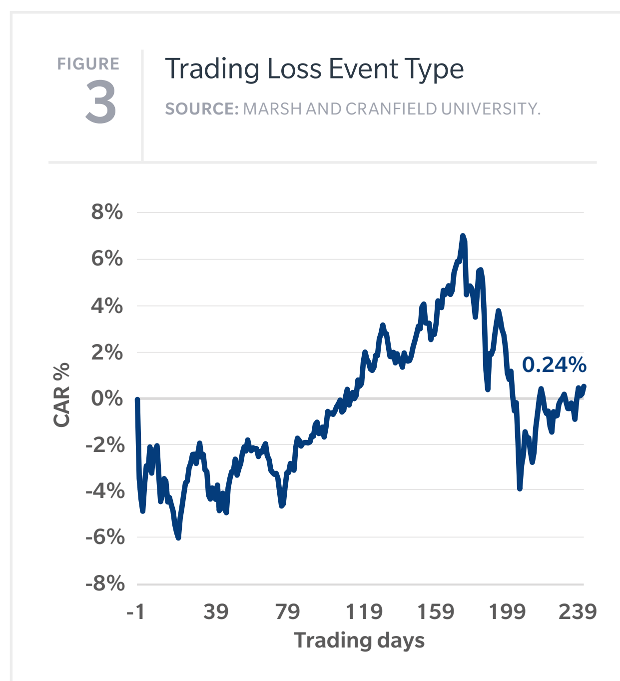


The potential for such significant losses places a premium on being able to quickly determine the causes of the event and communicate an action plan to stakeholders and the market. This would involve bringing the audit committee, forensic accountants, and the legal counsel into the crisis decision making process – stakeholders that may not typically form part of existing crisis plans and crisis simulation exercises.

Consequently, crises relating to significant trading losses are the least damaging, resulting in an average 0.24% increase in share price performance (see Figure 3). In our case studies, such events are limited to financial services organisations where these events are, to a certain extent, already factored into business models or the overall strength of the organisation's financial position. In addition, it is highly probable that the performance of other trades made by the organisations were able to shield the business from a more significant shock.

FIGURE 3 Trading Loss Event Type

SOURCE: MARSH AND CRANFIELD UNIVERSITY.



There are parallels here with legal or regulatory issues, which resulted in an average 0.19% increase in share price performance. This may be partly explained by the nature of some of the crises being tracked. In the legal and regulatory case studies we reviewed, some of the events took place in markets where corporate governance controls are generally weaker and corruption risks are greater. In these cases it is possible that markets had already factored the risk into the pre-event share price, or expected a higher risk for the rewards of operating in such environments. Companies appear further insulated when such events are experienced in a small part of their operation with limited impacts on group level structures.

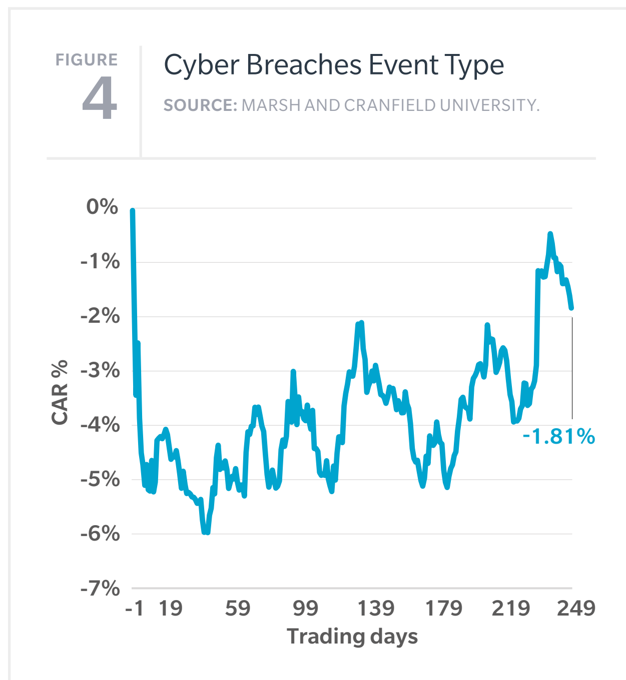
It is easy to say with hindsight, but in these instances preventing the product issues would have been the wiser investment.

The case studies that led to the most significant share price losses in this category were large European or US businesses that had either made having a strong moral compass a major part of their external image, or had allowed wrongdoing to persist for many years unchallenged. It is as if the share price became an expression of the public's view that these companies should have known better.

Cyber events present a more surprising set of results. For all the noise in the media about the latest corporate hacking, the average level of share performance loss was limited to 2.46% (see Figure 4). However, the average figure hides some significant variances with one company suffering a 12% loss, versus another organisation that saw a 7.9% increase. Looking at these two examples, the difference was an early recognition of the risk in annual reporting documentation, and once the event occurred, immediate transparency on the issue with stakeholders backed by high quality and honest communication.

FIGURE 4 Cyber Breaches Event Type

SOURCE: MARSH AND CRANFIELD UNIVERSITY.



The strength of a leadership's response to a crisis appears to be the single most important hallmark of a thriving company.

What else do the results tell us about organisational resilience?

The strength of a leadership's response to a crisis appears to be the single most important hallmark of a thriving company. Strong and decisive leadership that can make informed decisions quickly is crucial. In addition, management transparency proved another important factor in maintaining stakeholder confidence following a crisis. Delivering swift and accurate information to investors and customers typically had a positive effect in helping to regain trust from the market. In one example of a fraud-related crisis the organisation was quick to take charge of the situation, cutting Director bonuses, running an extensive internal investigation, removing staff found to be responsible for the fraud, and compensating customers affected. The response led to a 3.2% increase in share value. Whilst a modest rise, compared with an average 18% loss for comparable accounting crises it demonstrates the value of strong leadership and in taking a proactive response.

The supply chain agility at one car manufacturer proved beneficial in responding to the 2011 earthquake and tsunami in Japan. The company's supply chain could be quickly reconfigured to address disruption to production at their Japanese manufacturing plants. Consequently, the organisation saw a 3.8% increase in share price versus a loss of 0.89% in their nearest competitor who suffered similar damage.

In examples where financial impacts were extreme, having the head room to move was a clear enabler for recovery. Having strong financial reserves and the ability to effectively transfer risk was in some cases the main reason why a company not only survived but ultimately did not fail. The lessons for resilience are clear here. Understanding risk exposures and ensuring the Board has a healthy discussion on provisioning and risk transfer in advance of any event will help prepare organisations to weather the storm should they suffer a significant crisis.

Reliability of products and services offered to consumers can also be a strong indicator for future share price performance. We looked at a large electronics organisation that suffered a major global product recall of a flagship product just after launch. The recall was embarrassing to the company at a crucial time when competing against similar product launches from competitors. Whilst the organisation suffered only a modest 2.14% loss in share value, their main competitor saw a 14.47% increase following the successful launch of a similar product. The difference represents a significant loss of potential value. Another case study from a global car manufacturer showed how a slow and poorly managed response to a large product recall ultimately led to difficult and probing scrutiny from politicians and a loss of over 8% in share price value.

From a resilience perspective, these product recall examples demonstrate the value of stress testing, product testing, and a culture where staff can speak up about possible risks and mechanisms to do something about them. There are also relationships with wider business continuity, enterprise risk management, and IT resilience capabilities which are needed to ensure the critical parts of the organisation are protected from disruption.

Conclusion

For an organisation to thrive post crisis they need more than just a business continuity procedure or crisis management plan.

Words on a page are not how an organisation is ultimately measured. Instead organisations that do well out of a crisis event can be broadly split into two groups: One is measured by how they behave post-crisis and the other group exhibits key indicators of organisational health before a crisis impacts.

Of course most organisations have characteristics from both groups, but our research shows that one is more dominant when turning surviving into thriving.

Health pre-crisis

This group shows signs of organisational strength pre-crisis. They typically have:

- Deep financial resources available to cover the costs of a prolonged crisis.
- Proactive approach to the identification and control of risks.
- Flexible and agile supply chains, and availability of other resource pools with sufficient redundancy built in to support speedy changes to operating structures and processes.
- Competent workforce with sufficient capacity and depth to respond swiftly to a crisis, whilst also providing the capability to prevent many events from occurring in the first place.
- Consistent risk management culture with effective oversight.
- Sufficient investment in comprehensively testing their IT resilience, business continuity, and crisis arrangements through stress testing and simulation exercises.

Organisations that thrive are broadly split into two groups. One is measured on their post-crisis behaviour and the other exhibits key indicators of organisational health before a crisis impacts.

Post crisis behaviour

This group is defined by how successful it is in demonstrating it is in command of a crisis situation. These organisations typically:

- Take control quickly, showing humility where they have fallen short and decisiveness where criticism is unwarranted.
- Communicate transparently, honestly, and often with stakeholders, building confidence.
- Make decisive decisions that demonstrate to stakeholders they are taking things seriously and taking charge of the situation.
- Make good any damage caused to third parties.
- Continuously improve by embedding lessons learned.

For more information on the impact a crisis can have on your business, please contact a colleague below:

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