HOTEL BUSINESS REVIEW Best Practices in Hotel Management & Operations
HotelExecutive.com YOUR VIEW FROM THE TOP

Public Relations

Managing Reputation Risk: What the Hospitality Industry Can Learn from the Banking Industry

By Nir Kossovsky, CEO, Steel City Re

Dr. Kossovsky

The hotel industry today operates in the reputational equivalent of a tornado zone, where external events or incidents involving malicious individuals can cause serious damage at such a rapid speed that it is almost impossible to respond to if defenses are not put in place well in advance. Among the most rapidly evolving and potentially most damaging risks arise from security breaches and the loss of confidential information, ethical breaches by leadership and talent, and the overarching risk of reputation loss arising from angry and disappointed stakeholders. Once a crisis strikes, it quickly spins out of control and the going-forward economic impacts are often long-term.

Any incident, whether it is customer-facing - a physical assault on the premises by a guest, a claim of food poisoning in the restaurant or a burglary - or an internal breach of legal compliance or financial controls, or general poor execution of change management and growth, can trigger a social media barrage. In the competitive hospitality marketplace, the ensuing cascade of economic impacts could amount to a drop in bookings, lost revenue, concerned lenders and shareholders and a higher cost of attracting and retaining key employees. All these costs are the consequences of reputation risk, which broadly stated is the threat of economic damage from angry, frightened and/or disappointed stakeholders.

Like natural disasters, many types of incidents from rogue customers, rogue employees, rogue regulators and well-intentioned but bad decisions can occur that are beyond management's control and can destroy a brand's or a group's reputation and impact its business in significant ways quickly. If customers decide to avoid a property for whatever reason, the costs can be profound. Consider how quickly Wynn Resorts lost nearly 20% of its market capitalization in the aftermath of #metoo.

While every industry needs to manage stakeholder expectations, mitigate disappointment, and address the failure to meet expectations when incidents occur, the speed and intensity at which destructive tornado force attacks can occur at any time in the hospitality industry is just like the banking industry.

Under intense regulatory pressures, the banking industry has amassed large enterprise risk management apparati to address a range of perils whose common path of value destruction is the decision by customers, business partners, and peers to stop doing business with them. The core risk, called “liquidity risk,” is what brought on the major global equity market collapse, and was largely precipitated by stakeholder fear. In other words, “reputation risk.”

Today, the banking sector only has major meltdowns when global events manifest; localized institutional failures have been largely mitigated by the success of an insurance product—federal deposit insurance—that helped mitigate anger and fear and avert actions by potentially disappointed stakeholders. It did so by telling a story of sound governance and security in a way that provided assurance without inviting rouges to test the integrity of that assurance.

The hospitality industry does not have the regulatory-inspired analogy to federal deposit insurance. To get the same effect, it needs to create both the capital and story-telling benefits synthetically.

Firstly, it needs internal systems that allow for rapid information gathering, analysis, decision making and communication with all stakeholders. And then it needs to be able to signal proactively that these defenses exist.

To do this, hotels need to tell an affirmative story about the governance of their establishments and their corporate parents without disclosing specific tactics or methods. That requires the kind of assurance provided by third-party warranties, bonds and insurances, reassuring stakeholders that a hotel is well run in a way that is pre-positioned, simple to understand, and completely credible.

While the hotel industry may have its own unique challenges, it is certainly not alone in dealing with the potentially severe impact of reputational tornados. Research by Steel City Re shows that the cost of reputational attacks against companies has risen by more than 500% over the past six years. Our analysis shows that these losses come against a backdrop of an increasingly angry public, whose anger can be rapidly directed toward entities and individuals whose missteps are broadcast across social media channels that disseminate accurate and inaccurate information with equal speed and volume.

Compare that to our analysis of how credit markets have behaved toward companies dealing with reputational issues, which concludes that, all things being equal, the variance between great and poor reputations can alter the cost of capital by around 80 basis points. And our RepuSPX index, an equity index of companies arbitraging underappreciated reputational value, has outperformed the S&P by 375% over the past 15 years.

Reputational threats can be thought of as a blunt instrument that often causes damage across a wide path, without necessarily distinguishing good companies from bad, ethical from unethical, well governed from poorly governed. One of the ways companies have historically addressed such challenges is with insurance products that provide stakeholders with that differentiation.

In the early days of fire insurance, for example, not every building was insurable - only those constructed according to standards that mitigated the risk and protected life and safety. Which buildings do you think were viewed as safer by tenants? Which property owners do you think were viewed as most responsible? When Hartford Steam Boiler Inspection and Insurance Company began offering insurance to riverboats in the 1860s, “inspection” was part of its name for a reason - and only those that met its standards qualified. Which vessels do you think were viewed as more desirable by travelers and shippers?

In today's weaponized social media environment, companies need to communicate those signals of strength in advance of issues developing - as a way of deterring attacks before they can occur. They need to recognize the tangible impact reputational crises can have and be able to consider these risks and plan to mitigate them just as they would an operational crisis. The difference is that an operational crisis occurs when something a company is expected to control goes wrong. Often this involves a failed control for ethics, innovation, safety, security, sustainability or quality. A reputational crisis, however, occurs when stakeholders believe the company did not make an authentic effort at mitigation - and they are disappointed or angry that the company's leadership failed them.

That appears to be the case among angry stakeholders who are suing MGM Resorts, the parent of Mandalay Bay in Las Vegas, from which a mass shooting was unleashed on a crowd of nearby concert-goers - claiming among other things that the hotel's practice of allowing a patron to prevent hotel staff from entering his room for several days by placing a “do not disturb” sign on his door was a serious security flaw that management should have recognized. MGM stock dropped 6% the day of shooting and underperformed the S&P500 Hotel Subindex by up to 13% two weeks after the event. At four weeks, it was still underperforming by 8%. Obviously, all other issues are dwarfed by the human toll and suffering this senseless attack caused, but at the same time, every company in the industry needs to be concerned that, if such an incident were to happen again, it could have significant reputational issues for the entire industry.

But today, even incidents that were once considered run-of-the-mill risks now pose far more serious reputational hazards. For example, if intoxicated patrons cause a brawl at the bar, and video from guests go viral on social media, will stakeholders conclude that safety and security are an issue at that hotel? Or will they be preconditioned by clear and convincing signaling that staff at this property is carefully vetted and well-trained, that security systems are intelligently deployed, and that management is skillful and attentive to detail? Will they believe that, if there was a bar fight, the property may be unsafe? Or will they believe that it must have been an anomaly that was quickly and efficiently handled?

These are the kinds of issues everyone felt they knew how to handle. But today, with these images and potential hostility associated with them traveling at tornado speeds, reaching a massive audience within hours, the tactics and defenses companies would have used just a few years ago are no longer sufficient.

Stakeholders will forgive an unanticipated operational failure if they believe the company did everything they expect it should have done to avoid it. But they need to believe - based on clear, convincing and prior signaling - that the company is dedicated to the needs, concerns and values of its stakeholders, has identified future risks to stakeholder expectations and is doing what is ethically prudent to mitigate them.

In other words, has the company inoculated itself against reputational damage? Has it built storm shelters in advance of the tornado appearing on the horizon?

At the same time, the hospitality industry is susceptible to cultural changes - changes in perception or attitudes toward practices and events that may occur. One such area clearly involves the environment and how hotel staff deal with issues ranging from wildlife and plant life around their properties to their policies for dealing with water conservation and waste disposal. What may have been acceptable - or not even a consideration - for stakeholders some years ago, can now be a front-burner issue for reputation risk managers.

The issues continually evolve and, when they do, they alter the reputational risk equation. As they have done for years, companies need constantly to be challenging their own assumptions about future events and stakeholder expectations - protecting themselves against every “what if” they can imagine. But today, they need to do so more often, and they need to appreciate that failing to understand stakeholder expectations correctly can lead to existential economic risks.

Companies, along with their officers and directors, learned a generation ago that in a litigious society, they could be sued even in cases where they'd acted appropriately and to the best of their ability. They shored up their internal systems and bought insurance products—both to protect themselves if litigation occurred and to deter litigation by signaling in advance that they had strong defenses and practices that were validated through an independent underwriting process.

Reputational threats are different. Unlike in litigation, in the court of public opinion, there is no time for preparation, no rules of evidence, no discovery process and no objective and final decider of fact. And there is no question that defenses are needed - and that boards and CEOs need to place reputational risk management as high on their agendas as the operational enterprise risks they are accustomed to facing.

They need to do so to protect their companies and their brands, and they need to do so to protect themselves. More and more frequently, we are seeing anger in the wake of reputational incidents being directed at CEOs and board members personally, often with politicians, the media and activist investors stirring the pot. Individual corporate leaders have a lot to lose in these situations - companies' reputations are a lot more resilient than personal ones.

Hotel executives need a risk management plan that considers stakeholder expectations and builds an affirmative narrative about their company's corporate practices and governance before the reputation risk tornado hits. Once the crisis breaks, it is far more difficult to undo the damage, regain stakeholder trust and rebuild the reputation. If there are already third-party warranties in place, they can serve to assuage stakeholders' fear with a credible counter story and validation from an outside authority. It reassures stakeholders that a company is well run, creates value and bolsters reputation resilience. That way, when something bad does happen, stakeholders will give the benefit of the doubt, chalking the incident up to an anomaly rather than a systemic failure. It's the reputational equivalent of building a storm shelter before any tornados are yet on the horizon.

Dr. Nir Kossovsky, CEO of Steel City Re, is an authority on business process risk and reputational value. He has been an industry-wide leader in the development of indexed measures of reputational value and actuarily sound underwriting methods that deter reputational attacks, and protect companies and their leadership. He holds more than a dozen patents, including an algorithmic reputational value measurement system currently enabling insurance solutions, third party investment strategies and governance products. He has written hundreds of articles and four books, including “Reputation, Stock Price and You,” Apress 2012). He has degrees in philosophy, business, and medicine, served as a Captain in the US Navy Reserves, and early in his career was a tenured faculty member at UCLA. Dr. Kossovsky can be contacted at 412-877-0537 or nkossovsky@steelcityre.com