Effective leadership response to crisis

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Excerpt from Strategy & Leadership’s Editor’s Letter Vol. 34, No 1, 2006:

“This issue offers a number of important learning sessions – each presented by authors who are world-class authorities – that your leadership group should share.

The first article – “Effective leadership response to crisis” by Helio Fred Garcia – should be discussed by the management team and then laminated and put under every leader’s desk phone. As he explains, whether an organization survives a crisis with its reputation, operations, and financial condition intact is determined less by the severity of the crisis than by the timeliness and effectiveness of the response. But some leaders who are otherwise given credit for vision, strategic focus, and discipline preside over undisciplined responses to crises, often at great risk to their career and their company’s future...”

Robert M. Randall
Editor
Strategy & Leadership

Effective leadership response to crisis

Helio Fred Garcia

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Effective crisis response is a competitive advantage; ineffective crisis response causes a competitive disadvantage, and can even put an enterprise's existence in jeopardy. But many leaders who are otherwise given credit for vision, strategic focus, and discipline preside over undisciplined crisis responses, often at great risk to their career and their company's future.

Two weeks after New Orleans flooded, as the federal response was just getting into full swing, *Time* magazine's web site published a cartoon of a man standing waist-deep in water, holding a sign that implored, ''Leadership Please''[1]. The next day, Michael Brown, the embattled head of the Federal Emergency Management Agency (FEMA), resigned.

Whether an organization survives a crisis with its reputation, operations, and financial condition intact is determined less by the severity of the crisis than by the timeliness and effectiveness of the response.

For years the paragon of ineffective crisis response was the Exxon Valdez oil spill. Exxon suffered significant loss of reputation and eventually a great deal of financial loss – because the public perceived that its primary concern was not the harm that the spill caused. Fifteen years after the spill a federal appeals court upheld a lower court judgment of $4.5 billion against the company (in addition to the more than $3 billion it had previously paid for cleanup and related costs). The Court said its purpose in upholding the award was to achieve ''retribution and justice.'' *The New York Times* opined that such a judgment and such a purpose were entirely appropriate, given Exxon's seeming indifference in the initial phase of the spill[2].

This perception of indifference is the single largest contributor harm in the aftermath of a crisis, especially when there are victims. Companies, governments, and leaders are forgiven when bad things happen. But they won't be forgiven if they're seen not to care that bad things have happened. This is a lesson that many leaders fail to understand or to act on in the initial early phases of a crisis.

The new paragon of ineffective crisis response is the government's delay in marshalling resources to help the victims of the New Orleans flood in late August 2005. President George W. Bush had been seen to rise to the occasion after the attacks on the World Trade Center and Pentagon on 9/11/2001. But in the days immediately after the flood he seemed disengaged, uninformed, and unconcerned about the plight of New Orleans citizens. On Day Three after the flood, FEMA chief Brown appeared on CNN and admitted that the government had been unaware of thousands of people stranded in the New Orleans convention center without food and water for days – a fact that had been widely reported on television – until told about the situation in an interview. Two days later the President, invoking the FEMA chief's nickname, told him on television, ''Brownie, you're doing a heck of a job . . . '' Two weeks after the flood President Bush's approval ratings fell to record lows[3].

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> **"Whether an organization survives a crisis with its reputation, operations, and financial condition intact is determined less by the severity of the crisis than by the timeliness and effectiveness of the response."**

When the Exxon Valdez disaster occurred, a failed response to a crisis wasn't likely to cost a CEO his or her job, at least not immediately. Times seem to have changed. In 2004 more CEOs were forced out of their jobs than in any previous year, three times the number as in 1995. According to the consulting firm Booz Allen Hamilton's annual CEO succession survey, the ''giant sucking sound heard in the business world during 2004 was the extraction of chief executives from seats of power . . . The first quarter of 2005 brought headline-generating forced successions at Disney, Hewlett-Packard, Boeing, and AIG, linked to shareholder dissatisfaction, scandal, or both[4].''

The ''Golden Hour'' and the golden arches

Speed matters, and time is a leader's enemy in a crisis. When a crisis looms, the usual business processes and decision velocities need to be suspended and decisions need to be made in ways that reassure key stakeholders that a company and its leaders: (a) understand that there's a problem; (b) take it seriously; and (c) are taking steps to address the problem. But many leaders recognize too late that business-as-usual practices have to be suspended.

Crisis management professionals speak of the Golden Hour of crisis response, invoking a metaphor from emergency medicine. The Golden Hour refers not to a particular period of time, but to the observation that incremental delays in responding to a crisis – whether a medical emergency, a flood, or a more routine corporate setback – have greater than incremental impact on the outcome.

The new paragon of effective crisis response is McDonald's Corporation. Its 60-year old chairman and chief executive officer, James Cantalupo, died of a heart attack the morning of April 19, 2004 while attending McDonald's Worldwide Owner/Operator Convention in Orlando, Florida. Mr Cantalupo had been instrumental in reconfiguring McDonald's menu away from the seemingly unhealthy focus on fats and super-sized portions to more healthy alternatives such as salads and grilled chicken.

At 8:07 that morning (East Coast time) the company issued a press release announcing his death. When the stock market opened at 9:30 the stock traded down on heavy volume. There was a significant risk that attention would be drawn to the irony of Mr Cantalupo's suffering a fatal heart attack while spearheading the move away from McDonald's fat-rich menu. Indeed, some early news accounts made just that point.

But at 10:42 a.m. just over two and a half hours after announcing Mr Cantalupo's death, and just 72 minutes after the stock market opened, McDonald's announced that Charlie Bell, President and Chief Operating Officer, would be the new CEO, and Andrew J. McKenna, the Board's presiding director, would be the non-executive Chairman of the Board. The analysts focused on McDonald's' future rather than its tragedy, the media coverage was factual and forward-looking and the stock quickly recovered.

The next morning's *The Wall Street Journal* praised McDonald's ability to make and announce its decision quickly:

> The swift decision gave immediate reassurance to employees, franchisees, and investors that the fast-food giant had a knowledgeable leader in place who can provide continuity and carry out the company's strategies. It may also shift any spotlight away from McDonald's high-cholesterol, fat-rich foods and prove a savvy public relations move[5].

The *The Wall Street Journal* noted that such quick action is uncharacteristic of large companies. It quoted Jay Lorch, a Harvard Business School professor: ‘‘The speed with which they moved is exactly what you would expect to happen, but few companies are as prepared as McDonald’s appears to have been for this calamity[6].’’

McDonald’s had a clear succession plan in place. Its directors moved quickly to implement the plan and announce the new CEO. If they had delayed, the company would have been subject to continued stock volatility as well as speculation about its future and its strategy of emphasizing more healthy choices in its restaurants, and would even have risked late-night comics pointing out the irony of the manner of Mr Cantalupo’s death. Worse, its worldwide franchisees, gathered at the convention where Mr Cantalupo had died, would have seen a leaderless organization. McDonald’s prompt actions and announcements prevented the turmoil that a delayed appointment and announcement would have caused, and allowed the company and its stakeholders to focus on the future.

Another company that learned the value of the Golden Hour is the Boeing Co. From 2002 to 2004 Boeing was involved in a series of scandals involving the recruitment of Pentagon officials for senior positions in the company while these officials were still overseeing Boeing and other defense contractors for the government. Eventually Boeing’s chief executive officer, Phil Condit, was forced to leave the company. Retired vice chairman Harry Stonecipher, who promptly instituted a revised Code of Conduct, replaced him. The new single-page *Code* includes the following sentence: ‘‘Employees will not engage in conduct or activity that may raise questions as to the company’s honesty, impartiality, reputation, or otherwise cause embarrassment to the company[7].’’ It also requires that employees promptly report any unethical conduct.

Ironically, soon after implementing the *Code*, Mr Stonecipher conducted a romantic affair with a female subordinate. A fellow employee, following the Code’s requirements, reported his suspicions to the company’s board, which promptly investigated. Mr Stonecipher was immediately fired for violating his own code. In a single news cycle the company announced the CEO’s departure, and he was gone. The company was able to get on with life with minimal distraction and harm to its reputation.

Paradoxically, both McDonald’s and Boeing’s quick response took place in the absence of CEO input; their boards directed the decisions.

Why are McDonald’s and Boeing’s responses so uncommon, and Exxon/New Orleans kinds of response so prevalent? One big reason is the tendency of CEOs and others in positions of authority to assume that they can manage their companies in bad times the same way they do in good times. But many leaders mis-judge their own ability to control the course of events, and wait too long before suspending business as usual.

Ron Alsop, a *Wall Street Journal* reporter who wrote *The 18 Immutable Laws of Corporate Reputation*, describes typical corporate behavior:

> Too often companies become complacent. They begin to feel almost invincible. Their financial performance is strong, and they fall into the trap of believing they have little to worry about. Then they’re blindsided by a crisis and don’t have a response plan in place. Flailing around and looking helpless aren’t inspiring to your stakeholders[8].

“Companies with effective crisis response saw their stock price recover quickly, and remain above their pre-crisis price thereafter, closing an average of 7 percent above their pre-crisis price one year after the crisis.”

Leadership ability and enterprise value

Effective crisis response isn't just a matter of protecting reputation. It also allows a company to get on with business faster and more effectively than if it delays its response. More important, effective crisis response has direct impact on a company's productivity, demand for its product, stock price, and other quantitative measures of success.

Two Oxford University researchers have demonstrated the extent to which effective and ineffective crisis response affects a company's enterprise value. Rory F. Knight and Deborah J. Pretty studied the stock price performance of prominent publicly-traded corporations that had suffered significant crises. They calculated each company's stock price performance attributable to the crisis – stripping out market movements and other factors unrelated to the crisis that might have affected the stock price, and calculating what they called the ''cumulative abnormal returns'' for each company[9].

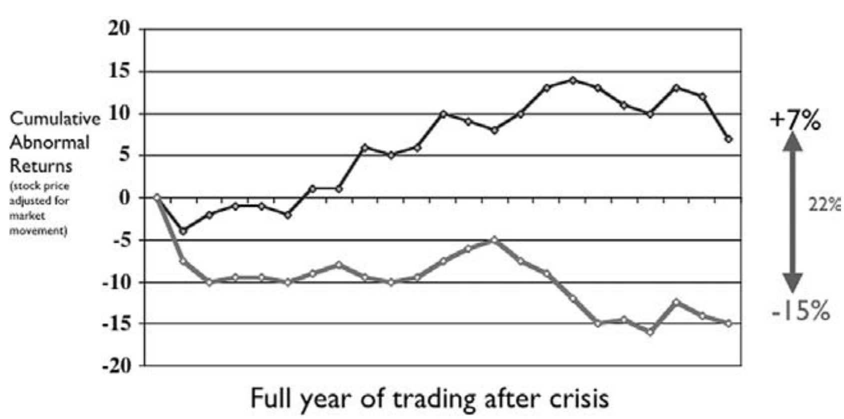
Knight and Pretty found that companies that mishandled crises saw their stock price (calculated as cumulative abnormal returns) plummet an average of ten percent in the first weeks after a crisis, and continue to slide for a year, ending the year after the crisis an average of 15 percent below their pre-crisis prices.

Companies with effective crisis response, on the other hand, saw their stock fall an average (cumulative abnormal returns) of just five percent in the weeks following a crisis, about half the initial decline of companies that mis-handled the crisis. More significant, companies with effective crisis response saw their stock price recover quickly, and remain above their pre-crisis price thereafter, closing an average of 7 percent above their pre-crisis price one year after the crisis (Exhibit 1).

In other words, the tangible difference between effective and ineffective crisis response was, on average, 22 percent of a company's market capitalization. Knight and Pretty assess the reasons for this disparity, and conclude that the most significant factors are not the scope of financial damage or reduction in cash flows caused by the crisis. Rather, the most important determinant of a company's ability to recover and increase its market capitalization after a crisis is the management team's response. Knight and Pretty conclude that positive stock performance:

> . . . springs from what catastrophes reveal about management skills not hitherto reflected in value. A re-evaluation of management by the stock market is likely to result in a re-assessment of the firm's future cash flows in terms of both magnitude and confidence. This in turn will have potentially large implications for shareholder value. Management is placed in the spotlight and has an opportunity to demonstrate its skill or otherwise in an extreme situation[10].

Exhibit 1 Effective v. ineffective crisis response



Source: Knight and Pretty (1997)

> “ **Effective leaders see crisis response not as an interruption in their stewardship of a company, but as the test of that stewardship.** ”

Lessons for leaders

Effective leaders demonstrate situational awareness in a crisis, grasping the significance of the underlying event and its likely impact on the company and its stakeholders. They also demonstrate self-awareness, and the ability to redirect their attention and energy to mobilize a quick response and thereby protect the company's enterprise value. More than 2,500 years ago the Chinese philosopher-warrior Sun Tzu identified the need for both self-awareness and situational awareness in navigating through perilous times. He wrote:

> If you know others and know yourself, you will not be imperiled in a hundred battles; if you do not know others but know yourself, you win one and you lose one; if you do not know others and do not know yourself, you will be imperiled in every single battle[11].

The government's initial response to the New Orleans flood and Exxon's early response to the Exxon Valdez spill demonstrated lack of both situational awareness and self-awareness. They also demonstrated a lack of leadership discipline and command focus. In both cases leaders fell into one of the common perils in a crisis: denial. Former General Electric CEO Jack Welch describes the need to get past denial quickly. In a *Wall Street Journal* Op-Ed piece soon after the flood, Welch said:

> One of the marks of good leadership is the ability to dispense with denial quickly and face into the hard stuff with eyes open and fists raised. With particularly bad crises facing them, good leaders also define reality, set direction, and inspire people to move forward. Just think of Guiliani after 9/11 or Churchill during World War II. Denial doesn't exactly come to mind – a forthright, calm, fierce boldness does[12].

Effective leaders demonstrate this forthright, calm, and fierce boldness early. They see crisis response not as an interruption in their stewardship of a company, but as the test of that stewardship. And as the exodus of CEOs in 2004 and 2005 showed, ignoring a crisis won't make it go away, but it may result in the CEO going away.

Notes

1. *Time magazine*, September 19, 2005 issue, published online on September 11, 2005, available at: www.time.com/time/magazine
2. ''Time for Exxon to pay,'' Editorial, *The New York Times*, January 30, 2004, p. A24.
3. ''Support for Bush continues to drop, poll shows'' by Todd S. Purdum and Marjorie Connelly, *The New York Times*, September 15, 2005, available at: www.nytimes.com/2005/09/15/politics/15poll.html
4. ''CEO Succession 2004: the World's most prominent temp workers'' by Chuck Lucier, Rob Schuyt, and Edward Tse, *Strategy + Business*, available at: www.strategy-business.com/
5. ''McDonald's CEO tragedy holds lessons'', by Carol Hymowitz and Joanne S. Lublin, *The Wall Street Journal*, April 20, 2004, p. B1.
6. Hymowitz, C. and Lublin, J.S., *The Wall Street Journal*, April 20, 2004, ibid.
7. Boeing Code of Conduct, 1/26/2004, available at: www.boeing.com
8. *The 18 Immutable Laws of Corporate Reputation: Creating, Protecting, and Repairing Your Most Valuable Asset*, by Ronald J. Alsop, A Wall Street Journal Book, Free Press, 2004, p. 218.

9. *The Impact of Catastrophes on Shareholder Value: A Research Report Sponsored by Sedgwick Group*, by Rory F. Knight and Deborah J. Pretty, The Oxford Executive Research Briefings, Templeton College, Oxford, 1997.

10. Knight, R.F. and Pretty, D.J., ibid., p. 7.

11. *The Art of War* by Sun Tzu, translated by Thomas Cleary, Shamhala, 1988, p. 82.

12. ''The five stages of crisis-management'' by Jack Welch, *The Wall Street Journal,* September 14, 2005, p. A20.

CEO checklist for crisis response preparedness:

Are you prepared for a crisis facing your organization? Here's a checklist to help you understand your level of preparedness.

Have a clear sense of what constitutes a crisis, and know how to mobilize energy and resources quickly:

- Develop an early warning mechanism/rapid response capability.
- Designate a senior executive as responsible for crisis preparedness and response.
- Make this executive accountable and provide sufficient resources to conduct a thorough analysis of vulnerabilities, crisis response strategies, and crisis implementation.
- Pre-authorize this executive to take initial response steps without going through usual corporate approval processes.

Test the system with wargames, table top exercises, and other processes that challenge leaders to make tough decisions and act quickly:

- Remember that the best plan won't help if executives don't know what to do.

Recognize when business as usual needs to be suspended. A quick test:

- Are the constituencies who matter expecting you to take prompt action?
- Will delay in taking prompt action provide an opening for your adversaries or others to define your involvement negatively?

Control the agenda: don't let the media, adversaries, or the rumor mill define your situation.

Keep in mind the Golden Hour of crisis response: incremental delays cause greater-than-incremental harm to reputation.

Develop messages and tactics with a goal in mind: how do you want your key stakeholders to think and feel, and what do you want them to know and do?

In a crisis, assure both self-awareness and situational awareness:

- Coordinate all functions of the crisis response with frequent meetings/conference calls.
- Correct mistakes early.
- Understand what your stakeholders, adversaries, the media, and others are saying about you.
- Keep your focus on the goal: influencing stakeholders. Decisions become clear when you keep stakeholders in mind.

Avoidable missteps

Leaders that mishandle the early phases of a crisis typically behave in one or more ways that prevent the company from harnessing resources early and taking control of their destinies. These missteps have two negative effects. First, they make the crisis worse; second, they distract internal attention from solving the underlying problem, while lulling management into a false sense that the crisis is being dealt with.

The four most common missteps are:

1. *Ignore the problem*: management seems unaware and is surprised by a crisis that others saw coming, or that they themselves were warned about but chose not to take seriously. We saw such behavior in the early days of the New Orleans flooding; the Catholic Church sex abuse scandal; the Ford Explorer/Firestone Tires recall; and when accounting firm

Arthur Andersen ignored numerous internal warnings that it was compromising auditor independence in its dealings with Enron.

2. *Tell misleading half-truths*: management tries to misdirect attention by speaking literally true statements with the intention of misleading, which challenges adversaries or whistleblowers to uncover the full story. On the first day the Monica Lewinsky story broke in the *Washington Post*, President Bill Clinton told *MacNeil/Lehrer NewsHour* host Jim Lehrer a literally true but misleading statement: ''There is no sexual relationship.'' The media and the President's critics noticed the use of the present tense, and turned up the pressure to get the president to address past behavior.

3. *Lie*: management tells a deliberate untruth with the intention of deceiving. Four days after telling Jim Lehrer that ''there is no sexual relationship,'' President Clinton hosted a White House ceremony during which he told the media the lie that has become the defining soundbite of his administration: ''I did not have sexual relations with that woman, Miss Lewinsky.'' The lie challenged his critics and special prosecutor Kenneth Starr to seek evidence to prove the relationship. When the evidence surfaced, President Clinton went on television and admitted both the relationship and the lie.
   Martha Stewart was indicted, tried, convicted, and imprisoned not for violation of securities laws, but for lying to federal authorities investigating whether securities laws had even been violated.

4. *Assign blame to others*: rather than taking meaningful steps to solve the problem, management tries to redirect attention away from itself and to someone else. When the Ford Explorer/Firestone tires crisis first became public, Firestone tried to shift blame to Ford, saying that Ford instructed customers to inflate tires to the wrong pressure. Ford blamed Firestone for making defective tires. Consumers were left to wonder what would become of them.

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