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Managing Risk Within the Retail Industry

Protecting Your Brand, Reputation, and Bottom Line

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Introduction

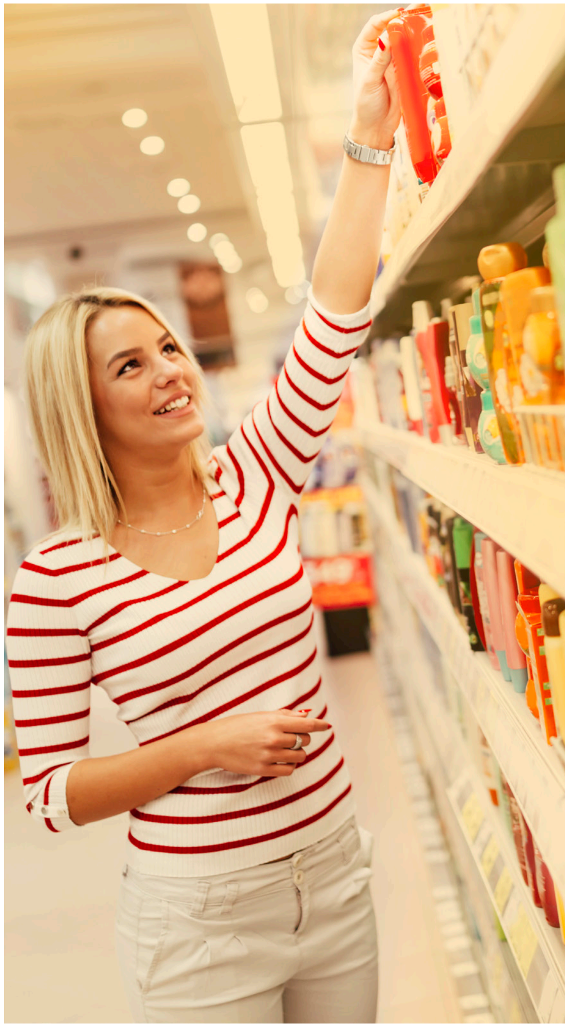
Today's consumers are more capricious than ever before, and why not? With a world of information at their fingertips, they don't need to depend on a brand's intangible image or their own previous loyalty to make purchase decisions. They can assess a consumer product company's current reputation for themselves based on available evidence: *Is the company environmentally and socially responsible? Does it protect consumer data? Does it respond quickly and satisfactorily to customer-service issues?*

Increasingly, retail and consumer product companies are subject to a broad range of risks that have an impact on their reputations and revenue growth. IT, financial, product safety, social responsibility, and supply chain issues can be direct and indirect sources of reputation and revenue-growth risk for these businesses.

This e-book enumerates five challenges that consumer product companies face as they strive to maintain their reputations and growth. It will identify sources of increased reputation risk and threats to revenue growth, and also offer solutions that companies should consider.

Challenge 1: Social Media and Consumer Technology

In the information age, consumers hold the power, not the brands. Whereas retail and consumer product companies were once able to control the message that established their reputation, today's consumers can easily assess any claim against news reports, social media, review websites, and other sources. Consumers are wielding this power with increased scrutiny. In addition to seeking quality and value, they also demand social and environmental responsibility, community involvement, and high levels of customer service from the companies they do business with. What's more, switching to an alternative product is as simple as navigating to another online retailer and clicking "buy." Performance in any of these areas can improve or degrade a brand's reputation, affecting revenue growth as well.



Solution: Keep Reputation Top of Mind

Consumer product companies should prioritize reputation risk in order to sustain revenue growth. Since reputation is highly sensitive to upstream risks such as third parties, supply chain, and technology, each business should uncover and address root causes of risk to reduce likelihood and severity. Although companies can mitigate risk in a number of ways, they cannot eliminate it altogether. For that reason, they should establish contingency plans to address issues as they arise, communicate their efforts to the public, and compensate affected stakeholders. History has shown that consumers reward brands for such transparency, and punish those attempting to bury damaging information or "greenwash" their reputations.

Challenge 2: Cyber Resilience

It has become a truism that all modern companies are technology companies. Our ever-growing reliance on information technology brings with it a broad range of risks. Even minor glitches, such as slow internet page loads, confusing customer service queues, or the use of outdated point-of-sale (POS) systems at retail outlets, can degrade consumer experience to the point of affecting revenue growth. Consumer confidence can also erode if a company's technology is seen as outdated. The last one to develop or adopt new technology initiatives, such as loyalty apps, mobile payment systems, or one-click purchasing, could ultimately lose market share.

On the security front, companies are gathering and retaining a growing volume of consumer data (not to mention proprietary intellectual property) that can be compromised by a breach. The issue isn't solely a technological one. Employees who lack security awareness are often an organization's weakest link, falling prey to phishing schemes or circumventing security policy at their convenience.

Solution: Take a Holistic Approach to Technology

Maintaining the efficiency and security of a company's technology requires a coordinated effort between the IT department and other business and functional units. Companies can address IT risk with a thoughtful technology road map, inventorying risks, and prioritizing projects to mitigate risk as quickly and efficiently as possible.

This road map may be freestanding or part of a strong merger and acquisition process. When it comes to security, a multipronged and redundant approach works best. Not only should the technology be secure, but internal controls should also be in place, as should employee security training and education.

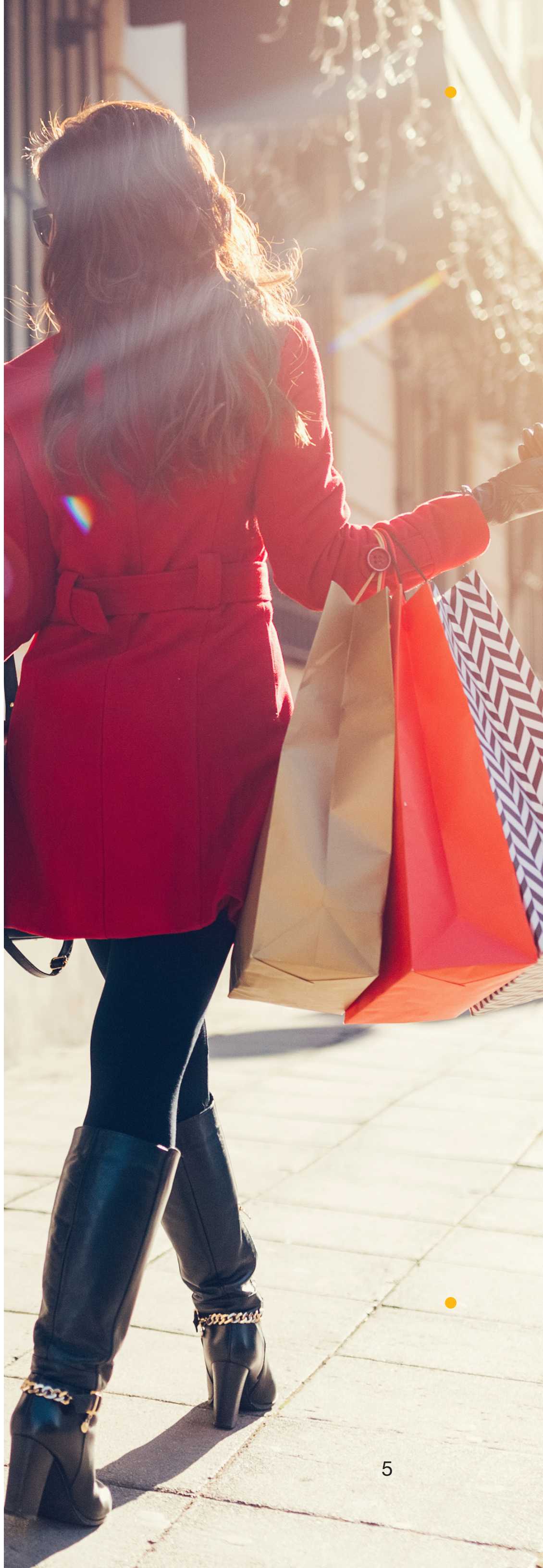
Challenge 3: Supply Chain and Third-Party Risks

As consumer brands focus more on core competencies, such as product development and marketing, they often outsource critical functions. These include manufacturing, distribution, and sourcing, effectively turning key components of success over to third parties, which in turn contract to their own third parties. Risks include product contamination, quality issues, corruption, indentured labor and other human rights violations, and theft of intellectual property, as well as issues stemming from natural disasters, production problems, or delivery delays. It may be no fault of a consumer brand if its manufacturing or supply chain partners fail to meet consumer and regulatory expectations, but the brand's reputation could nonetheless take the hit. Even giant multinational companies can fall into this trap. For example, Nestle SA was sued over claims that its Fancy Feast cat food contained fish from a Thai supplier that used slave labor.[1] Similarly, multiple clothing and retail companies became the targets of negative public attention following the collapse of Rana Plaza in Bangladesh, which killed more than 1,100 people in 2013.[2] Companies that delivered quickly on promised victim compensation, such as Canada's Joe Fresh, were lauded in the press while those who hesitated, such as J.C. Penney Co., were depicted as shirking their responsibility.[3]

Solution: Make Procurement Strategic

Companies can no longer afford to dismiss procurement as a merely administrative function. By elevating procurement to a strategic role, they can gain greater control over third-party and supplier relationships in order to protect and enhance reputation. Contractual agreements should reach beyond quality and timeliness to address sourcing, employee working conditions and fair wages, environmental stewardship, and community development.

Once the relationship is established, companies should put in place ongoing controls such as audits or other mechanisms to monitor the quality of products and processes throughout the entire supply chain, from raw material to the retail floor. Increasingly, companies are being held responsible for tracking and documenting material origination. This trend began with conflict minerals used in electronics and jewelry. It has since expanded into multiple industries to include long-term liability issues, environmental and social concerns, and point-of-origin regulations.



Challenge 4: Corporate Social Citizenship and Responsibility

In response to increased consumer scrutiny and demands, companies are making claims about their products that can be challenging to meet for a number of reasons.

First, such claims raise consumer expectations for these companies across the board. For example, a company making sustainability, environmental, or health claims about its products may come under increased scrutiny for its labor practices.

Second, the claims themselves can be difficult to define, communicate accurately, and support with evidence. The Coca-Cola Co., for example, claims that it replenishes 100 percent of the water it uses in beverages and production through community water projects.[4] But that effort and others have done little to silence critics who continue to accuse the company of "greenwashing."

And finally, few such claims are subject to any legal or regulatory definition. Companies that claim their products are "all natural," for example, can find themselves in the peculiar position of being on the right side of the law but on the wrong side of public opinion. Actress Jessica Alba discovered this when her business, the Honest Company Inc., was sued in April 2016 by consumers claiming that many of the company's products contained synthetic ingredients.[5]

Solution: Get Ahead of the Issues

Before a company makes any claims related to social citizenship and responsibility, it should proactively establish the criteria for its efforts and be transparent when backing up its claims. Coca-Cola, along with rival PepsiCo Inc., has done so by creating detailed policies that document goals, efforts, and progress. In response to the Rana Plaza tragedy, Gap Inc., which had no production facilities in the ill-fated building, nonetheless established and funded a policy to address garment worker safety and support in Bangladesh.[6]

Challenge 5: Managing Risk

Just as upstream issues can affect reputation and revenue growth downstream, so too can interrelated risks magnify the likelihood and severity of their consequences. This is particularly true of reputation and revenue-growth risk, which are vulnerable to numerous other risk areas.

A significant challenge in managing risk is rationalizing the myriad viewpoints that result in disparate definitions of risks and mismeasurement of their severity. Each functional and business unit has its own understanding of the risks it faces, and the impact these risks have on results. On an organizational level, this disparity can cause a misalignment of priorities and misuse of resources. Influential or vocal “squeaky wheels” receive the most attention while risks in other areas go unnoticed and unmitigated.

A related problem is a lack of coordination when addressing risk. Companies experiencing rapid growth may be focused on getting product to the customer, almost to the exclusion of other concerns. When problems arise, these companies typically deal with them in an ad hoc manner without much consideration for systematic change. This reactive approach not only leads to waste and inefficiency – it also threatens reputation and revenue growth alike.

Solution: Engage the Entire Organization

The most effective approach to manage risk is one that relies on an established method to identify, categorize, and mitigate it at an organizational level. This approach addresses three primary issues. First, it helps companies understand the risks that are most relevant to the organization as a whole. Second, this categorization helps identify efficient preventive measures. Third, a formal process leads to ongoing management.

In order to address risk in a holistic, organizationwide manner, stakeholders have to speak the same language. Through facilitated sessions with key stakeholders, disparate functions can establish a common vocabulary and taxonomy to define individual risks. The group can then trace each risk category across functional boundaries to get a clearer understanding of its causes and effects. Finally, the group can develop a mitigation strategy that addresses not just individual risks, but entire categories, in an efficient and organizationwide manner.

Consider the example of an apparel brand that has had its offshore factory closed due to safety violations. To the chief operating officer, the closure exposes an operational risk, as the company scrambles to make up the loss of production capacity. To the chief financial officer, the incident is a financial risk that will tax the company's contingency fund with legal, production, and marketing costs associated with its mitigation. To the chief marketing officer, this is a serious reputation risk, as the company, despite its best efforts, has been linked to unsafe working conditions.

By exposing the risk proactively and discussing the effects it has on each functional unit, as well as the organization as a whole, internal stakeholders can clarify how to categorize it. Subsequently, they mitigate not only the specific risk in question, but others related to it as well. In the case of the closed factory, the determination may be to categorize it as a third-party risk, mitigated with contractual agreements, verification, an ongoing monitoring program, and a contingency plan.

Four response strategies exist for reducing inherent risk and bringing the resultant residual risk within acceptable parameters. They are:

- **Avoidance.** If the risk offers little to no upside, the company may choose to avoid it altogether. An obvious example of risk avoidance would be a no-tolerance policy for illegal activity or regulatory violations.
- **Acceptance.** If the inherent risk already falls within acceptable levels, the company can simply accept the risk as is. This is the typical response for "low-low" risks with minimal likelihood and severity.
- **Mitigation.** Mitigation strategies are as varied as the risks they address. Examples include safety measures, training, redundant processes, hedging of financial risk, and internal controls.
- **Transfer.** Risks can also be transferred to a third party. The most common example of risk transfer is insurance that covers specific types of risk.

It is important to note that even residual risk has a cost attached to it, including the cost of mitigation itself. It is therefore critical to build this cost into the pricing of products and services, as that is the only point at which companies can be compensated for the risks they take on. Once risks have been identified and matched with appropriate response, a company should have an ongoing monitoring and assessment program to facilitate implementation of the response in a timely manner. Risk is not static, and so a company's response should adapt as necessary.

Conclusion

Reputation may be the single most important asset of any consumer products company, and one that has a powerful effect on revenue growth. Companies can protect and enhance their reputations by paying close attention to upstream "hidden" risks that affect them. In doing so, however, companies face multiple challenges: the newfound power of the consumer, data vulnerability, third-party and supply chain risk, and the growing importance of corporate sustainability. What's more, companies often lack the tools to address these challenges in a holistic, strategic manner. The solution for overcoming these challenges is a formal, disciplined risk management program that identifies, categorizes, and responds to risk on an ongoing basis.

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[1] Edvard Pettersson and Robert Burnson, "Nestle Accused of Putting Fish From Slave Labor in Cat Food," Bloomberg, Aug. 27, 2015.

[2] "Rana Plaza: Two Years On," Ethical Consumer, December 2015.

[3] Clare O'Connor, "These Retailers Involved in Bangladesh Factory Disaster Have Yet to Compensate Victims," Forbes, April 26, 2014.

[4] Bryan W. McNally, "Coca-Cola on Track to Being Water Neutral by End of 2015," Sustainable Brands, Aug. 25, 2015.

[5] Jonathan Chew, "Jessica Alba's Honest Company Sued Over Baby Food Ingredients," Fortune, April 27, 2016.

[6] "Gap Inc. 4-Part Fire & Building Safety Action Plan for Approved Apparel Vendors in Bangladesh," Gap Inc., March 2013.