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Reputation matters
Developing reputational resilience ahead of your crisis

Deloitte Risk Advisory
June 2016

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Why reputational risk matters

Recent high-profile crises remind us of the impact of reputational damage, resulting in the destruction of market value and subsequent recovery costs. Even so, many organisations remain unsure what to do about reputational risk. In this brief, we identify two fundamentals in building ***reputational resilience*** – identification of risks from an outside-in perspective, and being prepared for a crisis through a robust crisis readiness programme.

What do we mean by reputational risk?
Understanding what we mean by reputational risk starts with understanding the nature of reputation.

The reputation of an organisation sits in the collective thoughts and feelings of a broad set of stakeholders. It is an outcome that results from the accumulated decisions, actions and behaviours of the people within an organisation and how these are perceived.

Reputation is a social phenomenon. We make judgements about the character of an organisation the same way as we do about people, influenced by direct and indirect interaction with its employees, its products, and by commentary in the public domain.

An organisation's reputation typically reflects how we judge three key attributes:

- **Competence** – how it instills confidence through sound financial performance, quality, safety and security, corporate social responsibility and also its ability to respond effectively to a crisis
- **Transparency** – how it builds trust through openness and integrity, and by demonstrating corporate values and ethical behaviour
- **Guardianship** – how it creates goodwill by demonstrating care and consideration for others' interests ahead of its own.

A strong, positive reputation translates into long-term value in an organisation represented by confidence in brand equity, intellectual capital, sustained earnings and future growth. In this sense, reputation is one of an organisation's most important assets.

All risk eventually flows through to value, and reputational risk is no different. A specific event can impact how stakeholders such as customers, regulators or investors perceive an organisation. If stakeholders subsequently choose to change their behaviours it may ultimately impact on, for example, an organisation's sales, license to operate, or market value.

This 'cause and effect' view captures what we mean by reputational risk. We are interested in how an incident, activity or behaviour has the potential to change current perception and behaviour of key stakeholders, and how likely it is that these changes may impact value.

To understand reputational risk, an organisation should ask itself two questions. How do existing business activities and risks impact reputation and value? What might impair reputation and value from a stakeholder perspective?

Crisis of Confidence[1]
Survey participants said the crisis areas that made them feel the most vulnerable are:

1. Corporate reputation (73%)
2. Cyber crime (70%)

This is consistent with previous survey results which ranked ethics and integrity ahead of security and cyber as the top drivers of reputation concern[2].

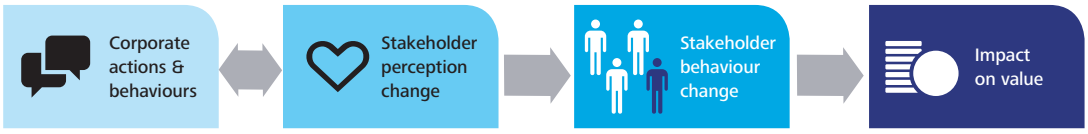
1-5 years

Time it takes to recover from crisis according to experienced board members[1].

1 Q3 2015 Forbes Survey | Conducted on behalf of the Deloitte Centre for Crisis Management

2 Reputation@risk | Deloitte 2014 Global Survey on reputation risk | October 2014

Reputational risk – cause and effect



The cause and effect model illustrates the relationship between corporate actions and behaviours and stakeholder perception. Changes to stakeholder perceptions in turn will lead to changes in their behaviour, and this will directly impact value.

The model provides a framework through which reputational risk can be described, measured and monitored. Ultimately it will allow an organisation to enhance its resilience to reputational risks by understanding stakeholder perceptions and adjusting corporate actions accordingly.

In relation to sector-wide risks, the model also supports analysis and forecasting of longer term impacts to enable strategic decision-making, for example in relation to emerging social issues. This type of analysis can help an organisation to turn a risk into a reputation-enhancing opportunity.

In 2015 a number of organisations lost over one third of their share value as a result of either poor management of an operational crisis event or a specific reputation issue.

Why it matters

Reputation matters to all organisations, but less than half have a plan to address reputational risks. A recent survey found that 73% of board members surveyed identified reputational risk as the area where they felt most vulnerable, but only 39% had a plan to address a reputational crisis.[3]

This paper looks at why many organisations find it hard to address reputational risk, even though the costs of not doing so are considerable:

1. Reputation is estimated to account for a quarter of market value.[4]
2. In 2015 a number of organisations lost over one third of their share value as a result of either poor management of an operational crisis event or a specific reputation issue.
3. Reputational crises often have personal impacts, affecting careers, and occasionally leading to the departure of senior figures in an organisation.
4. Failure to invest in reputational resilience may lead to a significant increase in costs, distract from business as usual, and lead to more fundamental organisation change.
5. Public expectations are continually rising, for example in relation to data protection from cyber-attack, or redress commitments for impacted customers.

3 Q3 2015 Forbes survey | conducted on behalf of the Deloitte Center for Crisis Management.

4 The Impact of Reputation on Market Value | Simon Cole | World Economics VOL.13, No.3 July-September 2012

When reputations are judged

"It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently."

Warren Buffett

Reputation at risk

Recent reputation-damaging events typically fall into two categories:

1. Organisations not meeting stakeholder expectations – in particular poor internal management and malpractice, poor product and service delivery

2. Ineffective management response to a crisis situation

It's clear that an organisation's reputation is most at risk when it fails to demonstrate competence, transparency and guardianship in public – both in the day to day running of the business and during a crisis situation. Building reputational resilience requires effective risk management and crisis preparation.

Issues associated with daily operations may be triggered by surprise revelations such as a product fault or internal fraud. The larger the gap between the reality and stakeholder perception, the larger the potential impact is likely to be. Weak business performance, and highly incentivised businesses, may lead to internal cultural and behavioural issues. Failure to manage these secondary consequences create the conditions for high impact trigger events. They may also lead to a long term deterioration of value.

The public perspective

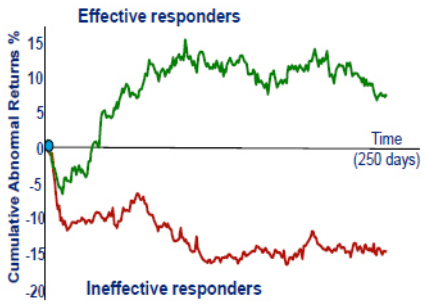
There is evidence that although the public may have some tolerance of issues due to poor management, there is little or no tolerance of misrepresentation and intentional wrongdoing.

Reputation is most at risk in times of crisis for those that are unprepared. News spreads fast in today's connected world, and can be in the public domain before the organisation is ready to respond. Poor co-ordination and communication reflects badly on the competence of the organisation and its leaders. The impacts have been all too clear. Loss of customers and revenue, loss of investor confidence impacting market value, significant recovery costs, regulatory penalties, boardroom and C-suite casualties.

Although it may be difficult to control crisis events, demonstrating reputation-enhancing behaviours is always in the gift of an organisation. A well-managed crisis can improve perception and accelerate recovery.[5]

In addition, a strong positive reputation can afford organisations some protection, especially during a sector-wide event. Poorly regarded organisations find themselves more exposed to negative reactions.

The impact of crisis response effectiveness on share value



Research from 15 high-profile crises focused on the impact on shareholder value following the crisis.[5]

5 Reputation Review | Oxford Metrica and Aon, 2012

For any FTSE 350 organisation, the reality today is that a crisis is a matter of when, not if

Why organisations find it difficult to address reputational risk

Managing reputational risk doesn't fit neatly into a single function, and this is the first of a number of barriers that organisations may face:

- unclear ownership of reputational risk, which may fall between the Risk and Communications functions, and the parts of the business that manage stakeholders on a day to day basis such as buyers, service teams, investor relations;
- poor understanding of the sources of reputational risk and how to manage them;
- low awareness of the full cost of a crisis impact, for example market value, market share, customer redress, and delayed business plan delivery;
- failure to take into account the external stakeholder perspective; and
- substantial issues relating to corporate culture and behaviours that are heavily invested in the status quo.

Establishing clear responsibility for managing reputational risk is a good starting point for organisations. It is also important to recognise that managing reputation reaches across all teams that interface with external stakeholders.

Reputation through the stakeholder lens

If reputation sits with stakeholders, then the identification of reputational risk needs to reflect their perspective. It is not enough to apply a purely internal view; what's required is an 'outside-in' approach, understanding stakeholders and what matters to them.

Internal and external stakeholders

A coherent view across all internal and external stakeholders helps to identify the important perspectives that influence reputation.

Stakeholder	Potential reputational risk impact
Regulators	Reduce market access; increase costs through investigations and sanctions
NGOs	Act like a concerned voice in a range of situations; energise public attention
National & Local Government	Tax policy, market access, regulatory influencers, write laws, local enforcement
Activists	Able to increase issue profiles; tap into public sympathies; initiate protests
Suppliers/3rd party contractors	Reputations are intertwined, aware of issues through regular contact, own issues reflect on organisation reputation
General public	The public information space, especially when amplified by media, defines what's acceptable, with typically low tolerance of malpractice
Customers & Consumers	Existing consumers can influence brand, corporate profile and financial performance, they impact front line service employees
Local community	When mobilised they impact media coverage, they may have significant influence for geographically constrained assets
Distributors	Linking consumers and companies, they provide important feedback loop, but also risk exposure
Competitors	May be allies or threats depending on their own exposure to risk – important to understand which
Shareholders & investors	Driven by financial returns, their actions may drive media headlines and wider stakeholder influence
Commentators	High-profile influencers may alter debate trajectory e.g. key media outlets / newspapers / TV shows
Board & Non Exec Directors	Responsible for reputation, should challenge the Executive team on reputational risk, they can be a positive stakeholder influence
Leadership Team	Translate top down direction and set the internal culture, they should be alert to employee and external concerns
Employees	Are sensitive to culture issues and media, they influence external stakeholders, they can have a strong social media voice

What's on your risk register?

Most organisations will have listed a range of operational, strategic and financial risks on their registers based solely on an internal perspective. If your organisation has not made it clear how these are likely to impact reputation, or if the register shows 'Reputation' as a standalone strategic risk, then it may be at considerable risk without understanding how or why.

Identifying the reputational impact for each of the risks already captured is a positive first step in bringing clarity to the extent of the risk exposure. Applying a consistent 'cause and effect' lens across the risk register helps to clarify the critical stakeholders, the size and nature of the impact on them and their behaviour and the resulting business outcome.

Capturing the reputational impact of these risks will start to bring substance and transparency to an organisation's reputational risk, and filter out those with little or no impact. By the end of this initial review, every risk on the register will have been assessed for its impact on reputation, and generic 'reputational risk' entries will no longer exist.

Such an analysis will help to bring consistency to how reputational risks are identified, but it may still not reflect actual stakeholder perceptions.

What drives your reputation?

Understanding the stakeholder landscape is critical for managing reputational risk. It will typically reflect a broad and diverse group, each with different priorities, attitudes, roles and levels of influence.

An organisation's reputation is driven by the interaction between these different groups in response to what the organisation is seen to do. This takes place internally (reflected in corporate culture), externally between stakeholders (reflected in the prevailing attitudes or behaviours), and between the two groups as they participate in transactions together.

Stakeholder actions may impact the organisation directly, for example customers could stop buying the organisation's products or services. Others may have significant indirect influence, for example the impact of media on customers.

In the case of more complex situations, it can be useful to map out key stakeholder relationships – clarifying who interacts with who, their level of interest, attitude and relative influence – to identify what's driving the reputational narrative.

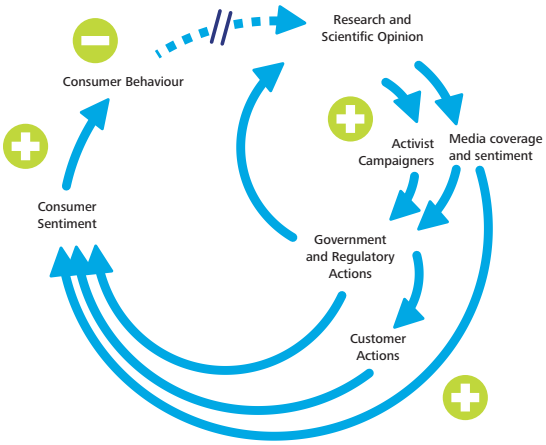
The stakeholder landscape will vary by organisation. Based on our report, A Crisis of Confidence, the survey findings show that customers and consumers are consistently identified as the number one stakeholder. Although employees, investors and regulators are also recognised as significant, their relative importance varies across sectors, geography and culture.[6]

What matters, ultimately, is understanding how you are perceived by stakeholders and how their expectations match the organisation's strategy and delivery.

Where expectations are high or where alignment is low, there may be an increased threat to reputation and this applies equally to internal and external stakeholders.

A mature reputational risk assessment will cover internal and external interaction to establish a coherent view of the risks to reputation. Establishing an 'inside-out' and 'outside-in' perspective will help to describe fully what's driving reputation, and may be crucial if the organisation has particular blind spots that may lead to potential crisis trigger events.

Example: Consumer product ingredient risk system



Reputational risk as opportunity

Reputational risks within a sector are also opportunities to enhance reputation and value. There can be upside from more effective reputation management that adds value for the organisation in the long term.

Taking a lead on sector-wide risks can also provide competitive advantage by establishing differentiation in the sector, strengthening relationships with key stakeholders around issues that are important to them, and building reputation capital.

Understanding future trends and anticipating the reactions of influential stakeholders provide the basis for transforming risk into opportunity.

What board members should be asking on reputational risk:

Does our risk register adequately reflect our reputational risk?
- Have we assessed our current principal risks from a reputational perspective ('inside-out')?
- Have we assessed our stakeholder groups and identified risks that reflect their priorities ('outside-in')?
- For significant reputational risks, do we have clear mitigation plans, and are we prepared for these?

Have we identified our main stakeholders and do we have a coherent approach for managing them all?
- Have we conducted a comprehensive stakeholder assessment? How often do we do this?
- Does it include both internal and external stakeholders?
- Do we understand their perspectives, priorities, attitudes and influence?
- Have we identified any significant gaps between their expectations and what we're doing?

Who is responsible for reputational risk in our organisation?
- Who represents our key stakeholders' point of view at the board?
- Does their remit include internal and external stakeholders and the functions that regularly engage?
- Does management have a plan to record and answer the main concerns of our stakeholders regarding our reputational risks?

Has management considered sector-wide risks to identify opportunities to enhance our reputation?
- What are the future risks facing the sector, and which provide a long term reputation opportunity?
- Which stakeholders need to be engaged?

6 Reputation@risk| Deloitte 2014 Global Survey on reputation risk | October 2014

Measuring reputational risk

Making reputational risk tangible brings substance to the issues. It supports more effective decision-making in relation to what the organisation needs to adapt, or protect, to improve its reputation.

Identifying stakeholders does not mean a company has engaged with them

"A good reputation is more valuable than money."

Publilius Syrus
Latin Writer
85 BC – 43 BC

How do you measure reputational risk?
A stakeholder assessment should involve a consistent approach to measuring reputational risk using the cause and effect model. This helps the organisation understand the impact of stakeholder reaction, but it also pinpoints the mitigating actions – where they need to adapt and change, or reinforce existing protection. Assessment should cover three key areas:

1. **Stakeholder perception and alignment to the organisation's activity**
   Evaluating stakeholder sentiment in relation to the organisation's competence, transparency and guardianship provides powerful feedback and insight for the organisation. This can be established through direct stakeholder engagement, for example facilitating customer, employee and supplier feedback, setting up confidential reporting phone lines, and through media and social media monitoring.

   Organisations can also use stakeholder 'war games' to provide an alternative source of indirect stakeholder insight and anticipate likely reactions to specific events. In particular, external facing employees are likely to have a good knowledge of what customers and suppliers, for example, are saying about the organisation, how they may respond to given risk events and how this can best be managed.

   Truly listening to what stakeholders value most and committing to action may not be easy especially if there is a wide gap between perception and reality. It could lead to the need for a frank and honest appraisal of corporate culture and the way an organisation conducts itself.

2. **Stakeholder propensity to change**
   Understanding how changes in perception drive changes in behaviour is a key link in the cause and effect model. In the first instance the use of historical evidence can help to frame and size the likely actions to expect. This could be extended by a review of broader prevailing conditions to forecast changes from the norm. For example the impact of economic austerity alongside changing perception of discount stores resulted in significantly altered shopping habits for a large number of supermarket customers.

   Monitoring changes in stakeholder sentiment allows an organisation to identify how the risk profile is shifting. Understanding how likely it is that this will result in significant changes in stakeholder activity is critical to any evaluation of reputational risk.

   Organisations can model a simple set of assumptions around propensity to change. More sophisticated evaluations can be made using analysis of historical data, using Big Data and specialist analytical support to help to develop more complex scenarios.

3. **Impact on the organisation**
   The impact on value can be instantaneous and significant, or cumulative over time. In the case of the latter, there may be a tipping point that leads to a sudden surge, or beyond which recovery to previous performance is unlikely. A pragmatic approach to assessing potential business impacts of a reputation-driven crisis will include:

   - financial – including sales, market share, cost of capital, profitability impacts and market value;
   - customer churn and supplier reactions;
   - regulatory fines and sanctions, preclusion for government contracts;
   - one-off operating costs such as customer redress, new technology;
   - avoidable increases in day to day operating costs resulting from new ways of working required; and
   - delayed delivery of current business plans such as new product launches, M&A activity.

Breaking down reputational risk measurement in this way is consistent with the traditional 'likelihood and impact' risk assessment, and provides a greater level of granularity around the assumptions being made. It also supports a data-rich approach for modelling more complex risk evaluations, for example in relation to a specific sector threat.

Building reputational resilience

A two-fold approach emerges for building reputational resilience; an outside-in approach to stakeholder management to identify risks and drive continuous improvement in the organisation, and a robust crisis readiness programme that prepares it for unexpected threats and crises.

A model for building reputational resilience

Building resilience involves two principal activities, which are effectively minimising risk, and at the same time preparing for the worst outcome. Together, our resilience model addresses the two categories of reputational exposure – failure to meet stakeholder expectations, and ineffective crisis response:

1. Aware

Identify the risks associated with organisational behaviour not being aligned to stakeholder expectations, and develop strategies to either adapt or protect existing ways of working.

2. Prepared

Prepare for a crisis and develop capabilities to respond to a crisis and manage recovery to address the risks associated with ineffective crisis management.

Building stakeholder awareness

Identify, Adapt & Protect

The journey to reputational resilience starts with the identification and measurement of risks, and calls for board level involvement in line with the UK Corporate Governance Code. We have covered this first stage in some detail already, emphasising the need to take both internal and external stakeholder perspectives to identify and measure the broadest set of risks, using a variety of methods from stakeholder 'war games' to direct engagement.

The identification of reputational risks requires a thoughtful review of the nature of the organisation's operations, and the regulatory framework that it works within. Reputation-damaging crises often emerge from the gap between reality and stakeholder expectation.

Managing reputational risk doesn't fit neatly into a single function. Ultimately governed through the board, it needs clear accountability, leadership and engagement across a number of teams. These include risk, compliance, internal and external communications, human resources, and the operational functions that regularly engage external stakeholders such as consumers, suppliers and investors.

Identify, Adapt & Protect

Mitigating the priority risks will require some action on behalf of the organisation. Adapting ways of working to prevent or avoid unnecessary risks is a logical first step.

Some of these solutions may be low cost, others may have implications for short to long term operational costs. For example increasing supply chain channels to improve operational resilience by reducing dependency on a single channel will usually have a long term cost impact. Having a clear picture of the likely costs of not taking action will help decision-making in the organisation.

Often, decisions will need to be taken quickly to prevent an unfolding risk from developing into a reputational threat or even a full-blown crisis situation. Re-aligning the activities and behaviours of organisations to meet increasingly demanding stakeholder expectations is a continuous process. Positive responses demonstrate competence, transparency and care and help to improve sentiment.

Where it is not possible to adapt ways of working, the next consideration is to protect against the perceived threat, for example through enhanced physical and technical security of assets and systems in relation to man-made or natural disasters, or against deliberate attacks.

Building in additional protection effectively increases the cost of operations and may make them uneconomic or unfeasible. Understanding the extent of protection afforded and the remaining risk to reputation is another important aspect.

Careful consideration of opportunities to adapt or protect what the organisation does is often the most effective crisis management activity it can do – preventing crises from occurring in the first place. It may also be the most cost-effective.

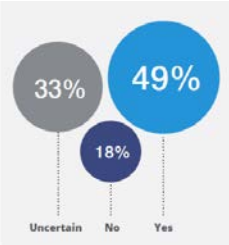
Building Reputational Resilience

Reputation damaging crises often emerge from the gap between reality and stakeholder expectation.

The importance of crisis readiness

When a major crisis event occurs, it will have an immediate impact on reputation perception and market value. Being ready to respond effectively is the best strategy for limiting the initial damage and enhancing reputation in the long run.

Less than half have crisis playbooks ready to use – and one-third don't even know if they do[7].



Identifying stakeholders does not mean a company has engaged with them

Being prepared

Prepare, Respond & Recover

Being prepared for a crisis is an essential element of a reputational resilience strategy, and in the event of a crisis is critical to limiting reputational damage.

Establishing an effective crisis management framework allows organisations to integrate the right processes, roles and governance around existing contingency plans. Working through potential reactions of stakeholders to likely crises enables organisations to prepare effective responses outside of a crisis event. For example, what options for customer redress may be considered? How would these work? At what cost?

Managing incidents and moving into crisis mode is learned through experience. Knowing when to mobilise a crisis response, how to manage crisis decision-making, knowing what to communicate, to whom, and co-ordinating communications across a wide range of stakeholders takes practice. Running crisis simulation rehearsals based on most critical reputational risks to test processes and gain experience can make all the difference. This is vital to building and maintaining capability or 'operational readiness' to respond to crisis.

Good preparation allows the organisation to demonstrate competence in the glare of publicity. Where internal experience or capability may be limited, organisations should ensure they can get the best support externally when they need it most.

Prepare, Respond & Recover

Reputation-damaging crisis events often start as issues which grow into major crises as information emerges and the implications become clear. This can unfold in a very short space of time, playing out in a highly visible way, with limited information available.

During a crisis there are two parallel priorities:

1. To contain and resolve the issue in hand
2. To address the risk to reputation both in the short and long term

This requires swift decision-making, responsive communication through multiple channels, and a consistent narrative which addresses what's important to your stakeholders to demonstrate competence, integrity and care.

What Board members should be asking on crisis readiness:

How well-prepared is the organisation to manage an inevitable crisis event?

- Do we have crisis processes and structures in place?
- Do we have playbooks for the most common potential issues?
- Do we have immediate access to expert support in the case of multiple, complex or organisation-threatening crises?

Are our people trained and have they rehearsed their crisis response?

- How often are rehearsals run each year?
- Do our leadership team actively participate?

Do we have a plan to deal with a reputation issue or crisis?

- Have we considered likely customer and other key stakeholder issues to be managed?
- Does our crisis process ensure we will demonstrate competence, transparency and guardianship?

Are senior representatives of the organisation media-trained?

- Who are our media spokespeople?
- Are they all trained?

Do we understand the role of the Board and its members in a crisis?

7 Q3 2015 Forbes Survey | Conducted on behalf of the Deloitte Centre for Crisis Management

For global organisations reputation considerations become increasingly complex, particularly when it comes to communication strategy across widely differing cultures. Being prepared with a well-considered approach can make all the difference.

After the initial crisis response, the recovery programme may extend over months or years. During this period, making public commitments, and regularly being seen to deliver on these is the best strategy for rebuilding trust and reputation.

Conclusion

Reputation is one of the most important assets an organisation has. It is impacted by the way the organisation is perceived to manage its day to day business and how it responds in a crisis situation.

An organisation can protect itself by building reputational resilience, and it can repair reputation damage by ensuring an effective crisis response and recovery programme. Both call for the demonstration of behaviours that indicate competence, transparency and guardianship.

We recommend two priorities for an organisation:

1. An outside-in approach to stakeholder management to identify current perceptions and likely responses or reactions to given risk events through reputational risk maturity assessment and stakeholder war games.

2. Establishing a robust crisis readiness programme that prepares it for reputational events, with access to expert support where needed.

In addition to affording an organisation the best protection against reputational damage, these also offer the opportunity to enhance its reputation, especially in the face of sector-wide threats.

Key points

- Understand reputational risk in terms of cause and effect – how the organisation impacts its stakeholders, and how their reaction impacts value.
- Establish clear accountability for managing reputational risk, with a broad remit across all key parts of the organisation.
- Establish a coherent view of all your stakeholders and points of interaction – use it to highlight areas of risk e.g. poor alignment, and gaps between perception and reality, and likely reactions to given risk events.
- Ensure you are crisis-ready and likely to demonstrate competence, transparency and guardianship in the heat of the action.
- Look at sector-wide risks to identify opportunities to enhance reputation.

Deloitte can help

1. **To understand your exposure to reputational risk** by conducting a reputational risk assessment against our maturity model.
2. **To understand your stakeholder risks and likely reactions to key risk events** by running 'outside in' reputation war games.
3. **To identify reputation enhancing opportunities** by strategic risk modelling of sector-specific issues.
4. **To develop crisis readiness** through good practice crisis frameworks and rehearsals.
5. **Provide the necessary expert support at times of crisis in key areas.**

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To discuss any of the topics and approaches in this document, please do not hesitate to reach out to one of the Deloitte experts below:

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Notes

Designed and produced by The Creative Studio at Deloitte, London. J6127