Reputation Risk As A Board Concern

by Henry Ristuccia and Michael Rossen

Legal, financial, supply chain and operational risks are a topic for monitoring in every boardroom today. Yet when a problem strikes under any of these headings, it is usually only the first step in a crisis. The second stage is the hit to your company's reputation with investors, customers, suppliers, regulators and the general public. The results can be devastating. Does your board have the tools and expertise to monitor *reputational* risk—and to head off problems before they strike?

Reputation risk is not new; it has been a part of business forever. What has changed is how vital reputation risk has become to the overall health of businesses—and how difficult it can be to manage. In a digital world where bad news spreads more quickly than ever before, a company's reputation can suffer severe and sometimes irreparable damage in the blink of an eye.

Worse, companies are now being held accountable for everything that happens in their global supply chain; even for the questionable business practices of an obscure third- or fourth-tier supplier in a distant land.

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In this challenging and volatile business environment, reputation risk has become the number one strategic business risk. As such, it is now an issue boards must actively monitor and oversee as part of their overall responsibility for corporate governance.

A study conducted by *Forbes Insights* on behalf of Deloitte Touche Tohmatsu Limited (DTTL) which was released on October 28, 2014, found that companies around the world view reputation risk as a top risk concern. The *Reputaion@Risk* report is based on a global survey of more than 300 executives from major companies around the world and looks at how businesses are managing reputation risk—both now and in the future. Among the 300-plus executives surveyed, 87 percent rated reputation risk as "more important" or "much more important" relative to other strategic risks. Also, 88 percent said their companies are explicitly focusing on reputation risk as a key business challenge.

For better or worse, a company's reputation has a huge impact on its value. In fact, according to World Economics in its September 2012 study *The Impact of Reputation on Market Value,* on average more than 25 percent of a company's market value is specifically attributable to its reputation. In a world of evolving technological innovation and instant global communication, that number is likely even higher.

According to the DTTL survey, key impact areas reported by companies that had previously experienced a negative reputation event included: loss of revenue (41 percent), loss of brand value (41 percent), and regulatory investigations (37 percent).

Given the growing importance and impact of reputation risk, it is not surprising that 73 percent of the surveyed executives said their board was involved or very involved in helping to oversee risks to the company's reputation. Further, 14 percent said their board had primary responsibility for reputation risk.

Boards and business executives have traditionally viewed reputation risk as an outcome, the result of other risks related to core business issues, such as fraud, bribery, cybercrime, and product safety. The

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prevailing wisdom was that if a company took care of those other risks, reputation would take care of itself. However, companies have started turning that traditional risk model on its head, placing reputation risk at the top and everything else flowing from it.

The fact that reputation risk is now viewed as more important does not mean other risk areas have become less important. After all, those other risks are still essential to business survival. So it remains critical to manage them effectively.

This is especially true in areas that are fundamental to the business. For example, food and beverage companies cannot focus solely on branding and reputation risk. When all is said and done, they still need to produce products that taste good and are nutritious, just as automotive companies still need to manufacture vehicles that are appealing, safe to drive, and perform well.

The importance of reputation risk is rising at an alarming speed, hastened by business trends and technological innovations such as social media, mobile, and big data.

Placing reputation risk at the top is not just an academic exercise. Rather, it is a critical step in bringing reputation risk out of the shadows and helps guide organizational behavior, from the boardroom all the way down to the front lines.

The importance of reputation risk is rising at an alarming speed, hastened by business trends and technological innovations such as social media, mobile, and big data. Many companies are still struggling to make sense of these new technologies, understand their full business impact, and what to do about them.

For example, boardroom and C-suite discussions covering social media may solely focus on company social media policies. In isolation, this completely ignores the much more important issue of how outsiders are using social media to affect the company's reputation in the external marketplace.

Here are some specific actions boards can encourage their companies to adopt in order to avoid being blindsided by reputational risk:

Hidden Reputation Risks

All Risks Carry Reputation Dangers

A company's reputation is affected by its business decisions and performance. Boards should be assessing the reputational impacts in areas such as:

☐ *Financial performance.* Shareholders, investors, lenders, and many other stakeholders look at financial performance when assessing a firm's reputation.

☐ *Quality.* Willingness to adhere to quality standards goes a long way to enhancing reputation. Product defects and recalls have an adverse impact.

☐ *Innovation.* Firms that differentiate themselves from their competitors through innovative processes and unique/niche products tend to have strong name recognition and high reputation value.

☐ *Ethics and integrity.* Firms with strong ethical policies are considered more trustworthy in the eyes of stakeholders.

☐ *Crisis response.* Stakeholders keep a close eye on how a company responds to difficult situations. Any action during a crisis ultimately affects the company's reputation.

☐ *Safety.* Strong safety policies affirm that safety and risk management are top strategic priorities for the company, building trust and value creation.

☐ *Corporate social responsibility.* Actively promoting sound environmental management and social responsibility programs helps create a reputation "safety net."

☐ *Security.* Strong infrastructure to defend against physical and cybersecurity threats helps avoid security breaches that could damage a company's reputation.

☐ ***Clarify the link between reputation risk and other risks.*** Reputation risk is inextricably linked to other business risks, many of which are already aggressively managed as part of a company's day-to-day business. In order to get a handle on reputation risk, it is crucial to untangle the complex web of interdependencies. Understand exactly how reputation risk relates to other risk areas, and what programs are already in place to manage those risks.

For example, every life sciences company has existing programs to help ensure the quality and safety of its products. However, those programs often are not explicitly linked to managing reputation damage in the event of a crisis, or improving the company's reputation for safety and social responsibility when things are going smoothly. Clarifying and formalizing such connections can help eliminate critical gaps and duplication of effort, reducing both cost and risk to help businesses get in front of this critical issue.

☐ ***Adopt a pre-emptive mindset for reputation risk.*** The traditional view of reputation risk as an outcome tends to foster a passive, reactionary approach to risk management. You should not wait until a negative reputation event strikes and then launch into crisis mode—calling the lawyers, cranking up the public relations machine, and throwing massive amounts of money and manpower at the problem to salvage your reputation and avoid a recurrence.

A passive approach might have been good enough in the past when bad news traveled slowly and companies had time to react and control the damage. In today's highly connected world, though, obscure problems can become global headlines in a matter of minutes. Often the board and CEO are among the last to know.

In this environment, it becomes essential to detect and disarm problems before they reach critical mass. By the time a story hits the mainstream media, much of the reputation damage has already been done. Boards should assess whether management has the proper procedures in place to manage reputation risk.

☐ ***Ask the right questions.*** To manage reputation risk effectively, companies need forward-looking, outward-facing capabilities. These can help them to not only improve their reputation, but to systematically track evolving stakeholder expectations.

Questions for boards to ask of management include:

▫ *Where to look?* Identify stakeholders and data sources for stakeholder information, considering both internal and external stakeholders. This includes regulators, shareholders, employees, and customers. Tap into varied data sources for a more complete perspective. Use independent and objective data to track stakeholder perceptions.

▫ *What to analyze?* Identify factors that indicate changes in stakeholder expectations and potential reputation risks. Identify elements of your strategy and operating environment that could affect reputation. Design an analytical framework around the identified elements, and then develop automated tracking and reputation risk monitoring. Define risk indicators to monitor potential reputation impacts.

▫ *How to move forward?* Use insights gleaned from answering the first two questions (particularly the analysis of key risk indicators) to inform ongoing risk management decisions. Take early action on evolving stakeholder expectations and unmet expectations to allow time for recalibration as needed. Develop a company culture where the strategy for managing reputation risk is constantly recalibrated in response to emerging information.

Ensure that when your reputation risk program is launched both the "known knowns" and "known unknowns" are fully explored.

☐ ***Develop robust capabilities for monitoring and managing reputation risk.*** The true value of a reputation risk program is to integrate an outside-in perspective into your enterprise risk program. This provides a holistic view of current and potential risks. There are three steps for setting up an effective program to manage reputation risk.

First, embark on discovery. Core to the discovery phase is a detailed examination of the company's current view of its strategies, risks and vulnerabilities. This helps ensure that when the reputation risk program is launched both the "known knowns" and "known unknowns" are fully explored through a series of in-depth interviews conducted at the board and C-suite level.

Through this basic research, the company's primary stakeholders are identified, those who will provide the outside-in perspective. Meanwhile, secondary research can identify other stakeholders (such as sustainability indices, non-governmental organizations, and the Department of Justice) whose impact on sector and corporate reputation might be vital.

"Listening posts" can then be identified to monitor and harvest the opinions of these stakeholders from a wide range of diverse sources, such as staff and analyst blogs, industry forums, academic papers, media commentary, direct interviews, and the full range of social media.

Discovery culminates in a presentation to management about the company's inside-out perspective, at which point the overall program is ready for launch.

Next, establish the baseline. In this phase, critical stakeholders are engaged to help assess the company's existing "view from the outside." This might cover regulators, financial and sector analysts, and local communities based around partners, customers, staff, suppliers, and stakeholders. A variety of techniques are employed to gather intelligence from the different audiences involved. These various audiences can offer perspectives on the perceived impact of the company's reputation drivers.

Search Internet dialogue (blogs, forums, websites, and other social media platforms) to detect reputation threats and opportunities.

The baseline report analyzes strategic threats and opportunities on an enterprise level, and provides a breakdown of those threats by stakeholder and by reputation driver. The report also looks at interconnected threats across the various listening posts and stakeholder groups. Individually these may seem innocuous but, when viewed together, they represent significant threats that require action.

During the baseline phase, analysis of the "unknown unknowns" begins. This includes searching Internet dialogue (blogs, forums, websites, and other social media platforms) to detect potential threats and opportunities, and relate those findings to reputation drivers.

The primary output of the baseline phase is a gap analysis of how company stakeholders view reputational impacts on strategies versus management's objectives. The analysis sets the agenda for actively managing strategic threats and opportunities, and provides a baseline for bridging the gap over time. This phase culminates in a presentation to management about the organization's outside-in perspective.

☐ ***Proactively manage reputation risk.*** By this time, techniques for outreach and research have been established and the lessons from the discovery and baseline phases have been put into action. There are now three focus areas for proactively managing reputation risk: anticipating threats to strategy, and opportunities for enhancement; analyzing trends that may lead either to threats or opportunities; and taking action on reputational levers and corporate

Crisis Management

Five Lessons For The Board

A single big event (or a combination of small events) can trigger a major crisis that threatens the very survival of the business. These critical situations expose an organization's readiness and responsiveness, testing its values, leadership, and character at a time when there is no room for error. Here are some lessons to consider when developing an approach to crisis management:

☐ *Do not wait until a crisis hits to get ready.* Monitoring, preparation, and rehearsal are the most effective ways to get ready for a crisis event. Companies that plan and rehearse potential crisis scenarios are better positioned to respond effectively when a crisis actually hits.

☐ *Every decision during a major crisis can affect stakeholder value.* Reputation risks destroy value more quickly than operational risks.

☐ *Response times should be in minutes, not hours or days.* Teams on the ground need to take control, lead with flexibility, make decisions with less-than-perfect information, communicate well internally and externally, and inspire confidence. This often requires outside-the-box thinking and innovation.

☐ *The business can emerge stronger.* Almost every crisis creates opportunities for companies to rebound. However, those opportunities will surface only if companies are looking for them.

☐ *A crisis is never over until it is over.* The work goes on long after company leaders breathe a sigh of relief. The way a company captures and manages data, logs decisions, manages finances, handles insurance claims and meets legal requirements on the road back to normality can determine how strongly it recovers.

behaviors to assure successful strategic execution.

Crisis management is a critical capability for handling major reputation problems, and an area that more companies are investing in. An effective crisis management approach helps a company stay ahead of serious threats that have the potential to undermine the business. It begins with identifying and preparing for strategic risks, and includes a broad portfolio of capabilities such as simulation, monitoring, risk sensing, response, and communications.

These capabilities need to be in place before a crisis hits. The absolute worst time for a company to develop a crisis management strategy is when its back is against the wall and it is running out of options.

☐ ***Invest in risk-sensing technologies.*** Effective reporting mechanisms can help companies tackle the challenges of monitoring and managing reputation risk. This includes alert services for operational management that flag emerging risks (risks are picked up by software and vetted by people with expertise in reputation risk). Prepare online reports for senior management that identify strategic reputation risks and opportunities, and quarterly presentations to top management about major trends that could affect strategic outcomes and may require changes to corporate behavior.

Risk sensing systems are an emerging technology that can provide companies with early warning about potential reputation problems. According to the DTTL survey, 63 percent of companies intend to invest in such technology moving forward.

Capabilities of risk-sensing systems include:

□ *Real-time analysis.* Efficiently processing and synthesizing real-time data. Tools such as pattern detection and recognition enable real-time problem identification and reporting.

□ *Text analytics.* Using natural language processing, sentiment analysis, and computational linguistics to identify and extract subjective information.

□ *Big data.* Cost-effectively monitoring a vast array of internal and external data sources.

□ *Forward-looking and outward-facing view.* Assessing future strategic, operational and tactical business drivers, supplemented with an outside-in view of emerging risks.

□ *Early warnings and triggers.* Improving the signal-to-noise ratio to detect faint early warning signs and avoid surprises.

□ *Actionable insights.* Delivering operational insights that can be easily integrated into the business, delivering a direct and positive impact on performance.

Integrating technology with these capabilities into a company's risk management processes can give decision makers the deep, timely insights they need to identify and address hidden reputation risks before they become tomorrow's headlines.

Leading companies treat reputation risk as strategic. This need not require more work, just a shift in focus.

Reputation risk will likely be more critical in the years to come, which means companies must continue improving their capabilities in this area. Leading companies already treat reputation risk as strategic, and we expect this trend to accelerate—in many cases driven by the board's growing awareness of the issue.

Of course, most boards already have a full plate of responsibilities and are not seeking more to do. The good news is the increased focus on reputation risk need not require more work; just a shift in focus and priorities. Savvy boards already keep a close eye on the major strategic risks their companies are facing. The emergence of reputation risk as a top business risk simply provides a new focal point for all of the other risk management activities with which boards are already involved.

Protecting your company's reputation and brand is a major challenge, but also a manageable one. By encouraging companies to factor reputation risk into their business strategies and invest in the right capabilities, boards can lay the groundwork for a more active approach to managing reputation risk, clearing a path for continued growth and success. ■