GEC Risk Advisory
Transforming Risk into Value SM

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"Smart Reputation Management is Good Business"

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The regulatory responses to the many scandals of the past dozen years (Enron, WorldCom, Siemens, Wall Street and Fleet Street) should have curbed the excesses that caused them. But they didn't.

The endless parade of troubles continues – if it isn't one industry it's another, if it isn't one company it's another, if it isn't one hedge fund it's another, if it isn't one CEO it's another, if it isn't one insider trader it's another, if it isn't one briber it's another.

This parade isn't exclusive to North America or the UK and Continental Europe, Russia or Asia. Latin America has seen its fair share of scandals and difficulties. As the Transparency International Corruption Perception Index has repeatedly shown, corruption is rampant in most of the world (with the possible exception of some Scandinavian countries). And it hurts a variety of stakeholders everywhere – whether employees, consumers, communities, or others.

Regardless of geography, the same substantive topics exist – fraud, corruption, conflicts of interest, health, safety and environmental violations – and the same organizational challenges are evident: leadership failure, culture failure, the wrong strategic risk architecture.

What is the reason for all this malfeasance and recidivism everywhere in the world? One reason is may be that, historically, business has focused almost exclusively on financial results, metrics, performance and rewards. The remaining indiciae of behavior and performance – whether health, safety, environmental, governance or risk related – simply don't gain the same attention or passion from business people.

There are other reasons of course and another critically important one is human nature. Indeed, a series of studies conducted by several professors "Seeing green: Mere exposure to money triggers a business decision frame and unethical outcomes" shows that the mere physical presence of money changes people's otherwise ethical behaviors – they are willing to compromise their standards much more readily if the promise of money is near and real.[1]

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[1] Maryam Kouchaki, Kristin Smith-Crowe, Arthur P. Brief and Carlos Sousa in Organizational Behavior and Human Decision Processes.

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We cannot just ignore this basic fact of human nature. The consequences and collateral damage of a single-minded focus on achieving and maintaining wealth can seriously affect the financial and physical wellbeing of many stakeholders – whether it is the driver of a defective car who dies in a crash, or the investor in a Ponzi scheme who looses his life long savings, or the consumer whose baby gets sick on tainted baby formula. And the list, unfortunately, goes on.

However, it is in the interest business to not suffer serious financial or reputational damage. Look at the long-term hits that both Toyota and GM, two of the largest car makers in the world, are experiencing because of what appear to be cultures that didn't put health and safety of passengers first. Look at the companies that have disappeared off the face if the earth because of bad behaviors that led to bankruptcy and/or liquidation – Enron, WorldCom, Arthur Andersen, Bear Stearns, Lehman Brothers, just to name some notorious cases.

So if we all agree that bad corporate behaviour is not a social good, then how do we align corporate behaviour with producing more social good than harm?

There are solutions but they require leadership and the conscious decision to create a culture that goes beyond financial metrics and rewards. It requires some investment up front and the willingness by a business and its owners (shareholders) to forego short-termism and the expectation of, and pressure to, always achieve great financial results.

But many C-suites and boards don't think risk and reputation management is as important as revenues or profits. They often only have a reactive approach to risk downside, scrambling at the time to address the issue and then probably not that well. At best and at worst they see risk and reputation issues through a pure "cost of doing business" lens and by not being proactive expose the organization to serious reputational and potentially financial damage.

Smart risk and reputation management requires the creation of a triangular relationship between the board, the CEO and smart risk and reputation management. It involves a strategic focus not only on the downside of risk but the upside and opportunity of risk. A good system creates an early warning system to prevent serious reputation damage. It will also prepare an organization for the scandal that will inevitably happen. It will build and embed better processes in the system that will curb or thwart bad behaviour.

Businesses usually deal with scandal in one of two ways. Because of regulatory pressures or other stakeholder "demands", they grudgingly create an ineffective and under-resourced internal compliance program that's supposed to prevent future bad behavior. They build a compliance veneer where there's no substance and proper risk and reputation management barely exist.

Or, once they are "caught" in the act, they get a government-imposed solution with a monitor or a deferred prosecution agreement requiring a new or revised compliance program.

Both solutions are reactive. Both solutions are partial at best. And neither solution provides sustainable and strategic risk and reputation management or any other value-add.

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Smart risk and reputation management also adds value to the bottom line – through liability avoidance, cleaner and leaner processes and improved products and services. Indeed, properly deployed and integrated, strategic risk and reputation management will have a direct and positive impact on the financial bottom line.

There is a solution. Let's call it the magic triangle involving the CEO, an empowered risk executive and a risk-savvy board. This may also involve the creation of a new strategic executive perhaps an empowered chief risk and reputation officer (CRRO), sitting on the executive team, reporting to the CEO and the board.

Boards need to own risk oversight. CEOs need to be held accountable. They may want to consider a board risk, ethics and compliance committee with at least one independent director, savvy and experienced in these issues, not just tangentially but directly, proactively demanding a strategic approach from management.

This is the magic triangle. Together the CEO, the CRRO and the board will be able to triangulate risk and reputation management for the enterprise. And it's possible, that such a strategic approach may uncover hidden business value that otherwise lies fallow and unexploited.

The real obstacle to avoiding scandal and to creating better risk and reputation management isn't that there's no solution, Boards and executives have a choice – take a strategic instead of a haphazard approach to risk and reputation management and unlock new value. This will make for not only a better and more resilient corporate citizen -- it may also create a more sustainable and profitable bottom line.

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