SPECIAL REPORT

Reputation Risk in the "Age of Hyper-Transparency": What Leaders Need to Know

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1. INTRODUCTION

Reputation management has become a critical executive tool of the 21st century. It is focused on understanding, protecting and developing what is an essential asset for business and financial organizations of this century: reputation.[1]

Though often referenced as a soft or "intangible asset", a reputation is much more than that: while "intangible" it isn't devoid of tangible impact, which can be material and even devastating. One need only remember some of the companies that are gone because of their lost reputations (Enron, Arthur Andersen, WorldCom, Lehman Brothers) and those whose reputations have been severely affected (Siemens, Parmalat, and almost every US or EU based "too big to fail" global bank).[2]

To understand reputation, one must also understand reputation risk, develop a strategy to mitigate it and even try to transform this type of risk into an opportunity for better business. Effective reputation risk management, at the end of the day, can add real value to the financial bottom line of an organization.

So it is not surprising that over the last couple of years we have seen reputation risk moving to the top of the list of concerns for senior managers, c-suites and boards especially in large organizations. And it is really only in the last year that we have heard a buzz in the c-suite and the boardroom about reputation risk. In its 2013 survey on Strategic Risk, Deloitte found that reputation risk had become the number one strategic risk for c-suite and board members worldwide.[4]

1 This report is based in part on (a) the book by Andrea Bonime-Blanc, "The Reputation Risk Handbook: A Practical Guide for Managers, Executives and Boards". Dō Sustainability. Forthcoming, October 2014 (to order the book, please send your email address to abonimeblanc@gecrisk.com); and (b) the forthcoming paper by Jorge Cachinero, "Reputational Risks", January 2015 (expected).

2 Axel Gietz and Jorge Cachinero, "The Reputational Free-fall of the Financial Services Industry: Why It Is Unprecedented and How It Might Be Reversed", d+i LLORENTE & CUENCA, www.dmasillorenteycuenca.com, December 2011; and Andrea Bonime-Blanc, "Do Banks Care About Reputation Risk?" Ethical Corporation Magazine, March 5, 2014. http://www.ethicalcorp.com/business-strategy/globalethicist-—-do-banks-care-about-reputation-risk

3 Jorge Cachinero, "Reputation Is Here At Last", d+i LLORENTE & CUENCA, www.dmasillorenteycuenca.com, June 2011; and Manuel Bermejo, Jorge Cachinero and Juan Luis Manfredi, "Leadership in the Society of Change: Corporate Diplomacy, Reputation and Business Schools", d+i LLORENTE & CUENCA, www.dmasillorenteycuenca.com, November 2013.

4 Source: Deloitte. Strategic Risk Survey, 2013. http://deloitte.wsj.com/riskandcompliance/files/2013/10/strategic_risk_survey.pdf

"The ultimate goal is to equip organizations with the tools they need to understand, frame, mitigate and transform their reputational risks into value"

In keeping with this development and focusing more specifically on reputation issues, the 2013 Reputation Leader Study arrived at the following conclusions:

- 4 out of 5 companies agree that they compete in a reputation economy
- 56% of companies see reputation as a high priority for executive management
- 94% of reputational priorities are directly tied to business results
- The main reputation challenge is internal planning and integration[5]

And reputation risk is not purely the domain of corporations —indeed, reputation risk is something that affects the smallest of units (each of us as individuals) all the way to the largest of entities— the most powerful governments on earth (the US and China). And it is relevant to all kinds of organizations in between— from the small local non-governmental organization (NGO) to the largest or most influential global one's (the Red Cross and Doctors without Borders), from the boutique on the corner to the largest retail chains (Wal-Mart), and from the local football team to the largest global sports entities (FIFA and the Olympics). There is a thread that runs through all of them: the need to maintain and improve reputation and the need to mitigate or lessen reputation risk.

However, due to its relative novelty and the inability of many (including very smart, highly placed executives and board members) to understand this concept, many leaders and their organizations have no idea how to get their arms around "reputation" let alone "reputation risk".

In this article, we examine why there has been a rush to understanding reputation risk in recent times and provide a framework to understand how to tackle effective reputation risk management in an organization. The ultimate goal is to equip organizations with the tools they need to understand, frame, mitigate and transform their reputational risks into value.

2. 21ST CENTURY REPUTATION RISK HIT PARADE

Why, all of a sudden, is reputation risk of such great interest? The "Age of Hyper-Transparency"[6] is why. It's about massive volumes of information —including the good, the bad and the ugly— traveling almost literally at the speed of light through the Internet and the wide, growing and dizzying array of social media platforms.

The Age of Hyper Transparency might best be characterized by the words: "Nowhere to Run,

5 Source: Reputation Leader Study. Reputation Institute, 2013.

6 Source: The "Age of Hyper-Transparency" is more specifically described and examined in Chapter 2 of Bonime-Blanc, The Reputation Risk Handbook.

"The proliferation and visibility of high impact scandals since the turn of the century has highlighted the relevance of reputation"

Nowhere to Hide". This adage is well illustrated by the constantly evolving and complex GlaxoSmithKline (GSK) corruption scandal which began in China in 2013 with a government investigation into what first appeared to be corruption issues, and has since morphed and expanded into a multifaceted set of issues involving sex, privacy, lies and videotape. Because of the hyper-transparent age we live in, multiple governments, prosecutors, investigators, the media and others have jumped on the GSK investigatory bandwagon and are looking under every possible rock, including in such unlikely and unrelated places like Iraq and Syria.

There are several factors that explain why reputation risk is suddenly so important and so strategic:

- Scholarly and practitioner work on the real value of intangible things has improved over the past few years yielding greater and more reliable evidence of its hard-core impact
- The proliferation and visibility of high impact scandals since the turn of the century has highlighted the relevance of reputation
- Growing awareness and impact of non-financial considerations, namely, environmental, social and governance (ESG), and the related development of the field of sustainability, has aided in underscoring the importance of reputation
- Greater transparency and velocity of information through technology has made it nearly impossible for people and entities to escape the global microscope

3. UNDERSTANDING REPUTATION RISK

Where Does Reputation Risk Come From?

There are essentially four general sources of reputation risk[7]:

Natural are those reputation risks emanating from the natural environment and include, among others, climatic, atmospheric or seismic events or phenomena that cannot be easily predicted by companies.

A dramatic example of this type of reputation risk is the Fukushima case where natural causes (earthquake and tsunami) materially damaged a nuclear plant which was later revealed to have serious environmental, health and safety (EHS) flaws leading to far more reputational damage than would have been anticipated. These events in turn severely affected not only the reputation of the company running the Fukushima plant, TEPCO, but of the government regulators who didn't enforce EHS laws, among other things.

Leadership are those reputation risks that are directly related to the mistakes made by organiza-

7 Source: Cachinero, "Reputational Risks".

"Reputation risk is a broad and malleable concept"

tions, and especially by their senior managers, in the decisions they take about the general management of the organization and its business and, therefore, in exercising their responsibilities as leaders of these.

There are many examples of this type of reputation risk, which includes not only leadership failures (Enron, Lehman Brothers) but the closely related culture failures that go with them.[8] The overall banking and financial sector crises the world has witnessed since 2007/8 provide a dramatic example of this type of reputation risk.

Operational are reputation risks that arise as a result of the production process intrinsic to the nature of a business, or in other words, to the functioning of the value chain, the supply chain and the logistics chain of a business.

Once again, it is possible to point to an entire sector for this type of reputation risk - one need only mention the words Rana Plaza (Bangladesh) to evoke the systemic failure of much of the global retail industry in tackling human rights and other compliance and ethical vigilance in their supply chain. Many of the world's leading retailers have had their reputation seriously affected by this risk issue.

Environmental & Regulatory are those reputation risks resulting from important regulatory or legislative changes that have had a decisive effect on the operating environment of a specific industry or sector.

The case of the reorganization of the Spanish banking sector over the past half a decade illustrates this category. Long-standing Spanish institutions, such as the savings banks (Cajas de Ahorros) and charitable pawnbrokers (Montes de Piedad) have, with some exceptions, gradually disappeared. Many of their ex-directors are still dealing with the corporate, commercial and criminal repercussions of their actions and behaviors while running these organizations in the past. The change in the regulatory framework, along with the leadership risks associated with executive behaviors at these institutions, has completely transformed this business sector to the point that many have literally disappeared from the market.

So, What is "Reputation Risk"?

As these categories and examples demonstrate, reputation risk is a broad and malleable concept and, because of this, it presents challenges for a precise definition. However, it is this very malleability and amorphousness that is at the heart of what reputation risk is.

While it is possible to define a complicated subject in different ways, in The Reputation Risk Handbook, Andrea Bonime-Blanc

8 See: Andrea Bonime-Blanc, "The Biggest Risks Nobody Talks About". Ethical Corporation Magazine, February 7, 2014. http://www.ethicalcorp.com/business-strategy/globalethicist-–-biggest-risks-nobody-talks-about

"Reputation risk is here to stay. Executives and boards need to first, accept, second, understand, and third tackle this new reality"

provides the following definition: *Reputation risk is an amplifier risk that layers on or attaches to other risks —especially ESG risks — adding negative or positive implications to the materiality, duration or expansion of the other risks on the affected organization, person, product or service.*[9]

And, yes, reputation risk can have positive implications as well as negative or neutral ones. Companies and organizations that know how to get their arms around their reputation risk —starting at the very top of the organizational food chain: the board— are entities that will not only reduce the negative consequences of reputation risk but they may also be able to improve reputation, and enterprise value, in the process.

4. BUILDING A RESILIENT REPUTATION RISK MANAGEMENT FRAMEWORK

Reputation risk is here to stay. Executives and boards need to first, accept, second, understand, and third tackle this new reality. In this final section of our article, we outline some simple but compelling ideas for building long term reputation risk resilience based on our many years of experience counseling entities from the inside and the outside on building a strong reputation and building the essential components of that strong reputation —by creating all the right internal programs, enabling the necessary resources, acting in accordance with professed standards and strategies and being prepared for the inevitable crises that will come.

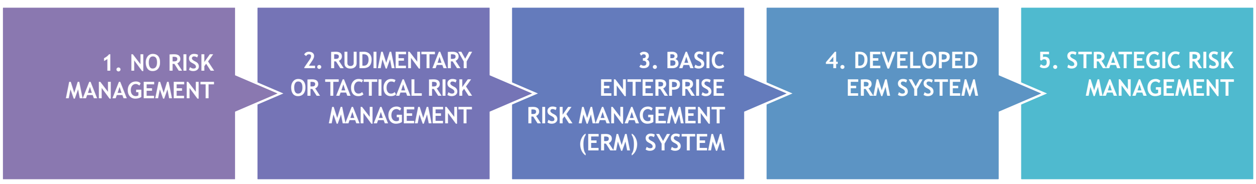
Risk management in general —how effective it ultimately is— depends largely on the organization, its sophistication, age, experience, geographical footprint, industry, sector, leadership, etc.

In The Reputation Risk Handbook, Andrea Bonime-Blanc details where reputation risk fits within the larger pantheon of risk management —both structurally and substantively. Figure 4 from the Handbook, copied below, shows five stages of risk management evolution: it is only in the latter stages of development (namely 3-5) that effective reputation risk management is even possible.[10]

9 Source: Bonime-Blanc, The Reputation Risk Handbook, Chapter 3.

10 Source: Bonime-Blanc, The Reputation Risk Handbook, Chapter 2.

Risk Management Architecture: An Evolutionary View



REPUTATION RISK MANAGEMENT LIKELY TO OCCUR ONLY IN LATER STAGES

Figure 4 from Bonime-Blanc, The Reputation Risk Handbook

"Once an organization can situate where it falls within this evolutionary spectrum, it can understand how best it can tackle reputation risk management"

Once an organization can situate where it falls within this evolutionary spectrum, it can understand how best it can tackle reputation risk management. In the Handbook, the author develops a typology of reputation risk management strategies that relate to these stages of evolution and to other important criteria (including leadership and culture). In addition, the author details a suite of fifteen reputation risk management tools that entities and their risk experts, executives and boards should consider as part of their larger risk management strategy.

The typology of reputation risk management strategies includes the following:

The "Incipient" Reputation Risk Management Strategy

An organization does not yet have a risk management program or deep know-how in place. This could be because the organization is relatively new, small, local, unregulated, unsophisticated or thrives on high risk. Whatever the reason, the organization does not believe in, nor does it know that it needs a formal risk management program, let alone a reputation risk management strategy.

The "Chaotic" Reputation Risk Management Strategy

This is an organization that understands, to a certain extent, that it faces certain risks, including reputation risk, but does not have a formal program, policy or internal architecture in place to deal with such risks. It may draw upon the expertise of one or more internal experts when needed.

The "Façade" Reputation Risk Management Strategy

This approach is more about form and less about substance. This could include a global company that undertakes annual enterprise risk management but doesn't effectively manage its risks including reputation risk. This is a strategy waiting for an accident to happen.

The "Effective" Reputation Risk Management Strategy

It is only when we reach the combination of deep risk know-how within an organization, including how to tackle reputation risk, and the existence of a proper framework and infrastructure to enable the optimal use of that know-how through an evolved ERM system that we reach what can be called Effective RRM.

Amongst some of the salient tools reputation risk experts and their management and board should consider are those listed in Table 1.

TABLE 1 REPUTATION RISK MANAGEMENT TOOLKIT EXAMPLES
1. Assessment and monitoring
2. Knowledgeable Resources
3. Cross-Functional Approach
4. Front Line Integration
5. PR & Communications Integration
6. Clear Policies & Guidelines
7. Problem-Resolution/ Speak-Up Culture
8. Crisis Management Plan Integration

Source: Bonime-Blanc, The Reputation Risk Handbook, Chapter 5.

"A successful reputation risk management strategy will be dependent on that rarest of all qualities: great leadership and a great organizational culture"

5. CONCLUSION

It is evident that in the "Age of Hyper-Transparency" there is indeed nowhere to run and nowhere to hide. And why should there be? Business and other types of organizations have stakeholders and have responsibilities to those stakeholders —whether financial, operational, or reputational.

The art and science of reputation risk management is only just beginning to develop but it is already acknowledged to be a necessary and critical component of a resilient and sustainable approach to business management and overall organizational management —whether we are talking about a corporation, an NGO, a government agency or a university.

The skills needed to successfully manage reputation risk in this century are the skills needed for success in general in this century: an outside-of-the-box mentality when it comes to managing, a cross-functional and multi-skilled approach to solving problems and the right kinds of experts, both internal and external, helping to shape and execute on a successful strategy. Obviously, the monitoring of potential reputation risks by the use of available tools which enable an active and permanent listening to ongoing conversations through social media is critical.

In today´s world, reputation risks tend to be sparked and amplified online more than in any other communication environment.

In conclusion, more than anything else, a successful reputation-risk management strategy will be dependent on that rarest of all qualities: great leadership and a great organizational culture[11].

11 The authors want to express their gratitude to Beatriz Herranz from LLORENTE & CUENCA for her valuable support in undertaking the necessary research and editing to make this essay possible.

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