Reputation Risk Management, Ethics, and Values: An International Debate

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Chapter 1: Background, trends, and drivers relating to reputation: The integration of ethics, values, and transparency

‘The reputation of a thousand years may be determined by the conduct of one hour.’ Japanese proverb

‘Who steals my purse steals trash… But he that filches from me my good name, robs me of that which not enriches him and makes me poor indeed.’ William Shakespeare, Othello

THIS REPORT focuses on reputational risk management and its role in the creation of a resilient or sustainable organisation, as well as the debate over ethical leadership and values. It is considered that resilience is intrinsically linked to a company’s values, culture, and reputation and that it is established through adequate risk and crisis management. The effective identification and management of a company’s risks should minimise any major threats to reputation. In addition, an effective response strategy, including dedicated crisis management teams should limit damage should risk ‘crystallise’. Together, risk and crisis management are fundamental to good governance.

Good corporate governance involves maintaining effective internal control over financial reporting and transparent disclosure of material matters to stakeholders to ensure that publicly reported information is reliable. As markets often take public reports at face value, inaccurate information can result in a loss of public confidence and damage to the reputation of the company that is difficult to recover from.

A strong operational focus is vital to the management of reputation risk. Without a supporting culture and controls imposed from the top, an organisation is susceptible to embarrassing control breakdowns, which could tarnish its reputation. Therefore the board must be fully engaged in an integrated reputation risk strategy that is aware of, and sensitive to, the evolving needs and demands of a growing international community of stakeholders. With regard to such a strategy various pertinent issues arise, including:

- The meaning of reputation and its value;
- Establishing reputational capital;
- Distinguishing stakeholders or constituents;
- The clear understanding of the company’s vision, mission, and culture; and
- Founding principles or values that affect the organisation’s life cycle and which are implemented openly and transparently.

As access to information and freedom of information expand globally, drivers of ethics, values, and transparency are becoming increasingly evident and there is a growing need for any risk management strategy to consider these drivers and to understand the positive impact that ethical behaviour has both on a company’s reputation and its bottom line.

There has been increased awareness of the significance of reputation risk management since the concept of globalisation was first recognised and
generally embraced. This report is intended to provide international or trans-boundary comment on reputation risk and to take into account the impact of the internet, social media, and related tools, such as Facebook or Twitter, on reputation and risk management strategy.

While PR, issues management, customer service, corporate social responsibility, and quality assurance have all been acknowledged areas of corporate strategy for decades, they are now beginning to merge with aspects of risk management. In June 2013 Forbes magazine said ‘Reputation management is the new black of corporate strategy’.1

Over the last 20 years, experts have advised that reputation risk management must be taken seriously as a sound business strategy. Yet it is now considered timely to bring the debate to the fore by proposing the value of an integrated reputation risk management strategy. This is particularly pertinent in view of international trends following several years of economic downturn, the effects of which have been felt worldwide. Hence some international case studies are included in this report from the USA, India, the EU, and the UK in particular.

Defining reputation
Reputation is a concept that has existed and evolved throughout the ages. Indeed, according to historians, in the Viking culture nothing was valued more than an immortal reputation and accordingly epic historical sagas celebrated the deeds of the dead. According to the Oxford English Dictionary, reputation covers the beliefs or opinions that are generally held or expressed about someone or something. The stem is found in Middle English: from Latin reputation-ē-, from reputare, ‘think over’. Sometimes it can be understood to mean the state of being well thought of when the term is not further qualified. For the purposes of this report and the discussion developed here reputation is generally considered to be an intangible asset that should be managed carefully in order to realise an individual’s and/or an organisation’s full potential in every way. For instance, building a positive reputation brings success to a company as it increases its relationship with a community.

Simply put, reputation is the belief and trust, or lack thereof, that people have in an individual or organisation. It is a term that also signifies the value of a name, an identity, image, or brand. The value placed on acquiring and maintaining a good reputation has also evolved over many years and in different ways in different parts of the world as a matter of social, professional, corporate, and policy debate but the American Heritage definition may suitably be cited here:

‘A reputation crystallizes from the plethora of images produced. Based on this description a corporate reputation represents the “net” effective or emotional reaction – good or bad, weak or strong – of customers, investors, employees and the general public to the company.’

Thus, in terms of business management, the intangible value of a name can have a measurable effect on revenues when well-known and respected names are paired with consumer products. There are other aspects of name identity, which should be considered, in addition to the association of a product with a name. For instance, when a merger goes wrong there may well be the need for name realignment. Indeed, reputation and identity go hand-in-hand and managing reputation involves identity-defining questions such as who we are and what we want to be.

In business, a good reputation generates consistent shared and favourable
impressions among observers about what a company is, what a company does, and what a company stands for. To focus on a company’s reputation is to put the spotlight on such long-term issues as the ways in which constituents (stakeholders) influence a company’s values and the company’s role not only as an economic vehicle but as a social institution.

Since reputation is about perception the key constituents are often:

- Employees;
- Customers;
- Suppliers;
- Distributors;
- Competitors; and
- The public.

According to sociologist Robert Bellah, corporate reputation derives from an organisation’s ability to directly manage impressions, develop strong relationships with key constituents and stakeholders, and to indirectly manage rumours by interested observers, including analysts and the media.

Much of the debate surrounding reputation involves values. Indeed, core values or principles, interwoven with managerial best practice, are vital to an enduring and resilient reputation, capable of withstanding scandal and crisis (this subject is discussed further in Chapter 4). There is now an industry around reputation building; indeed, this has been developing for some time. Longstanding examples of reliability include the case of the Campbell Soup Company and its brand, Campbell’s. Campbell’s consumers have continually supported a reputation based upon trust and integrity principles. Other sound principles to consider in building a resilient reputation include the ‘credibility principle’, that is that a company will fulfil their claims and commitments to investors and suppliers, and the ‘trust principle’ of trustworthy behaviour towards employees and other stakeholders. As is discussed in this report, the ‘responsibility principle’, demonstrated through corporate citizenship, is increasingly important internationally.

Reputation is an important corporate asset, and as societal perceptions shift, companies strive more and more to understand how reputation works and how to make it work for them. Most recently this search has been enhanced by the impact of globalisation and the ‘online world’ that we are part of. Reputation is especially important in an economy where more than 70 per cent of a company’s market value comes from intangible assets that are difficult to ascertain.

Reputation risk and current influences

‘Reputation risk is the potential for damage to the value of an organisation’s good name resulting from negative public opinion.’

Wisegeek.com

Effective reputational risk management begins with understanding that reputation is a function of perception. Reputation stems from a company’s various stakeholders, including investors, customers, employees, and the community in which the company operates, and emerges from within certain categories including product quality, financial performance, customer service, and intellectual capital. A strong reputation across these categories will lead to a strong reputation overall (as discussed in Chapter 2).

Strategic alignment with a focus on a sustainable reputation begins at the top, with board oversight, strategy setting, cultural alignment, image or brand building, business planning, quality commitment, operational
focus, and organisational resilience. The risks inherent in a company’s corporate strategy, coupled with the risk appetite of management in executing that strategy, are critical to the organisation, as are any assumptions underlying the strategy. The board’s risk oversight lays an important foundation for managing reputational risk.

The evolution of social media is a game changer for image and brand building. Communities are now established through highly accessible media that have transformed how brand awareness is managed. Social media provides an environment where customers and other parties drive the dialogue. Therefore, in establishing a sustainable reputation, cultural alignment is as important as strategic alignment. Following the recent financial crisis, the importance of responsible business behaviour has never been more evident. As is discussed in Chapter 7, a strong culture to manage compliance in a proactive, holistic manner can contribute to lowering costs, increasing effectiveness, and sustaining reputation during difficult times.

The phenomenon of technology and the prevalence of media in our society have shifted the focus of media interest from complex business information to business leaders, who make far better and more interesting stories. These leaders personify the attributes and values of the company they represent. As a result of this shift, institutions now need to determine a positive individual face for the company, a decision that could make or break its reputation (explored in Chapters 4 and 8).

An Economist Intelligence Unit survey asked companies which individual in their company had the biggest responsibility for the company’s reputational risk; 84 per cent responded, ‘The CEO’. Consequently, when a company succeeds, its leader typically takes the credit, and when the leader fails, the company suffers. It is therefore vital to ensure that the face of the organisation is up to the task; that is their face ‘fits’. A developing trend relates to the encouragement of individual potential or human resources by business leaders and there has been growing understanding that being a leader does not mean merely giving orders to others: it requires that you are seen as a leader and that you lead by example. ‘If your actions inspire others to dream more, learn more, do more, and become more you are a leader’, as John Quincy Adams once said.

While reputation risk now ranks as the number one strategic risk for large companies, according to Deloitte, it is an intangible risk, ‘an identifiable non-monetary asset without physical substance’. Therefore, it is difficult to isolate and manage. Additionally, it can be difficult to pinpoint potential risks before they occur, largely because the speed with which they strike is now accelerated through social media and mobile technology. Well-known international leaders from Benjamin Franklin to Warren Buffet have lamented how easily a reputation may be destroyed. Because reputation is so swiftly damaged, it is important for companies to manage their reputational risk and mend any problems before they escalate.

Just as corporate policies relating to health and safety, the environment, energy, sustainability, and corporate social responsibility (CSR) have required some uniformity when operating in different jurisdictions, the same is true of reputation risk management across an organisation as a whole, even if management strategy may be subject to some local variation. In the same way that supply chain pressures demand recognised standards, there is an
increasing pressure for companies to manage corporate reputations internationally. As this report underlines, managing reputation risk effectively is a priority for any successful company.

The four acknowledged major types of risk include:

- **Strategic risks**, that is risks that change a business strategy;
- **Operational risks**, or risks that affect ability to execute a strategic plan;
- **Financial risks**, that is risks in areas such as financial reporting, market, and credit; and
- **Compliance risks** relating to legal and regulatory compliance.8

Apart from management risks faced by an individual company, there are sector risks and location or region-specific risks that must also be managed. In this report it is proposed that an integrated reputation risk management strategy should incorporate such risks. It must be sensitive to the fast-paced development of technology that exposes organisations to risk in a manner that is often difficult to contain without a high degree of understanding and proactive management coming from the top. As previously noted, without a strong operational focus and a supporting culture, an organisation is susceptible to control breakdowns that could tarnish its reputation. When potentially damaging events do occur, managing the company’s response, including apologies where appropriate, requires mindful corporate behaviour.

While such instances have occurred and lessons have been learned over many years, as in the Johnson and Johnson case study which follows, the corporate world still needs to improve its understanding of the need for a practical strategy to develop and maintain a sound reputation. The handling of the thalidomide problems and the ongoing trust-related issues in the pharmaceutical sector is one example where injured parties still battle to be heard more than 50 years on.

**Case study: Johnson and Johnson**

In 1982, Johnson and Johnson’s response to the Tylenol crisis in the US was regarded as world class. Someone had replaced extra-strength Tylenol capsules with cyanide-laced capsules, resealed the packages and deposited them on the shelves of at least a dozen pharmacies and food stores in the Chicago area. The poison capsules were purchased and seven people died. Upon learning of the tragedy, the company’s response team was given two tasks: first, to protect consumers; second, to save the product. The company acted swiftly to avoid further loss of life by immediately warning consumers nationwide via the media not to use any type of Tylenol product until the extent of the tampering could be determined. The company stopped production and withdrew all Tylenol capsules from stores in Chicago and surrounding areas. It then ordered a national withdrawal of every capsule. By taking such measures in a decisive manner, Johnson and Johnson prevented further loss of life by immediately warning consumers nationwide via the media not to use any type of Tylenol product until the extent of the tampering could be determined. The company stopped production and withdrew all Tylenol capsules from stores in Chicago and surrounding areas. It then ordered a national withdrawal of every capsule. By taking such measures in a decisive manner, Johnson and Johnson prevented further loss of life. It prioritised public safety, irrespective of cost, and the company’s reputation was enhanced. By managing reputation risk openly a company or institution can shape its reputation over time and can reduce reputation risk to an acceptable level. At some stage every company is
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In view of ongoing failures and headline cases affecting major brands, their supply chain, and stakeholders, reputation risk management remains a vital strategic matter for all businesses. The key premise here is that risks such as stakeholder pressure, whether from the financial community complaining about executive remuneration or non-governmental organisations (NGOs) complaining about the lack of published policies, can impact upon the intangible asset value and the accumulated ‘goodwill’ of a company. While the potential for reputational damage to both tangible and intangible assets is vast, this report mainly deals with the impact upon those elements which are less tangible and more affected by stakeholder influence. This subject is explored extensively in Chapters 2 and 3.

Building a reputation

Building a positive reputation is largely dependent on how consumers view a company and its employees. Consumers need to feel that they can trust a company; there needs to be a feeling of relationship between the parties. When a consumer feels close to or has a connection with a company, they will feel more loyal towards that company. In order to garner trust, a company needs to foster an ‘intimate’ relationship with its consumers. It needs a strong media presence, especially in regards to telling its story (What is the company’s history? Who are the leaders? Who are the employees? What is the company vision?).

One positive example of this in the UK is the Body Shop, founded by Anita Roddick, which has built its reputation on causing no harm to animals. To date, its cosmetic products and its brand, now owned by Unilever, continue to highlight the fact that there has been no animal testing involved in making the products. While there have been challenges to this claim over the years, the Body Shop’s reputation remains distinct from many others in the cosmetics sector.

Establishing a positive reputation through media depends on a variety of factors. First, the company must ‘land and remain on the public’s radar screen’. The company must maintain a certain level of exposure which is quantified by a minimum number of stories mentioning or featuring the company. Second, in order to maintain a positive reputation, at least 20 per cent of these stories must be positive and no more than 10 per cent should be negative. It is also beneficial if these stories cover a broad range of topics, essentially spreading the risk in case of a negative story. Third, managers can raise the number of positive stories in the media by increasing the percentage of stories quoting someone from the organisation. This media presence creates a feeling of credibility and an intimate relationship with whomever is watching or reading the medium.

A feeling of familiarity is a very important factor in how a consumer regards a company’s reputation. Therefore, having direct interaction with your consumers can positively influence your reputation. In a crisis, one approach to containing the effects of a crisis upon a company’s image is to consider the six key areas of business performance that underpin reputation. These are ethics, innovation, quality, safety, sustainability, and security. The corporate culture in each of these areas ultimately shapes stakeholder expectations. Reputational crises are often the consequence of operational failures in one or more of these six processes.
survey of banks, consumers that had direct interaction with the company rated the company an average of ten points higher than customers that had no direct interaction with the bank. A current example from the UK of a bank successfully employing the ‘personal touch’ is TSB with its slogan ‘Local Banking for Britain’. TSB’s successful campaign follows:

‘Five questions you should ask your bank:

1. Does your bank operate right across Britain and nowhere else?
2. Does your bank serve only local people and local businesses, not big corporations?
3. Does your bank refuse to gamble your money in overseas speculation?
4. Does your bank say no to using its customers’ money to fund investment banking?
5. Does your bank use every penny of its customers’ deposit to help its other customers?’

If the answer to all these questions is yes, thank you for banking with TSB. If not, maybe it’s time for a change. Call, click or visit to find out how we’re different.

Stakeholder dialogue
In business, reputation is everything, and companies are willing to spend large sums of money to shape, protect, and defend their images. Reputation insurance is a product that has been available for years, but insurers are finding new ways to define and sell the protections it offers. Indeed, corporate social responsibility (CSR) has become a form of reputation insurance in itself because if a company is seen to do good or at least not to harm it can be regarded more positively in the event of any crisis. Therefore the importance of stakeholder dialogue is repeatedly highlighted throughout this report.

Another important global trend (discussed in Chapter 10) relates to increased demands from stakeholders such as shareholders, investors, lenders, and governmental and non-governmental bodies. Increased governmental demands can be seen in the form of: corporate codes of conduct; tax increases; new taxation like carbon taxes; waste duties; fuel duties; and other market mechanisms to drive organisations in directions that governments deem the public wants them to go. These increasing demands require greater transparency on behalf of a company.

As has been increasingly understood, a good reputation is judged to:

- Improve sales in goods and services;
- Assist in the ability to attract and recruit new employees; and
- Reflect positively on a company’s share prices.

It supports shareholder value by strengthening employee capital, creating a ‘virtuous circle’. Delivering on a ‘brand promise’ is crucial to reputation management and the quality of its human resources can have a positive influence on a brand. It has often been noted that companies that commit themselves to a brand promise generally demonstrate the following characteristics:

- The effective use of internal communications to raise employee morale and commitment through shared beliefs and vision;
- Better training of managers and staff leading to a deeper understanding of the brand promise and the behaviour and value this promise demands;
- More clarity for all employees regarding how their work processes and
responsibilities contribute to delivering the brand promise to customers; and
- Flexible company policies on recruitment, training, and rewards are changed so that the organisation is also behaving in line with its brand promise.

It has been proved that when employees understand and accept that brand values are genuine, they align their attitudes and behaviour to these values. As a result, there is greater satisfaction for both customers and employees, leading to employee and customer preference and loyalty.

As is developed in this report, the above approach is consistent with the responsibility of organisations towards their employees and fits into the principles of corporate responsibility as so many reputational risk issues do. At the same time, neglecting the human interface between the company and its stakeholders, especially customers, can destroy all other attempts at reputation management. Nowadays the old ‘decide- implement-deny’ corporate attitude, which was supported by the board as part of a clear corporate strategy and vision is no longer appropriate or helpful. Implementing an integrated approach to reputation management across an organisation is thus critical to success and can become part of a corporate culture that stakeholders are proud of and value. Cultural issues are a key feature of this debate.

Some cultural issues

It is worth noting that corporate culture has often been given relatively modest attention in transactional decision-making. In fact, the high proportion of mergers and acquisitions (M&A) failures over some considerable time can be attributed largely to the inability of managements to align corporate cultures. This fact supports the importance of having an integrated approach to reputation management for the creation and sustainability of shareowner value. Reputation management is necessary for protecting the long-term value of the brand and should not be confused with the task of creating a marketing image for a product or a mere public relations exercise. Reputation risk management involves a culture of integrity and authenticity.

In view of the recent economic downturn, from which the world is still reportedly recovering, people – and companies – are more and more risk averse. This is pertinent not only as it relates to corporate reputation risk issues but also to individual leadership styles. Indeed, many of the same interconnected issues are relevant when considering an individual company or personal leader, sector, country or region. Transparency, ethics, and openness are increasingly called for in today’s business world. The banking and financial sector is a prime example of a business sector that has been under the spotlight for its approach to risk for some time. One instance indicative of the financial sector’s attitude to risk took place in the UK when a Treasury Select Committee found that a leading bank had removed its head of risk because he highlighted risk in the bank’s business model in the run-up to the recent credit crisis. As the message was distasteful, he was removed. Furthermore, it is said that his replacement came from retail banking with no previous knowledge of risk and governance.

For some time in the post-Enron era conflicts of interest have emerged in the finance and financial services sector, which have caused a justified lack of trust and earned the sector as a whole a poor reputation. Indeed, at the time of the Enron...
collapse, which was followed by several other headline corporate scandals, this reputational damage was already clearly visible.

Accountancy firms with consultancy interests – such as the Anderson firm, which failed as a result of the Enron collapse – faced the challenge that the company’s audit side gained fees from regulatory compliance, while the consultancy side earned from advisory services. This led to cultural incompatibility in that one half of the firm consisted of risk takers and the other half risk avoiders.

Similarly, in investment banking there are inherent risk takers as well as natural risk avoiders, including internal auditors and risk compliance departments. Risk management departments have generally been independent of the strategic decision makers, causing a cultural divide. At first sight risk management is not a profit centre but a cost to the company. This view has been reflected in, for instance, the annual reports of leading UK banks and insurers over recent years. The risk section of these reports details operating and market risks with processes in place to control them; risk is seen as a governance function rather than being part of strategy. Meanwhile, the strategy section of the report refers to future opportunities for growth without reference to risk, as the latter has often been seen as a threat to business continuity, rather than an opportunity. The link between risk and strategy may also have been ignored in the past in case it deterred potential investment. As is developed in this report, after risk management came of age and its connection with value was recognised more proactive strategies have emerged internationally.

Risk does not have to be a threat to business continuity; it can be an opportunity for competitive advantage. Moreover, the banking crisis has provided an opportunity for companies to:

- Adjust how the risk function should be engaged; and
- Reassess what is part of strategic risk.

The crisis has enabled the debate about greater integration of risk and strategy with a discussion of risk now regularly forming part of business strategy in general and an integrated reputation risk strategy in particular. Indeed, in the UK this debate has been highlighted by the Turnbull Report (the Report of the Internal Control Working Party, first published in 1999). In its guidance to listed companies, the Report recommended embedding risk and risk strategy within the culture of an organisation. After all, investors generally seek assurance that a board can manage or reduce risk, not that risk has been eliminated. A greater degree of honesty and integrity in business generally, and risk reporting in particular, will bring its own rewards. Moreover, it is very important that companies engage in dialogue with their stakeholders and that, where the company has failed in its duties to these stakeholders, an appropriate apology is given.

The Goldman Sachs case study referred to in Chapter 3 is illustrative of the key issues in the debate over transparent reporting and reputation risk. Meanwhile the ongoing question of bonuses has impacted the reputation of the banking sector as demonstrated by Barclays’ reputational issues and in comments following HSBC’s approach to rule changes made this year. Swiss banking culture has also come under some scrutiny.

Another more recent banking sector case study relates to Deutsche Bank, which, according to reports near the end of January 2014, now faces a ‘long battle to restore [its] reputation’.12
Case study: Deutsche Bank

Germany’s largest lender is facing an array of investigations into the conduct of its employees and a hike in litigation costs. This was partly responsible for a surprise €1-billion ($1.37 billion) fourth-quarter loss at the end of 2013. Deutsche Bank paid about €2.1 billion in fines in December 2013, but evidently fresh investigations — including one into possible manipulation of the $5.3 trillion-a-day foreign exchange market — has meant that analysts and investors forecast an additional €1.4 billion to €2 billion will be paid out in settlement costs in 2014 and 2015. In response to a series of scandals, the bank has reportedly moved to shake up corporate practices, particularly at its investment banking operations in London and New York. This ‘shake up’ has included:

- Rejecting deals viewed as too risky;
- Deferring bonuses for dealers; and
- Giving the dealers less leeway on trades.

The reputational risks surrounding Deutsche Bank have grown and its two CEOs, Anshu Jain and Jürgen Fitschen, evidently have some distance to go to win back public trust and prove that the bank can overhaul its corporate culture. Jain has admitted that, while a more cautious attitude had already lost Deutsche business, this was a price he was happy to pay and he was confident that most of the litigation problems would be sorted out in 2014. ‘We are hopeful that towards the end of 2014 we will have the bulk [of these problems] behind us,’ he said. ‘We know that here we have something to prove to you,’ Fitschen told reporters at the bank’s annual news conference in Frankfurt. ‘We have realised that the reputational risk has become more and more significant.’

Jain and Fitschen have also come under assessment as individual leaders. Indeed, their ability to oversee the cultural overhaul at DB has reportedly met with scepticism in some quarters. Jain once headed the investment bank at the centre of many of the current tribulations, while Fitschen has become embroiled in an investigation into tax evasion. While Jain has admitted accountability for mistakes made at the investment bank, particularly during the ‘very troublesome period’ preceding the financial crisis, he has also insisted that the bank needs his experience. The German financial regulator has also questioned the rigour and independence of the bank’s internal investigation into alleged rigging of Libor, the London inter-bank offered rate, according to documents leaked to German media. Meanwhile, the bank has reportedly held on to ambitious earnings goals for 2015. These include a return on equity of 12 per cent, six times higher than last year, despite a tough trading environment in its core debt markets. The bank is reported to be aiming to boost returns by further shrinking its balance sheet. The faster the bank trims, the easier it will be to meet regulators’ capital demands. Jain and Fitschen also said they were well positioned to lead consolidation in Europe after 2015, though they did not specify when or where deals would happen. In the meantime bankers at the 2014 World Economic Forum in Davos said that they expect a European Central Bank (ECB) health check of the Eurozone’s largest banks this year to reignite domestic and cross-border merger activity by rebuilding confidence among lenders.
Ethical issues

The final comment in this opening chapter relates to the growing importance of honesty, integrity, and transparency in the business world as a whole. In view of trans-boundary trends and actual – as well as perceived – risks to reputation, it is important that such values govern corporate behaviour so that trust and belief are restored in sectors that are now vital to the economic wellbeing of the world. It is considered that reputation risk management, if approached seriously and with clarity and honesty, can be a key tool to improve overall standards and behaviour within a business, regardless of its size or location, thereby inspiring positive change and greater confidence in individual businesses and entire business sectors.

References

4. Ibid.