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Viewing Business Risk Through the Reputation Lens

By Melissa Lackey, President & CEO

Most companies understand the value of reputation today. In fact, 54 percent of executives polled in the 2015 Global CSR RepTrak 100 would give reputable companies the benefit of the doubt in a crisis compared to only 20 percent for companies with perceived lower reputations.

Executive teams identify and monitor risks related to finance, operations, IT, market, and legal/compliance – but as siloed functions.

Businesses create vulnerability if they don't evaluate the interconnectedness of those functions and decisions made within them. Despite what most organizations believe, they lack an effective, cross-functional risk assessment process.

The plethora of risks facing today's organizations can be overwhelming for any executive team, given increased regulation, legislation and connectivity. Sophisticated companies aren't just aware; they consciously manage risk by monitoring for potential reputational issues.

Or do they?

Take Volkswagen, for example, a company with an 80-year history that enjoyed a strong brand and reputation. And as recently as 2009, it had been lauded for its clean diesel engine. However, the company clearly had competing mandates: increasing profit or meeting environmental standards. The company's decision to use software on millions of its diesel-powered cars, making vehicles appear to meet steeper emissions standards now has fueled litigation, mistrust and reputational damage. How did this happen? Where was the oversight?

What is Reputational Risk?

Reputational risk is an erosion of stakeholder trust/confidence resulting from a company's actions, which appear inconsistent with its values or strategy. It shows up as lost revenue, increased operating capital or regulatory expenses – leading to a decrease in shareholder value.

Some would argue reputation is a standalone risk. But, in reality, it is the consequence of poor management and/or oversight of other risks.

There is no doubt that organizations must refine and advance enterprisewide decision-making to build reputational risk competency. Standing Partnership and Edison Research conducted a Reputational Risk Survey of nearly 1,000 senior executives in manufacturing, finance and health care. While many

> *"...in an economy where 70% to 80% of market value comes from hard-to-assess intangible assets such as brand equity, intellectual capital, and goodwill, organizations are especially vulnerable to anything that damages their reputations."*
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> "Reputation and its Risks," by R.G. Eccles, S.C. Newquist and R.Schatz. Harvard Business Review, February 2007

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executives noted being aware of risks that had reputational implications, nearly half of respondents (47 percent) do not take steps to monitor. It's this gap that increases an organization's reputation vulnerability.

Understanding Your Vulnerability

Many organizations "claim" to monitor risks. However, our survey found that nearly 50 percent of senior leaders lack confidence in their organization's ability to identify reputational risk. Surprisingly, 78 percent of those same respondents believe they are doing a good job of building and managing a positive reputation.

How can this be? This points to an unfortunate reality – most organizations operate under a false sense of security. Every business has inherent risk. Proactive monitoring, identification of issues, and mitigation strategies that involve senior leaders from multiple functional areas can reduce that risk.

Identifying and prioritizing an organization's reputation risks can be difficult and varies on the size/ complexity of the business. Enterprise Risk Management (ERM) programs assess the likelihood of risk and the severity of the impact. Today, however, another dimension worth considering is velocity. Connectivity and the speed at which information (accurate or inaccurate) is shared makes monitoring and prioritizing even more critical. But, watch out for blind spots.

2016 Reputational Risk Report

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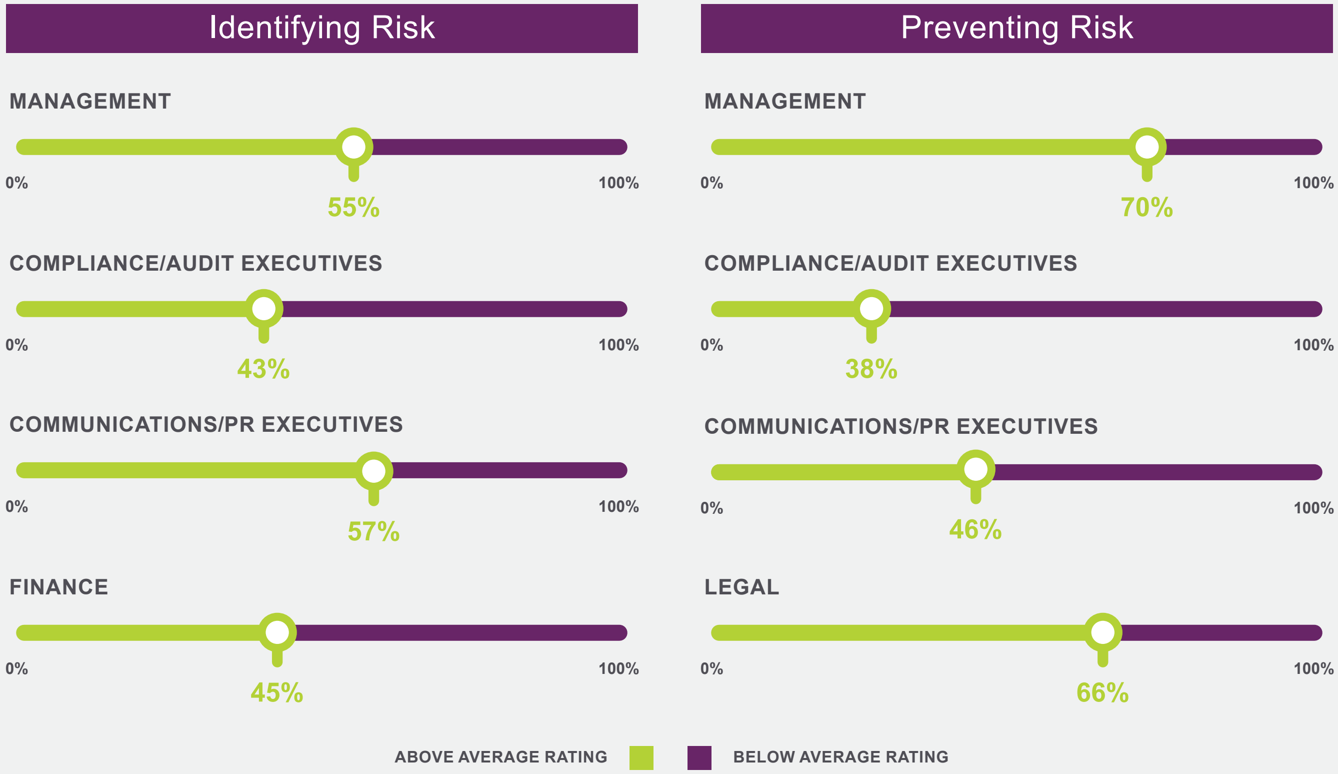

Blind Spots

1. Lack of Data

Accurate data is a critical component in prioritizing risk. Ask:

- Do we have all the information?
- Is it accurate?
- What information is missing?
- What would we like to know?
- Is everyone involved who needs to be involved?
- What perspective are we missing?

2. Unwillingness to Change Focus

There's commitment to strategy – and there's inability to adapt to new ideas, technologies and processes that may help a business grow. No one wants to be a Kodak or Blockbuster. Be willing to pivot, when needed.

3. Bias

Organizations and leadership should also be cognizant of biases – company and personal. Bias can hamstring a company when it comes to prioritizing risk.

4. Group Think

When a group's penchant toward consensus leads to pressure for unanimity, it quells creativity and alternative courses of action, which can lead to faulty decisions. Designate roles to challenge consensus.

5. Organizational Myopia

Be careful to avoid being so focused on one particular initiative or outcome that you can't see the long-term effects and possible consequences.

Let's Revisit Volkswagen

On September 18, 2015, the EPA accused Volkswagen of using software that circumvented emissions testing and equipping certain models with defeat devices.

Within just four days of the EPA's accusation, the number of negative tweets involving Volkswagen jumped from 766 to 16,070, according to Amobee Brand Intelligence, a global marketing technology company. The company quickly felt the financial implications of the realized risk. In just one week, Volkswagen saw a 30 percent drop in stock price.

Martin Winterkorn, Volkswagen's chief executive at the time, said his company had "broken the trust of our customers and the public." He resigned.

After nearly a year, *The Wall Street Journal* recently reported that VW and U.S. federal prosecutors are working to reach a settlement by the end of 2016. While criminal charges are still pending, negotiation discussions hint at a large financial penalty in addition to the $15 billion VW already has agreed to pay in civil claims. Meanwhile, Winterkorn is being investigated in Germany for allegedly withholding information about the U.S. investigation of emissions fraud from investors.

Trust is today's currency. While reputation is an intangible asset, an organization's valuation significantly increases its trust.

Reputation management is a marathon, not a sprint. There's no quick fix – and there's no one person responsible. It requires long-term commitment and breaking down organizational silos. Building enterprisewide reputation risk competency through cross-functional risk auditing and planning can help companies avoid significant hits to their brand, stakeholder perceptions, and – most importantly – to their bottom line.

Our 2016 Reputational Risk Report showed that more than one in four organizations have experienced a reputational issue. Among those who experienced an issue, 18 percent reported that it cost the organization more than $500,000. The true cost of the reputation damage is typically highly underestimated.

Standing Partnership specializes in reputation management, creating stakeholder strategies that deepen understanding, build trust and mitigate risk in complex, ever-changing environments. The firm's comprehensive approach drives business results by building, protecting and restoring reputations.

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Melissa is a 2015 St. Louis Business Journal Most Influential Business Woman and a recipient of the 2015 Enterprising Women of the Year award, widely considered one of the most prestigious recognition programs for women business owners.