Corporate Compliance Insights

Understanding **Reputation Risk**

the Qualitative & Quantitative Imperative

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Understanding Reputation Risk:
The Qualitative and Quantitative Imperative

By

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New York, New York

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To compete internationally,
you must comply internationally.
"A strong compliance program provides us a competitive advantage"
Lori Queisser
Executive Vice President
Chief Compliance Officer
Teva Pharmaceuticals
and Conselium client
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She served for two decades as a senior corporate executive at several international energy, technology, media and professional services companies (Bertelsmann, PSEG, Verint). She began her career as an international transactional attorney at Cleary Gottlieb, a global law firm. She is a life member of the Council on Foreign Relations, a Director Member of the NACD, Chair Emeritus of the Ethics & Compliance Initiative and serves on several boards including NYC-based, Epic Theatre Ensemble, Madrid-based Corporate Excellence - Centre for Reputation Leadership & IE Business School's Research Centre on Governance, Sustainability & Reputation.

Dr. Bonime-Blanc is an Adjunct Professor at NYU and a frequent global keynote speaker. She has been interviewed by or written for the *Wall Street Journal*, *The Economist,* the *BBC*, *The New York Times*, *Foreign Affairs*, *El Pais*, *El Cronista*, *Expansion* and *Jornal do Commercio*. She holds a JD & PhD from Columbia University, was born and raised in Germany and Spain. She tweets @GlobalEthicist and can be reached at abonimeblanc@gecrisk.com and https://gecrisk.com/

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Prior to joining ReputationInc, Leonard spent nearly 10 years at the Reputation Institute building its global business. As a Managing Partner, he became recognized as a subject matter expert on global stakeholder research methodologies, data analytics, and corporate reputation management strategy.

Leonard's multi-industry experience solving client business problems includes a unique blend of consulting engagements. He has lead client engagements in a wide range of industries including: automotive, consumer package goods, pharmaceutical, publishing, travel, and hardware and software manufacturing.

Leonard holds an MBA and a Ph.D. He also was an adjunct faculty member for 10 years at two New York universities where he instructed graduate courses in marketing, marketing research, and consumer behavior. He is a speaker at various conferences and has several publications in the area of management and statistics. He can be reached at LJPonzi@Reputation-inc.com and www.Reputation-inc.com

Dr. Bonime-Blanc and Dr. Ponzi have joined forces to provide reputation risk qualitative/quantitative solutions for clients – they call this customized, client-centric service REP/RISK Q2. Download a brochure *or contact the authors directly.*

REP/RISK Q2
The Quant/Qual Enterprise Reputation Risk Solution

INTRODUCTION

As co-authors, each of us come from very different backgrounds – one of us is a governance, legal, ethics and corporate responsibility practitioner (the "qualitative" type) and the other is a PhD in information science with an interest in statistics and data modeling, known as a pioneer in corporate reputation measurement (the "quantitative" type)." But the one thing that brought us together was our passion for understanding reputation and reputation risk – from very different experiences, angles and lenses.

This e-book presents our joint work over the past year developing a rigorous, practical and we believe groundbreaking approach to reputation risk management for organizations combining the best of the qualitative and the quantitative approaches to understanding and managing reputation risk.

This work consists of five chapters. In Chapter 1, we provide perspective on what reputation risk means. In Chapter 2, we tackle the issue of why reputation risk management needs to be part and parcel of any organization's strategic agenda, the critical importance of knowing who your principal stakeholders are and why they are important and the need for the coming together of a qualitative and quantitative perspective and expertise on this most challenging of strategic risks.

In Chapter 3, we begin to introduce the "quantitative" aspects of understanding reputation risk by looking at several key concepts including: What is the perception of a "Reputation Risk Event"? What is a "Reputation Risk Event"? What is the resulting scale of the negative impact on an entity's reputation and supportive or adverse behavior by key stakeholders?

Chapter 4 continues to examine the quantitative aspects of reputation risk analysis by delving more deeply into measuring "Reputation Value" and breaking this question down into component parts of a formula. We conclude, in Chapter 5, with several actual case studies of reputation risk and an assessment of how the companies examined were affected (Starbucks, Barclays, GSK and BHP Billiton) from both a qualitative and quantitative standpoint.

We want to thank several of our strategic collaborators and friends for the use of some of the materials in this book namely: Greenleaf Publishing (for several excerpts from Andrea's book, The Reputation Risk Handbook: Surviving and Thriving in the Age of Hyper-Transparency); RepRisk AG (for their permission to use several of their data analytics graphs and tools); and both of our companies -- ReputationInc. and GEC Risk Advisory -- for their assistance in publishing and marketing the original 5 part series that this e-book is based on.

Reputation risk analysis, management and governance continues to be fertile for further exploration, improvement and refinement and we plan to continue to break new ground on behalf of our friends, colleagues, partners and clients and hope that our combined forces will allow you to pay better attention, improve and conquer your organization's reputation risk and opportunity.

Andrea Bonime-Blanc & Leonard J. Ponzi

New York City
December 2016

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CHAPTER 1

UNDERSTANDING REPUTATION RISK: WHAT IT IS AND WHAT IT IS NOT

"A reputation is more valuable than money".

Publilius Syrus - 1st Century BC

Introduction

The concept of "Reputation Risk" is relatively new - it has been around for about a decade and only more seriously examined in the last 2-3 years.

Prescient as always, the Economist called reputation risk the "risk of risks" in 2007. But it was not until around 2013, that several major surveys found that executives and boards not only ranked reputation risk as one of their top concerns but also considered it to be a strategic risk -- one that could have a dramatic or material effect on their business, prospects and overall organizational wellbeing. This was a clear reflection of significant events in the financial sector (involving many leading banks and investment banks), the tech sector (Google v. China), the automotive sector (Toyota's faulty brakes), and the oil and gas sector (BP's record oil spill), just to name a few.

We have approached this topic from various different angles – Len focuses on reputation and a more quantitative and metrics-based approach while Andrea explores the topic from a more qualitative, governance, risk and crisis management perspective. Both of us have been developing tools and resources on issues of risk and reputation, now we are focusing on what that means to the combined concept and reality of reputation risk.

Reputation Risk: What Is It & What Isn't It?

We start our discussion by noting some of the more popular Reputation Risk definitions. We then make the claim that reputation risk management is risk management and lastly, we draw the distinction between reputation risk and crisis management.

***What It Is* –** Below are several popular definitions that illustrate cross-functional efforts to operationalize the concept:

> *"Reputational risk is the risk of damaging the institution's trustworthiness in the marketplace".* Measuring Operational and Reputational Risk: A Practitioner's Approach
>
> *Reputational risk is "the potential that negative publicity regarding an institution's business practices, whether true or not, will cause a decline in the customer base, costly litigation or revenue reductions."* The Federal Reserve System Commercial Bank Examination Manual.
>
> *"Reputational risk is the possible loss of the organisation's reputational capital. Imagine that the company has an account similar to a bank account that they are either filling up or depleting. Every time the company does something good, its reputational capital account goes up; every time the company does something bad, or is accused of doing something bad, the account goes down."* The Financial Times Lexicon.

Reputational risk is the "risk arising from negative perception on the part of customers, counterparties, shareholders, investors, debt-holders, market analysts, other relevant parties or regulators that can adversely affect a bank's ability to maintain existing, or establish new, business relationships and continued access to sources of funding." The Basel Committee on Banking Supervision.

The authors propose that reputation risk describes the threats to a company's financial health. We believe that reputation management is a system aimed at managing the possibility of reputation failures and that reputation risk management done right is a system that mitigates reputation risk and builds long-term organizational resilience.

Reputation risk Management is not Crisis Management

Reputation risk management is definitely not and should not be considered to be crisis management. Reputation risk becomes subject to crisis management when and if a crisis emerges with reputational implications in which having a well-developed and ready to deploy crisis management plan and team is essential to successful reputation risk management.

REPUTATION RISK MANAGEMENT	CRISIS MANAGEMENT
Long term planning	Short term execution
Assess & predict which issues will hurt the company reputation the most (likelihood & impact) before they happen	Unclear how the issues will affect organizational reputation unless good reputation risk management has been deployed in advance
Identify which reputation attributes should be addressed to mitigate the risk issue	Lack of control over the issue unless good reputation risk management has been deployed in advance
Ability to manage the issue through a robust enterprise risk management approach	Driven by the media and other uncontrollable events and reactions unless good reputation risk management has been deployed in advance

Unlike reputation risk management, crisis management is something that happens suddenly and in the short term. Although to be successful, crisis management requires advance planning, the creation of a crisis management plan and team and plenty of training and scenario planning at different levels of management and even the board.

Taking it Forward

Reputation risk management is becoming a central aspect of developing reputation strategy. With that said, developing a reputation strategy requires set competencies for success, namely:

1. The understanding that reputation strategy is a long-term vision
2. The ability to assess and predict what issues will hurt company reputation most
3. The capability to identify of reputation attributes that will mitigate the issue
4. The ability to manage the issue through proper internal resources and budget
5. The authority to identify and empower risk owners and other management in charge
6. The skills to influence the company culture
7. The experience to map company processes to understand causation, occurrence, consequences and remedies
8. A keen understanding and prioritization of key stakeholders

Measuring Reputation Risk: Media & Social Media Scans

An early and interesting way to get a snapshot of the reputation risk of an entity was developed by RepRisk AG about 10 years ago by deploying big data analytical tools/algorithms as well as human intelligence to scan and analyze vast amounts of both traditional media and social media keyed to company and project names and tagged to a wide variety of ESG (environmental, social and governance) issue tags. By 2016, over 70,000 companies are being tracked.

Following is the summary report for the "Most Controversial Companies" of 2015 which scored the highest RepRisk Index for that year.[1]

Overview and ranking

MCC 2015 ranking	Company name	Peak RRI in 2015	Sector	Country of headquarters
#1	Ruihai International Logistics Co	**94**	Industrial Transportation	China
#2	Uber Technologies Inc.	**89**	Software and Computer Services	USA
#3	Samarco Mineração SA	**86**	Mining	Brazil
#4	Takata Corp	**82**	Automobiles and parts	Japan
#5	Blue Bell Creameries LP	**80**	Food and Beverage	USA
#6	HSBC Private Bank (Suisse)	**75**	Banks	Switzerland
#7	Sony Corp	**74**	Personal and Household Goods	Japan
#8	Volkswagen AG	**72**	Automobiles and parts	Germany
#9	Fédération Internationale de Football Association (FIFA)	**70**	Travel and Leisure	Switzerland
#10	1Malaysia Development Berhad	**69**	Financial Services	Malaysia
#10	Odebrecht SA	**69**	Construction and Materials	Brazil
#10	General Motors	**69**	Automobiles and parts	USA
#10	Honda Motor Company	**69**	Automobiles and parts	Japan

1 Click here for a full explanation of how the RepRisk Index and overall approach is structured.

CHAPTER 2
REPUTATION RISK, STRATEGY & STAKEHOLDERS

"It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently"

Warren Buffett - 21st century

In Chapter 1, we explored what reputation risk is and what it isn't – for example, it is risk management but it isn't crisis management. We believe reputation risk describes the threats to a company's financial health and organizational resilience and sustainability. Our view is that reputation management is a system aimed at managing the possibility of reputation failures and that reputation risk management done right is a system that mitigates reputation risk and builds long-term organizational resilience.

In this second Chapter, we explore the issue of why reputation risk management needs to be part and parcel of an organization's strategic agenda – whether a corporation, a non-profit, a government agency or a university.

We also delve into the critical importance of knowing who your principal stakeholders are and why they are important. We conclude with a call to arms on the need for a combined qualitative and quantitative perspective on reputation risk – one of the most challenging strategic risks of them all and something that we are developing together and joined forces on.

REPUTATION RISK MUST BE A PART OF THE STRATEGIC AGENDA

Organizations and stakeholders have been paying increasing attention to reputation risk as a serious and pervasive strategic issue -- as well as opportunity. Research is pointing to one inevitable conclusion nicely encapsulated in this Conference Board publication (The Conference Board: Managing Reputation Risk and Reward, March 2009):

- Reputation should be managed throughout the organization and not as a 'silo' function
- Reputation risk should be incorporated into overall risk management program
- Executives have defined the following top challenges in current strategy:
    - Assessing perceptions and concerns of key stakeholders
    - Demonstrating value

Because of its pervasive and potentially material nature, it is clear that reputation risk is a strategic risk and that's also partly because reputation risk acts as 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." (Andrea Bonime-Blanc. The Reputation Risk Handbook: Surviving and Thriving n the Age of Hyper-Transparency (2014)).

Additionally, there are increasingly interesting and important examples of how reputation risk is becoming part of the agenda of various and disparate sets of stakeholders. Below we touch upon three: I. Regulators; II. Consumers, and III. Practitioners.

I. REGULATORS

Reputation risk is being mandated to be part of the strategic agenda in several sectors and companies. Above and beyond specific examples, there seems to be a trend worldwide to require reputational risk assessments especially with regard to the financial and banking sector. Among some of the developments representing this trend are:

- G20 Principles for Sound Stress-Testing (2009) - proposes that bank should add reputational into their stress testing scenarios
- ISO 31000 (2009) – outlines guidelines to implementing risk management to strengthen a company's reputation which will lead to improved public acceptance
- UK Companies Act (2006) - proposes that company directors be held accountable for reputation as a part of their primary duties
- Basel II (2004) make available a framework for protecting against financial and operational risks including reputational risk

II. CONSUMERS

Metrics such as Edelman's Trust Barometer, Harris Reputation Quotient, and Reputation Institute's RepTrak™ are examples of measures that can help make it clearer that customers and citizens alike are increasingly disheartened and distrustful of institutions whether corporate, governmental, NGO or media all over the world. And trust has everything to do with reputation risk.

III. PRACTITIONERS

Reputation risk is developing as a new and distinct practice area and area of advisory work as our own personal experience within our own companies demonstrates. Some of the distinct ways in which reputation risk is beginning to take hold within organizations includes:

- Reputation risk management and risk registers are becoming part of the enterprise risk management lexicon (and even dashboard) in a number of leading companies and industries
- Boards of directors are increasingly aware of the importance of reputation risk and are demanding that executive teams and risk management include a consideration of it in their risk work
- Surveys are showing that both boards of directors and chief executives are placing reputation risk (not just brand) in their top 5-10 strategic risks
- Ethics, compliance and corporate responsibility practitioners are starting to understand and integrate the reputational aspects of their work into their policies, training and systems
- Human resources and public relations professionals are integrating reputation risk into their respective considerations especially as it relates to social media – its uses and abuses as they reflect on their organization
- Those at the forefront of this issue in their companies, realize that reputation risk is not only about downside protection but presents untapped opportunities for value creation
- Managing reputation involves managing opportunities as well as risks. Doing it well requires cooperation between all those who have relevant knowledge and skills

There are many reputation and reputation risk stakeholders and it is essential that entities understand who they are and what their expectations are of the institution. Below are two visual excerpts from The Reputation Risk Handbook[1] in which are depicted the main groups of stakeholders that have expectations and a stake in the reputation of an entity and an example using the BP Deep Water Horizon event

TABLE 5. A multitude of organizational reputation stakeholders

Internal	External
• Owners/shareholders/ investors: – Family – Private – Public – Government – Institutional – Activist hedge funds • Boards of directors, trustees or supervisors • Board committees & chairs • Council of advisors • Employees • Temporary & contract workers • Labor unions • Workers councils	• Customers, purchasers and clients • Users of products and services • Prospective owners, shareholders, investors • Partners & suppliers • Communities • Non-governmental organizations • Prospective employees • Government agencies, regulators, enforcers: – Local – Provincial/state – National – International • Media & social media

1 Reprinted with permission from Andrea Bonime-Blanc, The Reputation Risk Handbook: Surviving and Thriving in the Age of Hyper-Transparency (Greenleaf Publishing 2014).

TABLE 6. Reputation risk 'Rashomon' effect example: Stakeholder interpretations & reactions to the BP Deepwater Horizon disaster

Stakeholder	Range of reactions/interpretations
Employees & their families	Anywhere from deep anger and distrust (families of dead and injured) to defending the status quo (BP did its best and these things can happen)
Partners	Each of the partners to the project (BP, Transocean, Halliburton) blamed the other partner(s) to varying and differing degrees
Community	From legitimate grievances for damage restitution to misrepresentation, fraud and theft in order to collect undeserved restitution money
Protected habitats	Claims of varying levels of destruction of wildlife and protected natural habitat
Customers	Anywhere from no reaction to boycotting BP at the gas pump
Investors	Anywhere to staying invested in BP for the long term to divesting immediately
Regulators	From possible previous laxity in enforcing regulations to full-on law enforcement
Media	From accepting the statements of BP officials to deeply critical investigations

CHAPTER 3

PROPOSING A QUANTITATIVE SOLUTION TO REPUTATION RISK ANALYSIS

"If you lose dollars for the firm, I will be understanding.
If you lose reputation, I will be ruthless."

Warren Buffett - 21st century

Introduction

In this Chapter 3, we begin to delve into the "quantitative" side of the reputation risk equation, so to speak. In Chapter 1, we started our exploration of reputation risk by providing the reader with a brief introduction to this relatively new concept and distinguished it from related concepts – like crisis management. In Chapter 2, we made the case that reputation risk management should be part of the strategic agenda and that every type of organization – whether corporation, non-profit or government agency -- should know who their most important stakeholders are, as stakeholders are a vital part of any reputation risk management solution. In Chapters 4 and 5, we will be applying our qualitative - quantitative approach to describe industry case studies.

Reputation risk management is a process that benefits organizations by protecting their most valued asset – their organizational (corporate, non-profit, governmental) reputation.

The process begins with proactively identifying risks to an organization and the associated reputational threats. Appropriate strategies and tactics are then developed to mitigate each risk and associated implications. While the process is mainly completed through workshop and in depth interviews with the c-suite and other relevant leaders and staff, this qualitative approach alone lacks the rigor that quantitative research can provide to the development of reputation risk strategies.

In this Chapter 3, we propose a quantitative solution to visualizing an organization's reputation risks. Visualization provides a key input into developing the strategy and tactics of addressing each risk. It's the rigor of this reputation risk methodology that can directly improve the ability of a company or other type of organization to manage its reputation.

Context

To place this discussion in context, in our experience, the following are the important elements of a best-in-class reputation risk management program:

1. **Reputation Risk Register**. Formalize the list of reputation risks associated with underlying risks to monitor from a reputational standpoint.
2. **Research**. Collect data to measure, evaluate, and prioritize the indicators that lead to risks that could potentially cause reputation damage.
3. **Risk Analyses.** Understand stakeholder expectations to properly gauge reputational risk exposures.
4. **Reputation Risk Strategy**. Formulate reputation risk strategy with tactics to eliminate or mitigate reputational risks and, where that is not possible, to manage them effectively.

5. **Reputation Risk Crisis Management**. Integrate both table top scenario planning as well as effective incorporation into crisis management plan and team composition.
6. **Reputation Council/Committee**. Implement a cross-disciplinary reputation council or committee that is responsible for overseeing the ongoing management of the reputation risk register and associated risk events. ("Reputation Risk Events" occur when there is a deterioration in stakeholders' perceptions of the reputation attributes of an organization.)
7. **Reporting Program**. Construct an executive and board level reporting program format and system in which to effectively report reputation risk.

Our focus in this brief is principally on Item 3 above - Risk Analyses - and specifically, proposes an approach to quantifying reputational risks. When designing our approach, we developed a set of key characteristics to guide us in developing a rigorous methodology:

1. Theoretically based parameters
2. Developed from qualitative and quantitative data inputs
3. Scalable to include multiple stakeholders
4. Designed to meet qualitative validity tests
5. With sufficient data collected to minimize sample bias
6. Tested analytically to demonstrate validity and reliability

Our Quantitative Approach

With this set of criteria in mind, we are proposing a quantitative approach to visualize the Risk Register through a Risk Heat Map. The Risk Heat Map is a 2-by-2 mapping of the risks. Its purpose is to visualize the potential impact of each risk event derived from answers to two key questions:

1. What is the perception of a Reputation Risk Event occurring?
2. If this Reputation Risk Event occurs, what is the resulting scale of the negative impact on the company's reputation and supportive or adverse behavior by key stakeholders?

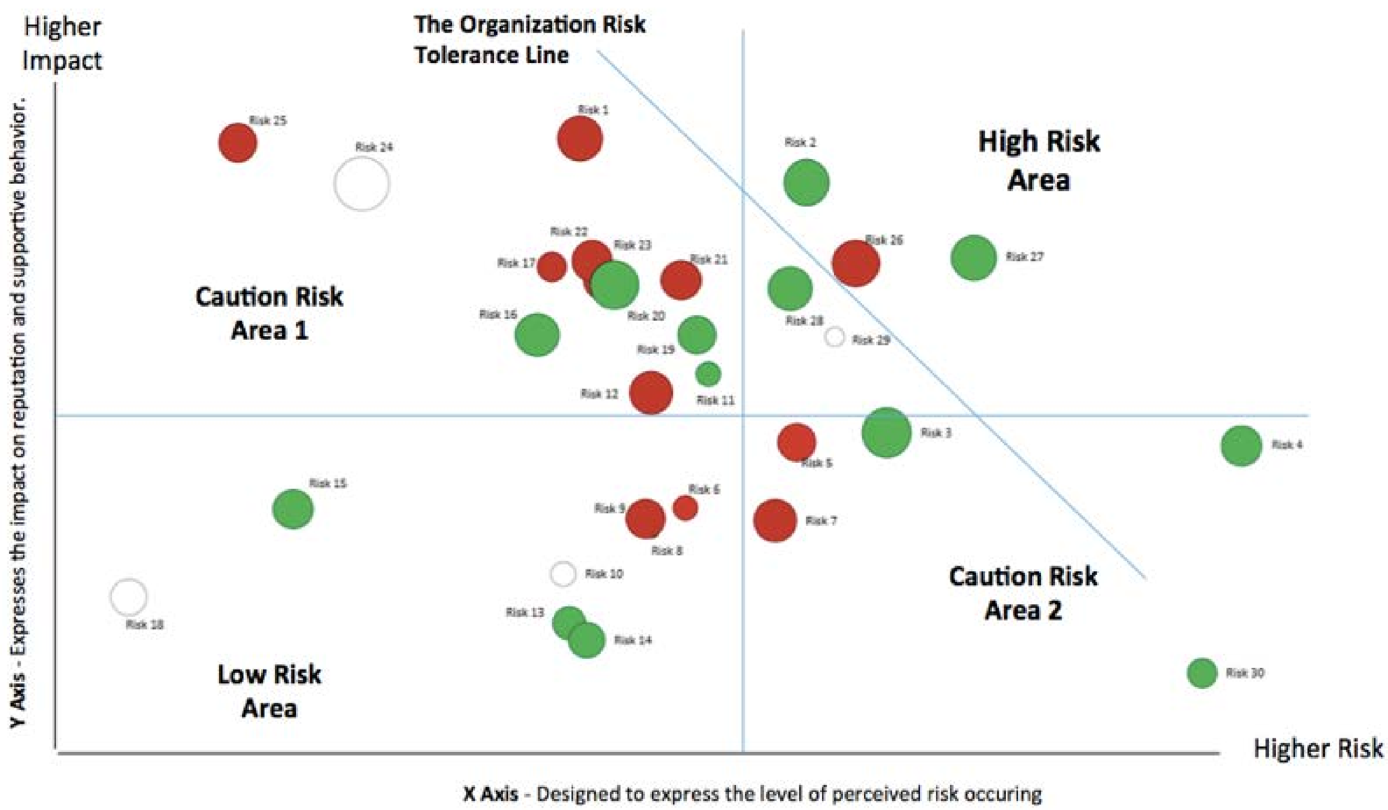
Our quantitative approach starts by understanding the inputs for this analysis. There are two sources of data:

- **Stakeholder Reputation Studies –** These research studies are based on respondents that rate a company on customized reputation attributes. These attributes are then associated or mapped to specific risks. This approach has several advantages such as refiguring the associations to risks as they change or as new risks are added.
- **Media** - A media-tracking tool is used to build the model in terms of the likelihood and impact of Reputation Risk Events.

Methodology

1. Building a Quantitative Reputation Risk Map – Understanding the X & Y Axis

Reputation Risk Heat Map Example: Global Financial Banking Institution



Below is a description of how each axis is calculated.

X Axis - Designed to express media influence on stakeholder perception. This area is subject to a higher possibility of opinion change (negative or positive) among stakeholders. Thus:

X = ((a+b)c)d

Whereas:

a = % of Stakeholders Not Sure
b = % of Stakeholders Neutral rating
c = Media Coverage Intensity
d = Severity

"% of Not Sure and Neutral" from the stakeholder study is then applied to show the proportion of respondents who have no opinion or a neutral opinion. The assumption is that this overall cohort is easily influenced by media since it hasn't formed any opinion of the company. This cohort, however, may also indicate a potential reputation risk to the company given that they do not have a strong opinion either way.

The variable "**Media Coverage Intensity**" is the "Volume" measure from the media tool. "Volume" is the number of media mentions standardized over a certain period of time.

Severity is measured via an expert panel made of up industry experts and/or company c-suite members.

The result is a measure of impact of the media and its ability to change the perception of stakeholders.

Y Axis – Designed to express the impact on reputation and stakeholder supportive or positive behavior. The attributes on the upper part of the map have a higher impact on reputation and stakeholder supportive behavior if negative media coverage occurs. Thus:

$Y = \beta_1\beta_2$

Whereas:

β_1 = Linear Regression Standardized Betas

β_2 = Logistic Regression Categorized Exponential Beta

"Standardized Beta" represents the importance by which each attribute is regressed on reputation (dependent variable).

"Categorized Exponential Beta" indicates the impact on stakeholder supportive behavior. This measure is derived from an *adjusted* Exponential Beta in Logistic Regression analysis where supportive behavior is the dependent variable (i.e., I would recommend the company). Note: The italicized word indicates a statistical methodology description that is beyond the scope of this work.

Z Axis – Color and size of the plot bubbles represents the Media Quality (or Tonality). Red = slightly negative; Clear = neutral; and Green = slightly positive.

2. **Interpretation**

The Reputation Risk Heat Map is divided into four quadrants that illuminate the priority of each risk based on perceived level of the risk occurring and the level of impact. In this example, not all risks are created equal. For example, although Risk 25 would have a substantial impact on the business, it is unlikely to occur (i.e., data breach of the main servers). Another example, Risk 30, has a higher possibility of occurring but will only have a slight impact on the overall business (i.e., perceived as not environmentally responsible).

Risks positioned above "The Organization Risk Tolerance Line" – a subjective risk tolerance criterion that reflects the appetite of a particular company's c-suite or board – requires an immediate and deeper understanding of the impact on the overall business and its stakeholders, and cost of implementing an appropriate solution.

While Risks 2, 27, and 4 are of concern, Risk 26 is of particular importance because the media tone is slightly more negative, which might indicate that the press might not see the company's side of the issue and thus the reputation risk with important stakeholders may be more severe.

Conclusion

In this Chapter 3, we have finally delved more deeply into what we mean by a "quantitative" approach to reputation risk management.

But this discussion does not end here – it's only the beginning because we are convinced, based on our many years of dealing with this topic (Andrea from a more qualitative and Len more quantitative standpoint), that the only solution to truly understanding, managing, mitigating and eventually monetizing reputation risk is to develop what we are calling the "Quant/Qual" approach to reputation risk.

CHAPTER 4

MEASURING REPUTATION VALUE

"A reputation once broken may possibly be repaired, but the world will always keep their eyes on the spot where the crack was."

Joseph Hall, English Bishop and Satirist (1574-1656)

Introduction

The purpose of this series has been to describe the elements of a robust reputation risk management program with an enhancement to the quantitative framework for visualizing an organization's reputation risks. Visualization provides a key input into developing the strategy and tactics of addressing each risk. In this Chapter 4, we add to the quantitative toolbox of our approach to reputation risk.

We started our series on reputation risk in Chapter 1, where we provided a brief introduction to this relatively new concept and distinguished it from related concepts, like crisis management. And in Chapter 2, we made the case that reputation risk management should be part of the strategic agenda and that every type of organization – whether corporation, non-profit or government agency -- should know who their most important stakeholders are, as stakeholders are a vital part of any reputation risk management solution.

We will conclude with Chapter 5 where we will pull it all together – the qualitative and quantitative aspects of reputation risk management – and apply it to several mini-case studies which we hope our readers will find useful and maybe even inspiring.

Our approach is different from what we have seen before because our philosophy is that successful reputation risk management requires a mix of art and science, quality and quantity, the objective and the subjective.

In Chapter 1 and 2, we suggested that current approaches are mainly qualitative in nature. More specifically, in the "Risk Analysis" phase of risk management, inputs on the "likelihood" and "impact" of an event are determined mainly by an expert committee of insiders. Although it can be a highly qualified and insightful committee, its view will be by definition more "art" than "science" as it is the view of insiders who by virtue of where they are situated within their company can only provide an insider perspective.

It is not that we think that there is perfection to the "science" part of this equation – quite to the contrary, we fully acknowledge that the quantitative part of our approach to reputation risk will also have its flaws as everything carries a mix of objective and subjective elements. What we are saying, however, is that because of the inherently complex, ever-changing and intangible nature of reputation risk, to be as highly effective as possible, both the "quant" and "qual" sides need to be robustly taken into account and applied.

In this Chapter, we propose two supporting analyses aimed at enhancing the current methodology with some science by addressing two key questions, namely:

1. What is the *Total Value of Reputation Risk to Your Company*?

2. For each reputation risk, *what is its reputation value*?

We would like to be clear, however, that this work doesn't answer the question of all questions – the Holy Grail, as it were: "What is the value of reputation?" What it does, however, is point to estimates based on qualitative assumptions and quantitative inputs -- qualitative assumptions set by expert committees and quantitative insights based on rigorous stakeholder research.

1) What is the Total Value of Reputation Risk to Your Company?

The Math.

Let's now delve into some equations:
Reputation Capital Value X Model Fit = Total Value of Reputation Risk ($)
Where: *Reputation Capital Value = Intangible Value X Reputation Capital %*

Corporate reputation and the inherent risk associated with it is a part of a company's intangible value. In order to get to our starting point of the "value of reputation", we need to cover a few definitions, namely: "Intangible Value", "Reputation Capital", and "Model Fit":

Intangible Value = Market Capitalization – Book Value

Where we use the following components based on well-accepted financial definitions:

- Market Capitalization = Stock Price x Outstanding Shares
- Book Value = Total Assets - Total Liabilities

We define **Reputation Capital** as the total sum of a company's relationships with its stakeholders (i.e., customers, partners, employees, regulators, investors, distributors, media, etc.)

Reputation Capital is a percentage of *Intangible Value*. While our view is that this percentage varies from industry to industry, for the purpose of this work, we'll adopt *The World Economic Forum*'s claim. According to The World Economic Forum, on average more than 25% of a company's market value is directly attributable to its reputation (World Economic Forum, 2012). In other words, 25% of a company's intangible value is *Reputation Capital*.

"**Model Fit**" is the Adjusted-r^2 (i.e., how well the data fits the predictive model) from Linear Regression Model Fit whereby a set of reputation attributes is regressed on a reputation variable or construct. Examples of well-worded attributes might include:

- "Is committed to the development of its employees"
- "Provides good customer service"
- "Offers products that are responsibly made and sourced"

The data for this analysis would be derived from company stakeholder customized surveys.

An Example.
Company X has three stakeholders: customers, suppliers and employees, an Intangible Value of $5 billion and a Model Fit of 60%.

If we apply the following formula:
Reputation Capital Value X Model Fit = Total Value of Reputation Risk ($)
($5B (Intangible Value) X 25% (*Reputation Capital %)*) X 60% (Model Fit) = $750 Million

As a result, the *Total Explained Value of Reputation Risk* among all three stakeholders would be $750 Million.

Additional advanced analytics could further determine the *Total Value of Reputation Risk* by stakeholder. This analysis is beyond the scope of this brief.
The next step is to leverage this figure to further understand the reputation value at risk for each reputation risk. More concretely:

2) For each reputation risk, what is the reputation value?
Let's assume that our reputation model had 20 attributes with a *Total Explained Reputation Risk Value* of $750 Million. To estimate the value of a specific risk (e.g., perception of poor customer service), the *Explained Reputation Risk Value* would be multiplied by the regression Standard Beta coefficient (i.e., a measure that explains what each attribute contributes to explaining the dependent variable, in our case, reputation). In other words, the *Total Explained Reputation Risk Value* would be distributed across each attribute by the multiplied value of the regression Standard Beta coefficient.

Attributes of Reputation	Standard Beta Coefficient	Reputation Value ($Million)
Attribute 1	0.18	$135.0
Attribute 2	0.16	$120.0
Attribute 3	0.14	$105.0
Attribute 4	0.11	$82.5
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Attribute 18	0.04	$30.0
Attribute 19	0.03	$22.5
Attribute 20	0.01	$7.5
Explained Values	1.0	$750.0

Reputation Risk & its Associated Attributes

Attributes of Reputation	Standard Beta Coefficient	Reputation Value ($Million)
Attribute 1	0.18	$135.0
Attribute 2	0.16	$120.0
Attribute 3	0.14	$105.0
Attribute 4	0.11	$82.5
To Save Space - Mid Section was Removed		
Attribute 18	0.04	$30.0
Attribute 19	0.03	$22.5
Attribute 20	0.01	$7.5
Explained Values	1.0	$750.0

Reputation Value at Risk $210 Million

Additional analysis would further determine:

- What estimated budget is needed to mitigate this risk?
- If such an amount is invested, what is the ROI?

These analyses are beyond the scope of this brief.

Conclusion

In this Chapter, we have taken a bold leap forward in presenting quantitative inputs to developing a more complete framework for understanding reputation risk.

As we have emphasized throughout this series, we don't believe that either the quantitative or the qualitative sides of reputation risk analysis can stand-alone. We are also very cognizant that each of the qualitative and quantitative sides of this "equation" has limitations. We are convinced, however, that the combination of a well thought through combined approach of the "quant" and "qual" aspects of this complex and evolving topic – reputation risk – offers the best way forward for a holistic, strategic and practical solution to the dilemma many companies and other organizations are facing on this topic today especially in the financial sector where entities are facing demands from multiple regulators to quantify their reputation risk.

In our final Chapter, we will demonstrate how this all fits together by showing you how our approach applies to several actual case studies.

CHAPTER 5

UNDERSTANDING REPUTATION RISK: CASES & OVERVIEW

Character is like a tree and reputation like a shadow. The shadow is what we think of it; the tree is the real thing.

Abraham Lincoln (19th Century)

INTRODUCTION

In this book on "Understanding Reputation Risk", we have sought to accomplish two main objectives:

1. Provide our readers with the first and most comprehensive understanding of a combined quantitative and qualitative approach to reputation risk analysis
2. Point to a solution for a better qualitative/quantitative (qual/quant) approach to this issue in the age of hyper-transparency and super-connectivity where companies and all forms of organization can better manage their reputation risk….and reputation opportunity

In this final Chapter 5, we provide a summary overview as well as a series of snapshots of real world cases of reputation risk and how a qualitative / quantitative approach might help an organization deal with this complex issue.

There are a multitude of cases at any given time of companies that may not have properly identified and/or managed their most important underlying risks and challenges in the marketplace. When that happens such underlying risks can blossom into bigger risks with additional and serious reputation risk implications and consequences for the company or organization layered on top of their existing core risks. This is the worst-case scenario for a company.

The better case scenario is for an organization to have a robust system of enterprise risk management, customized to its footprint, purpose, mission, needs, etc., and able to surface the principal and most important risks confronting it. When companies have such an effective system in place, they can then layer on the necessary reputation risk analysis that will enable them to:

1. Know who their high priority stakeholders are
2. Manage their key stakeholders' principal expectations
3. Manage the inevitable crises that may come in an effective manner that does not erode reputation or brand
4. Understand how to transform the experience (risk and crisis) into an opportunity for better business and even value creation

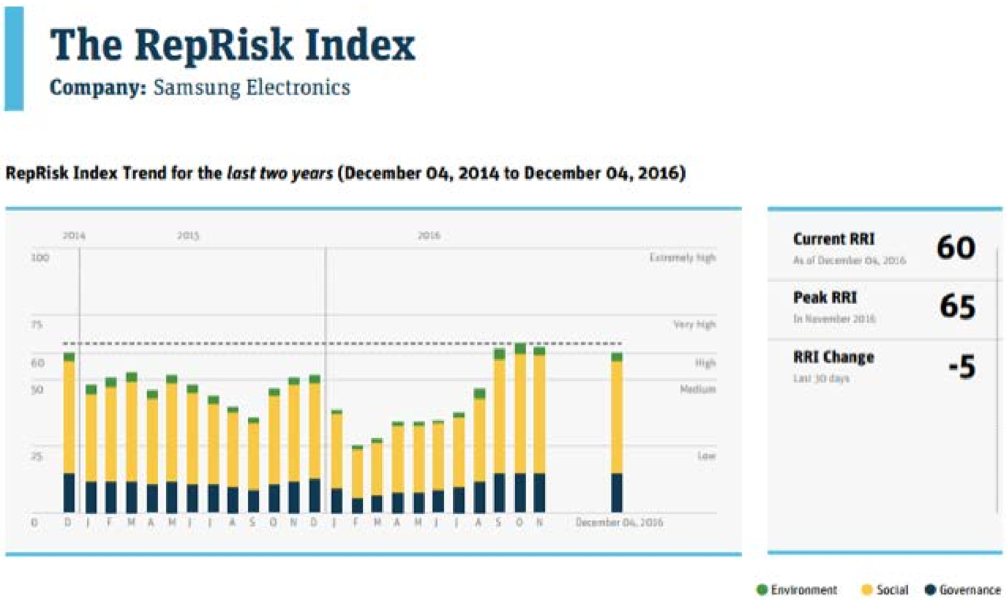
REPUTATION RISK: MEDIA & SOCIAL MEDIA METRICS

Earlier, in Chapter 1, we introduced readers to a tool that RepRisk has developed that allows companies and others to get a snapshot of their reputation risk through media and social media data mining that converts into a quantitative RepRisk Index. This index and related metrics allows the company to understand how high, medium or low their reputation risk is as measured by such media and social media analytical tools.

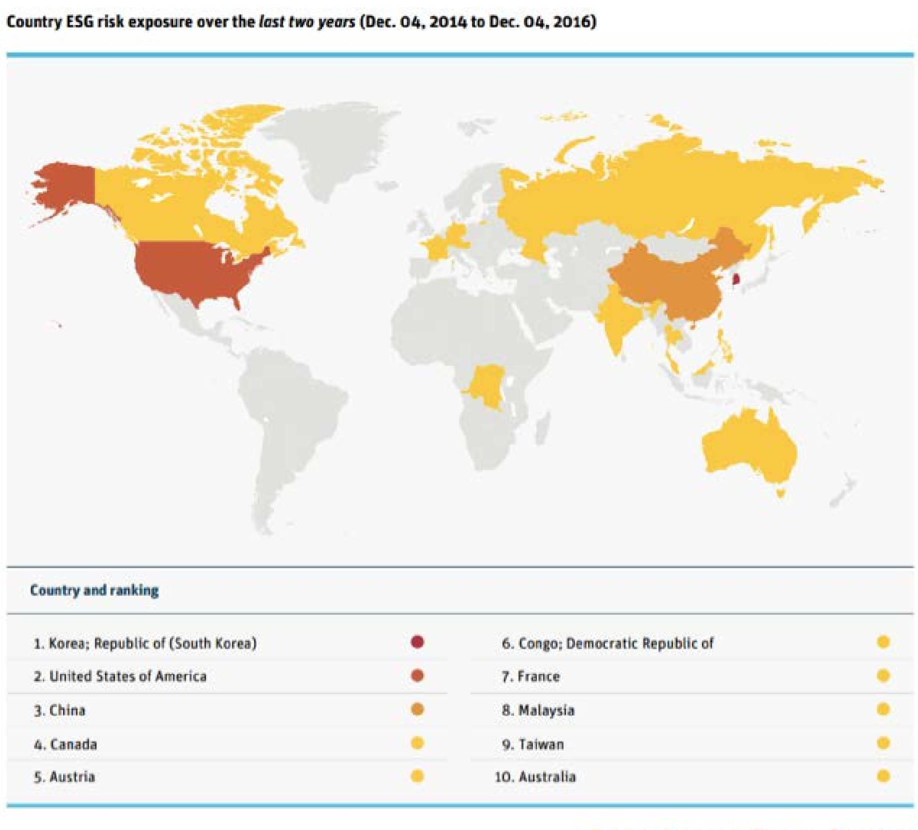
Below, are two examples of contemporary reputation risk situations involving two major global companies – Samsung and Petrobras -- with one or more ongoing ESG issue crises taking place at this time for which we provide an ESG RepRisk Index 2 year snapshot as well as a world heat-map for where they have most of their exposure.

The Samsung Case

The case of Samsung as of December 1, 2016, demonstrates that there has been a strong increase in ESG risk exposure to the company over the past few months – clearly related to their Galaxy Note 7 phone crisis but other issues as well.

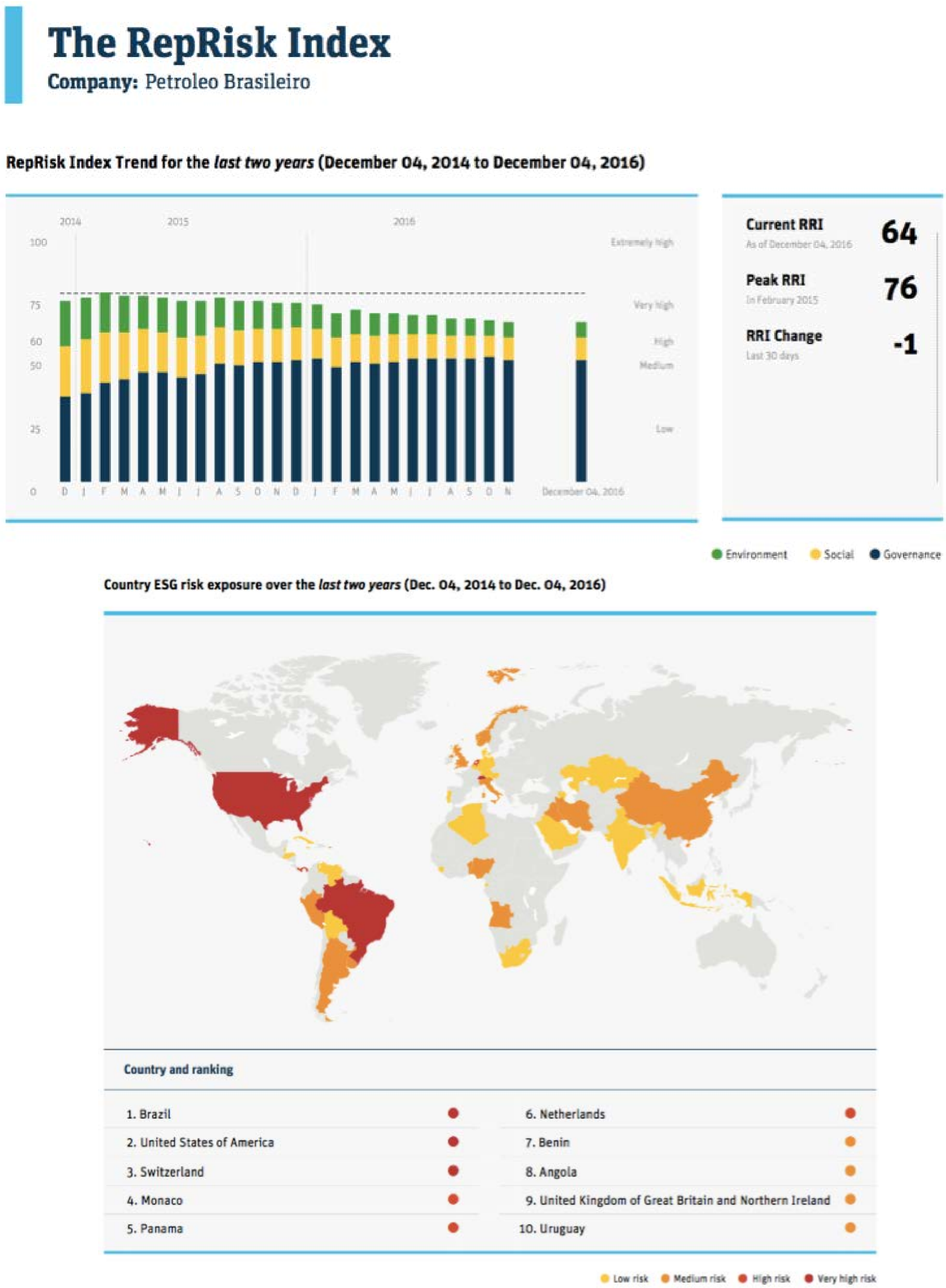


Most of the exposure on these issues for Samsung is in the following countries:



The Petrobras Case

In the case of this longer-standing and unprecedented corruption scandal not only involving the company but the entire economic and political infrastructure of its host country – Brazil – we can see the serious increase in ESG risk represented in both the metrics below and the heat map of where Petrobras does business.



The RepRisk tool is a very useful metric to use to track reputation risk in social media and benchmark it against peers and other data. What we offer below goes a few steps further to suggest that in addition to metric tools like the one above, companies need to undertake a combined qualitative/quantitative analysis that will allow for a preventative, proactive approach to reputation risk management before the crisis occurs and in furtherance of creating greater resilience and long-term value for the organization.

REPUTATION RISK: CASES AND SOLUTIONS

What we offer the reader below goes beyond the useful metrics we share above – which at the end of the day provide a useful on going and retrospective tool to understand a company's exposure to reputation risk – to an approach that combines such metrics, other analytical tools and a quantitative approach shared earlier in this book, that will truly equip a company or other type of organization with the full toolkit necessary to preventatively and proactively manage such risk and also create a situation where risk can be transformed into value.,

Below are several actual cases of reputation risk from companies around the world in which we provide a brief summary of the risk and illustrate how a qualitative/quantitative approach to reputation risk management would help the company overcome the challenge and even create an opportunity for value creation.

CASE 1: STARBUCKS TAX REPUTATION RISK IN THE UK

The Facts:

- To avoid taxes in the UK, Starbucks allegedly used its coffee bean roasting plant based in the Netherlands to minimize profits for 7 years.
- The Starbucks roasting firm had been charging inordinately high prices for roasting and for knowledge transfers.
- Starbucks approached the Dutch government to test whether this practice was legal.
- An investigation by the European Chamber of Commerce into this practice (which included other companies like Fiat) found it illegal and Starbucks had to pay an additional £30 million in taxes.

The Qualitative Analysis

This case is an example of the possible downside effects of borderline or cutting edge practices. On the one hand, Starbucks undertook a practice that is widespread amongst international companies who would all probably consider the tax planning to be cutting edge and even aggressive but not over the edge (illegal).

However, such practices can also backfire in this age of hyper-transparency and the growing importance of other key global topics such as the growing role of income inequality, populism, and aversion to tax avoidance schemes, all of which could provide potential additional reputation risk to multinational companies who don't properly mind their tax risk exposure.

On the other hand, Starbucks, unlike many other companies, asked the relevant government agencies whether their practice was legal and in doing so demonstrated relatively good core tax risk management which undoubtedly helped them to ameliorate and lessen the potential for more extensive reputation risk associated with the underlying tax risk.

Net/net, while Starbucks acted aggressively for 7 years regarding this issue, they also demonstrated proactivity and sensitivity to the reputational risk consequences of the underlying tax risk and resolved their issues with minimal negative reputational effects.

CASE 2: GSK BRIBERY REPUTATION RISK IN CHINA

The Facts

- Starting in 2007, GSK allegedly engaged in the bribery of government officials, hospitals and doctors in China.
- In June 2013, Chinese authorities began investigating GSK, laying bare a tale of intrigue involving a mysterious sex tape, whistle-blowers, private investigators and a culture of bribery and graft in China's vast medical industry.
- At first, GSK denied being involved in such practices. After public pressure and the revelation of additional details, the company admitted wrongdoing.
- In 2014, they were fined £300M and suspended prison sentences were meted out to several top managers.

The Qualitative Analysis

This is a case where a company, like many others that entered the Chinese market over the past two decades, may have had what appeared to be a sufficient global corporate compliance and anti-corruption program that satisfied, at least on paper, the requirements of the U.S. Foreign Corrupt Practices Act and other applicable extra-territorial anti-corruption laws under the OECD Anti-Bribery and Anti-Corruption Convention of 1997.

However, GSK and others during this period may not have anticipated another critically important corruption risk: that of the Chinese government enforcing its own national and local anti-corruption laws – something that didn't happen often if at all to multinationals doing business in China prior to the actions against GSK in 2013.

In this case, GSK (and we're sure other MNCs) missed another serious and important consideration in the global marketplace: the fact that nations that may not have enforced their existing national anti-corruption laws before may suddenly start to enforce them.

The key lesson learned from this case is that no global corporation or other form of organization like a university or NGO can do business around the world thinking that specific nations in which they are doing business will not enforce their own laws just because there has been lax or non-existent enforcement in the past. The reputation risk and other consequences can be dire, as the GSK case has demonstrated.

CASE 3: BHP BILLITON OLYMPIC GAMES CORRUPTION REPUTATION RISK IN CHINA

The Facts

- At the 2008 Beijing Olympic Games, BHP hosted a number of government officials. The guests where mainly from Asia and Africa and were offered up to four days of hospitality at the event, which included tickets, a luxury hotel stay and excursions with a total value of between $12,000 and $16,000 per guest.
- In 2013, the US SEC investigated the case and fined the company a total of US$30 million. The company paid the fine without admitting any wrongdoing.

The Qualitative Analysis

These facts illustrate a very common corruption / bribery problem that most global companies face: where is the line between courtesy and non-corrupt business development activities or client service and the appearance and/or reality of bribery and corruption?

The 41 nations that have adopted extra-territorial anti-corruption laws pursuant to the OECD Anti-Bribery and Anti-Corruption Convention of 1997, have issued guidance or laws that provide parameters (some more than others) to help their companies understand when business development involving government officials becomes bribery. Lavish entertainment does not fit within any of these laws and guidelines and in fact is considered to be corrupt regardless of local practices including in some cases (like the UK Bribery Act) between two private parties. Companies know or should know better that, if they are caught, they will not only suffer the legal but also the reputational consequences of being considered bribers or corrupt by their stakeholders and the public in general.

CASE 4: BARCLAYS INTEREST RATE MANIPULATION REPUTATION RISK IN LONDON/GLOBALLY

The Facts

- Dating back to 2005, Barclays (like a number of other banks) was found to have manipulated LIBOR (the London Inter-Bank Offered Rate) with the intention to fix the rate and hence gain higher profits from mortgage and loan trading.
- In 2007, employees internally cautioned management against these unethical practices. Nothing happened.
- In 2008, the Wall Street Journal revealed these practices in an investigative report.
- Barclays, as was the case with the other banks involved, continued to deny their involvement until 2012, when they were fined £290 million.

The Qualitative Analysis

This case provides a very clear illustration of “reputation risk contagion” a term coined in The Reputation Risk Handbook. The LIBOR cases more than anything else illustrate the power of the race to the bottom within a sector or industry. If one leading player is known to be at the cutting (unethical) or even bleeding (illegal) edge of a practice (in this case LIBOR rate manipulation), frequently other members of that sector catch on to that practice, in order to compete effectively (the argument goes), and then everyone indulges in the unethical or illegal practice. This is in effect what happened with the LIBOR cases.

Lessons learned? Companies and organizations generally need to mind their own store when it comes to risk management and have a clear concept of the key reputation risks that are associated with their primary risks in the marketplace. The slippery slope that reputation risk contagion encourages can lead companies that otherwise have decent risk management in place to dangerous zones where unethical or illegal activity might take place. Hence the great importance of including reputation risk analysis and assessments in an enterprise risk management program that not only understands the risks directly challenging the company itself but also the overall sector.

The Quantitative Analysis

In each case above, the company’s corporate communications, marketing, legal, risk and crisis management functions would have benefited from a robust reputation risk management program enhanced with the quantitative inputs similar to the ones proposed in Chapter 3 and 4.

In Chapter 3 and 4, we outlined the importance of improving the **Risk Analysis** phase of any risk management process. We proposed that the results of these analyses be strengthened with independent and objective third party analyses and measures.

As described in Chapter 3, the first additional measure we suggest is to visualize the **Risk Register** through a **Risk Heat Map**. The **Risk Heat Map** is a 2-by-2 mapping of the risks. Its purpose is to visualize the potential impact of each risk event derived from answers to two key questions:

1. What is the perception of a **Reputation Risk Event** occurring?
2. If this **Reputation Risk Event** occurs, what is the resulting scale of the negative impact on the company's reputation and supportive or adverse behaviour by key stakeholders?

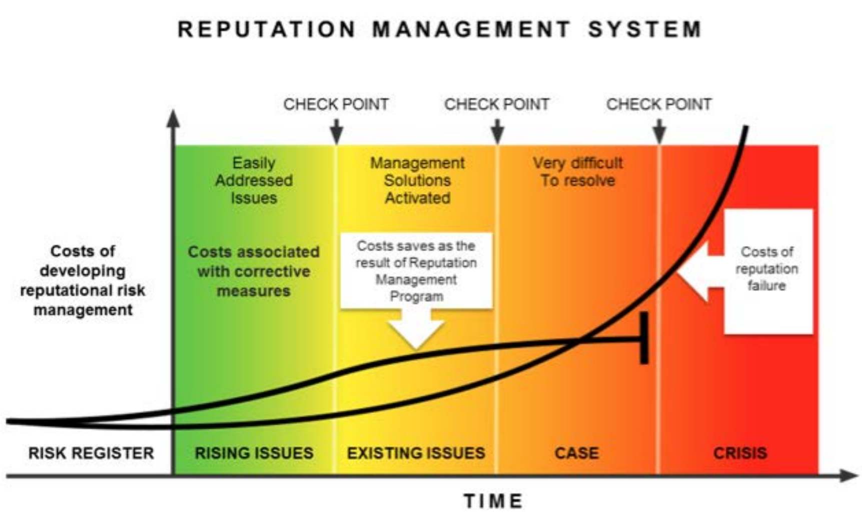
The key inputs of this analysis are:

- **Stakeholder Reputation Studies –** These research studies are based on a variety of stakeholder respondents that rate a company on customized reputation attributes. These attributes are then associated or mapped to specific risks. This approach has several advantages such as refiguring the associations to risks as they change or as new risks are added.
- **Media Studies** - A media-tracking tool is used to build the model in terms of the likelihood and impact of Reputation Risk Events.

In Chapter 4, we propose the second analysis that illuminates the dollar value of reputation as well as values that lead to specific event/risk planning. More specifically, this analysis addresses the following topics:

1. What is the **Total Value of Reputation Risk** to our company?
2. For each specific risk or event, what is the **reputation value at risk**?
3. What should be our **budget** for mitigating a risk?
4. What is the **ROI**?

It is our view that these additional analyses will allow reputation risk strategists to adopt better risk management parameters and curb the cost of managing reputation risk (see graphic below).



We also fully acknowledge that quantifying intangibles is the 'holy grail' and that our approach will also have its flaws - as every methodology has subjectivity.

What we are saying, however, is that because of the inherently complex, ever-changing and intangible nature of reputation risk, to be as highly effective as possible, both the "quant" and "qual" sides need to be robustly considered, combined, and applied.

CONCLUSION

In this work, "Understanding Reputation Risk", we have attempted to convey a simple but we hope powerful message about a complex problem:

> *Reputation risk will continue to be a core issue for global companies in the foreseeable future. While it is a difficult intangible topic to grasp in concrete terms and is not easily susceptible to scientific analysis, it is a subject that can be submitted to a rigorous quantitative/qualitative methodology combining the best of both worlds to provide a disciplined analysis and methodology and a practical set of recommendations and solutions.*

We have stated elsewhere in this series that our qualitative/quantitative approach to reputation risk analysis and recommendations is neither art nor science. Or perhaps stated more accurately – it is part art and part science. We believe that this era of hyper-transparency, super-connectivity, and the current and coming digital transformation of almost everything we do, requires that we apply the best of both worlds to this changeable, complex and ever-amorphous issue.

We look forward to engaging in a robust conversation on this important topic and assisting friends, colleagues and clients with solving their reputation risk challenges.