

A Short Guide to Reputation Risk

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The Nature and Value of Reputation

Talk of reputation is most commonly associated with damage. A reputation attaches itself to a person, place or organisation and can be damaged accidentally. Damage of course destroys value whether this is financial or more intangible: esteem or prestige. It is this destruction of value that makes news; an increase makes for a dull story.

Definitions of reputation are not hard to find. Here is one from *Invisible Advantage* by Jonathan Low and Pam Cohen Kalafut:

In a sense a company's reputation is the ultimate intangible. It's literally nothing more than how the organisation is perceived by a variety of people. It is slippery, volatile, easily compromised, impossible to control, amorphous.

I like this definition because it admits reputation is hard to pin down in monetary terms, despite the fact that damage ultimately carries a cost. It makes reputation risk a particular challenge to internal auditors and risk managers.

Reputation is a term that is over-used by journalists, and often incorrectly used within organisations themselves. Reputation is not synonymous with brand, goodwill or even image. A brand is a consumer proposition created and managed by its owner in order to generate revenue. A reputation is a perception held by others about you, in anticipation of future behaviour. The two could not be more different in terms of ownership, control or purpose.

Goodwill is an accountancy term for the intangible value of customer loyalty. Image is a one-dimensional mental picture or snapshot without the future or historic element present in reputation.

In order to appreciate fully the nature of reputation I use six simple aspects. This is based on the acronym REPUTE and it may help you get a handle on the slippery, volatile and amorphous side of its nature.

Relational construct – You have a reputation with somebody for something. In a domestic context your wife will expect you to behave as a husband, your daughter will expect you to behave as a father, and so on. In a commercial world your organisation has stakeholders – those groups of people who are affected in some way by your actions. Each group has a unique relationship with your business, a unique perspective and a distinct expectation.

Most businesses consider their reputation with shareholders or investors to be the most critical, after all investor confidence is reflected through market capitalization and share price. Nevertheless reputation with customers, suppliers or employees is equally important, as without any one of these the business would cease to exist. Stakeholder groups that create value are

called primary, as distinct from those that merely influence value (secondary).

It is possible to have more than one reputation. Consider a major grocery chain with attractive retail prices for customers achieved through squeezing supplier margins; a good reputation with customers for value can result in a poor reputation with suppliers. Perception depends on where you stand. City investors may rate your business for its ability to deliver dividends, however employees might feel that this is achieved at the expense of salaries that are below market average.

Is reputation with one group more important than another? Should you take notice of all stakeholder concerns? Is there a hierarchy? Should you prioritise? These are strategic questions the board should be asking. Stakeholder relationship management is taking over from customer relationship management as a business focus. One leading CEO defined a stakeholder as: ‘anyone who can bugger up your business’.

Exception attributed – Reputation is attributed for some action or behavioural characteristic that sets you apart from competitors or peers, it is both a perception of character and differentiator. Among investors it may be for delivering forecast dividends as promised; among customers it might be for delivering value-for-money consistently; among employees it might be for providing a generous pension plan. Reputation is for a specific activity that others won’t or can’t match. In one sense this is reputation as notoriety.

Attributing reputation by exception presumes that the stakeholder group has some knowledge of competitors and peers in order to make the comparison. Take for example the

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previous case of a corporation with a reputation for delivering forecast dividends: if every operator in the sector delivered forecast dividends then this would not suffice as a differentiator, investors would choose a different characteristic. Stakeholders use reputation as a differentiating tool not unlike a brand name.

Reputation by exception must also be seen against the background of stereotypes. For example, banks are seen as risk averse, cautious and prudent organisations, a safe haven for your money. A reckless bank should be conspicuous by its behaviour as exceptional (although we live in exceptional times when quite a few were shown to have been bigger risk takers than expected). Reputation management is about managing expectation and avoiding surprises which draw attention to performance above or below expectation.

Consider the fact that we tend to trust bishops and headmasters more than estate agents or car salesmen. We are therefore more disgusted when those in whom we place greater than average trust betray us. Reputation is a relative concept and reflects the environment in which we operate as much as our own actions.

Perception comparison – Reputation is based on a perception, it doesn't have to rely on truth or reality but on a combination of the experience, knowledge and belief of stakeholders. An organisation has the capacity to improve a stakeholder experience and some ability to improve stakeholder knowledge but relatively little power to influence belief. If a stakeholder group believes your organisation is incompetent or fraudulent, there is very little you can do to dissuade it.

We have seen that reputation is attributed by exception, so that a norm or benchmark exists against which this behaviour is deemed exceptional. I have seen employee surveys that show employees think they are paid below the sector average, despite the evidence to the contrary. If your organisation pays its employees in line with industry averages, this will matter little if the employees believe their pay is lower. The net result will be a poor reputation among employees.

Perception changes over time and with changes to the business environment. For example, a few years ago a social responsibility policy was a differentiator in itself, however today every major corporation publishes one. This (in itself) is no longer a guarantee of a good reputation but merely an expected business output like an annual report. Reputation does not exist in a vacuum; it is vulnerable to the evolution of stakeholder expectation. Managing this expectation requires engagement with stakeholders to improve perceptions.

Unintended consequences – Nobody sets out to damage their reputation or reduce their own value. Granted some third parties might have an interest in driving down the value of a corporation from which they intend to profit, but no organisation sets out to damage its own good reputation on purpose. Damage is almost invariably the result of a sequence of actions the outcome of which is inadvertently detrimental.

Fear of reputation damage focuses on good turning to bad, not bad turning good. Quality, on the other hand, manifests itself in many ways not obviously good and bad. For example, a reputation for supporting good causes may make you appear philanthropic. If next year all your peers contributed significantly more to charities than your contribution might

look miserly. Activity by others can influence the quality of your reputation: you may not do anything and your reputation quality could be reduced by exception and perception.

It follows that something of which you can justifiably be proud today becomes something of which you could suddenly be ashamed tomorrow. This volatility of reputation is something that corporations ignore at their peril. Reputation management requires constant vigilance. A good reputation is not easily won and commonly hard earned. A bad one of course can attach itself quickly and prove very sticky.

Building a good reputation is not something that many organisations do consciously, as a good reputation is a by-product of good management. Organisations that acquire a good reputation do so because they are managing the issues which are business critical not necessarily reputation critical. Attempting to manage reputation in itself is inadvisable and rarely successful, stakeholders soon become aware that reputation is more important than the business itself and this destroys trust. Effective reputation management is discreet and subtle.

Unintended consequences abound: who would have thought that the raising of the inter-bank lending rate in August 2007 would have created waves throughout the global economy? Hindsight is a wonderful perspective but before the run on Northern Rock, funds could be raised in the wholesale market and nobody predicted this would cease overnight.

The law of unintended consequences states that for every action there will always be some consequences that were unintended. We simply need to become more effective at

predicting all the implications of our actions if we are to protect reputation successfully.

Track record – A reputation is built over time based on an activity trend. Predicting behaviour through extrapolating from this trend is what sets out the quality of a reputation. Leopards don't change their spots and many organisations have a culture that can't change overnight, in most cases behaviour will be predictable.

Communication is important with stakeholders and an external relations function is valuable, however it is not what we say but what we do that determines reputation. Stakeholders judge an organisation on its behaviour not its claims. They are also more likely to believe media comment – which they see as independent – rather than stories put out by the company itself.

It follows that reputation management should not be the responsibility of corporate communications. Reputation is about behaviour and corporate culture. Stakeholders can be alienated by 'spin' and news management. Reputation depends on people and the HR department is a natural home for reputation management, more so than the PR department.

Where a disconnect exists between how an organisation behaves and what it communicates to the outside world, then there is ample scope for reputation damage. There is a common belief that reputation can be repaired after an event through crisis management and damage limitation activity, however this is always expensive. Stakeholders know that lasting change in corporate behaviour will not happen overnight.

Emotional appeal – A good reputation is a valuable endorsement of trust. Damage to reputation occurs when our trust is shown to have been misplaced and disillusionment sets in. We expect our money safe in a bank, and children safe with a teacher. So when we talk of damaged reputation we actually mean that we made a mistake and placed trust in someone that ultimately wasn't justified. Were we let down by a poor performance or did we expect too much in the first place?

When our value judgement, which is based on experience, fails us our confidence is eroded. This is why errant teachers and bankers make headlines. It is because our expectations of them are comparatively higher than of others, in whom we don't place as much trust. The better the reputation the more vulnerable it is and the more susceptible to damage. The principle of 'The higher you are the further you fall' applies.

Reputation dictates how people behave and in whom they place trust. Once this trust is lost it is almost impossible to regain. Damage to reputation correlates positively with trust recovery. Damage is greatest where trust is difficult to regain as in cases of fraud, conversely it is slightest where trust recovery can be achieved easily, for example, after a minor incident.

Trust in any relationship requires predictable behaviour and 'no surprises'. There is a fairly close correlation between ethical behaviour and a good reputation. This is because trust requires both a mutual understanding of right and wrong, linked to a determination to do the right thing irrespective of cost.

THE VALUE OF REPUTATION

The value of reputation is frequently under-estimated because it is rarely measured. In many global corporations it is the silent asset that only shows up in the gap between book value and market capitalization. A significant part of the Intellectual Capital of a firm, reputation has enormous value in attracting new customers, employees and investors. Often a hidden boost to marketing and advertising activity of an organisation, nobody knows the true value of reputation in securing future revenue or maintaining market share.

At the time of writing, national governments across the world are stepping in to prop up banks in order to restore confidence in the banking industry, something that would have been unthinkable a year ago. This shows how much we rely on trust. We place our savings in a bank and trust that they will be there next week. Without trust there is no commerce, the high inter-bank lending rate reflects the distrust that still persists among banks.

Outside of the banking industry, the public sector has worries of its own. Government departments have been in the news for losing sensitive data entrusted to them and subsequently lost in transit between offices or contractor sites. What does this say about the trust placed in government by the general public? A government keen to introduce strict security measures and ID cards does not set a confidence boosting example. Does it enjoy a good reputation for security of our personal data?

In the professions where the partnership structure operates, reputation depends on client service and value for money. Reputation rests largely on the shoulders of partners, their

teams' expertise, and the combined ability to deliver both client satisfaction and fee income. Reputation of a professional firm relies on integrity as much as competence. How clients expect partners to behave is fundamental to quality of reputation. Professionalism underpins a good reputation, but can professionalism be defined any more than reputation?

There is no doubt that reputation has a value but it manages to avoid tangible measurement. However, there are two ways to measure reputation value. One is the monetary valuation applied to an intangible asset for either insurance or risk purposes. This approach which uses Market Capitalisation or Return on Assets modelling often attracts the attention of the CEO or Finance Director. It is a method that requires so many assumptions and caveats that the final figure is rarely meaningful. The alternative approach involves the relative valuation of reputation as intellectual capital for internal performance using score cards or similar indices. This can be an interesting exercise but may lead to a complex list of up to 100 different variables with subjective weighting.

To conclude, the value of reputation may be best expressed in terms of magnetism. A good reputation attracts and a bad reputation repels. A good reputation is slowly earned amongst stakeholders, a bad one is quickly assigned by the same stakeholders. An organisation or business has little control over its reputation, however it should understand that not all stakeholder groups share the same perspective. This implies that reputation is multifaceted and it offers a clue to reputation management – exploit the ones you have.

SUMMARY

Reputation is something you are given by others, you do not choose it, others assign it to you so its quality is a reflection of how they see you. You can of course influence how others see you by your behaviour, but a reputation is earned as a consequence of actions. It is a secondary feature that can become part of your identity among stakeholders.

The quality of reputation is determined by your behaviour, good or bad, within the context of your market or local environment. This quality is comparative and depends as much on the reputation of rivals as it does on your own. To achieve a good reputation it is first necessary to understand what a bad one would look like in your market. Opposites play an important role in expressing reputation quality.