Reputation is the soul of any business. Without it there is, basically, no business. Many factors, internal and external, may lead to the destruction of reputation. These factors are called risks.

Professionals have been debating whether there is such thing as reputational risk (category of risk by itself), or simply there are risks to reputation. In this article, I will attempt to shed some light on these two schools of thoughts.

Before I start the discussion, let’s familiarize ourselves with the related terminologies:

What is reputation?

Rep·u·ta·tion/repəˈtāSHən/Noun

The Merriam Webster dictionary defines reputation as “overall quality or character as seen or judged by people in general”.

Would this simple definition apply to corporate reputation as well? Moreover, what is the difference between reputation, corporate identity, image and brand?

Peter W. Roberts and Grahame R. Dowling define corporate reputation as follows:

"A perceptual representation of a company’s past actions and future prospects."

In other words, reputation is created when an organization’s experience meets or exceeds stakeholders’ expectations.

Reputation = experience - expectations

Oonagh Mary Harpur

Corporate identity, image and brand are all ingredients of corporate reputation.
What is risk?

Risk is the effect of uncertainty on objectives. Risk is measured in terms of impact and likelihood.

What is reputational risk?

The Committee of European Banking Supervisors defines reputational risk as follows:

“Reputational Risk is the current or prospective risk to earnings and capital arising from adverse perception of the image of the financial institution (organization) on the part of customers, counterparties, shareholders, investors or regulators.”

Does reputational risk exist?

Some risk managers believe that reputational risk is a risk of itself (standalone category) and that it can be isolated and measured.

Greg Shields, Partner at Mitchell Sandham Insurance Brokers in Toronto, writes in his blog:

“My support would go to the ‘standalone category’. Damage to reputation is a very real secondary risk to every primary risk, however, since it can also be a direct loss, with no primary risk cause, the risk has to have its own policies, procedures, measurements (prioritize if not quantify) and unique solutions. This means, crisis management plans, dedicated ‘category owners’, internal (separate from) external communication plans, oversight/policing of Reputational Risk Management component of every divisional/category Risk Committee, involvement in executive level Reputation Planning (including establishment, maintenance and monitoring.)

“Reputational risk is the starting point of all risks.”

Dr. Guruswami Raghavan

On the other hand, there are those who do not believe that reputational risk is a category by its own right, among them is Dr. Jean Paul Louisot, Professor of Risk Management at the Sorbonne University, who says:

“There is no such thing as reputational risk, only risks to reputation.” He adds: “The term ‘reputational risk’ is a convenient catch –all for all those risks, from whichever source that can impact reputation. The source could be legal, non-compliance, a data security lapse, an unexpected profit warning or unethical behavior in the boardroom."

There is no such thing as reputation risk; rather all risks may have an impact on an organization’s reputation.
There are those who believe that reputational risk status is determined by the organization’s ability to identify and manage first-tier risks, an example of this opinion is represented in a Deloitte publication, it reads as follows:

“Notwithstanding the fact that the majority of reputational damage can be described as a second order impact, a number of reputational risks can nevertheless be classified as ‘independent risks’ meaning that reputational damage could be considered as a first order impact. These independent risks can often be associated with ethics. Organizations that do not abide by high ethical standards and that ignore principles of market conduct are vulnerable to losing their customers’ trust and confidence. In short, each organization has a social responsibility that it cannot ignore and that it must address in its corporate governance.”

A 2005 Economist Intelligence whitepaper further explains this:

“Risk managers are divided on whether reputational risk is an issue in its own right or simply a consequence of other risks. The latter view predominates where there is a tradition of well-structured risk measurement and management. In industries where risk managers feel they have identified the key first-tier risks facing their business, they may be more inclined to consider reputational damages as simply a failure to manage these risks properly. In contrast, in sectors where first-tier risk is less quantifiable they are more likely to see reputational risk as a class in their own right.”

According to same study, 52% of respondents consider reputation risk as a risk by itself, while 48% consider it as a consequence of other risks.

What do I think?

In researching for this article, I have read a large volume of materials concerning reputational risk. I have concluded that all risks may have an impact on reputation and that reputational risk, in most cases, is a consequence of other risks.

When I think about the demise of Arthur Andersen, I am a former partner; I remind myself that what destroyed the firm’s reputation was a regulatory risk. Using the same argument, what tarnished British Petroleum’s reputation recently was an environmental risk.

So What?

What difference does it make if reputation risk is considered a separate risk or not? Risk is risk regardless of what you call it or how you classify it. Isn’t this just a formality and we should look at substance over form? The difference is in the organization’s response to this risk and how it is managed. If the reputational risk is categorized as a risk of itself, management may tend not to integrate it within the Enterprise Risk Management (ERM) or any other risk management framework, but rather treat it
as a public relation issue and assign it to public relations to manage it. If this is the case, one would expect a reactive reaction to risk in the form of damage management.

Although communication with stakeholders is a key to a successful reputational risk management, it should not be the only one. Reputational risk is the responsibility of every one. This applies to an employee posting his/her status and thoughts on social websites to the dealings and behavior of management.

Reputational risk management should be integrated with the organization’s risk management plan.

Key elements of managing reputational risks are:

- Prompt and effective communications with all categories of stockholders.
- Strong and consistent enforcement of controls on governance, business and legal compliance.
- Continuous monitoring of threats to reputation.
- Ensuring ethical practice throughout the supply chain.
- Establishment and continual updating of crises management plan and establishment of a crises management team, empowered with specific power and authority.

A white paper by Deloitte suggests that “Traditional risk management techniques aren’t adequate for countering today’s killer risks, because they focus almost exclusively on risk avoidance and an inside-out perspective on threats.” The paper calls for a new approach it calls “outside-in perspective of threats”. Under this approach, effective management of risks to reputation involves a three-step process of internal discovery, analysis of stakeholder and marketplace threats and opportunities, and proactive management of actions designed to protect and enhance reputation and value.

What is new today is the need for a 360-degree risk overview that effectively incorporates an outside-in risk perspective with inside-out Risk Intelligence.

Deloitte ..

Role of Internal Auditors

An article published in the IIA’s internal auditor magazine in June 2009 provides a comprehensive view on the internal auditors’ role in managing reputational risk:

“Internal auditors have long been involved with reputational risks at companies, monitoring these risks in ongoing audit engagements and in ad hoc consulting activities. With the growing prominence of reputational risks to organizations, internal auditors should ensure their level of
involvement is adequate to assist the organization in dealing with these risks appropriately. Internal auditors can accomplish this level of involvement in several ways:

- Identifying risk champions throughout the organization, whose roles include monitoring and reporting on reputational risks
- Having a place at the table when the committee in charge of risk management in the organization is discussing reputational risks
- Regularly discussing reputational risk as part of the risk universe at an organization
- Being aware of reputational risks and identifying areas that represent threats because they are not being managed correctly
- Ensuring organizations examine reputational risks at the inherent level as well as at the perceived residual level
- Increasing monitoring of social networking websites to track the public mood
- Maintaining awareness of changes to reputational risks; for example, environmental responsibility is a relatively new reputational risk impacting organizations
- Updating and adjusting risk assessments throughout the year as circumstances change

While new reputational risks are continually coming to light, other established reputational risks still exist and are often enhanced. Established reputational risks that may increase due to the economic downturn include fraud, theft, and quality corner cutting. Furthermore, the economic downturn has increased many reputational risks because companies may not be able to recover as quickly from the financial impacts of a misstep.”

**The last Word!**

The reputation of an organization is very important to its success and existence. All risks may have an impact on reputation on a way or another. The reputation risk management is the responsibility of everyone with management having top lead on it. Internal auditors play an important role in ensuring that reputational risks are identified and managed on timely basis.
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