

## Reputation Risks for 2019

### Background: “What is the dilemma for Risk Managers”

Reputation risk is often termed as the ‘risk of risks’ both for countries and for organisations. This is exacerbated by social media and other technologies that enable people to share information and opinions widely and swiftly. Reputation risks are one of the most challenging risks to identify, assess and to protect. This has led to a situation where in many risk registers reputation risks are omitted or hidden as much as possible so as not to show up and having to confront our inability to manage this risk in a structured and sophisticated way.

Reputation turns out to be the risk of risks because it determines the propensity of all stakeholders to productively collaborate with the country or company. Countries need to attract investment, tourists, talent and sell the products of their companies around the world similar to companies who need to be attractive to investors, attract talent, form productive relationships with suppliers and sell their products and services. No person, company or country is an island in this interconnected world where no one can win without the collaboration of others.

Despite the acknowledgement by political leaders and c-suite executive on the importance of reputation for future success and reputation being a core board responsibility, all too often reputation risk management has historically mostly been done ad hoc and without a structured approach. This makes reputation crisis more often than not seem like coming out of the blue and the management of reputation crisis often exacerbates the original damage rather than limit it.

Reputation risks are different to other risks in two fundamental ways. Firstly, reputation risks ultimately cannot be transferred to another actor, such as an insurance company. The reason for this is that it is difficult, if not impossible, to quantify the full effect of a reputation crisis on an organisation or community. While there are insurance companies that offer products to insure for reputational damage, such insurance products would never legitimately claim the full economic fallout from a reputation crisis. As such, reputation remains the responsibility of the leaders of countries and organisations.

Secondly, unlike with most other risks, the way the leaders of a country or company respond to a reputation crisis make a vital difference to the effect that such a crisis has. In some instances, a sophisticated and principled response to a reputation crisis has even led to an enhancement of the reputation.

Everyone who has been in a crisis situation knows how difficult it is to keep a cool head and confidently do the right thing. For this reason, it is critical that we are prepared for reputation crisis management. Such preparation requires a clear identification of the most prominent reputation risks so that we do not waste time and effort on risks that are either very unlikely to happen or those that would have only a minor effect on the overall reputation.

## **Reputation Risk as a Consequence of Other Risks**

A fundamental question that is repeatedly discussed is whether reputation risk and reputation damage is just a consequence of other risks materialising and therefore should be column in the reputation risk register, or whether it is a standalone risk and therefore should be a row in the risk register. The argument in the following will demonstrate that these are actually two distinct types of risks that are identified in different ways but both belong to a holistic reputation risk management approach.

It should be self-evident, that any risk - for example a breach in food safety that leaves customers harmed – would have also reputational consequences. As such it should be clear that it is worthwhile to assess the reputational dimension of each risk in a risk register. In such cases it is clear that such reputation risks are the consequence of another risk and that once such a risk materialises as a consequence thereof would also be reputational repercussions.

That reputation can be an aspect of other risks means never-the-less that it is important to understand what the severity of the reputational damage is likely to be, as how this aspect of the risk is managed is critical. Firstly, one should not waste time, effort and money on managing the reputational effect of a risk event if it likely to be negligible in the first instance. Secondly, if the reputational effect is likely to be large, managing the reputational fall-out can make the difference between it developing on the downside into an issue that can threaten the future of a country or company and on the upside, if well managed, can lead to a significantly improved reputation. For such an effort to succeed it is critical that such reputational risks are identified and prepared for, as it is very difficult and unlikely that crisis are handled well when they come as a complete surprise.

## **Reputation Risk as a Standalone Risk**

Reputation risk as a standalone risk can be identified by pinpointing aspects of the country or company where there are unrealistically high expectations from external stakeholders that are unlikely to be fulfilled in the short or long term. If such a perception gap persists it becomes highly likely that at some stage this is exposed. An example for this kind of reputation risk was the issue of 'state capture', as analysed below by the beginning of 2017.

Reputation risks that stem from misperceptions typically materialise as some stage. They either materialise gradually over time or materialise in a cataclysmic instance. It would be easy to interpret such a cataclysmic instance as the consequence of another event, but this misses the point as in all likelihood this event would not have had such a significant effect if it was not understood as a potential or actual symptom of a deeper misperception about an attribute or aspect of a country or organisation.

The likelihood of a stand-alone reputation risk to materialise depends on the degree of this misperception gap. If this misperception gap is big enough, meaning if there are vastly exaggerated perceptions and expectations that simply cannot be fulfilled, the likelihood of this risk materialising becomes very high and almost predictive.

In such cases, even relatively small events that vaguely point to this misperception gap will be picked up and have vast reputational effects. It would be a mistake to singularly blame such an event for the reputational damage caused.

The very public demise of Bell-Pottinger was such an instance. That a PR company misleads the public is in itself not headline making news and its activities to sugar-coat state capture and sow racial divisions would normally at best be a local issue. What caused it to be global headline making news was the context that it showed that the South African government did not deserve the halo of ethical leadership that still lingered from the Mandela years. Also, it would be flawed to blame Bell-Pottinger's activities for the decline in South Africa's reputation in 2017. Rather, this and other companies made the headlines because it came as a surprise to the international community that there was such widespread corruption at the highest levels of government in South Africa.

### **Identifying and Assessing Reputation Risk**

While there is broad acknowledgement of the importance of reputation for countries and companies, risk managers typically struggle to integrate reputation into their established risk management processes. The main reason for this is, that historically there has been a shortage of credible methodologies to identify and assess reputation risks.

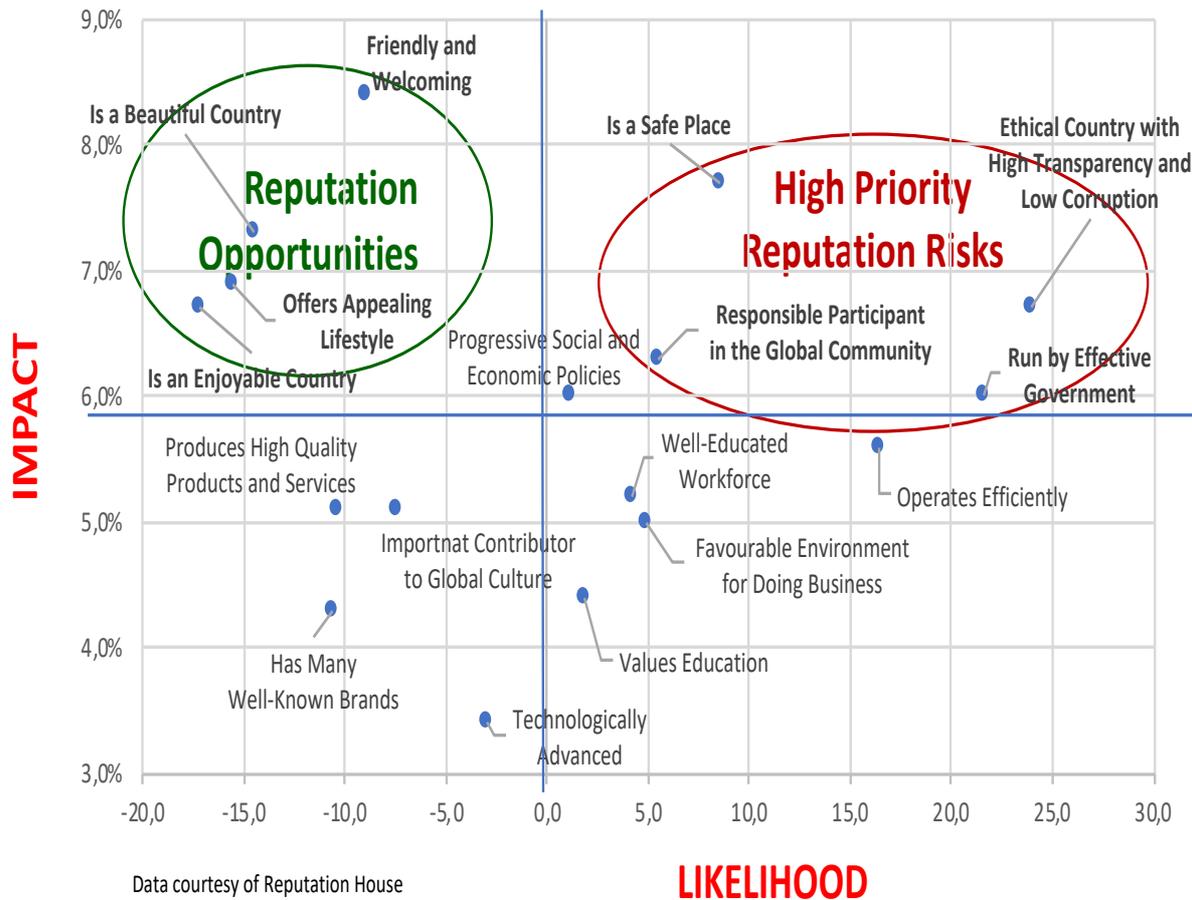
Reputation risk means the possibility of a decrease in the current reputation. This could happen through a particular event, such as was the case in the Greek debt crisis. It can also be the adjustment of the reputation over time of previously exaggerated expectations that just did not hold up to scrutiny and therefore perceptions were adjusted. It can be assumed that much of the reputational loss of the United States in recent years was not so much just the doing of Donald Trump alone. During the Obama years, the United States projected an image of itself that was hiding much of the racism, bigotry and provincial mindset that characterises many sectors of American society. In this sense, Obama created a reputation risk by projecting the US in a way that could in some aspects not hold up to closer scrutiny.

To identify reputation risks, a number of avenues need to be pursued. To assess the reputational effect of an event it is advisable to look at the existing risks of a country (or company) and then determine whether the resultant change in reputation would be big or small. From a recent analysis it can be deduced, that the unrest in South Africa in relation to student fees will have a relatively small effect on South Africa's reputation overseas as issues related to education do not feature prominently as an influence on South Africa's overall reputation. On the other hand, a major safety incident would have a much higher effect on South Africa's overall reputation, even though this effect would be tempered by the fact that South Africa is already perceived as not being safe and therefore to some degree a prominent safety incident would to some degree just confirm existing perceptions rather than change them.

The second avenue of determining reputation risks is to assess the gap between internal and external perceptions. If external perceptions and expectations exceed internal perceptions about aspects of a country or company, there is likely to be an adjustment over time.

Of course, the prioritisation of a reputation risk would also depend on the impact it would have on the overall reputation. The impact can be calculated through sophisticated mathematical modelling, the explanation of which would go beyond the scope of this article.

Below is a matrix that shows the reputation risk areas that were determined after extensive data collection and running advanced mathematical models to calculate the likely impact these areas of reputation risk would have.



The data for the above chart was collected in the earlier part of 2017. It shows that ‘state capture’, which is encapsulated here under the attribute of “Ethical Country with High Transparency and Low Corruption” was identified as the most prominent risk to South Africa’s reputation. A factor analysis has determined that this attribute has a relatively high effect on influencing overall outside reputation and it is the attribute where the difference between the perception outside and the estimation inside the country was highest. This leads to a high likelihood that a reputation crisis will emerge in due course.

The analysis was widely shared by the middle of 2017. Of course, it would have been unrealistic to expect the president of the country to take steps to mitigate this risk as he was a key player in causing this risk and a key beneficiary of state capture.

We know from data on South Africa published by ReputationHouse in 2018 collected among the global community, that the effect of the revelations of 2017 on state capture led to a decrease in South Africa's reputation. This decrease is particularly significant, given the experience that country reputations tend change very little over time. From this we can deduce that the cost of state capture to South Africa's political standing and economy in terms of lost investment and trade is presumably far bigger than just the money directly extracted from public institutions and state-owned corporations.

Where to with South Africa's reputation now? The fact that South Africa's reputation is now very low means also that there are not many reputation risks left. Of course, the way we deal with cleaning up the mess from state capture and wide-spread corruption way beyond the cases that make the headlines will be critical. For example, the very public murder case of Oscar Pistorius earlier this decade lead to an increase in South Africa's reputation as it allowed South Africa to showcase some very well working aspects of its legal system. Similarly, if South Africa uses state capture and corruption as an opportunity to showcase innovative ways to bring integrity and justice to the country, such as happened during the days of the Truth and Reconciliation Commission, once again a negative event can be turned into an opportunity to build South Africa's reputation.

Further to this, there is ample opportunity to build the reputation of South Africa on very solid ground by promoting South Africa and a beautiful and enjoyable country with lots friendly and welcoming people in it. Research shows that this would be a sustainable and robust avenue to build South Africa's reputation as this is what they will actually find to be true when getting to know South Africa better.

To build a reputation sustainably will only be achieved in a sustainable way it is built from the inside out. In other words, a country or organisation that wants to achieve a better reputation needs to chiefly put its efforts into first becoming the kind of country or organisation it wants to be perceived as. For South Africa the issue of safety and security stands out. If South Africa manages to become a safer country it will put South Africa on the path to a better reputation for a long time to come.

## **Conclusions**

Many risk managers find it disconcerting that reputation risk cannot be quantified and transferred as this is the typical game of risk managers. Understandably many managers' primary game is rather to transfer risks than to take full responsibility for them and manage them day in and day out. In this case, however, taking full responsibility for identifying, assessing, mitigating and responding to reputation risk is the only option.

To fulfil this responsibility, it is not necessary to have quantitative measures on the precise effect of a reputation crisis. It is however necessary to have tools that allow managers to prioritise reputation risks in such a way that they handle them in an appropriate way and make appropriate decisions in managing the reputation of a country or company.

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