

Reputation risk: Can it be managed?

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Abstract

Reputation risk is often seen as one of the more difficult risk types, which cannot yet be quantified. Therefore it is paid less attention to as to other risks.

However, if the effects are taken into account, the risk should not be underestimated. The reputation risk is mostly a secondary risk, which is triggered by primary risks (like operational risk). In order to quantify those primary risks properly, the reputational loss should be considered as well.

After the discussion of some interesting examples the factors determining the reputational risk are taken into account. The last part of this article gives an overview of the management of reputation risks.

Introduction

Reputation risk is a secondary risk, which is triggered by other risks. In most cases an operational risk is such a risk. The full range of operational risks can be taken into account. Swaran Sandhu (2007) distinguishes between material and immaterial reputation risks. In the area of material reputation risks the sensitive area is any affection of people's health. It may be remembered, that e.g. Bayer had to abandon the medicine Lipobay from the market after some

patients died after using this medicine. The USA-market was immediately blocked. The other medicines of Bayer were in focus. The main problem, however, is the risk to be scrutinised during the coming approval processes for new medicines. Except for the death of people, which was by far the most serious impact, the turnover of Bayer pharmaceuticals dropped significantly. Finally the managing board of Bayer decided to withdraw from the pharmaceutical industry and sold the division which is now operating under the name Lanxess.

The same is true for Merck, which lost about one third of the turnover after withdrawing one medicine of the US-market.

The financial sector also saw an interesting reputation risk case. UBS decided to stop the financial support of Swissair, immediately causing the bankruptcy of the Swiss airline. A considerable amount of retail customers did not accept the bank's treatment of the national airline and cancelled their relationship with UBS. They mostly went to the so called Kantonalbanken.

Reputation risk can also be of immaterial nature. In such cases the company is associated with corruption, bribery, but also with issues like accounting fraud or neglectance of corporate

governance rules can be taken into account. Lately WestLB was in the press after suffering a high double digit loss caused by deliberate mismarking. It was argued, that even information was syphoned in the market, which allowed market participants to speculate against the position of WestLB. Finally the bank suffered a three-digit-million loss. The chairman of the board and the chief risk officer were dismissed by the supervisory board, since the supervisory board was not fully informed in time.

Summarizing, it can be said, that reputational risk can cause a second wave of losses after the losses as direct consequence of the primary risk. In some cases the loss caused by reputation risk is even higher, since the turnover is missing in all subsequent years as well. The net present value of such losses should be considered.

In this article the elements influencing reputation risk are considered. The management of reputation risk is discussed as well.

Factors influencing reputation risk

The **attitude of stakeholders** towards companies changed over time. Nowadays companies are more seen as "corporate citizens" which behaviour is checked for conformity. A famous example was the public reaction on the disposal of the Brent Spar by Shell. The public started boycotting Shell by purchasing fuel by other companies. Some extreme groups even demolished some fuel statements.

The problem did not stay in just one territorial area, but swapped over to other countries as well. Since the media are now organised globally and internet is also emerged as a separate distribution channel, it only takes minutes to publish reputation damaging information around the globe. **Globalisation** in such cases is to be seen as a risk factor.

Social stakeholders also organised themselves in order to give the voices more impact. Attac is a well known organisation with clear ideas regarding cultural values. However, some violent groups attach themselves to demonstrations causing problems.

Trust in politicians and in board members is reducing and therefore some issues may be discussed in sharper words than before. Companies sometimes have problems regarding the top manager's salaries, which are seen as far too high. In Germany especially the pay-offs after the takeover of D2 by Vodafone were prosecuted.

People are currently more and more using the **internet** in forums, films (YouTube), etc. These films are easily distributed and may contain content, which can be damaging for the companies reputation. However, it is almost impossible to screen the internet for such material.

Reputation risk management

The management of reputation risk is normally handled by managing the primary risks.

However, as soon as such a risk becomes manifest, companies should have a damage control plan. It is all about the communication to stakeholders and giving transparency regarding the risk event. The better the market is informed about the risk and the taken actions the less reputational damage is to be feared. However, many managers hope to get the curve in time, but crash against the reputation risk wall, since the public deems itself not completely informed. The trust relationship with the stakeholders is then damaged.

Literature

Swaran, Sandu, Management von Reputationsrisiken bei Konsumgüterherstellern, in Wettbewerbsvorteil Risikomanagement, Erfolgreiche Steuerung der Strategie-, Reputations- und operationellen Risiken, Erich Schmidt Verlag, Berlin, 2007

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