Unbiased Stakeholder Intelligence Improves Reputation Risk Management and Governance

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IN THE PAST SIX MONTHS, more than $130 billion in shareholder value was lost by 39 banks due to reputational risk—the risk of unmet stakeholder expectations resulting in incinerated business value. Why? Because they were collectively punished when at least a few proved to lack effective processes for capturing and interpreting stakeholder-centric risk intelligence for risk management and governance.

Enterprise risk professionals recognize that it is vital to understand the expectations of stakeholders, which is only possible via the reporting of knowledgeable staff who have their fingers on the pulses of those stakeholders. These critical reporting processes are vulnerable to human frailties, such as the biases of senior management. Indeed, 80 percent of the 560 chief financial officers surveyed by North Carolina State University and AICPA in 2022 on enterprise risk management saw no strategic advantage in their companies' risk management processes, which means that flawed execution is undermining risk management's contribution to enterprise resilience.

There is a path to mitigate human capital systemic bias, ensuring more reliable enterprise intelligence for the purposes of reputation risk management. This path is built around three core actions:

1. Establishing a reliable, repeatable process. Process drives information flows and a stable process ensures no idiosyncratic bias.
2. Ensuring that those managing the process represent a variety of backgrounds (i.e., as they pertain to gender, race, experience, and culture). Diversity of backgrounds and diversity of personality types mitigate systemic bias.
3. Institutionalizing the processes managed by individuals with diverse backgrounds and personality types by executing the intelligence gathering and processing on a regular schedule and meeting the needs of enterprise risk management, risk communications, and risk governance.

Reputation Risk Management and Governance Are Mission-Critical

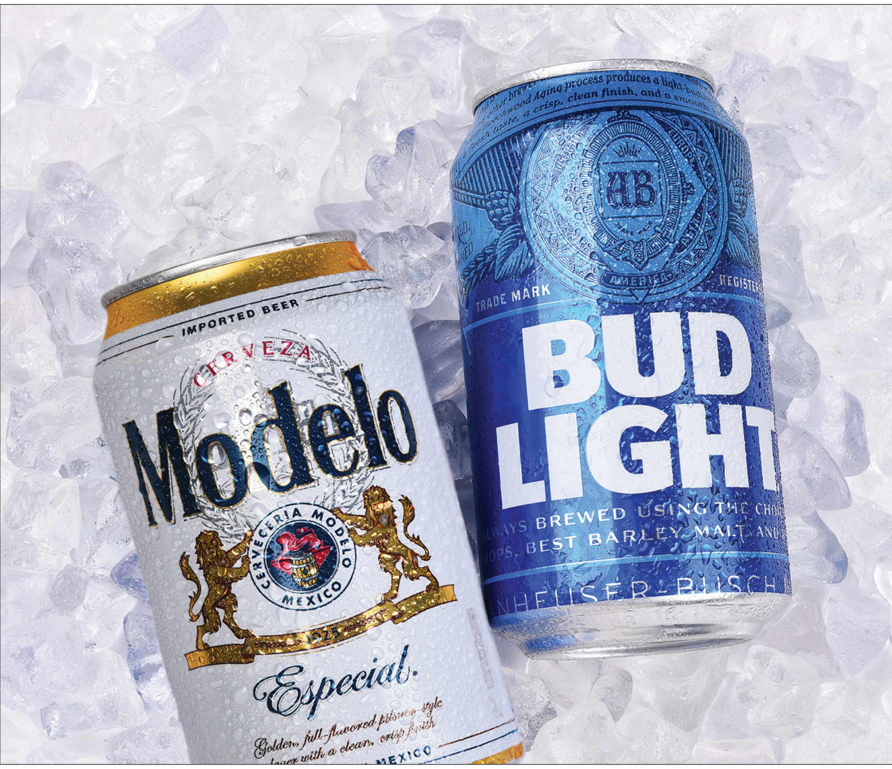
Corporate reputation—the expectations of the corporation by its stakeholders—stimulates either value-creating or value-destroying behaviors. Customers buy or boycott, employees work or flee, investors buy or sell, lenders adjust interest rates, regulators enforce or defer, and social license holders acquiesce or protest.

A run on a bank is a perfect example of a reputation crisis. A bank run occurs when depositors, for any reason, no longer expect that their bank will continue to be a safe place for their assets. An example of an event-triggered reputation crisis is the $2.2 billion net-equity loss by Southwest Airlines: 235 days after its week-long December 2022 meltdown due to overwhelmed scheduling software, the airline's equity return was underperforming the Dow Jones US Airline Index by 24 percent. A prime example of the new age of reputation crisis linked to environmental, social, and governance issues is Bud Light's monumental loss of America's top beer sales spot this year to Modelo following a marketing campaign that involved a transgender influencer and Anheuser-Busch's subsequent backtracking on the campaign.

Bank runs triggered by social media panic, widespread customer anger from software failures, and advertising campaigns that go wrong are not new risks. Because reputation value loss does not always follow an adverse event, nor does it always require an antecedent adverse event, reputation risk management and governance are best recognized as a distinct task, integrated with other enterprise risk controls.

But today the stakes are far higher—many risks that were once delimited can surge if unmitigated, because reputation risk management is blindsided by yesterday's ineffective risk intelligence processes. This surge effect is a potential board liability because corporate reputation is an asset and protecting its value is a board duty.

It can also put boards and their individual members at personal reputational risk. Proxy campaigns are becoming personal.



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Activists abound. Business judgment, a reliable defense, is limited to specific claims in a court of law. It offers no solace in the court of public opinion, as many public and private companies can, unfortunately, now attest.

Consider the following what-if scenarios:

- If Silicon Valley Bank had an effective reputation risk management process in place, could it have responded earlier to signals that stakeholders were getting worried and avoided a collapse?
- If Southwest Airlines had an effective risk management process that highlighted the potential enterprise costs of a travel debacle during peak demand, could the billions in equity lost; the legal costs of loss and harm, securities litigation, and derivative litigation; and the loss of business to its competitors have been avoided?
- If Anheuser-Busch had reputation risk executives working in tandem with marketing executives, could Bud Light have retained its position as America's top-selling beer for a 23rd straight year?

Solutions

Because the answer to all of the above questions is yes, it is critical to pair enterprise risk management systems and insurances with human capital systemic bias minimization.

The state of the art in enterprise risk management, reputation risk management, and governance comprises two activities, enabled today through the rigors of measurement made possible by big data and artificial intelligence:

1. Predicting surges in potential reputation value loss, usually heralded by observable shifts in stakeholder expectations.
2. Preventing shifts in expectations by either conforming corporate behaviors to stakeholder expectations or managing stakeholder expectations to align with operational realities.

Adding reputation insurance promotes and authenticates the quality and effectiveness of corporate prediction and prevention efforts so that stakeholders can appreciate and value them.

Notwithstanding the visibility afforded by technology, the highest-resolution visibility into the stakeholder expectations and issues most likely to precipitate shifts in expectations depends on quality human intelligence. Reliable enterprise intelligence depends on human capital free of systemic bias.

The most easily implemented human capital systemic bias minimization action a board or company can do is to incorporate into any group that is performing significant strategic or risk management functions a variety of personalities. D

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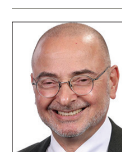

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