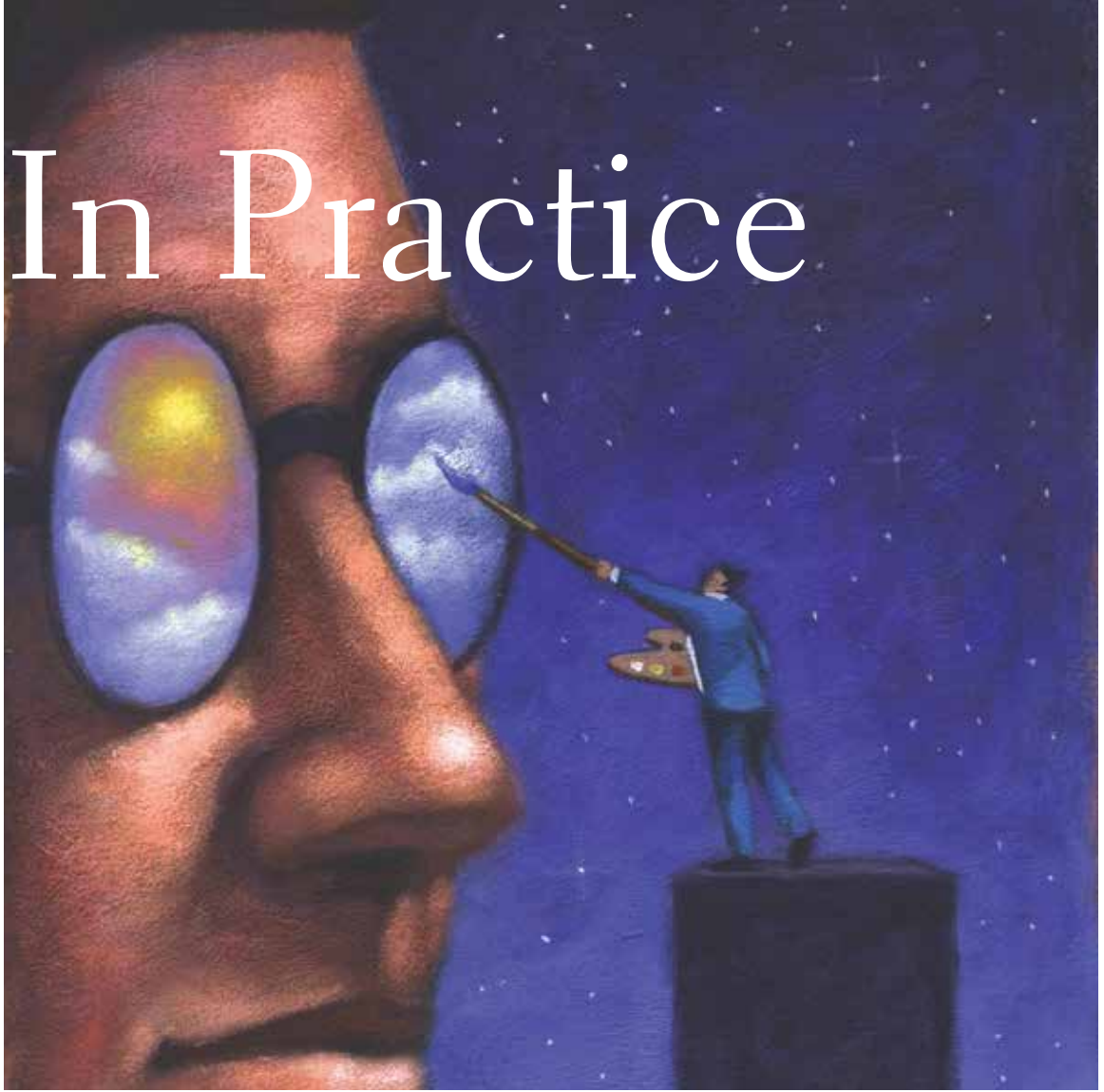


In Practice



Seeing Opportunity in Reputation Risk

Lessons from human trafficking, the Boy Scouts, and education.

By Jeff Hoffman and Andrea Bonime-Blanc

How Johnson & Johnson (J&J) responded to the 1982 Tylenol crisis remains unrivaled as the case study on managing reputation in the aftermath of unthinkable tragedy. As some readers may recall, J&J recalled 31 million bottles of Extra-Strength Tylenol after the deaths of at least seven people in the Chicago area were linked to cyanide-laced caplets purchased in local drugstores. While no arrests were ever made in the case, investigators believe that bottles of Tylenol were bought, opened, caplets laced with cyanide, and then returned to store shelves to be purchased by unsuspecting consumers. While some analysts at the time predicted that J&J and the Tylenol brand would never recover, the company did such a masterful job of managing the crisis that it realized both positive intangible benefits (reputational opportunity) and tangible (financial upside) results. The crisis turned into an “enhancement event” when J&J was able to

demonstrate through its proactive warnings to consumers to toss or return purchased Tylenol products and its subsequent product recall that it took corporate responsibility (CR) for its customers’ health and safety very seriously. Tamper-resistant product packaging was among the outcomes.

The business world learned valuable lessons from J&J, namely that hits to reputation can be mitigated by preparation and that there is considerable equity in brands. A crisis can result in negative tangible and intangible consequences, but handled well, it can lead to a reputation opportunity or a reputation-enhancing event.

There is no longer any doubt that reputation is a strategic risk that will only increase in importance and vulnerability in the age of hyper-transparency and super-connectivity. Recognized sources—from respected authors and experts, Big Four accounting firms, and insurance company surveys of C-suites

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and boards—have identified reputation as frequently among the top five most significant strategic risks to boards and executives.

Reputation risk in the organizational context is not isolated to a sudden, stand-alone event that creates unexpected material damage (e.g., a cyber breach, unlawful acts by a rogue employee, or violations of laws such as the Foreign Corrupt Practices Act by a manager playing by his own rules). Rather, the board should consider whether the organization has invested sufficient time and resources to understand and prepare for the potential known and unknowable reputation risks it may face.

When the inevitable crisis occurs, the unprepared, negligent, or even reckless organization is likely to suffer an “amplification event,” which causes greater financial and reputational damage. Remember the lesson of Watergate: It was not only the crime but the cover-up that led to greater harm and the subsequent resignation of President Richard M. Nixon.

How does corporate responsibility play in the realm of reputation risk? *The Reputation Risk Handbook* (Greenleaf Publishing, 2014) provides the following definition: “Reputation risk is an amplifier risk that layers on or attaches to other risks—especially ESG risks—adding negative or positive implications to the materiality, duration, or expansion of the other risks on the affected organization, person, product or service.”

When this definition is applied to corporate responsibility (CR) or environmental, social, and governance (ESG) risks, it becomes clear that the organization that has not properly identified or managed risks has an additional layer of reputation risk to worry about. Meanwhile, those paying proper attention to CR and ESG-related risks may recognize reputation-enhancing opportunities. Let us turn to some real-world examples.

Human trafficking and the hospitality industry. According to the International Labour Organization (ILO), the acquisition of people by improper means such as force, fraud, or deception with the aim of exploiting them is the world’s fastest-growing crime. Human trafficking is the third-largest illicit moneymaking venture in the world, after drug dealing and the arms trade. More than 35 million people worldwide are estimated to have been trafficked into slavery for prostitution, domestic servitude, agricultural labor, and other jobs. According to a 2008 ILO report, human trafficking is a \$32 billion a year industry.

Hotels are identified as high-risk entities because they can be settings for human trafficking and sexual exploitation. Social media users raised public awareness of this scourge, and have been successful in pressuring the hospitality industry to respond. While it might have been easy to look the other way, the industry recognized that doing so was an even bigger risk to reputation.

There have been many headlines about trafficking, but these three reports illustrate the range of possible risks:

- *The Telegraph* in June reported that the Hilton Hotel in the Chinese city of Chongqing closed over an alleged brothel operating in the basement.

- A report by the CNN Freedom Project spurred a Change.org petition that resulted in Wyndham Worldwide’s agreement in 2011 to sign the Tourism Child Protection Code of Conduct to prevent child sex trafficking.

- In advance of the World Cup, the Interfaith Center of Corporate Responsibility’s 2012–2013 annual report pressed more than 300 institutional investors and members of the faith-based community to publicly ask hotels what they do to deter trafficking.

According to the nonprofit organization Businesses Ending Slavery and Trafficking, human trafficking at hotels brings safety risks to guests and staff, as trafficking is often connected to violent assaults by gangs that can put everyone present in jeopardy. Perhaps nothing lands a bigger blow to a property’s reputation than flashing police lights, news helicopters overhead, and any publicity associated with trafficking. Hits to reputation are quickly followed by financial risks resulting from reservation cancellations and fewer bookings. Additional costs can come in the form of legal fees and property damage associated with trafficking activity. Various state and municipal laws could hold hoteliers liable, at least in part, for any trafficking that occurs in their hotels.

What was a reputation risk has now turned into a reputation

Reputational Hits and Consequences

Reputational Hit Type	Description	Example
Deadly blow	Organization, product, service, and/or leader disappears	Enron, Lehman Bros., News of the World
Recoverable hit	Organization, product, service, and/or leader regroups and recovers	Siemens, BP
Enhancement event	Organization, product, service, and/or leader is prepared in advance and builds reputational equity over time	Johnson & Johnson

Source: *The Reputation Risk Handbook* (Greenleaf Publishing, 2014)

Sample ESG Issues

Environmental

- Climate change
- Sustainability
- Environmental laws and regulations

Social

- Human rights
- Labor rights
- Child labor
- Health and safety
- Discrimination, harassment, and bullying

Governance

- Anticorruption
- Anti-money laundering
- Antifraud
- Regulatory compliance
- Conflicts of interest
- Corporate governance

Source: GEC Risk Advisory

opportunity for the hospitality industry as solutions are being developed to combat trafficking. Today, the hospitality industry is a leader in the global fight against modern-day slavery. It has worked to raise awareness of the issues with both employees and guests. Procedures and zero-tolerance policies have been established and included in training programs so that the housekeeping, front desk, and other hotel staff are better able to identify possible trafficking, know how to respond, and understand how to work with law enforcement during an investigation.

Much of the hospitality industry's efforts and success have been in collaboration with the Global Business Coalition Against Human Trafficking and through the International Tourism Partnership's Human Trafficking Working Group. Their efforts are also working to meet the call of Target 8.7 of the United Nations' Sustainable Development Goals (SDGs), which calls on governments to "take immediate and effective action to eradicate forced labor, end modern slavery, and human trafficking."

Corporate philanthropy. Corporate giving usually elicits a positive reaction from both inside and outside a company. Over the years, corporate philanthropic efforts have evolved to become more strategic, and are now an important component of companies' socially responsible strategies. Providing support to certain issues and specific organizations, however, can cause polarizing emotional responses, even when there are solid business reasons for such contributions.

The attention surrounding corporate contributions to the Clinton Foundation that emerged during the 2016 presidential campaign was particularly timely. The election resurfaced concerns that during Hillary Clinton's tenure as secretary of state, corporations made contributions through the Clinton Global Initiative (CGI), an initiative of the Clinton Foundation that convenes global leaders to create and implement solutions to global challenges. The primary concern was the perception that such corporate contributions would lead to favorable treatment by the State Department or diplomatic connections. In response to this criticism, the Clinton Foundation made significant

governance and structural changes that included no longer accepting donations from corporations or foreign governments.

While most companies made contributions in good faith toward important social programs, their names (including UBS, Boeing Co., General Electric Co., and Wal-Mart Stores) were dragged into the debate. This is a prime example of a philanthropic contribution backfiring because of reputation risk contagion.

Boy Scouts of America and corporate philanthropy. Few images conjure the idyllic American heartland like the flying flag, apple pie, and Boy Scouts earning their badges. Companies have supported this organization for decades both nationally and at the local level through councils and troops. Donating to the Boy Scouts of America (BSA) was a safe, noncontroversial action for much of its century-long history. Starting around 35 years ago, however, society began to become more inclusive of the Lesbian, Gay, Bisexual, Transgender, and Questioning (LGBTQ) community—yet not all were in lockstep with this evolution, including the BSA.

In 1980, an Eagle Scout named Timothy Curran was barred from scouting by a local council after Curran attended his prom with a male date and shared his story with *The Oakland Tribune*. In a separate case 20 years later, the U.S. Supreme Court ruled in *Boy Scouts of America v. Dale* that the BSA had the right to discriminate based on sexual orientation. Yet two years later, in 2002, sexual orientation protections appeared in 61 percent of Fortune 500 companies' nondiscrimination policies.

Fast forward to 2013. After pressure on both sides of the issue from companies, governments, nonprofit organizations, communities of faith, and individuals, the Boy Scouts lifted its ban on openly gay scouts, though there continued to be a prohibition within the organization of openly gay scout leaders and Boy Scouts' employees. In 2015, the Boy Scouts' governing body lifted the ban on gay leaders as well.

The reputation of the Boy Scouts likely suffered more between 2013 and 2015 than at any other time, as one side didn't think the organization's policies had changed enough while the other side

wanted no change at all. Shifts in cultural norms made navigating the wide spectrum of opinions during the evolution of the Boy Scouts' policies a minefield of potential risks to companies that chose to support the organization philanthropically. Alienating customers could have bottom-line implications. Yet another layer of complication to the BSA's story was the differences in personal beliefs about social issues that exist regionally within the United States. With the national ban lifted, corporate funding spigots have begun to turn back on for the Scouts. Some individual councils and troops are still allowed to discriminate, preventing some companies from supporting them, but this too is likely to change with time. A new chapter in the organization's storied history began in January when the BSA announced that it will no longer require review of birth certificates as a part of a scout's application, a move that would open

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scouting to transgender boys. Time will tell how this plays out for corporate giving.

Supporting education—controversial? Ensuring a strong education system is important for business because it is critical that they have a job-ready workforce and future customers with the wherewithal to purchase their goods and services. However, American society struggles to agree on the means to that end.

School reform has many connotations for a broad range of stakeholders. Teachers' unions, charter schools, testing, and standards such as Common Core are all topics that elicit varying and impassioned responses. How, then, should corporations approach funding education initiatives while safeguarding their reputations?


Foundations are one way for corporations to support controversial initiatives. Corporations have to be concerned about the real risks of alienating customers, employees, and shareholders. Giving to foundations allows their administrators to grant the money, one step removed from the corporation. In addition to philanthropists, corporate executives in human resources and government relations are joining the conversation. Reputational risk needs to be balanced with other strategic risks in evaluating how best to affect the education system.

When looking at this issue through the board lens, education reform is about future economic viability, and specifically about having an adequately trained workforce and consumers with sufficient income to support industry. Companies are at risk of harming their reputation by associating with organizations or movements that could be construed as interfering with families' most precious and important asset—their children.

Owning Reputation Risk

ESG and CR are frequently not on boards' radar. When they are, there is rarely sufficient time allocated to their discussion. There are reputation risks and value creation opportunities that can be found beyond what is normally discussed at board meetings. Unfortunately, many ESG and CR risks are unknown to the board until an incident happens and it goes public—and possibly viral. The risks around ESG and CR are generally easy to identify, mitigate, and plan around. While being prepared for the worst-case scenario may take time and effort, it will be far less painful than the alternative: negative headlines and conversations on social media.

One question companies should ask is: Who owns reputation risk? The answer is everyone who works for the company, from the most recent factory hire to the longest-tenured board member. A decision made at a fairly low level in a company, or an issue that is ignored by a middle manager, can blow up quickly. With proper training, a culture can be fostered that empowers all employees to elevate concerns without fear of retaliation. It can be as easy as getting employees to understand cause and effect. For the board, first understanding potential risks is critical. Then the board should ensure that management has the proper processes in place to identify, mitigate, and handle these risks.

Whatever the cause of a reputational hit, boards are liable to be held accountable and can mitigate their own reputation risk by diligently asking the right questions about the company's ESG and CR strategies, practices, risk management, crisis preparedness, and the potential reputation-enhancement opportunities embedded in successfully managing such risks. 

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