

## **Reputational Risk and Integrity**

Integrity and reputation are closely correlated. Someone with high integrity is usually someone perceived as having a very good reputation. Similarly, organizations who aim to keep high integrity are considered organizations with good reputation. It is in the interest of individuals and organizations to keep such a high moral and professional standing since it could bring them a lot of benefits such as credibility, trustworthiness and loyalty besides the fact that integrity is a value in itself worth pursuing.

However, recent surveys show that trust in the integrity of business leaders has been dramatically eroded over the last couple of years. The age-old respect for leaders in business or public life has been tainted and their reputation has nosedived. In the wake of the numerous recent corporate and organizational scandals in the corporate world in general, politicians and lawmakers are demanding more stringent reporting and control mechanisms in an attempt to restore the reputation of the corporate world.

Institutions in the developing world where most corruption is perceived to take place do suffer from a similar fate of bad reputation because of poor perceived integrity and governance (compliance oriented).

Bad corporate reputation hurts. How to turn the situation around?

### ***1. Organizational anti-corruption reform:***

#### ***Reputational Risk Management & Good Corporate Governance***

### **Reputation**

The complexity of today's business world requires executives and managers to make responsible decisions which benefit the corporation in a socio-economic sense. People are expecting solid financial results from business, yet they are also expecting that attaining these healthy financial returns can only be through fair play and socially responsible conduct. Hence, creating a good

reputation is about creating certain 'soft' capital and generating value for the firm. 'Green' corporations for instance are committed to socially responsible behavior regarding the environment for instance which not only benefits its social reputation but also positively affects its financial long term strength. Its socio-economic reputation is built by demonstrating integrity as in the commitment to socio-economic & environmental values and principles, beyond targeted PR and tactic motives. Integrity creates 'goodwill' and ultimately enhances the reputation of the organization. When an organization can convince its key constituencies that its products and services not only match but exceed those increasingly more demanding socio-economic expectations, the organization has created reputational capital which will enhance its financial performance.

Indeed, firms 'creatively' gain sustainable competitive advantage by cultivating intangible assets such as reputation. A positive reputation is like a healthy immune system or having a comprehensive insurance in case of crisis. The risks to reputation – both threats and opportunities – arise from some main drivers behind the reputation:

- corporate governance and leadership,
- financial performance & long term investment value,
- regulatory compliance,
- meeting customer expectations and needs,
- workplace talent and culture,
- corporate social responsibility and
- communications & crisis management.

By systematically identifying these risks to reputation and nurturing the relationships with its key constituencies or critical stakeholders, organizations can safeguard and even enhance their reputation. In a way, continuous *reputational risk management* should be integrated and embedded into everyday decision-making, strategy development and the organization's policies, processes and procedures. Ultimately, it is the board's role in establishing such organization's vision, values, organizational culture and strategy that will determine the appropriate framework for managing risks and setting tolerance boundaries. If a board does not ensure that significant risks to the organization are identified and controlled so that exposures are acceptable and opportunities exploited, they are failing in their primary fiduciary duty to investors and stakeholders. Despite the superior 'green' quality of Australian farming products, the board of AWB for instance now unfortunately faces the charge of not fully safeguarding its reputation. The prudent and supervisory role of Australian organizational boards and its independent member(s) – as the "conscience" of the organization ensuring some (internal) accountability – cannot be overstated.

A clear set of values and principles that are consistently translated in corporate strategies and communicated by competent top managers may prevent damaging scandals. Although values and principles in themselves do not guarantee superior financial performances, the board and its CEO may hopefully not only create some competitive edge appealing to some intrinsic ethical values as in 'good reputation' in this increasingly scrutinized and transparent business world, but they may have created themselves an important and useful 'insurance policy' for the shareholders in the process.

Let us focus on one of those critical drivers behind a good reputation:

## **Governance**

Corporate governance is a set of mechanism through which firms operate when ownership is separated from management. The objective of a good corporate governance framework would be to maximize the contribution of firms to the overall economy, which includes all stakeholders.

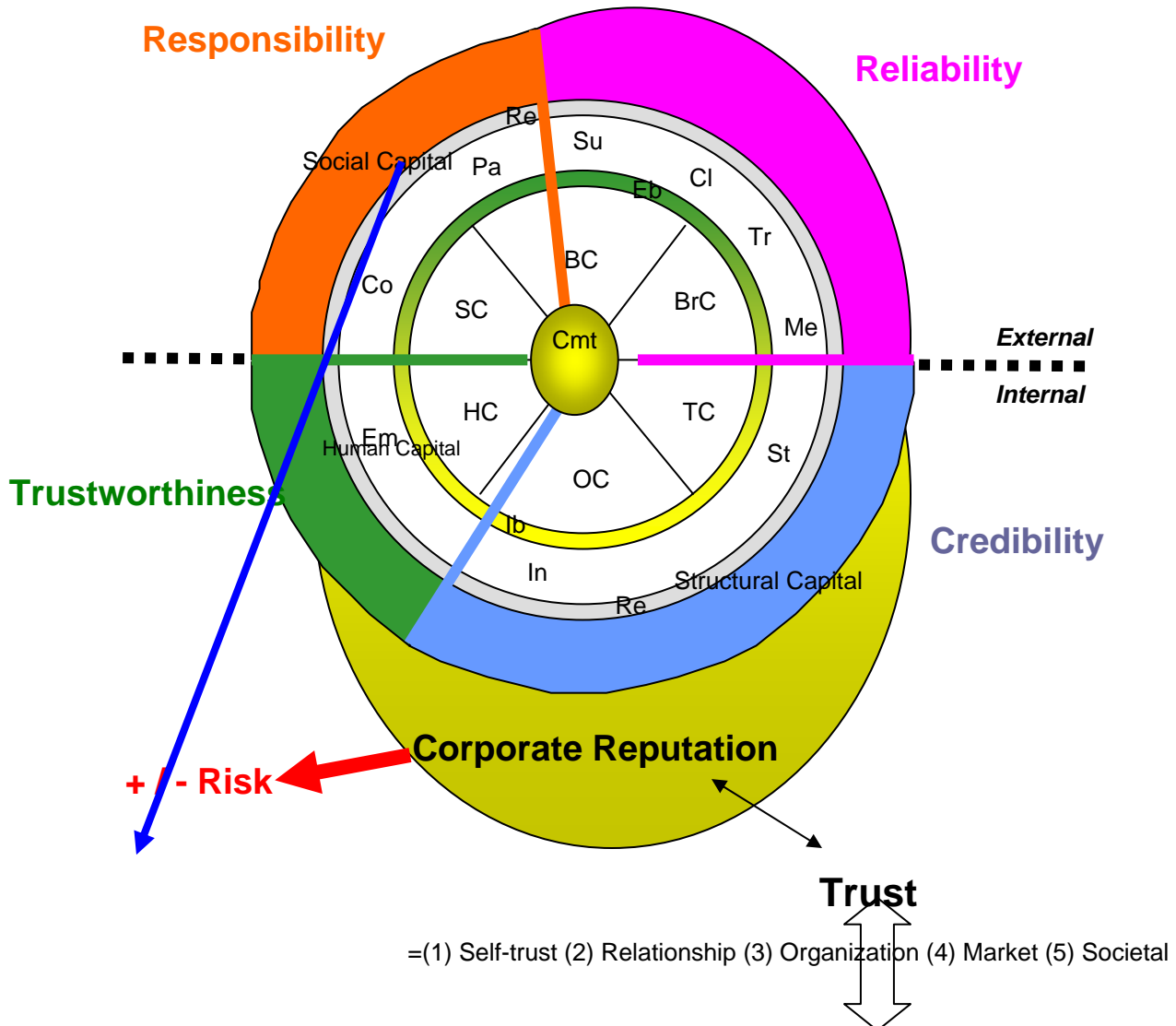
Good Corporate Governance usually aims to complying with strict corporate legal procedures and law, focusing on the responsibility of governing the organizations through Risk & Strategic Management, Appropriate Remuneration and Succession Planning and Internal & External Auditing (Check & Balances). The implementation of codes of conduct, strict procurement procedures, having an overall vision in place expressing the principles and values are all important elements contributing to improving governance.

However, as result of changing and shifting values in the broader business environment, corporate governance (is forced to) extend its range of influence through monitoring not just the traditional relationship between managers and owners of an organization, but now also emphasizes the importance of relationship risk with other critical stakeholders who could affect the reputation of an organization. Hence, it becomes obvious not only to comply with the letter and the spirit of the law, organizational rules and codes, regulatory regulations but also to acknowledge the importance to build relationships with critical customers, suppliers, regulatory institutions and community at large.

If ethical values and strictly implemented rules and regulations are part of an organizational culture, chances are that activities undermining reputation may decrease over time.

# Hypothesis & Proposed Framework for Organizations

Based on VERHEZEN, Peter, "Reputational Risk & Integrity", Working Paper Melbourne University, October 2006



- Integrity** = virtue & principle oriented / ETHICS
- Compliance** = obligation & duty oriented / LEGAL
- Competence** = result oriented professionalism / ORGANIZATIONAL & Market SKILLS

So far the supply side in the possible corruption equation. What about the demand side of governance and anti-corruption reforms?

## **2. Institutional anti-corruption reform:**

### ***Public Reputation & Good Governance***

#### **Public Reputation**

Although public office is less accountable on short term basis, the rules of reputation still counts as well. Reputation is the difference between perceived as expectation minus the experience which is determined by concrete results.

Somehow, research has proven that there is a direct relationship between competitiveness of a country and its level of corruption. In order to grow in a sustainable manner and to enhance the competitiveness of a country, anti-corruption measures will need to be taken. Countries like Singapore have high productivity and competitiveness and low levels of corruption. The opposite is true for Indonesia for example.

#### **Ant-corruption reform**

##### **a) Good Governance**

Substance of anti-corruption reforms focuses on prevention rather than the traditional prosecution of corruption. Key reforms for improving governance and combating corruption:

- (1) Rule of Law which focuses on promoting the independence of the judiciary from the executive by revising procedures for appointing, assigning, remunerating, and removing judges and prosecutors + capacity building;
- (2) Procurement Reform emphasizes the use of a transparent and competitive bidding process, and the involvement of outsiders in bid evaluations;
- (3) sound Financial Management implying timely managerial reporting, the use of a single Treasury bank account for all public funds and the prohibition of off-budget expenditures, transparency in the use of public expenditures, and an independent external audit;
- (4) Civil Service Reform that promotes on merit as opposed to patronage;

- (5) Customs & Tax Reform attempting to eliminate and simplify trade regulations, reduce discretion in processing, and professionalize customs and tax operations with a focus on results orientation and integrity;
- (6) Media allowing to investigate and report incidences of corruption, and raising public awareness;
- (7) Parliament play a crucial role in setting an example of integrity and in striving to hold government accountable for its actions; and
- (8) Local Government Reform include simplified administrative procedures, increased citizen participation in government, and monitoring and evaluation systems.

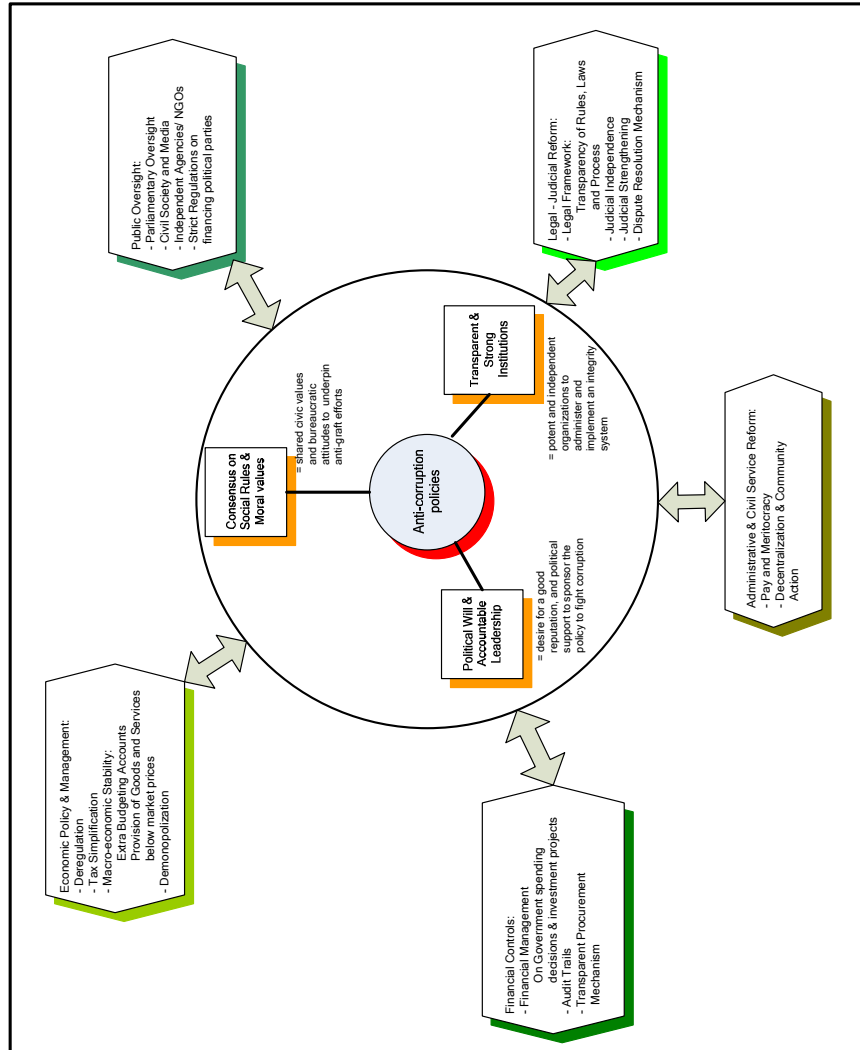
### **b) Institutional Investment Policies / Regulations**

The government will need to take responsibility to prepare investment strategies which won't deter foreign investment as result of lack of appropriate investment policies.

# Hypothesis & Proposed Framework

## אמצעים להשגת הצלחה כלכלית: שוחד ודולרים או פוליטיקה נכונה

### Bribery



Source: VERHEZEN, Peter, "Gifts or Bribes?", PhD Dissertation, Leuven, 2005

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