

Rethinking Reputational Risk

Why do well-respected organisations with intelligent, honest leaders nonetheless fail catastrophically, leaving the board stunned that such a thing could have happened to them?

Though big disasters sometimes provoke a deeper exploration, the search for truth has long been confined to superficiality by a combination of knowledge silos, the lawyerly notion of 'proximate' cause, the power of leaders and obsequious courtiers. Digging across disasters, we discovered a series of deep causes of failures that are not found by classical risk analysis frameworks and that you will rarely find in risk registers. The lens of reputational risk is an effective tool to find them.

Reputational risk is the risk of failure to fulfil the expectations of your stakeholders in terms of performance and behaviour. Performance is about what you do; behaviour is about how you do it. But what lies beneath them? The answer is a series of layers. Peeling away the first we find that performance and behaviour are driven by the organisation's systems. This is Lesson One. *Organisational failures are not usually caused by bad people but by bad systems.*

Organisations have many systems but we can divide them into three main categories. There are the systems that deliver performance whether they create cars or consultants' opinions or. Beneath those are underlying systems such as the IT system, the system for managing money, the back office. Further down is the people-system that keeps the organisation working effectively. But when we think more deeply we see that the 'performance' and 'underlying' systems ultimately depend on the people systems. This leads to Lesson Two. *Since all the systems ultimately depend on people, organisational failures are ultimately about failure of the people systems.*

The risks that lead people systems to fail, which go far beyond risks from culture and incentives, are not widely known let alone understood. We catalogue and explain them in "Rethinking Reputational Risk". These risks are hard to find because we all find it hard to see our own weaknesses. We need someone we can trust to observe us closely, see what we cannot see and explain our weaknesses to us in a way that we can internalise.

What lies beneath people systems? Without good communication, people cannot behave as a cohesive, well-directed team. Without learning from experience including mistakes, they will be less effective than they should be. Dysfunctionality follows. But learning and communication both depend on a third requirement of people systems: leadership. This leads to Lesson Three. *Since leaders devise and manage the systems, leaders are an important cause of failure.*

Leaders readily accept that their influence gives them more power to do good than those beneath them, but many find it hard to accept the corollary: that greater influence and power amplify the consequences of leaders' weaknesses and mistakes. Lesson Four emerges here. *Leaders' weaknesses and mistakes matter more than those of their subordinates, in proportion to their influence and power.*

We divide leaders' strengths and weaknesses into three areas. The first is intellect. Research suggests that beyond a certain level, more intelligence is not necessarily helpful; and intelligence is not sufficient.

What matters more is the level of skills, knowledge and experience a leader brings, for this determines the options open to them. But what a leader decides to do depends on the third attribute: character. As the Ivey School put it in “Leadership on trial”¹, competencies determine what leaders can do but character determines what they will do. This leads to Lesson Five, hardest lesson for leaders. *Leaders’ character matters at least as much as their skills, knowledge and experience; and these are more important than the leader’s intelligence provided it meets a minimum, albeit substantial, level.*

The corresponding risks from leaders are also catalogued and explained in “Rethinking Reputational Risk”. They include risks from leadership character, incentives, attitudes and perceived behaviours as well as what leaders do, or omit to do.

These risks are not just beyond the classical risk lexicon and hard to find. They are deeply personal to leaders. This puts them far beyond the authority (and skill) of risk professionals and into territory that any risk professional can see is too dangerous to explore. Yet when these risks materialise they regularly cause a re-assessment of the performance and behaviour of organisations and their leaders. In plain English, these are at the deepest levels of reputational risks.

In practice only two people can take responsibility for dealing with these risk areas – given the wish to do so. The CEO can tackle them below and perhaps in the C-Suite. But only the Chair can tackle them at board level: within the board and as regards the CEO. Here too, the CEO and Chair need a trusted professional to see what insiders cannot see and hear what leaders cannot be told: and to bring any unwelcome news to leaders so that they can absorb it and act on it. This leads to Lesson Six. *Such professionals do not just need the requisite skill, experience and independence. They must have the courage, personal integrity and incentives reliably to deliver what may be uncomfortable truths to powerful paymasters.*

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Anthony Fitzsimmons and the late Professor Derek Atkins are authors of “Rethinking Reputational Risk: *How to Manage the Risks that can Ruin Your Business, Your Reputation and You*” published by Kogan Page. You can benefit from a 20% discount on the full price by buying a copy from the publishers at <https://www.koganpage.com/product/rethinking-reputational-risk-9780749477363> by using the code RRRF20

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