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# REPUTATIONAL RISK: MANAGING BUSINESSES AND RESPONDING TO CRISIS



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# Business Risk



Business Dictionary defines Business Risk as “The probability of loss inherent in an organization's operations and environment (such as competition and adverse economic conditions) that may impair its ability to provide returns on investment. Business risk plus the financial risk arising from use of debt (borrowed capital and/or trade credit) equal total corporate risk.”

Business risks can be of five types –

Strategic Risk	Compliance Risk	Operational Risk	Financial Risk	Reputational Risk
Strategic Risk arises from making poor business decisions or the lack of making any decision.	The risk that arises from failure to comply with laws and regulations is known as Compliance risk.	Operational risk remains after determination of financing and systematic risk, and includes risks resulting from breakdowns in internal procedures, people and system.	It is the risk that arises from financing and capital structure including financial transactions.	It is a hidden danger that threatens the reputation of the company which might eventually affect the capitalization or the revenues of the company.



# Reputational Risk

- Reputation is a prized, highly vulnerable, asset for any business. Reputation is one of the most important corporate assets. Its very crucial for a corporation yet it is difficult to protect. In the Economist Intelligence Unit's Risk Barometer, a regular feature of the risk programme's quarterly surveys, reputational risk emerges as the main concern for the majority of risk managers—ahead of regulatory risk, human capital risk, IT network risk, and market risk and credit risk. This preoccupation with reputational risk rises primarily from the fact that executives now see reputation as a major source of competitive advantage.
- Everyone from the board down to ordinary employees has a role to play in guarding the company's reputation.
- Compliance failures are the biggest danger to reputational risk.
- Organisations must learn how to communicate with customers and the media when things go wrong. Communications is the key to effectively deal with any challenge. Companies that have a communications strategy, which enables them to respond quickly and effectively to “bad news” events by addressing issues openly and proactively, often emerge with their reputations in tact and even enhanced.



# Significance

- The management's inability to appropriately perceive the risk attached to given information flowing into the system which rapidly transformed huge legal crises throwing up reputation risk of immense proportions is a huge challenge for business facing reputation risk.
- Most businesses try and evaluate the risks and challenges through data analytics, brand tracking tools, media monitoring including social media and survey monitoring and risk sensing mechanisms in the operational aspects, but that by itself has not been able to mitigate high reputation risk resulting from seemingly small developments/ issues.
- The strategic significance and surrounding circumstances of any given information or development (that may otherwise appear to be routine, normal or manageable) could make it cause for a potential reputation risk.
- The dynamic mix of AI / technology driven measures as well as strategic reputation risk prevention frameworks is essential to have in order to make management perceive potential risk real time and be responsive to such risks and to prevent risks from transforming into reputation risk.



# Financial Consequences

- Financial Risk – Reputational risk affects the goodwill of the business which leads to negative impact in the capital market by affecting the share value of the company.
- Credit Worthiness – Businesses run on profit motive. The reputation of the business is important for the business to grow. A reputed business will earn more profits as customers trust the services or good. With a challenge against the reputation, the brand value and the credit worthiness of the business decreases unless the business can effectively control and eliminate the risk.
- Credit Ratings – Risk to the reputation of the business can further negatively impact the credit ratings of the company consequently leading to challenges to the equity of the company.
- Action by Regulators – A reputational risk or a challenge arising therefrom can invite undue and undesired attention from the concerned regulators and invite scrutiny that can be damaging to the market image and goodwill of the company.
- Legal Actions – Various legal forums can suo motu initiate legal proceedings based on the damaging informational crises further aggravating the situation of the company.



# Sources of Reputational Risk

Some of the sources for reputation risk are -

- **Client due diligence** is required not only at the preliminary stage of the new business (operational risk) but throughout the client relationship (financial risk and regulatory risk) to determine if the client is seeking to misuse legal services to launder illicit funds. Suspicious transaction reporting is also a critical risk management aspect (financial risk and regulatory risk).
- **Cyber risk** is another major source of reputation risk. Various complaints and reports in the internet about the company tends to affect its reputation. Cyber attack, i.e., breach or loss of personal and confidential data of consumers also affect the reputation of the company. With social media, information spreads quickly and can potentially affect the company's reputation rapidly. Adverse comments, or false allegations on social media about a law practice, if left uncorrected, may harm the reputation.
- **Ethics** play a very important role in mitigating risk. Limited ethics practice may lead any person, no matter what role he is in to make a bad decision.
- **Proper communication** within the business organization and outside will help responding and tackling the challenges effectively.



# Subramanian Swamy v. Union of India



- The Hon'ble Supreme Court of India has in *Subramanian Swamy v. Union of India & Ors.* extensively and at significant length delved upon the concepts of *reputation* and *defamation*.
- The Supreme Court with respect to reputation has noted that:  
*“reputation is fundamentally a glorious amalgam and unification of virtues which makes a man feel proud of his ancestry and satisfies him to bequeath it as a part of inheritance on posterity. It is a nobility in itself for which a conscientious man would never barter it with all the tea of China or for that matter all the pearls of the sea. The said virtue has both horizontal and vertical qualities. When reputation is hurt, a man is half-dead. It is an honour which deserves to be equally preserved by the downtrodden and the privileged.”*



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- And with respect to the crime of defamation the Court noted that  
*“To constitute the offence, there has to be imputation and it must have made in the manner as provided in the provision with the intention of causing harm or having reason to believe that such imputation will harm the reputation of the person about whom it is made. Causing harm to the reputation of a person is the basis on which the offence is founded and mens rea is a condition precedent to constitute the said offence. The complainant has to show that the accused had intended or known or had reason to believe that the imputation made by him would harm the reputation of the complainant. The criminal offence emphasizes on the intention or harm.”*
- The remedy to reputation risk through recourse to charging the perpetrator begins with the identification of the perpetrator, making it a seriously conditioned process, like most other criminal processes; thereby making recourse to remedy for criminal defamation only a facet, and a rather limited one at that, to the remedial measures against reputation risk and harm.



# Factors affecting Reputational Risk

- It is **difficult to analyse** whether a risk is major or minor. A minor risk may escalate quickly than a major risk and affect the reputation of the company. Thus, it is important that each risk is eliminated as soon as it is recognized.
- Reputation Risk often **emerges from the conduct of business entities and its officers**. Ethics, integrity, quality of best practices and value systems relating to sustainability of businesses should be followed systematically to avoid reputational risk.
- **Compliance to regulations, laws and procedures** should be done effectively to prevent risk.
- An **unforeseeable development** like change in public policy, compromised ethics, corruption, bribery, fraud, etc. should be dealt as soon as it is identified and recognized.
- The **nature of risks** is not universal. It depends from business to business, sector to sector.
- **Internal factors** like objectivity and subjectivity of the management decisions, extent of transparency, monitoring of law, policy compliance management should be done cautiously to avoid any risk.



# Trends of Reputational Risk

- 1. Global Trust Decline

Edelman Trust Barometer, 2019, categorizes trust in organizations in four –

- a) NGOs
- b) Business
- c) Government
- d) Media

The report also categorizes the people taking the survey into general public and informed public. It is seen globally that two out of four organizations, i.e., Government and Media is distrusted by the general public while the informed public are neutral about the same. On the other hand, the informed public have trust on NGOs and Business but the general public are neutral about the same. The report is important because it shows the rise of mistrust in all the organizations year after year.



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- 2. Cyber Insecurity

Cyber insecurity plays an important role in this generation. Breach of privacy and confidential information about the organization itself and its customers affects negatively. To prevent such loss and raise challenges with respect to reputation, the organization has to have strategic framework preventing such breach. The organization should also anticipate and have proper mechanisms set up to prevent such loss.

- 3. Complex Risk Rising

Digitization has brought in various changes. With the development of science and technology, business are changing and so are the level and nature of risk. The business has to anticipate the risks that are not only general to it nature but also specific. Examples of risks can be AI, labour forces, geopolitical, climate changes, etc. Eg, A company dealing in oil business has to be very careful. If there is any accident and oil spills in the ocean by that company, then they should be prepare to mitigate it.



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- 4. Social Media fuelled Reputation Risk

The complaints in social media rise rapidly and can snowball into dire consequences of unforeseeable turmoil for the company and can be extensively challenging to address and deal with. It severely endangers the reputation of the business. Thus, it is very important for the business to address it as rapidly and proactively as possible.



# Anticipation of Reputation Risk

- Strategic anticipation of a risk or a crisis is the key in managing and responding the same.
- **A well-structured reputation risk management team** is required at the senior management level to anticipate and identify the risk.
- The team should manage and monitor potential crises to mitigate the same before hand and additionally respond to such crises as it arises and eliminate it.
- The members of the team should be from business units, risk managers, key personnel and also external experts like lawyers.
- Continuously evaluating and accessing short term, middle term and long term developments in businesses and issues surrounding the same in order to continuously keep up the preparedness to deal crisis and risk associated with the continuous change and development.
- Unforeseeable developments are difficult to visualize and anticipate. It may arise from external or internal factors. Such developments should be eliminated quickly.



# Preparing for Reputation Risk

- The test of preparedness for a reputation risk management team is to be able to signal in advance and anticipate the right stakeholder intervention likely to be triggered by a potential reputation risk. In addition to being prepared, the what how, when and who aspects of a response to reputation risk are very important to be in place in advance.
- While in-house counsel can provide a calm advisory head internally, external counsel can contribute much in crisis management situations. Communications consultants can be useful, too, bringing to the table a knowledge of the media landscape.
- Moving quickly to rebuild credibility is also important. Isolating the exact extent and nature of the damage is a good starting point. If the problem is related to one person or a group, the solution may be as simple as replacing them with others who are trusted.
- Effective media campaigns can help broadcast the message that things are changing. It can have reassuring messages of change with proper facts.



# Responding to Reputation Risk

- The response to reputation risk in India has to be well timed. The response should not be late as it may escalate the risk even though it might look minor.
- It is mandatory for the team to continuously review and monitor the frameworks by gathering information and collaborating response strategies.
- The mechanism and procedure to operate the reputation risk is not uniform. It depends from business to business. Factors like nature and size of business affect the mechanism to mitigate the risk and challenges.
- It is important to avoid the interventions from the stakeholders by keeping the communications on the right side of law, policy and stakeholder. Use of mis – information and unclear statements should be avoided at any cost.
- All evidences relevant in consequential legal or remedial actions should be safeguarded.
- It is important to map the path of restoration of reputation with proper strategy. Recovery should be done with at-most transparency.



# Managing Reputation Risk

The following are steps a law practice could consider in managing reputational risk –

- Identify the various components of risk (e.g. operational risk, financial risk, etc.).
- Understand how the various components of risk could affect one another. For example, as most data breaches involve a cyber or IT incident, IT and cyber security measures (operational risk) could affect the obligations of the business in relation to personal data (regulatory risk).
- If there are different departments or teams handling different components of risk, then it is mandatory to ensure that there are no gaps, and there is coordination and communication between the different departments or teams.
- Identify how the various components of risk could affect the reputation of the business, in particular IT and cyber security, personal data protection requirements, new business acceptance, and prevention of money laundering and financing of terrorism requirements.
- Adopt a firm-wide approach to manage or mitigate reputational risks. For example, IT & cyber security should not be only an IT matter, but a firm-wide risk management consideration. Similarly, new business acceptance should be a firm-wide risk management consideration in order to mitigate any regulatory risks.



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- Monitor and review the online reputation of the business practice. Review and monitor the comments and replies in any social media feed. Also relying on tools such as Google Alerts or Yahoo! Alerts to monitor the business online reputation.
- Regularly review the various components of risk, and how they could affect the reputation of the business.
- Incorporate reputational risk into business continuity plans, e.g. succession plans.



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