MANAGING REPUTATION IN A DIGITAL WORLD

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"Reputation is a fragile commodity but a powerful tool for doing business"

Reputation is one of the most valuable assets of a bank and safeguarding it has become a preoccupation in every boardroom today. The reputation of an organization is largely based on peoples' perceptions of it. Perceptions can be good or bad and reputations need to be actively managed by communicating effectively with all stakeholders.

Reputation is based on trust and belief. People who depend on, or who are responsible for shaping, an organization need to understand the importance of protecting a reputation. Different stakeholders have different interests. Customers and investors ensure the daily functioning of the business. Employees enhance productivity and provide service quality. Analysts report on the well-being of the business, making recommendations to sell, buy or hold a company's shares. Regulators set guidelines and standards and monitor these on an on-going basis. And of course the general public which can be a combination of any of these groups, responds to the actions of the organization, either favourably which helps to strengthen the reputation of the organization or in a negative manner creating unwanted publicity which then needs to be managed carefully, depending on the nature and level of bad news.

With rapidly changing technology, banks are becoming more exposed to new channels of risk and managing reputation is everything. As banks innovate and create products and services to facilitate customers' ease of doing business, they need to not only manage increasing cyber risks due to the sheer number of connected systems and devices, but also to minimize system failures and fallouts which could affect customer service, brand loyalty and reputation.

Imagine a world without ATMs, internet banking, smart phones or social media connectors such as Facebook or Twitter, unthinkable for many of us today. In an era of fast moving technology and digital innovation, the local banking sector is facing exciting times. New technology and changes in consumer preferences are leading banks to re-think the manner in which they serve their customers and do business. The need to develop new channels to connect with multiple customer segments is something Sri Lankan banks have recognized during the past few years and adapting a bank's business strategy to account for digital technology is no longer an option.

Most Sri Lankan banks have in the past five years made investments in new technology, implementing systems to improve IT security, asset and liability management, risk monitoring

and anti-money laundering surveillance. New initiatives which rely on digital innovations are also being rolled out across the network, to cater to customers' changing expectations. Banks are also experimenting with more customer-centric and flexible branch formats in order to provide a wider product range and a faster and more efficient service to their customers.

Traditional branch models are vital to banks and still represent the best way for them to build a long term relationship with their customers. Face to face interaction and familiarity with the local branch remains a key focus point for customers, who may need to deposit money in their savings book, sign a bank document or cash a cheque.

Consumers are however spending more and more time on their computers, tablets and smart phones, attending to their banking needs from the comfort of their homes or on-the-go, digital banking is gaining momentum and banks need to be ready for the changes. They will need to revisit the concept of branches, maintaining important ones and giving other branches a facelift, transferring them into modern centre of competence to accommodate the new generation of technology savvy customers. Banking will in time to come, no longer be a hustle and bustle centre, but one with comfy chairs and internet banking applications that will guide customers with the help of a virtual branch assistant, who will be capable of advising and making recommendations as a real bank assistant would do.

Simplicity and the convenience of managing one's finances at the touch of a button is totally transforming the banking world. Customers expect tailor-made solutions to suit their fast and modern lifestyles. Seniors and the boomers of the 60s are making this transition and showing increasing willingness to adopt digital banking. The expectations of the technology savvy GenY group are also increasing rapidly. In order to meet the growing demand, banks are investing heavily in apps for smartphones and tablets, to keep up with the expectations of their customers and to be competitive in the market.

Cloud, Crypto Currency, Digital Wallets, Augmented Reality are some of the buzz words we hear in the industry when discussing digital technology.

Cloud technology is where computers get networked together and one can access that network from anywhere.

Crypto Currency is a virtual currency that is used to facilitate online payments, the most popular of which is Bitcoin.

Digital Wallet, a fancy word a few years ago and calling upon our imagination, is now finding its way into peoples' pockets. A digital wallet, also referred to as an e-wallet by some, is a new method of paying for things on the go. The services provided work through apps on our smartphone. At the bus station for instance, we may tap our phone to a registered app in order to pay our fare and save our bus ticket on our mobile phone instantly.

Augmented Reality is a virtual reality that aims to duplicate the world's environment in a computer or mobile device. This is done by combining a scene from the real world and a virtual scene generated by the computer or other device, augmenting it with more information to enhance the user's sensory perception of the virtual world they are seeing. For example the Sixth Sense augmented reality system, allows an individual to project a phone pad on their hand and phone a friend without removing the phone from their pocket.

The challenges banks are facing all over the world in coming to terms with the new technology are the same and local banks which don't step up to the digital age fast will lose to the more efficient financial institutions who are cooperating with other companies to offer the latest investment and financial products which lean on digital technology.

Any product innovation requires experimenting with new ideas and tolerating high levels of failure. However developing a world class reputation requires delivering results which are consistent with stakeholder expectations. Banks that are able to deliver digital innovations that have been tested and have a high level of reliability, weighing the consequences of the trade-off between risk and return will be rewarded with star branding and reputation.

Consider some of the technological developments that have taken place recently worldwide. In the US for instance, solutions such as the new Google Wallet app and Apple's Passbook are in use. Google Wallet for instance, not only facilitates mobile payments but also includes customer loyalty programs, coupons, and other services which are on the increase. Apple's mobile wallet app called Passbook, gives consumers a whole new level of convenience, keeping things like airline boarding passes, movie tickets, and gift cards all in one place. It allows users to scan their mobiles in order to check-in for a flight, catch a train or to redeem a coupon. Some passes include time- or location-based information. They may automatically appear at the appropriate time or place. For example, when a user arrives at the airport, his or her boarding pass will appear on the screen. Bank of America's "BankAmeriDeals" application, offers its online customers promotions based on the retailers they frequent. When users check their account online or via the app, cash back deals are listed next to the names of participating stores they have shopped at and restaurants they have visited. Rewards can be redeemed at these locations on future visits.

In China, WeChat with 250 million active users daily has launched a service which allows Chinese department stores to set up their own online stores on the WeChat platform.

The financial platform 22seven in South Africa has developed a software which looks at customers bank statements, to find out if they can help them to save money, highlighting the areas where customers spend a lot of money and showing them ways of reducing their outgoings.

Lurking in the shadows of any new euphoria is risk. Financial innovation was part of the cause of the global banking crisis in 2008, when bankers designed a plethora of complicated financial products in order to manage risk and free more capital, re-packaging these products under various names and selling them to clueless investors. With the emergence of complex

technology in mobile and internet banking over the past few years, greater importance needs to be given to safer and more robust systems and processes. As banks innovate and create products and services to facilitate customers' ease of doing business, computer criminals are also hard at work.

Over the past few years, banks have been the target of cyberattacks, mainly due to poor security measures in their IT systems. Identifying a bank's vulnerabilities and building system security expertise in-house could prevent not only financial losses but also minimize the risk of losing customers, brand loyalty and market share. Better intelligence on cybercrimes and security breaches in other companies whether local or abroad can help banks to build an early warning system and increase their ability to predict and protect their systems, with additional servers in place to cover business interruptions.

While crisis management is an important way to react to online risks and threats, even the minor events which could have an impact on stakeholder behavior need to be addressed in a professional manner. For instance known system downtimes due to month end runs (internal customers) or important security upgrades (external customers) can be communicated via the bank web site or social media such as Facebook or Twitter. This will allow customers to plan their banking transactions around these events thus leading to less disappointment and frustration when a bank's website does not function.

Banks have always faced risks, but one particular area which has gained the right to be considered on its own terms is reputational risk. The bitter accounting scandals prior to the sub-prime crisis, led to the collapse of many companies including institutional giants like Enron and WorldCom, shaking the very integrity and reputation of the corporate world.

Enron, the world dominant energy company, failed in 2001 due to trading and accounting manipulations, taking down one of the most respected world audit and accountancy partnerships with it. WorldCom, one of the largest global telecommunication companies collapsed in 2002, when failed business ventures were misstated in the company's financial statements in order to conceal losses.

One of the consequences of the Enron scandal was the implementation of the Sarbanes-Oxley Act in 2002 in the US, which required more disclosure, increased accountability of auditing firms and higher penalties for financial fraud.

The importance of reputation however took on a totally new dimension with the financial crisis, which rocked the entire world, affecting the very substance and existence of banks and leading to a loss of confidence in the economy, governments and business leaders of our time.

In 2007 a news update on British television showed a queue of customers desperate to withdraw their savings outside the high street bank Northern Rock, showing how fast customers can lose trust in their bank and how a bank's reputation can evaporate amidst rumours of financial difficulty.

In the period 2008 to 2012, in the US alone over 450 banks failed. In contrast, the previous five years witnessed only 10 US banks failing. In Europe a similar story, over 130 banks collapsed or required bailouts. Banks in other continents were more fortunate but also suffered losses, inevitable due to the increasing inter-connectedness with the rest of the world, with Asia having already learnt from the 1997 crisis. Some of the factors which accounted for the global economic crisis were the hyped housing markets, financial mismanagement and poor regulatory oversight, as banks operated with low capital buffers and inadequate liquid assets making them vulnerable if things did go wrong.

A number of other banking frauds and irregularities came to light, post financial crisis, including the Libor manipulation, internal frauds involving rogue traders such as the London Whale scandal and money laundering issues. The developed nations were by this time inundated with so many country, county and bank failures that these aftermath scandals have become more or less part and parcel of the global financial crisis. More legislation, impressive regulatory fines, law suits with sometimes no clear culprits and promises from banks to be more mindful in the future were the consequences. Also after catastrophic events such as the Indian Ocean Tsunami in 2004 and the Fukushima disaster in 2011, stakeholders expect banks to be proactive in managing risk and to have adapted their business continuity plans to counter the effect of such risks.

Phishing and Pharming are the most common online frauds faced by many banks where users are made to part with confidential information by guiding them to a bogus website. Phishing is the fraudulent practice of sending an email to a customer under the name of the bank in order to induce customers to reveal personal information, such as their passwords and credit card numbers. Pharming is similar to phishing but here the user is redirected to a bogus website that is very similar to the appearance of the legitimate one, again in order to obtain the personal information of a customer. Cybercrime can be prevented by updating software on computers and other devices with current versions and the latest anti-virus packages, setting up passwords to prevent easy access and not divulging personal information to each and every one.

With the arrival of social media a new form of reputation risk has surfaced because rumours move fast and banks today need to manage their image more carefully than ever before. One mistake is all it takes to question the integrity of a business and if not managed properly it could damage a hard earned reputation and depending on the severity of the event, the ultimate consequences could be a failure and/or bankruptcy.

Today we can with the click of a mouse “like”, “unlike” or even “comment” on an individual or organization. With rising customer expectations, ignoring strong digital messages and social chatter on our organization is no longer an option. Communicating effectively and responding intelligently can help an organization to align its brand in line with stakeholder expectations. Consider Facebook with over 1.3 billion active users worldwide, YouTube with 1 billion users and 4 billion views a day and Whatsapp with 600 million users. Banks need to use these and other digital sources to identify and monitor sentiments whether positive or negative on their organizations and to respond accordingly.

The value of a bank's reputation is upheld as a result of the competitive advantage and market differentiation it delivers. Satisfied customers, a wide talent pool, the ability to raise capital, regulatory compliance, good crisis management and in some instances the option to charge higher fees for brand are key to the value of a bank.

Despite a widespread understanding of the importance of managing the gap between internal and external perceptions of an institution, there is a concern on how to monitor a bank's reputation meaningfully. Some professionals see reputational risk as a consequence of not managing a bank's main sources of risk adequately. They believe that the controls in place to manage these risks will also help to mitigate reputational risk to a great extent. Others see it as a risk on its own right with poor corporate governance and compliance failures being the main sources of reputational risk.

Managing reputational risk is about assessing potential risks to the business and having a clear response strategy and tools to contain the risk. Banks need to not only consider the risks directly under their control but also the risks of their business partners which might expose them indirectly to reputational risk. They need to monitor the business practices of their suppliers, large customers, advisors, activities outsourced to third parties and also other stakeholders. Managing a company's reputation is therefore not only a PR exercise but also a Risk Management exercise.

Formulated under Pillar 2 of the Basel II framework, a direction issued in 2013 by the Central Bank of Sri Lanka, requires all commercial and specialized banks in Sri Lanka to identify, assess and monitor their reputational risk together with all other relevant risks. Banks are expected to develop or enhance their risk management framework to be commensurate with the nature, size and complexity of their business and appropriate for their individual circumstances and needs.

An important stage of the reputational risk management process is identifying the key factors that could impact a bank's image and reputation. Some useful questions which we may need to ask ourselves as bankers when considering the factors driving an institution's reputation are, for instance:

* What are the threats which could affect key business lines and damage stakeholder confidence?

* Are there any contagion risks which could arise from the activities of other players in the banking sector, from companies in other industries with which the bank has a close relationship or through the bank's own subsidiaries and affiliates?

* Could reputation risk arise from the exposure and changes in the bank's investment, trading and lending portfolios?

* Would acquiring or merging with another company cause a reputational issue or provide a competitive edge?

The following are some of the key drivers of reputational risk:

Corporate governance

Good corporate governance is vital in managing a bank's reputation and Board oversight and leadership set the right tone at the top for a robust risk management process, laying the foundation for managing reputational risk.

The Board needs to understand the underlying assumptions in corporate strategy, the execution process, the bank's risk appetite and to be alert to behavioural patterns and ethical breaches which could lead to a disconnect between the bank's image and stakeholder expectations.

A bank's reputation can be impaired if for instance its leadership is seen to be poor, the bank lacks a clear vision for the future or personal ethics and behavior of key personnel are being compromised .

Culture alignment

A strong and effective corporate culture is necessary to support a bank's business objectives and to meet the changing expectations of customers and other stakeholders.

Banks need to promote a corporate culture where non- compliance is not tolerated and where the adoption of ethical and responsible behaviour is encouraged.

A mechanism should be in place for employees to freely voice concerns on any potential threats faced by the bank such as suspicion of fraud or business malpractice.

Also with social media increasing the pace of exchanged information and regulators encouraging more transparency and disclosure from banks, the focus is on employees at all levels of the organization living up to the values of the bank.

Risk management and control environment

Risk management and internal controls help to identify, assess and monitor the inherent weaknesses of the bank that could adversely impact its performance and also the bank's reputation.

Integrating risk management into the bank's strategic plan facilitates the what-if decisions, analyzing the scenarios which could have the highest negative impact on the business and thereby challenging the bank's strategic assumptions.

Independent assurance that existing risk management and control processes are running properly for instance through internal audits can help to mitigate reputational risk to a certain extent.

Financial soundness and good business practices

A bank's reputation is likely to suffer if its financial soundness is called into question. The business needs be run in a responsible, honest and prudent manner.

In dealing with customers and other counterparties, banks need to be guided by, and closely adhere to, all relevant ethical standards and codes of conduct. Banks need to be aware of the possible effects on their reputation due to other social and environmental responsibilities expected of it by stakeholders such as customers, business partners, governmental organizations and pressure groups.

Staff competence and talent management

Staff competence and support is essential for the success of the bank, given that human capital is an important asset. Talent management and maintaining a high level of employee engagement will help to enhance a bank's reputation.

Legal and regulatory compliance

A bank's reputation can also be impacted by the non-adherence to a country's laws and regulations (either deliberately or inadvertently). The Board and Management should ensure compliance oversight.

There should be a strong risk assessment process and robust systems to ensure compliance, keeping up to date with new regulatory developments and understanding the regulatory needs of other countries with which the bank or its customers do business and where a reporting requirement is necessary.

Contagion risk/rumours

The banks should be alert to the spreading of rumours and the effects of rumours. They should be aware of digital technology which is opening up new and faster channels of communication where rumours and bad news can travel much faster than before. When

operating as part of a Group (comprising of banking/non-banking entities) a bank will be susceptible to reputation events affecting members of the group such as subsidiaries and affiliates.

Contagion effects on a bank's reputation can also result from other problematic relationships, whether knowingly or unknowingly with major customers, counterparties or service providers.

Communication and crisis management

A bank's response to a crisis situation is critical. Since organizations are not prepared for unexpected events, it is important for a crisis management plan to be in place, in order to coordinate responses and minimize reputational damage when negative news hits the headlines.

A group of designated individuals should be trained in managing media relations, making public announcements on behalf of the bank and providing useful input regarding reputational matters.

The crisis management plan should be tested with realistic scenarios requiring a quick response plan. It should be updated regularly to accommodate changes to the team and other important details.

Key internal and external stakeholders who are crucial to the bank should be identified, good working relationships should be encouraged and a mechanism needs to be in place to notify them in a timely manner of a crisis. In a crisis, some points to consider are a fast response, a team to face the media, an apology if appropriate, corrective action taken and a designated person who can be contacted for media clarification and follow-up issues.

The first step in managing risk to reputation is for banks to identify the sources that could hinder the achievement of their strategic goals and the requirements and expectations of their main stakeholder groups. This can be done by requesting the bank's key departments to complete a questionnaire on reputation risk, reflecting their views on what aspects they consider as the key sources of reputation risk affecting their own departments and the bank as a whole. These questionnaires, media reports and customer satisfaction surveys can provide useful feedback on the risks which need to be managed. Discussions and workshops can follow, in order to obtain more detailed information or to discuss results. A risk register can then be developed to record the risks identified from these processes.

The Hong Kong Monetary Authority has identified the following broad categories which banks can modify to suit individual requirements:

* Operating environment
  Issues arising from market, political, social, regulatory and technological developments.

* Stakeholder relations and communications

  Issues relating to stakeholder loyalty and confidence, satisfaction of their needs and expectations, and effective communications with them.

* Strategic planning and business development
  Issues relating to setting and fulfillment of goals and targets, business performance and profitability, market standing and competitive situation, and business outlook.

* Human resources
  Issues relating to recruitment, retention, and succession planning, remuneration and incentive schemes, competence and training, motivation, conduct and integrity, morale, staffing and workload, health and safety and more.

* Systems, controls and infrastructure
  Issues relating to information, data and security management, operations and processing, supporting systems and infrastructure, risk management processes and controls, financial and budgetary controls, business continuity and crisis management.

* Legal and regulatory compliance
  Issues relating to compliance with relevant laws, regulations and codes of conduct, impact on authorization / licensing status and more.

* Corporate governance
  Issues relating to governance infrastructure and practices, and compliance with internal policies, codes of conduct, guidelines and procedures.

* Other reputation issues not covered above
  Issues arising from contagion risk, pressure group interest and media relations.

Once the reputational risk factors have been identified, a bank will need to decide which risks identified are significant and worthy of a follow-up if not already captured under a different risk type. For example there could be an overlap with operational risk Banks can prioritize the risks by “impact” and “likelihood of occurrence”.

Louisot and Rayner, in their paper “Managing risks to reputation - from theory to practice” suggest using a four level scale to qualitatively assess reputational “impact” by looking at both the short-term and longer-term impacts of a risk on a company’s reputation, including the effect on stakeholder behaviour and the future value of the business.

Impact Table

Low	Moderate	High	Very High
Local complaint/ recognition Minimal change in stakeholders' confidence Impact lasting less than one month	Local media coverage Moderate change in stakeholder confidence Impact lasting between one and three months	National media coverage Significant change in stakeholder confidence Impact lasting more than three months Attracts regulators' attention /comment	International media coverage Dramatic change in stakeholder confidence Impact lasting more than 12 months/ irrecoverable Public censure / Probe by regulators

Combining the Impact Table with a Likelihood of Occurrence matrix, we can generate a Risk Score for the identified risks to reputation.

Impact (A)
1-Low
2-Moderate
3-High
4-Very High

Probability/Likelihood of Occurrence (B)
1- Unlikely
2- Possible
3- Very Likely

Risk Score (A x B)
1-4 Low
5-8 Medium
9-12 High

If we were to assume that one of the risks identified is customer dissatisfaction with the bank's online banking facility, leading to a closing of customer accounts, the 'impact" and "likelihood of occurrence" ratings will depend on the bank's assessment of the probability of the risk materializing and the estimated drop in customer online accounts and possibly other accounts as a result.

If we were to gather data from various performance indicators that the likelihood of customer dissatisfaction due to downtimes in the internet banking facility is high with more than a 75% chance and the total number of customer accounts is likely to drop significantly by over 10% within a month based on past surveys or statistics, the "impact" and "likelihood of occurrence" ratings may be classified as high and very likely respectively, giving a risk score of 9.

If, instead the likelihood of customer dissatisfaction is low, say below a 5% chance due to stringent enforcement of customer service quality for internet banking, the "impact" rating will remain high but the "likelihood" rating will be unlikely, giving a score of 3.

These matrices are just an example and can be modified to meet a bank's individual characteristics and requirements. Based on the risk value calculated, action can be proposed for each low, medium or high risk scores. The bank can also perform other analyses such as control assessments and stress-testing, to assess and fine-tune the "impact" and "likelihood" ratings.

The benefits of managing reputation risk are many and leveraging on digital channels to improve an organization's brand image, reputation and customer engagement is still in its infancy. Local banks need to begin the journey if not already done on the social web, evaluating and strengthening their brand image and identifying any threats or challenges. And as more and more customers use online banking or their mobile phones to carry out specific money transactions or to check their account balances, Sri Lankan banks need to be mindful of the risks involved in implementing innovations in digital technology.

As Benjamin Franklin put it years ago "It takes many good deeds to build a good reputation and only one bad one to lose it".

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