# MANAGING RISK

## Public Affairs and Enterprise Risk Management

By Tom Price

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INTRODUCTION

# TAKING A RISK

When the news media cover corporate public affairs and communications, they always seem to focus on crisis management. Has a company handling a major product recall protected its image? Has a firm facing congressional scrutiny hired the right K Street lobbyist?

But, as any public affairs professional will tell you, executives in this business spend most of their time trying to *avoid* crises. For obvious reasons, they would rather dodge bullets than care for the wounded.

This is not to say that crisis management is not an indispensable skill. Two years ago, the Foundation for Public Affairs published "When Disaster Strikes" — a report designed to help companies prepare for a crisis, integrate their public affairs strategies and restore their reputations. It also focused on the important role social media play in globalizing an issue and rallying constituents around a cause.

Last year, the Foundation took on a much more complex topic: the role of transparency in public affairs. Our study, called "Opening Up," discussed public expectations for transparency and profiled firms that have improved their rapport with investors, local communities, employees and other stakeholders by being more upfront about their practices. In a distrustful world, being more transparent is one of the few strategies available to companies that want to win back the public's confidence.

Now, as companies try to recover from a devastating global recession, their business environment is more challenging than ever. The news is full of stories about companies facing huge calamities (such as Goldman Sachs, BP and Toyota) and major political changes (such as firms in the healthcare and financial services sectors).

At the same time, companies are coming to grips with other long-term threats, including political instability abroad and the rising cost of doing business domestically. That's why so many firms have created Enterprise Risk Management (ERM) departments to identify and assess risks across the company.

Given the important role public affairs plays in helping companies manage issues, it's only natural that we would want to explore how this function integrates its activities with other corporate risk management efforts.

In this groundbreaking report, author Tom Price explains the role of public affairs in ERM and how firms organize this activity, identify risks and mitigate their impact. We've also included definitions of ERM terms throughout the report to help public affairs professionals speak the language of risk management.

We encourage readers to share this report with other corporate executives — perhaps those in the ERM or risk management departments — who may not understand how functions such as public affairs, communications and corporate citizenship can help create a more favorable business environment.

After all, the goal is to avoid crises — not just manage them.

Doug Pinkham

Douglas G. Pinkham
President

**RISK** The simple dictionary definition of risk is the possibility of loss or injury. To a risk manager, it's also a measure of uncertainty or volatility, which is why risk can contain opportunity. According to risk communication consultant Peter Sandman, risk has two components: hazard and outrage. Hazard is the substantive risk of something bad happening. Outrage is the public's reaction to a risk. Because people can become outraged at a risk that contains little real hazard, outrage may pose the greater threat to an organization.

# UNION PACIFIC

## Riding the Rails to Find and Reduce Risk

One morning in the spring of 2010, Robert Turner ushered a half-dozen Union Pacific executives onto a special passenger train to ride the rails through the middle of Texas, with stops in Big Springs, Abilene, Sweetwater, Midland and Odessa. Traveling with Turner, the senior vice president for corporate relations, were the railroad's operating executives for the communities visited and the regional vice president for public affairs. At each stop, about 30 community leaders were invited on board to tour the train, have a meal in the dining car and discuss the railroad's impact on the community. It's an exercise Turner repeats several times a year across Union Pacific's vast rail network, which stretches from Chicago and New Orleans in the East to Los Angeles and Seattle in the West. Sometimes the CEO rides along, too.

"It's outreach to the community, keeping relationships up, keeping lines of communication open," Turner explained. It also makes a significant contribution to the corporation's enterprise risk management (ERM) program. Discussions on the train provide early warnings of community concerns about the railroad. Introductions and exchanges of business cards foster communication that can mitigate a risk before it grows into a crisis.

Union Pacific meets with community leaders aboard a special train to help identify potential reputational risks.


UNION PACIFIC INC.

Turner offered a small example from the 2010 Texas trip. A little town between Abilene and Sweetwater was trying to rejuvenate a section of the community, but town officials didn't know how to go about getting some old railroad tracks removed. A town representative raised the matter with Turner, who promised to find out. "It turned out they weren't our tracks," Turner said. But he was able to tell the representative whom to contact at the company that did own them.

A few years ago, Union Pacific noticed that it was getting angry complaints from community leaders who wanted to raise concerns with the railroad, but didn't know how to do so, said Turner, whose responsibilities include government affairs, internal and external communications, media relations, community relations and philanthropy.

"People wanted to call the company, but they wouldn't know who to call," he said. "So they'd call the CEO. Or, worse, they'd call their senator first.

"I view it as a failure if there is a community issue where the first contact with the company comes in at the chief executive officer level. So we set out to change it."

Community relations is particularly important to a railroad, Turner explained, because "we don't have the option of packing up and going off to China. So we better get along with the communities."

Intelligence gathered on the train excursions — and through other community relations activities — informs Union Pacific's enterprise risk management program because Turner and his subordinates are thoroughly integrated into the risk management process.

Turner sits on the senior executive panel that prioritizes the corporation's top risks. He participates in risk presentations to the board of directors' audit committee several times and year. He shares responsibility for political and regulatory risk with the general counsel.

Union Pacific realizes that political and reputation risk can emanate from any part of the company. Public affairs professionals are informed when key operational decisions are made. Operations executives are required to be "out talking with the community," as Turner put it.

ENTERPRISE RISK MANAGEMENT At its most basic, enterprise risk management (ERM) addresses risk systematically on an organization-wide basis rather than function-by-function. According to the Conference Board, ERM provides "visibility about the linkages, dependencies, and vulnerabilities across businesses and functions." Its components are identifying things that might go wrong, assessing their probability and magnitude, and figuring out how to cope with them, risk communication consultant Peter Sandman said.

# CHEVRON

## Forming Partnerships to Preserve its License to Operate

During a seven-day, 11-country rush through Africa in August 2009, Secretary of State Hillary Rodham Clinton touched down in the Angolan capital of Luanda to witness the signing of a partnership agreement between the U.S. Agency for International Development, the Cooperative League of the USA and Chevron.

The partnership provides training to farmers, strengthens schools, assists nongovernmental organizations that provide financial services to farmers and offers technical assistance to commercial banks that provide wholesale lending to rural financial institutions. The goals are to revitalize small- and medium-scale farming and to promote sustainable and environmentally friendly development.

The partnership "will help raise the income of Angolans, turn back hunger and drive sustainable development," Clinton said. "It will bolster Angola's efforts to rebuild a once vital agricultural sector destroyed by war, which again can be a source of broad-based prosperity."

Chevron partnered with the U.S. and Angolan governments to support economic development — an essential tool for preserving Chevron's license to operate in the country.


ASSOCIATED PRESS

The partnership also is part of Chevron's effort to address what the oil company's chief public affairs officer in Angola describes as the firm's biggest risk in that country: loss of its license to operate. Chevron must maintain the approval of the Angolan government, said Eunice Carvalho, the company's general manager of policy, government and public affairs there. And that requires more than cultivating the goodwill of government officials.

"In Angola, it's important to let the population know who we are, what we stand for, how we contribute to their economy and how we preserve the environment," Carvalho explained. "The risk we have here is if we do not operate in an environmentally friendly manner and we're not contributing to the economic and social development of this country. That could put our license at risk. A big expectation is the companies that operate here need to contribute to the social and economic development of Angola."

That approach is essential in developing countries, where changes in government can produce wholesale changes in public policy, according to Witold Henisz, associate professor of management at the University of Pennsylvania's Wharton School.

Success can be ephemeral when public policy goals are achieved solely through lobbying the government, said Henisz, who is studying Chevron's activities in Angola. "If all you've done is change the law, and the people don't want it changed, in the next government somebody is going to be asking: 'Why did you do that?' Real or perceived influence depreciates rapidly and can engender retribution by the political actors in a subsequent regime."

**"Success can be ephemeral when public policy goals are achieved solely through lobbying the government."**
Witold Henisz
Associate Professor of Management
University of Pennsylvania

Regime change can rapidly and dramatically alter the public affairs environment in developed countries also, as the 2008 elections demonstrated in the United States. Barack Obama's administration, with an enlarged Congressional majority, set out to reverse many of the policies that President George W. Bush had established in the preceding eight years, six of which had seen Republicans controlling Congress.

Needed, Henisz said, is "a campaign to win hearts and minds." Chevron does that well in Angola, he added.

Chevron participates in many collaborative projects in developing countries where it operates. "In each country, we have a number of strategies, because the risks are different," Carvalho explained. "My work here may be different from my colleagues' in Indonesia or Brazil."

Carvalho's shop is responsible for building and maintaining relationships with the Angolan government and with the populace at large. The company works in partnerships with government entities at all levels, local community organizations, NGOs and U.S. aid agencies. The Cooperative League's involvement, for instance, led to establishment of an agricultural cooperative run by Angolan farmers. Beyond economic development, Chevron's community development priorities include increasing the number of classrooms and the quality of teachers, and reducing the leading causes of disease and death.

"Identifying need in Angola isn't very difficult," Carvalho noted. "Just walk around any community." But Chevron does not set priorities on its own.

"We work with the government at the central, provincial and municipal levels," Carvalho said. "We have engagement sessions with the community to identify community needs. In some areas, working with the traditional leaders is the key. You sit down and hear what the concerns are and where you might be able to find some solutions. You involve all the key people from the get-go, including the community."

Chevron funds, but does not operate, the programs. The company transfers funding responsibility to Angolans as quickly as possible. Sustainability requires that Angolans be in control, Carvalho said. "To have sustainability, those actors have to be part of the conception of the project and the implementation as well."

Interacting frequently with governments at all levels and with rank-and-file Angolans helps Carvalho meet another one of her responsibilities, which is assessing political risk.

RISK PORTFOLIO A risk portfolio lists all of an organization's risks and key information about each one, such as its likelihood, magnitude of potential damage to the organization, and plans for managing it.

**RISK APPETITE** Risk appetite describes the total amount of risk an organization is willing to bear throughout the enterprise. According to a publication of the American Institute for Chartered Property Casualty Underwriters, "An emerging, entrepreneurial business might have a greater risk appetite than would a long-established mature company." Or, as Harvey Lermack, interim dean of the Philadelphia University School of Business Administration, put it: "My friends who go to Atlantic City and are willing to lose $500 have a different risk appetite than those who go with a role of quarters."

# DEERE & COMPANY

## Merging Business and Public Affairs Issues

Charles R. Stamp Jr. was president and CEO of InterAg Technologies when Deere & Company acquired the firm in 1999. He continued in business management at Deere — as president of John Deere Special Technologies Group and of Global AgServices — until 2002, when Deere & Company management suggested a new assignment.

Then-CEO Bob Lane asked Stamp — who had a law degree and "an intense interest in government policy" — to apply his extensive business management and legal experience to Deere's public affairs operations. Now Deere's vice president for public affairs worldwide, Stamp and his professional team integrated public affairs into Deere's business operations, including risk management, which is a focus of several of the company's senior officers.

Each of Deere's three major business units has a public affairs director who reports to Stamp. Public affairs professionals overseas report to Deere's country managers, "and they have a dotted line back to our Washington operations."

"We travel with the business leaders," Stamp said. "We sit in on leadership meetings." Public affairs executives "know exactly what's going on in the business. They know the people in the business. They know the officers in the business and what their responsibilities are. And all those people know them."

In the United States, the business units' public affairs directors take their businesses' concerns to Deere representatives in Washington and state capitals. The capital representatives keep the business unit directors informed of national and state legislative and regulatory risks.

Deere has a formal enterprise risk management process in which the business unit public affairs directors work with the business executives and company staff in the national and state capitals. ("You'll see things in Washington I won't see in Illinois," Stamp said.)

"Our public affairs people, because they know the business so well, are better able to identify what's important to the business in terms of policy and regulatory affairs and government affairs," he said. "They're better able to spot real issues — whether they be risks or opportunities — and return them to the table that they sit at with the business leaders."

**"We travel with the business leaders. We sit in on leadership meetings." Public affairs executives "know exactly what's going on in the business. They know the people in the business. They know the officers in the business and what their responsibilities are. And all those people know them."**

Charles R. Stamp, Jr.
President, John Deere Special Technologies Group
Deere & Co.

RISK TOLERANCE Risk tolerance essentially describes an organization's appetite for each individual risk. Usually, a business unit is permitted to make decisions until the risk tolerance limit approaches. Then the business unit's managers must seek superiors' approval before accepting more risk. "Typically companies are willing to take little or no compliance risk, but are willing to take a significant amount of strategic risk," said Harvey Lermack.

# THE BIG PICTURE

## What Public Affairs Professionals Contribute To Enterprise Risk Management

When brought to the table where key business decisions are made, public affairs professionals can spot risks that executives in operating units and other parts of the company may overlook. The nature of their work exposes public affairs personnel to the big picture — how their organization fits into the larger world. They can identify risks in politics, government, reputation and stakeholder relations. They can analyze how decisions and events throughout the company might damage their organization in the eyes of government officials and the public at large.

In addition to communicating the company's message to the outside world, public affairs professionals can monitor what the mass media and social media are saying about the organization. Because of their own knowledge — or their ability to find experts — they can help assess risk in foreign countries.

Public affairs professionals can help mitigate risk by improving stakeholder relations with government officials, community leaders and the general public.

According to the American Institute for Chartered Property and Casualty Underwriters, "Communicating with stakeholders is essential to every aspect of ERM." Poor understanding of stakeholders might explain why U.S. companies on average lose half of their customers every five years, half of their employees every four years, and half of their investors every year, the institute said.

According to "Managing Reputation Risk and Reward," a 2009 Conference Board report, "Companies have found they run the risk of substantial damage to their reputation if they engage in activities that conflict with the values of stakeholders — even if the actions meet the company's business objectives, avoid operational risks, and conform to all applicable laws and regulations."

Risks posed by customers, neighbors, activists and other outside stakeholders can be assessed more accurately when the company listens to those groups.

Through internal communications, public affairs personnel also can help assure that employees effectively implement the company's risk-management strategy throughout the organization.

Risks can emerge when decisions are made about building a facility, introducing a product, entering a new market or even conducting routine operations and maintenance. For that reason, risk experts say, public affairs personnel should be included throughout an organization's enterprise risk management process.

"Both public affairs and public relations are mission-critical," said Laura Taylor, who heads the enterprise risk management practice for Aon Global Risk Consulting. "Part of a mature process is to have cross-functional teams at multi levels of the organization doing risk assessment."

**"Both public affairs and public relations are mission-critical. Part of a mature process is to have cross-functional teams at multi levels of the organization doing risk assessment."**
Laura Taylor
Enterprise Risk Management Practice
Aon Global Risk Consulting

According to risk communication consultant Peter Sandman, “Public affairs people need to be centrally involved in every stage of enterprise risk management — not just implementing damage control at the final stage after earlier stages have gone awry.”

Public affairs professionals can point out the reputation risk that can be part of any decision, he said. It’s particularly important that they bring an “outrage perspective,” to the process, he added.

Business managers often focus on the substance of a risk while not understanding that public outrage at an event can be out of proportion to the real danger posed, Sandman said. “People often fail to get upset about risks that seriously endanger them, and often get very upset about risks that endanger them far less. If people are upset about a risk, they’re very likely to think it is doing a lot of harm.”

Effective public affairs professionals possess a “360-degree ability to look at challenges and see things other people possibly can’t,” according to Scott Walker, an international consultant in communications, public affairs, corporate social responsibility and risk. “They’re not just looking at things narrowly. They’re talking to other people who are outside the actual business. They are the bridge — the liaison — between the company and the outside world.”

**“Things that risk management people hadn’t thought about, the government affairs folks did think about, and vice versa. That sharing of ideas gave us more depth of thought.”**
Carol Fox
Risk Consultant

When he was risk management director at Conrail, Harvey Lermack said, the vice president for public affairs “was just as much a risk manager as any of the rest of us because, whenever we were talking about an issue, he was there.” As a risk manager, “I don’t necessarily understand how the public or other stakeholders will understand the decision,” said Lermack, who now is interim dean of the Philadelphia University School of Business Administration.

Potential public reaction should be considered during every strategic discussion in the C suite, Henisz said. Companies also need to “move away from pure quantification of risks and opportunities, and recognize there are subjective judgments along the way.” With their “softer social science skills,” public affairs professionals can point out that “there are some things we can’t quantify, that we have to work through with verbal logic.”

Public affairs professionals’ knowledge of current events and the media make them a “great repository of knowledge and information that can be brought to bear on how a company approaches risk,” said Carol Fox, a risk consultant who chairs the standards and practices committee at the Risk and Insurance Management Society. When she headed enterprise risk management at the relationship management firm Convergys, “things that risk management people hadn’t thought about, the government affairs folks did think about, and vice versa. That sharing of ideas gave us more depth of thought.”

Ellen Hexter, who leads the Conference Board’s work in enterprise risk management, said public affairs professionals can provide “an early warning signal to understand some of the risks external to the company that can impact business decisions.”

That can be especially important at relatively young high-tech companies whose activities can be difficult for the public to understand and whose scientists and managers may have a narrow focus, crisis management consultant Chris Nelson said.

“Operating people, who aren’t exposed to the need for public acceptance, don’t consider how stakeholders will view what they’re doing and whether they’re making risk decisions successfully,” said Nelson, who previously headed Ketchum’s crisis management network. “Public affairs has to carry that water.”

# IMPORTANT BUT UNDERUTILIZED

## Public Affairs Professionals' Role Today

Although a growing number of organizations are recognizing public affairs' importance to enterprise risk management, public affairs professionals remain underutilized in that endeavor, according to Hexter. Despite Chevron's effective use of such professionals in Angola, Henisz said, public affairs plays "a very limited role" in most risk management programs. Public relations and media relations personnel are involved in reputation risk management, Taylor said, but "I haven't seen the government relations or public affairs people as involved."

Experts offer several explanations.

"All too often, risk management finds itself stuck in the audit committee, and public affairs is peripheral to that," Walker said. "The audit committee tends to focus on financial

SHUTTERSTOCK

Oil companies, in many instances, are the most experienced firms in managing political risk.

issues rather than the broader policy issues. The policy issues tend to get pushed down the agenda when they're actually more important than people see.

"Integration is not necessarily in the mindset of the business managers."

Henisz cited the difficulty of quantifying political and reputation risks' potential impact on revenue and asset values.

Hexter noted a gap between operating executives and the public affairs function. "Companies are still very siloed," she said. Many operating executives "see the corporate people less as resources, to help run their businesses more effectively, and more as necessary evils."

Many companies have erected silos within public affairs itself, with government relations, communications and other public affairs practitioners working in separate shops, Nelson noted.

According to D.J. Peterson, director of corporate advisory services at Eurasia Group, many firms define themselves as specialists in their trade, "whether that's providing beloved goods to consumers or reliable services to clients." They don't tend to think about the broader society and political environment in which they operate, he said.

**"Companies are still very siloed. (Many operating executives) see the corporate people less as resources, to help run their businesses more effectively, and more as necessary evils."**
Ellen Hexter
Conference Board

Public affairs' role also depends on the nature of the business and the experience and expertise of the public affairs professionals, Taylor said.

"In many ways, the most advanced firms are the oil companies," Peterson said. "They've been dealing with political risk for decades." Companies that are highly dependent on the value of their brands and the loyalty of their customers have become sensitive to and sophisticated about political risk, he said. Older companies tend to invest more in political risk management, he added.

Conversely, according to Peterson, young high-tech companies tend to have little public affairs risk management capability. "They're focused on elegant technological innovations and winning market share (and) don't think about politics and society broadly."

Gonzalo Alonso confirmed that Google was not sophisticated about public affairs when he was the corporation's general manager for Spanish-speaking Latin America. "We keep forgetting Google is a very young company and they keep on learning all the time," he told *New Straits Times* in early 2010.

Ironically, several experts said, financial services firms have tended to manage risk in silos, in part because risk management has been so important to them for so long: Everyone manages risk, so no one thinks of taking an enterprise-wide approach. And that contributed to the financial meltdown of 2008-09.

"For the financial guys, risk management tends to be balkanized because everybody has to hedge (the particular products they are selling)," crisis management consultant Nelson explained.

According to Hexter, "Financial services firms for the most part were managing individual risks in a void, so nobody stepped back to look at the big picture." In addition, she said, risk management at banks was driven by what regulators required, "as opposed to dealing with business risks in a holistic manner."

The meltdown and its aftermath demonstrated that some investment banks failed to integrate public affairs into their risk management effectively, Peterson said. "Take the example of Goldman Sachs. The firm's leadership was credited for focusing on its business, but its executives' public statements, including those to Congress, were not seen as sensitive to the political environment in the United States."

A study of the meltdown by the Risk and Insurance Management Society concluded that financial services firms relied too much on financial models, in "the mistaken assumption that the 'risk quantifications,' based solely on financial modeling, were both reliable and sufficient tools to justify decisions." Noting the adage, 'All models are wrong, but some are useful,' the society described financial models as "indicators of volatility and uncertainty but not of certainty." The society quoted famed investor Warren Buffet as saying in a PBS interview: "Beware of geeks bearing formulas."

Charles Beach, regulation and compliance partner at PricewaterhouseCoopers, told *The Economist* that financial services firms must adopt a more balanced and forward-looking risk management process that includes scenario-based assessments.

Public affairs professionals play an important role in the Principal Financial Group's enterprise risk management, according to Ellen Lamale, Principal's senior vice president and chief risk officer. She described a "very close relationship" between risk management and public affairs personnel.

Public affairs workers keep risk managers informed of potential emerging regulatory or political risks and help those managers work directly with regulators and other government officials, she explained. "I talk to them all the time."

One person reports to both Lamale and Merle Pederson, the vice president for government relations, she said.

Convergys places public affairs professionals on its risk committees, Fox said.

"Government affairs and media relations were always on the list of people to include in discussions," she said. "They were go-to people when I was doing risk assessment. I would interact with them almost daily. It was mutual reaching out on both sides.

"We were able to partner with our government relations folks to educate regulators about unintended consequences of regulations. The government relations folks were bringing forward issues that they were observing to allow us to get on top of something sooner rather than later."

In her consulting, Fox encourages risk management professionals to reach out to functions that are likely to spot emerging risks, such as government affairs, media relations, strategic planning and marketing, among others.

Standard & Poor's says it's essential for an effective enterprise risk management program to have an early warning system to identify such risks. Many emerging risks occur in the public affairs area, such as regulation, the environment and "public mores," S&P reported in 2009.

Public affairs personnel are more likely to be engaged in risk management at heavily regulated companies or companies with heavily regulated clients, Taylor said.

Tom McMahon said public affairs and risk management personnel are involved in all significant decisions at Qwest Communications, where he is director of corporate communications and government relations, "because our business is so heavily affected by regulations" at all levels of government.

**"Public affairs workers keep risk managers informed of potential emerging regulatory or political risks and help those managers work directly with regulators and other government officials. I talk to them all the time."**
Ellen Lamale
Principal Financial Group

For example, Qwest CEO Edward Mueller chairs the National Security Telecommunications Advisory Committee, which advises President Obama on telecommunications' effect on national security. Yet Qwest also has to get permission from local governments when it digs trenches to install cable.

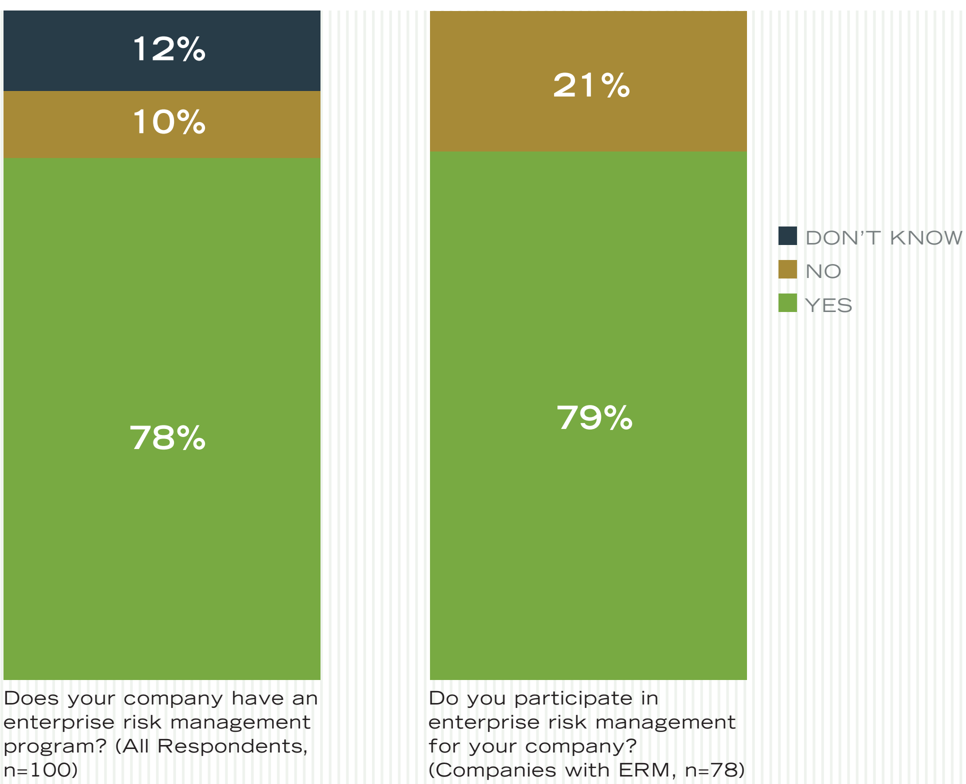
Fox has observed more involvement by public affairs professionals who have worked in the business side of the company, as Stamp did at Deere. Just as many risk managers don't understand public affairs' importance to risk, some public affairs professionals don't know enough about their firm's operations to contribute effectively to enterprise risk management.

Public affairs professionals are heavily involved in reputation risk management, but that also could be due to siloing, according to the 2009 Conference Board report, "Managing Reputation Risk and Reward."

A survey by the board's Managing Reputation Risk Working Group found that communications executives had primary operational responsibility for reputation risk management in 74 percent of the companies polled. Just 42 percent of the firms said primary responsibility went to risk management executives, and just 23 percent to business unit managers. (Respondents could list more than one function as primarily

Nearly 80 percent of companies participating in a Public Affairs Council survey had an enterprise risk management program. Of those, close to 80 percent involved public affairs staff in ERM.

## PREVALENCE OF ERM, AND SHARE OF PUBLIC AFFAIRS STAFF PARTICIPATING




PUBLIC AFFAIRS COUNCIL

responsible.) Asked which executives were highly involved in the process, 91 percent listed the head of corporate communications, 65 percent the head of risk management, and 54 percent business unit managers. In addition, media training was ranked the second most important reputation risk management technique.

The results suggest that "many companies view reputation risk management as primarily a communications issue rather than a key consideration in business decisions" and that "many companies may not fully integrate reputation risk into their risk assessments."

The report warned that this "information gap" leaves these organizations without a comprehensive view of the risks they face. As a result, their risk management programs may not connect reputation risk to strategy and operations.

Despite their current underutilization, public affairs professionals are becoming more involved with risk management, although to what extent is debatable. Sandman concedes that "there has been progress," but adds that "there is still a long, long way to go."

Peterson, on the other hand, sees a trend toward public affairs personnel playing more strategic, integrated roles in risk management. Companies also are becoming more likely to employ public affairs consultants to help them understand risk, particularly in areas where they lack experience, such as in emerging markets, he added.

"CEOs and boards are paying greater attention to risk management and to taking a comprehensive approach to risk management," Peterson said. "There's also a greater awareness of politics and how politics can play an important role in creating risks and in many cases creating opportunities."

Increased public affairs involvement is reflected in a survey of 100 companies conducted by the Public Affairs Council in mid 2010. Nearly 80 percent of the public affairs professionals who responded reported that their company has an enterprise risk management program. In companies with ERM programs, 80 percent of the respondents said they participate.

The survey suggests greater use of enterprise risk management and greater public affairs participation than experts interviewed for this report said they encounter in their work. Those who responded to the survey may have been more likely to be participants in an enterprise risk management program than those who were contacted and didn't respond, Peterson suggested.

Peterson likened the increased participation of public affairs practitioners to the way businesses' treatment of the environment evolved.

"In the 1970s, a lot of firms created environmental vice presidents and they were kind of off to the side, tasked with solving various engineering problems," he said. "As the environment became more important in the 1980s, companies made the environment a more central part of the management structure. Just as the environment has gradually become more and more central to a corporation's operations and leadership strategy, public affairs now is going through the same evolution."

Contributing to enterprise risk management increases public affairs' perceived value in the organization, Henisz said. "You go from public affairs being a cost center to public affairs being a source of value creation, and that's an enormous change of status and importance. It's not an act of charity. It's not a cost you have to bear. It's a way to unpack value."

**"In the 1970s, a lot of firms created environmental vice presidents and they were kind of off to the side, tasked with solving various engineering problems. As the environment became more important in the 1980s, companies made the environment a more central part of the management structure. Just as the environment has gradually become more and more central to a corporation's operations and leadership strategy, public affairs now is going through the same evolution."**
D.J. Peterson
Director of Corporate Advisory Services
Eurasia Group

**RISK MAP** A graphic depiction of risk, such as a matrix.

# MANY ROUTES TO SUCCESS

## Organizing Enterprise Risk Management

There is no single way companies should organize for effective enterprise risk management, but experts agree on a number of best practices, starting with commitment and engagement from the top.

Hexter cited three key ingredients: "The board has to be engaged and pushing on this. The CEO and senior management have to be engaged and endorsing this. There needs to be a person who is the focal point to oversee the conversation."

While "there's not one way to do it," Taylor said, "you want consistency within the organization."

"You want a common framework of how risk is governed in the organization, how risk is prioritized and how risk is integrated into the businesses," she explained. "You want to have similar risk language in the organization. That is important because it's the only way you can have a common lens. You want to be able to consolidate the risk information into a common view."

Peterson said risk management is most effective when its integrated throughout the organization. When Standard & Poor's analyzes corporate risk management practices, it has found that companies with the most advanced ERM programs do best in the stock market, S&P reported in a 2010 publication.

Walker stressed the need to integrate public affairs into the enterprise risk management process "as early as possible and as often as possible. You need to take a holistic look at the business."

"Ultimately," Hexter said, "you want to have every single person who is making decisions in your company to be thinking about risk. The best way to do it holistically is from a top-down perspective and a bottom up perspective. You need input from both ends."

AON has identified nine "hallmarks" of effective enterprise risk management: board commitment; a senior-level chief risk officer, whether that title is used or not; full engagement and accountability at all levels of the organization; engagement of internal and external stakeholders; transparency in risk communication; integration of financial and operational risk information into decision making; application of quantitative methods to understand risk and to demonstrate value added by risk management; harnessing of internal and external data to identify new and emerging risks; and use of risk management to create value.

While a growing number of companies are adopting enterprise risk management, the practice remains relatively rare, especially among smaller firms, Hexter said. In mid-2009, Standard & Poor's reported that "'silo-based' risk management, focused only at the operational managers' level, continues to be prevalent."

That said, more companies are adding a chief risk officer to the C suite, especially in industries that are particularly exposed to risk, such as insurance and energy. But enterprise risk management often is headed by someone at a lower level or by a senior executive who has other duties as well. *Reactions* magazine reported in 2009 about an insurance industry event, sponsored by PricewaterhouseCoopers, at which no CRO in attendance had carried the title for more than two years.

Often, the chief financial officer or general counsel heads risk management. The general counsel also often leads public affairs' contributions to risk management. Depending on the company, Lermack said, the head of risk management may come from the insurance, finance, audit, safety or environmental department.

The Public Affairs Council survey found a chief risk officer at 27 percent of the companies with enterprise risk management programs. In other companies, enterprise risk management was headed by the chief financial officer (20 percent), general counsel (16 percent), chief executive officer (7 percent), head of public affairs (3 percent) or another executive.

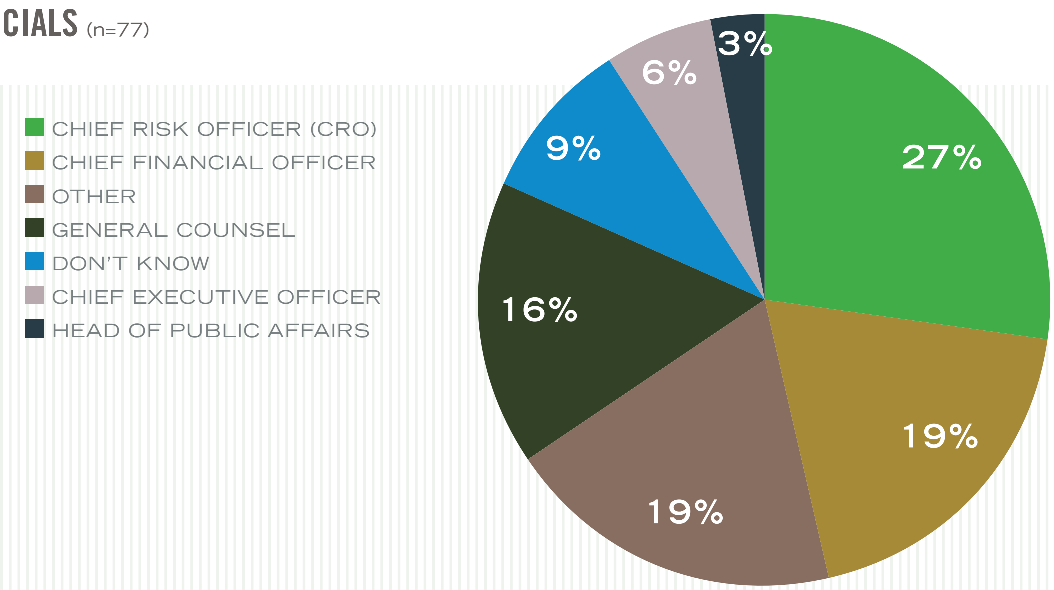
Beyond the chief risk officer, enterprise risk management participants in those companies included the general counsel (79 percent), business unit leaders (78 percent), chief financial officer (77 percent), chief executive officer (71 percent) and head of public affairs (65 percent).

"If the whole thing isn't overseen by a really good leader who can lay out the objectives and make it happen," Nelson said, "those silos can be a hindrance to people working well together to achieve a common goal."

Companies should have a risk committee that reports to the board, Lermack said. Some boards of directors have a risk committee, he said, but most companies' risk functions report to the board's audit committee.

## OWNERSHIP OF ENTERPRISE RISK MANAGEMENT BY KEY OFFICIALS (n=77)

**The Public Affairs Council found that 27 percent of companies with enterprise risk management programs have a chief risk officer.**




PUBLIC AFFAIRS COUNCIL

Some effective companies have an enterprise risk management committee with representation from all parts of the organization. Others include risk management as a recurring topic of senior executive meetings.

Principal Financial Group has a senior-level, corporate-wide risk committee, as well as risk committees comprised of the senior managers in each business unit, said Lamale, who reports to the CEO. "The business units are responsible for managing their risks," she said. "My area is a support area."

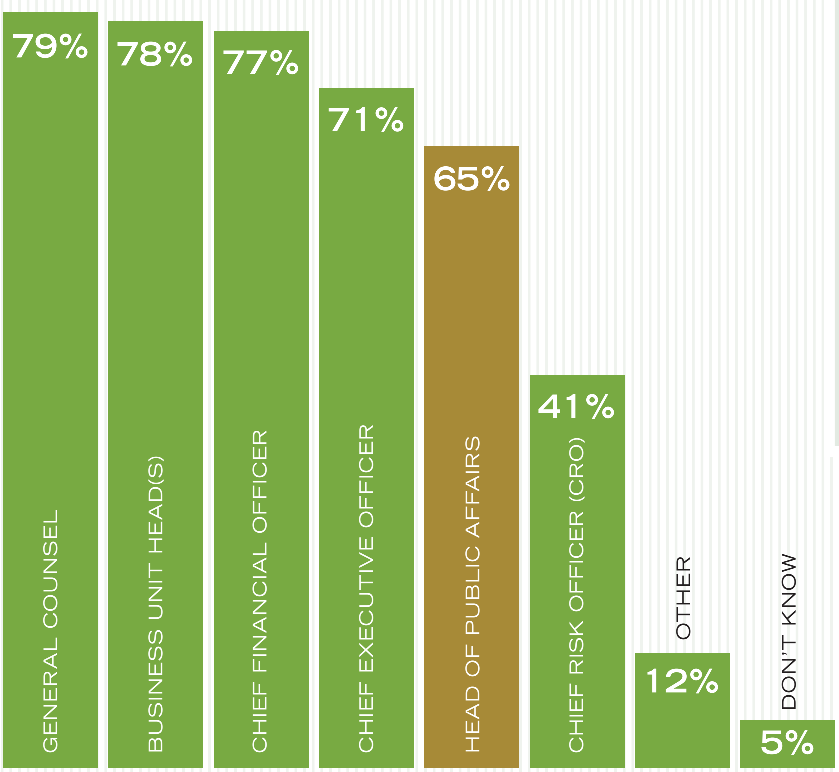
Lamale attends each risk committee's meetings, as does the general counsel, to whom government affairs reports.

Some government relations personnel are dedicated to a single business unit, "so they get to know it and understand it," she said.

"The reason we've been around as long as we have is because we've had a very strong, broad risk management culture forever," she said.

Beyond the formal risk-management structure, "multidirectional, frequent communication is what makes it work," Lamale said. "We have a culture that, if I need help with X, I'm going to call government relations. The government relations folks do a

## KEY FUNCTIONAL HEADS PARTICIPATING IN ENTERPRISE RISK MANAGEMENT (n=78)




The head of public affairs participates in enterprise risk management in 65 percent of companies polled by the Public Affairs Council.

great job of disseminating information to a lot of people. We introduce them to as many people as we can. Once (operations managers) have seen their faces and know them, they're more likely to reach out."

**"If you look at risk as something apart, you're going to trip up because you're not thinking about it day to day. But if you build it into your processes — the way you operate — you're successful."**
Eunice Carvalho
General Manager, Policy, Government and Public Affairs
Chevron (Angola)

At Union Pacific, enterprise risk management is headed by the senior vice president for strategic planning, who reports to the general counsel, Turner said. A committee of eight senior executives assesses risks and reports to the board of directors' audit committee. Annually, the senior executive panel ranks the company's top 10 risks and reports to the full board.

Turner is a member of the senior executive panel and participates in risk discussions with the board. Each of the top 10 risks is monitored by a senior executive. Turner and the general counsel share responsibility for political and regulatory risk. Day-to-day compliance is handled by the law department, which reports to the board audit committee on compliance issues.

Carvalho's political risk assessments at Chevron in Angola can travel "all the way up to the chairman," depending upon the issue, she said. Every Friday, she meets with her leadership team of communications, corporate responsibility and government affairs professionals. Then she goes into the weekly meeting of direct reports to Chevron's managing director for the country. The meetings address risk, as well as other key matters facing the company at the time, which Carvalho says is the best way to manage risk.

"If you look at risk as something apart, you're going to trip up because you're not thinking about it day to day," she explained. "But if you build it into your processes — the way you operate — you're successful."

Air Products and Chemicals Inc., a manufacturer of industrial gases and specialty chemicals, takes another approach. There, enterprise risk management is led by George Bitto, the vice president, treasurer and chief risk officer. Public affairs professionals do not have a formal ongoing role in the program, according to Timothy Holt, the company's corporate relations director, whose duties include government affairs, community relations and charitable giving. They engage on a case-by-case basis.

Holt helps assess and mitigate risks when Air Products plans and builds new facilities, he said, and when political, legislative, regulatory or other public affairs risks are being addressed.

"We had a couple of vice presidents approach me and ask if there's any way you can help us understand the investment climate of a certain country," he said, offering an example of his role. "I was able to work with some folks from Washington to set up meetings with experts to help them understand the investment profile and political risk scenario of that country."

His department also trains other personnel in risk communication.

Darrin Ocke, U.S. government affairs manager for Mead Johnson Nutrition, described an informal public affairs role in his company's enterprise risk management program, which is led by the CEO. He attributed it at least in part to the company's size (2,000 U.S. employees, 5,600 worldwide) and its age (spun off from Bristol-Myers Squibb in 2009).

Small companies can often avoid a highly structured risk management approach because it's easier for functions to interact informally.

When the infant formula manufacturer was part of Bristol-Myers, it didn't have its own public affairs staff. So Ocke's operation is "a work in progress."

"We're building a process so that we in government affairs can quickly and clearly communicate potential risks to the business units,' Ocke said, "and the business units are incorporating us into their planning and execution processes so that we can provide advice on potential risks."

Integrating public affairs into risk management at a company of Mead Johnson's size is "just a matter of getting to know the people and then the function — the work that they direct — so that there is a real good understanding of it," Ocke said. Then, he said, "if I'm dealing with a legislative proposal that we've concluded has potential risk to the business, we are integrated enough that I can go directly to whomever leads that particular business unit and lay out both the potential risk and what we're trying to do in the government affairs function to mitigate it."

A company sometimes adopts a more robust, integrated risk management process after it or a peer firm experiences a major crisis.

"At mining companies and utility companies, the kind of integration I'm talking about sometimes occurs unfortunately after a major disaster," Henisz said. "After a billion dollars is blown off the balance sheet because of lack of integration, then senior management becomes much more open to thinking about how to integrate their operations in all ways."

Companies without a chief risk officer sometimes create the position after "they have been burned," Walker said.

Lermack quoted a friend — a corporate vice president for environment — as saying, "The only thing that stands in the way of our having a world-class environmental program is the lack of one environmental disaster."

# IDENTIFYING AND MEASURING RISK

## Software, Formulas and 'Robust Discussion'

Just as there is no one way to organize effective enterprise risk management, there are many methods for identifying and measuring risk. These include tracking stakeholder opinion, quantifying risk and automating risk identification. Indispensable in this process are the old reliables: brainstorming and logic.

Most risk management programs use a "facilitated interview process" to identity risks, the likelihood that a risk could turn into an event that harms the organization, and the amount of harm that could be done, Fox said. These organized discussions should address "not just what keeps you up at night, but what risks you see in the next 12 to 18 months or the next 10 years," she said. "It's not just operations," she added. Public affairs professionals should be brought into the process, as should key stakeholders.

"Typically, from operations, you get a shorter term view," Fox said. "With government affairs, media relations and strategic planning people, you get a longer term view of what trends might be emerging and what regulatory environment might be emerging."

Public affairs professionals also are key to tapping into stakeholder opinion, which 59 percent of Conference Board survey respondents consider to be an "extremely" or "very" significant issue. Companies should, the Conference Board report said, "develop an understanding of and build relationships with key stakeholders." The effort can provide the company with important information, the report said. Building solid relationships helps a company mitigate a crisis should one occur.

"You need to have a continuing dialogue to identify changes to what you think is going on," Fox said. Public Affairs professionals at Convergys hosted conference calls and roundtable discussions with stakeholders from around the world, she said. Procter & Gamble holds conversations with activist groups, she noted. Such activities "can provide a wealth of information."

In the first half of 2010, Qwest sought stakeholder participation in revising its privacy policy, which the company considers risk-related because of its effect on reputation among customers and compliance with government regulation, McMahon said.

The company posted the proposed policy on its website in English and Spanish. The privacy policy Web page contained a link that readers could click to offer feedback. The policy was included in customers' bills and was promoted in the mass and social media.

Air Products has a formal program that trains managers how to deal with external stakeholders, Holt said.

Public affairs risks are difficult to assess because they're often harder to quantify than other types of risk.

For many years, companies and third parties have quantified an organization's reputation by conducting opinion surveys of the general public and of select groups. More recently, they have begun trying to quantify the impact of reputation on company operations and the potential financial cost of reputation risk. An APCO Worldwide analysis of court decisions, for instance, found that a company's reputation is a strong predictor of how a juror will vote.

Some organizations have developed methods for calculating the value of brands. Interbrand, a brand consulting firm, calculated that Coca-Cola was the most valuable brand in the world, worth $68.7 billion in 2009, for example. Interbrand set No. 2 IBM's brand value at $60.2 billion, Microsoft's at $56.6 billion and GE's at $47.8 billion.

A study by Interbrand and JP Morgan concluded that brands account for a third of an average company's shareholder value. McDonald's brand accounts for more than 70 percent of its shareholder value, the study reported.

In the Conference Board survey, 86 percent of U.S. executives said reputation has a very high impact on stock price. The board cited a 1999 study that found corporations with strong reputations enjoyed an average annual stock price increase of just over 20 percent, while those with a low-ranked reputation saw prices decline by just under 2 percent. The board noted a New York University business school survey of 216 Fortune 500 firms that concluded companies with stronger reputations command higher prices in mergers and acquisitions.

Cubit Media Research, Communications Consulting Worldwide, Echo Research, and Hill & Knowlton are among consulting firms that offer services that link reputation to stock price.

Using natural language processing software, Hill & Knowlton matches news reports with share price movements. "News coverage on lay-offs, employee relations and other topics can impact investor confidence and company share price as much, if not more than, a quarterly earnings statement," the consulting firm said in a statement explaining the service.

In 2007, *BusinessWeek* reported on work that Communications Consulting did for United Technologies and that Echo did the SABMiller brewing giant.

In late 2005, United Technologies hired Communications Consulting to analyze several years' worth of news articles, daily stock movements, other financial information, studies of consumer perceptions and employee satisfaction, and the views of stock analysts and investors. The consultants concluded that 27 percent of the company's stock value was attributable to intangible components, including reputation. It recommended that the company make a greater effort to tell investors of its environmental responsibility, innovation and employee training.

SAB hired Echo a year after the South African corporation had acquired Miller Brewing in 2002 and its stock had dropped. Echo analyzed news articles, stock analyst reports, and movement in share prices of SAB and its top competitors. The consultants found a strong correlation between unfavorable news reports and declines in SAB's stock. It identified which journalists had the most influence on stock movements and which analysts the journalists interviewed. Echo recommended that SAB's communications strategy emphasize gradual but steady progress at Miller to restore investor confidence in the brewer. From mid 2003 to mid 2007, SAB's stock quadrupled.

Warren Weeks, CEO of Cubit Media Research, told *BusinessWeek*: "With today's technology, we can find every scrap of information on what is said about a company, second by second, and correlate that to movements in the share price."

*PR Week UK* reported a 2005 academic study that found a good corporate reputation can have a substantive effect on stock price. *PR Week* cited Sainsbury's, the UK department store, as an example. Sainsbury's reputation rose substantially in the magazine's annual "Reputation Monitor" that year, as did its share price.

These attempts to quantify reputation's value are not without skeptics.

Describing quantification as "tough," Hexter noted that stock prices can be volatile, affected by many things in addition to reputation.

SAB attributed its 2003-2007 stock gain primarily to stronger financial performance, for example. Nigel Fairbrass, SAB's media relations chief, went so far as to tell *BusinessWeek* that "Echo's research was considered an expensive expression of what was abundantly obvious to anyone with eyes in their head."

However problematic quantification exercises may be, the effort can contribute to the overall risk management process.

"A lot of that work is really most helpful because it starts the conversation inside the organization," Hexter said.

Despite the difficulty, Hexter and Taylor said, participants in risk identification brainstorming sessions should attempt to estimate the impact of reputation decline on revenues and the ability to hire the best employees.

"Get a lot of input from experts in the organization," Taylor said, and organize vigorous discussions of "what-if" questions: "If this happens, then…"

"In public affairs, you're not going to get the kind of data you can in other places," Henisz said, "but you've got to try the best you can. Analyze systematically. Challenge assumptions."

Being able to assess unquantified risk can make public affairs professionals more valuable to the entire enterprise risk management process, Henisz said. As in the financial meltdown, risk managers can become too enamored of quantification and miss risks that require subjective judgments, he explained.

"Bringing public affairs people in can improve the overall enterprise risk management process because they generally think based on logic and reasoning, as opposed to pure formula mathematical valuation," Henisz said. "And there are some things we can't quantify, that we have to work through with verbal logic."

Information extraction software — such as that used in attempts to quantify reputation — is being deployed by some companies to help identify risks in the news media and other forms of communication. The software looks for words and phrases in texts to identify positive, negative or neutral information being disseminated about an organization.

It can be used to evaluate Internet postings or communications by employees, consultants, outside stakeholders or others, Henisz said. The software can consider the credibility of sources and the prominence, frequency and longevity of coverage to analyze what stakeholders are talking about and what government agencies and activist groups are doing.

**Being able to assess unquantified risk can make public affairs professionals more valuable to the entire enterprise risk management process.**

Hexter described it as a kind of early warning system that public affairs professionals can use as the first step in analyzing an emerging risk. Then, she added, "you need a human to step in and say: 'The software has flagged this. We can't get out of the news cycle, and we need to do some intervention here.'"

Organizations often employ matrices to rank the importance of risks. One axis displays the likelihood that a negative event will occur, the other the amount of damage the event could cause to the organization.

When matrices are built out of discussions and voting, Sandman said, the organization should keep track of the range of opinions expressed. "Don't average away the views of outliers," he said. And don't treat a matrix as a tool of precision.

"Risk matrices are extremely clear — often much clearer than they ought to be, leaving people with the impression that they know more than they know," Sandman warned.

Deere uses a nine-box matrix to describe each risk. Before Congress passed financial sector reform legislation in July 2010, Stamp said, that issue sat in the highest box on both axes of John Deere Credit's matrix: "Something's going to happen, and it's a big-time issue."

Public affairs risks are identified in each major business unit at Deere by the unit's public affairs director in conjunction with business managers and the unit's advocates in Washington and state capitals. The matrices go to Stamp and other executives.

The matrices are "continually reviewed and updated," Stamp said. Each quarter, Stamp conducts a roundtable review of risks with his direct reports. Then he and other public affairs professionals, including the company's chief economist (also a member of the public affairs team) make a formal risk presentation to Deere's Global Leadership Council.

At Principal, Chief Risk Officer Lamale meets quarterly with the general counsel to discuss public affairs risk. She and the vice president for government relations also meet quarterly with regulators. Each business unit prepares a quarterly risk report that includes public affairs risk. Lamale then reports to the board.

Union Pacific produces an annual "enterprise risk book," which documents risks facing the railroad. Public affairs risks are identified formally in an annual meeting of Turner, some of his subordinates and a member of the law department. Senior executives rank the risks, and the strategic planning vice president compiles the rankings into a top-10 list. The compilation then is subjected to a "fairly robust discussion" at a senior executives' meeting before the final rankings are determined, Turner said.

Turner and his staff also identify public affairs risks throughout the year through regular communication with operating executives.

Disruptions caused by track repairs can damage the railroad's reputation, for example, so a public affairs professional sits in when the company's engineering department reviews its annual plan, Turner explained. Public affairs personnel then notify affected communities and work with local officials to resolve any serious problems that might occur. If track maintenance will block a crossing, Turner said, the local fire department needs to prepare a plan for getting to a fire across the tracks from the fire station.

# THERE'S OFTEN AN UPSIDE

## Finding Opportunity in Risk

Risk managers at the University of California at Davis decided to make lemonade from lemons — but they used olives instead. Fox likes to tell the story to underscore the importance of seeking opportunity in risk.

People were being injured by slipping on olives dropped by the many trees on campus, Fox said. When the university's enterprise risk management committee met with the grounds crew to discuss the problem, someone suggested that instead of collecting and discarding the olives, why not harvest them to make olive oil?

"After they stopped laughing, they said let's do it," Fox related. "They not only did it, they won awards at county fairs and made a profit."

Too many organizations focus only on avoiding or mitigating risk, she said. As a result, they miss opportunities.

"Risk managers with a downside mitigation mentality are rarely equipped or have the vision or time to recognize and manipulate opportunities," UK-based energy consultant David Wood wrote in *The Oil and Gas Journal* in 2009.

At the University of California-Davis, an effort to enhance safety by removing fallen olives from walkways became a money-making olive oil business — illustrating the potential for risks to create new business opportunities.

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No company can do away with risk, Lermack noted. In fact, higher risk usually is associated with higher return. In the stock market, for instance, stocks with higher risks must produce higher returns to attract investors.

"You make money not by taking the safest alternative to avoid the maximum amount of risk," he said. "You make decisions by figuring out what is the best combination of risk for you. Risk management is understanding the upside and the downside of risk."

Good enterprise risk management will uncover several kinds of opportunities.

"The first company to identify risk trends and respond to them may be the most successful in a market," John Hampton, dean of St. Peters College's graduate business programs, wrote in *Business Insurance* magazine in 2008.

If your company manages risks better than your competitors, Taylor said, "you may see an opportunity where another company may see concern. The better a company understands the competitive landscape, they're going to be able to take advantage of a dislocation or an opportunity that someone else might not see."

Business managers typically are better equipped to identify opportunities within in their business than risk managers are, Hexter said. But the risk managers "may be able to ask the right questions to get that thinking going."

Because of their broad view of the company and the society in which the company operates, public affairs professionals can be especially effective in helping to spot opportunity in risk — including, of course, political risk.

Governments — whether national, state, local, domestic or foreign — can create various kinds of political risks in developing and developed countries.

When a government liberalizes trade rules or enters a new trade agreement, a company can find an opportunity to expand into new markets. Tax changes can decrease or increase a company's costs. Changes in laws governing foreign investment or currency convertibility can create risks or opportunities, depending on how they're written.

At the same time, tighter consumer protection legislation can force a company to redesign its products or services, or to discontinue offering them in that jurisdiction. If a national government enacts tougher clean air laws, a coal company could lose sales or be forced to find new foreign markets. If a local government decides it doesn't want big-box stores and passes enforceable legislation, a major retailer could lose a potentially profitable location. Finally, a company can lose business simply because a government adopts standards that favor a competitor.

"As with the management of any risk or uncertainty, political mastery can become a source of competitive advantage in addition to a means of avoiding losses," Henisz wrote with Bennet Zelner of Duke University's business school in the April 2010 issue of *Harvard Business Review*.

Writing in the journal *Industrial and Corporate Change in 2004*, Henisz and Bennet said that managers who can better identify pivotal actors in the policymaking process and deliver to those actors the messages most likely to generate favorable policy outcomes may generate super-normal returns for their firms." (The paper can be read on the Wharton School Web site at www.management.wharton.upenn.edu/henisz/papers/hz_ephs.pdf)

# IT'S A DANGEROUS WORLD

## Diverse Global Risks Call for Flexible Risk Management Tools

Enterprise risk management requires a common framework for addressing risk across the organization and a common language for enterprise-wide communication. But different risks can require different risk management approaches within the common framework. And organizations' approach to risk is influenced by their own culture and the industries in which they operate.

Reputation can be affected by anything a company does, so reputation risk should be considered in all decision making, the Conference Board report recommended. It said companies should show business managers how their actions can affect reputation and should make sure reputation risk management is part of the enterprise risk management process.

Reputation and political risks can be affected by perceptions that may have no basis in reality, Peterson noted. Legislation and regulation have concrete consequences, but their creation is influenced by perception. "You can become a political whipping boy, subject to punitive regulation," without substantive reason, Peterson said.

Addressing those risks requires different skills from those that address financial, health, safety and many operational risks, he said. "Engineering is objective. If you're an economist looking at the market, you're looking at hard numbers."

Managing political risk "is not about science," Peterson explained. "It's about art. It requires more soft skills. It requires forward thinking. It requires a real objectivity to consider how a firm might actually be perceived negatively even when it shouldn't be."

As companies venture into new markets and buy from global supply chains, their operations become more complex and complexity increases risk.

"While technology has enabled new forms of intra- and inter-enterprise collaboration," PricewaterhouseCoopers said in a 2009 report, "its risks are also borderless."

Companies face different risks when producing or selling overseas because laws, regulations, government structure, culture and social conditions can be different from what executives are used to at home. Risks also can vary widely from country to country. U.S. executives will find conditions different but recognizable and manageable in other industrial democracies. Differences are pronounced in developing or authoritarian countries, however.

"Identifying and adapting to cross-national differences in the political environment are among the foremost challenges faced by managers of multinational firms," Henisz said.

Walker described "a tendency of companies to go in and just do business in the same way they would in their homeland, and that can't be the case. If companies operate in different territories, they need to be conscious of social conditions and cultural issues. There can be rule-of-law issues, regulatory issues and lack of infrastructure. Companies ought to understand human rights issues."

Holt noted that "every country requires its own approach. Each culture has to be appropriately adjusted for."

Particularly in developing countries, companies can face currency volatility, inconvertibility, expropriation, violence and political instability. Protecting employees' safety can be a significant challenge. When identifying and addressing risk in developing countries, organizations should focus directly on the people, not just on governments and social elites, as Chevron does in Angola, Henisz said.

"The network of relationships in a society greatly influences policy outcomes, especially in countries with weak legal systems," Henisz and Zelner wrote. "To turn these networks to their advantage, international investors must identify and engage local politicians' power bases."

**"Reputation and political risks can be affected by perceptions that may have no basis in reality. Legislation and regulation have concrete consequences, but their creation is influenced by perception."**
D.J. Peterson
Director of Corporate Advisory Services
Eurasia Group

A company's good relations with a government can lose all its value after a regime change, Henisz warned.

In addition to learning what's unique about each country in which it operates, a company must understand how its overall business can be affected by events occurring all over the world.

A single product may contain components manufactured by several different suppliers in different countries. Some of the suppliers may have acquired materials for their components from other suppliers. So a company's reputation can be damaged by actions of a supplier on the other side of the world, by a supplier's supplier several times removed from the company or simply by adverse events that disrupt the supply chain.

In addition, companies face risks in stakeholder relations from overseas firms to which they have outsourced call centers and back-office functions.

"Over the last few years, we've seen a number of risks that started with a supplier four steps removed from the company," Nelson said. "It's critical that you get a handle on where your supply chain is and how it operates, because ultimately, companies here are getting held accountable for those suppliers four and five levels upstream."

Organizations face new risks also from the globalization of cable television and the Internet. A local issue can explode worldwide in short order. Activists from anywhere in the world can attack companies operating anywhere in the world. A company that nurtures good relations with the government and the people in a developing country can come under attack from Western activists who disapprove of the company's conduct.

As international markets become more important to them, companies are creating "a much more global public affairs function," Peterson said. "That's one way in which public affairs is becoming more integrated." Companies also are turning to public affairs consultants overseas or to U.S. consultants with an international practice, Walker said.

By hiring consultants in countries in which it operates, Air Products has created "a pretty elaborate network of public affairs practitioners in the United States and Canada," and is building one in Europe, Holt said.

According to Walker, "Globalization "heightens the role of the public affairs professional" and "makes the job more difficult and more interesting as well. It requires awareness of what each of the businesses is doing and to see ahead as much as possible."

With companies manufacturing and conducting business in many different countries, suppliers and contractors can be a major source of risk.

SHUTTERSTOCK

# IT'S BEST TO ENGAGE

## Angry Public Raises Risk

Businesses have faced heightened risks since the world economy collapsed in 2008 and Obama took the oath of office in early 2009. Obama's inauguration and the increased Democratic Party strength in Congress replaced a hands-off-business federal government with one more amendable to regulation and other government activism.

The shift started when Democrats seized control of the House and Senate in the 2006 elections, and it occurred as public antipathy to all institutions was soaring. The highly partisan political atmosphere has also made it difficult for government to address major public issues, further inflaming public anger toward institutions that are seen as unable or unwilling to meet the public's needs.

In this climate, it's easy for businesses — especially big businesses — to become targets of the public's wrath and of government action. As a result, Nelson said, "I don't remember any time in my lifetime when there's been a more critical need for really good public affairs work, really good issues management work and really good crisis preparation work than right now."

SHUTTERSTOCK

In today's contentious political environment, it is easy for "big business" to become a target.

> **"Speedy responses are essential... because there's a 'very short timeline' between when a person hears information and forms a firm opinion. In the absence of response in a timely way, it's very difficult to change public opinion once a belief is formed."**
> Timothy Holt
> Corporate Relations Director
> Air Products and Chemicals, Inc.

The economic collapse "seeded an incredible amount of public anger — real anger, not unfounded anger," Nelson said. "Millions of people lost their jobs. There are a lot of frustrated, scared, angry people out there, and they're looking for people to blame and they're looking for things to be done — partly for retribution and partly to protect themselves in the future. It's very easy for companies to become the focus of that if they're not careful."

Cable news and the Internet "can amplify a risk event because we have a 24-hour news cycle and lots of airtime to fill," Hexter said.

Cable news channels search for stories with victims and villains, and big businesses make excellent villains, Nelson said. "That's a very easy flashpoint for a corporation to fall into, especially when the issues we're dealing with are far more complex than 15-second sound bites allow for."

According to Walker, cable and the Internet create a "need to respond immediately to an array of different audiences."

Social media (such as Facebook and Twitter) can also be potential sources of risks, Fox said.

The Conference Board survey found that 21 percent of surveyed executives believe new media have a large impact on corporate reputation while 36 percent see some impact and 43 percent see little or none. The survey found that 34 percent of companies "extensively monitor" social media and 10 percent participate. Even though the use of social media varies considerably across companies, the Conference Board reports that firms benefit from tracking and participating in social media to influence stakeholders.

By engaging stakeholders online, Fox said, organizations can respond to inaccurate information. "Putting out the message is a real big part of managing reputation risk," she explained.

"Speedy responses are essential," Holt said, "because there's a 'very short timeline' between when a person hears information and forms a firm opinion. In the absence of response in a timely way, it's very difficult to change public opinion once a belief is formed."

Comcast and Symantec are among companies that take new media seriously, the Conference Board reported.

Comcast — the Internet, telephone and cable TV provider — has a "digital care manager" with a staff of seven to monitor blogs and social networking sites. They can respond to criticisms and attempt to solve problems complained about.

Symantec — the high-tech software and services provider — created a cross-functional team to monitor and participate in social media, and established an advisory panel of influential bloggers. As at Comcast, Symantec monitors can try to solve problems. After one monitor helped solve a problem that was complained about in a YouTube video, the complainer posted a new video that thanked the company for responding.

As this report went to press, the need for engagement was underscored by continued ferment on line and in public affairs.

Use of social media continued to soar and online news media continued to be created and to grow. And the public remained as angry as ever, poised to punish Democrats in 2010 as they punished Republicans in 2006 and 2008. This potentially set the stage for another upheaval in the orientation of government — and in the ways companies assess the political environment and the risks it presents to their businesses.

## APPENDIX 1 Sources Interviewed

Eunice Carvalho, general manager of policy, government and public affairs for Chevron in Angola.

Carol Fox, risk consultant, chair of the standards and practices committee at the Risk and Insurance Management Society, former head of enterprise risk management at the relationship management firm Convergys.

Witold Henisz, associate professor of management at the University of Pennsylvania's Wharton School.

Ellen Hexter, consultant, leads the Conference Board's work in enterprise risk management.

Timothy Holt, corporate relations director at Air Products and Chemicals Inc.

Ellen Lamale, senior vice president and chief risk officer at the Principal Financial Group.

Harvey Lermack, interim dean of the Philadelphia University School of Business Administration, former risk management director at Conrail.

Tom McMahon, director of corporate communications and government relations at Qwest Communications.

Chris Nelson, crisis management consultant, former head of Ketchum's crisis management network.

Darrin Ocke, manager of U.S. government affairs at Mead Johnson Nutrition.

D.J. Peterson, director of corporate advisory services at Eurasia Group, a global political risk research and consulting firm.

Peter Sandman, risk communication consultant.

Charles R. Stamp Jr., vice president for public affairs worldwide for Deere & Company.

Laura Taylor, heads the enterprise risk management practice for Aon Global Risk Consulting.

Robert Turner, senior vice president for corporate relations at Union Pacific.

Scott Walker, international consultant in communications, public affairs, corporate social responsibility and risk.

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