



SPECIAL REPORT

# Litigations and reputational risk

Measuring the impact of legal  
proceedings on the reputation  
of companies.

Madrid, April 2015

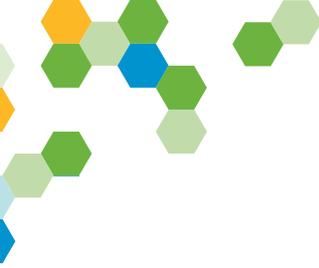
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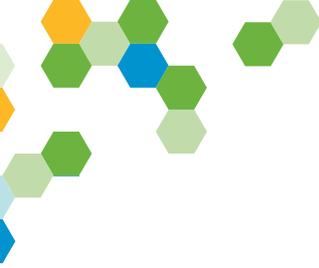
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## 1. INTRODUCTION

Over the last years, we have seen a growing concern for reputation management when facing legal proceedings. It is increasingly common for **litigations** to pose a **severe threat to the reputation** of a company and/or its management. This is due to the fact that legal processes significantly affect the opinion that the various stakeholders, and the society at large, have about the company, not only as a result of the proceeding itself, but also because of the **“parallel trial”** which involves the company or people that take part in the litigation, which might ultimately entail an **important loss of trust**.

The **development of Internet** and social networks has enhanced this “parallel trial”, which now has a larger scope and spreads at a faster pace. Thus, the creation of opinions regarding the litigation no longer exclusively involves journalists and the media; **any user can share his opinion** and even be relevant and, therefore, the credibility of the digital environment is slowly increasing. In this context, the people responsible for managing the case cannot, under any circumstances, ignore or do not take into account this scenario, but should act in compliance with the rules of **speed, immediacy and perdurability of the information** which govern this environment.

Furthermore, these opinions might entail discussions about other affairs that affect the company, either to its advantage or disadvantage, undoubtedly impacting its reputation. In this sense, much attention should be paid to **the processes that can generate greater interest** due to their own nature –for example, issues that fall within the scope of criminal law–. These procedures are usually in the limelight and attract more attention, entailing a **wide range of opinions**. However, thanks to our experience managing this type of cases, we can affirm that **“parallel trials” are unavoidable**, and thus it is increasingly important to combine the communication strategy of the enterprise with its legal strategy in order to minimize the impact that the litigation might have on the reputation of the company or the people involved. Legal proceedings are, beyond their legal scope, a competition where both parties fight so that their opinion prevails, so that their position is heard, understood and remembered. Therefore, it is **essential for the communication strategy to be based on the correct principles and be well-organized**.



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This being said, it is not surprising that the opinions of experts usually state that the management of communications influences, to a greater or lesser extent, the result of the litigation and the reputation of the people involved, regardless of the ruling or judgment thereof. However, it is essential, in order to achieve the aforementioned sound management of the communication and reputation, to be able to **exactly measure in what way and how much has the litigation affected the reputation of the company**. Identifying the changes on the thoughts and perceptions of our stakeholders will allow us to adapt our message and communication, which in turn, will help us to identify the weaknesses, strengths and spaces where we can act from a reputational point of view.

## 2. KEYS FOR THE MANAGEMENT OF CORPORATE REPUTATION IN LEGAL PROCEEDINGS

### THE NEW REPUTATION ECONOMY

The Internet and information society continues enhancing the intangible value of corporate and institutional reputation across all levels of society. In the business world, corporate reputation is key to achieve the **trust** of all stakeholders and, therefore, to meet all **objectives and results** that a company has regarding customer loyalty,

sales, access to talent and attraction of the latter.

But this also affects increasingly so, litigations. In fact, reputation is a kind of **global judgment** issued by the public opinion in relation to a person or institution. **A parallel trial without any type of procedural guarantee**, a trial based on impressions, rather than evidence, on hearsay or even prejudices and biased approaches. A trial that, at the end, influences the result of the litigation or might strongly sway it and, above everything, its consequences in the long term.

Reputation is the basis of trust and respect that every corporation or professional needs in order to develop its business model in the market, particularly in a context in which **prescription** is becoming increasingly important. Reputation guarantees the necessary environment to achieve business and professional success, in order to both **build a sustainable differentiation element** in the market and protect it.

Understanding the reputational aspects of the litigation – particularly as regards high-profile cases– and knowing how to appropriately define the features that need to be considered and protected is essential so as to achieve results that go beyond the outcome of the litigation. We would like

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to highlight several keys for the management of corporate reputation that might and should be applied as regards the reputational management of the litigation.

#### FROM CORPORATE MINDSET TO SOCIAL MINDSET

Since it is a shared social reality –a global judgment on companies– reputation is a measure that has to be informed by the stakeholders. That is, the starting point implies **carefully listening to the opinion of the stakeholders and understanding their expectations.**

However, even nowadays, most of the businesses manage their corporate reputation within their own corporate approach –corporate mindset–, which they try to transfer to their stakeholders by using communication and corporate marketing tools. This “inside out” management model is based on a very simple idea: **do it well and communicate it well**, in order to receive **positive feedback** from the stakeholders.

This is a classical push-model, which implies **transferring the corporate mindset** –our strengths– into the audiences that we address in an “inside out” manner.

This management model cannot appropriately explain the reasons for which certain enterprises are highly attractive for their stakeholders and

others, despite achieving positive results, fail to generate sympathy or respect across the market. This is the case of the financial sector in Spain, which barely obtains a passing-mark as regards reputation –5.6 out of 10– despite its positive results and the state of solvency of its main members.

In the business sphere, the “inside out” model usually shares the approach of managers and shareholders and, thus, it is not sufficient to meet the expectations of the remaining stakeholders. Most of the businesses make huge efforts to convey their message to the public opinion in an increasingly complex communicational environment, where competitiveness grows and wariness regarding corporations and institutions continues spreading. As regards litigations, the push model would imply merely conveying “armored” messages to the public opinion regarding the procedural strategy. But in order to carry out an appropriate reputational strategy it is essential to understand the mental processes that filter the information and augment it or completely delete it. **These mental processes are what we call expectations.**

#### FROM PERFORMANCE TO EXPECTATIONS

The works of Daniel Kahneman, 2002 Nobel Prize in Economics for his research on the process of elaboration

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of judgments, clearly points out that it is other **factors** beyond the performance which **determine the judgment of the stakeholders**: prejudices, biased ideas, impressions (the big picture), basic beliefs shared at a social level... All the aforementioned have a much larger influence in the creation of a reputational judgment than any thorough analysis of the management variables of any enterprise. As the research carried out by Carreras highlights, **reputation does not yield any results when it is kept at a rational judgment level; it does when it reaches the emotional level.**

In his analysis of the behavior of financial markets, George Soros developed the **theory of the reflexivity** based on an understanding close to the **reality of the expectations** of investors, rather than complex mathematical models to analyze the markets. This reality ultimately determines the trends of the market. This theory has proved to have a much more exact **capacity of forecast and anticipation** than traditional mathematical models.

Logically, businesses which seek to achieve a good reputation will have to “make things right” and “communicate them well”. But doing things right means, firstly, **understanding the expectations of stakeholders** and being able to **provide an appropriate response** to each of them. The same can

be said of litigations. In a good communication strategy, the conveyed message is not as important, the received message is what matters.

#### REPUTATION VARIABLES

But, what are the expectations that positively influence corporate reputation? The qualitative research and experience of LLORENTE & CUENCA regarding the management of corporate reputation has allowed us to identify **five main areas of expectations** that can explain, in over 80%, the corporate reputation of companies and people. These expectations **can be measured** and provide us truly relevant management indicators for all stakeholders.

- **Emotional expectations.** They are related to the **image of the company or the people** in question and they significantly influence the judgment both will receive. They depend on visibility, differentiation and success. An attractive image generates an emotional connection with the people that want to be related to that brand or person.
- **Pragmatic expectations.** Related to the **degree of credibility/reliability** of the company or person; the **degree to which they fulfilled their promises** or the quality of their actions. They establish a more rational connection.

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It shows that a company is reliable or professional.

- **Relationship and dialogue expectations.** They are linked to the **transparency and efficiency of the communication.** They depend on the ability of the company or person to explain themselves. It creates a personal connection of closeness.
- **Value expectations.** They are linked to **behavior and ethics.** They depend on the best management or professional practices: an honest, fair corporation which abides by the laws –an exemplary conduct–.
- **Contribution expectations.** Based on the ability of a company or person to contribute to finding a **solution to the problems** that affect society.

According to the **Reputation Relevance** model developed by LLORENTE & CUENCA, which has been statistically validated, the adequate response for this type of expectations allows us **to appropriately manage over 80% of the reputation**, whether corporate or personal, from a point of view of both risk and opportunities. Risks usually arise due to the inability to meet these five expectations at a social level; opportunities are more related to the competitive environment: corporate reputation is an advantage which provides

excellence in the management of these five expectations or, in many occasions, also being the “lesser evil”. The first three expectations, in the aforementioned order, contribute in terms of **differentiation**; the two latter are **legitimacy** elements.

#### KEYS TO BUILD THE CORPORATE SPEECH FOR LITIGATION

The organizations with the best corporate reputation are implementing a management model much closer to the reality of the stakeholders than most of the largest corporations. A model based on understanding the basic beliefs that promote or slow down their development within the market. A model based on meeting the expectations with tangible realities and clear messages. Building a **positive reputation implies “doing things well” and “communicating them well”, but always doing “what needs to be done” and “communicating what must be communicated”**. The key to reputation management is building, in a consistent manner, the big picture which gives meaning to the expectations of our stakeholders.

In order to manage the reputational “parallel trial” in litigations, as we have seen, the key is to have a **credible response capability** which meets the main five expectations that shape the corporate or professional reputation.

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### 3. SOME CONSIDERATIONS ON REPUTATIONAL DAMAGE, PARTICULARLY IN RELATION TO CRIMINAL PROCEEDINGS

Of the two meanings of the concept of “Reputation” – opinion or belief generally held about something or someone and esteem or good name that someone or something holds – it seems as if the latter is the definition we often use when talking about it. Recently, the concept of **reputational risk** has been coined in a more precise manner: **the risk of a negative public opinion preventing or diminishing the ability to carry out business** – particularly in the financial sector –. However, it should be noted that the *reputational damage* has rather different features which are much more difficult to handle.

In these cases, the **reputational damage** is the consequence of the disclosure or publication of information relating to natural or legal persons involved in criminal proceedings whose outcome might be uncertain or even in cases where it is clear that no unlawful activities were carried out.

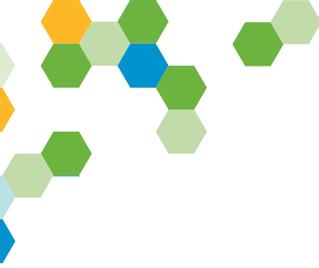
It is precisely within the business field where there is an important need to mitigate as much as possible any kind of reputational damage entailed by criminal proceedings. Moreover, it should be noted that a “**good reputation**”

**cannot be protected if there is no positive reputation in the first place.**

The main feature of **reputational damage** entailed by criminal proceedings is that it usually is **uncontrollable *a priori***, since the possibility of having to face a criminal proceeding or police or legal action cannot be predicted. Once the event that causes harm has taken place, the only strategy that can be implemented is the adoption of measures to minimize the damages, such as measures related to a **sound communication policy**.

In most cases the *reputational damage* presupposes an abusive action by the state bodies responsible for the investigation or prosecution of crimes or by the members of the justice administration. Thus, the only possible way to avoid any kind of *reputational damage* would be the **strict enforcement of the existing laws**, although, unfortunately, our daily routine shows various examples of breaches thereof which entail no consequences. The only possible legal actions within the civil scope are those covered by the rights of the **protection of the reputation and image**, which in practice, as regards this field, **lack any legal form**.

It is true that in the field of criminal law, there are certain statutory arrangements which protect the reputation,



basically, the offences of calumny and libel. But **the legal compensation they can provide is always late, unsatisfactory and very limited.** We could even include in this category certain crimes such as false accusation or report, but the result will be similar to the previously described one.

Under these circumstances **the only possible action against reputational damage is a posteriori, reactive, palliative,** seeking to control the information resulting from criminal proceedings from that moment on so as to alleviate its harmful consequences.

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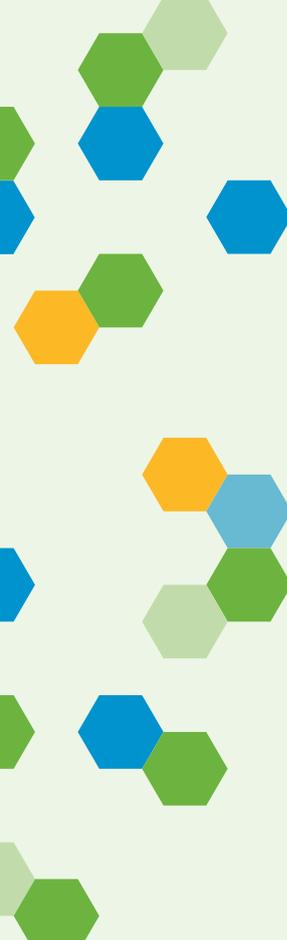
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