EAST-WEST
Journal of **Economics and Business**
Vol. XIX – 2016, No 2

REPUTATION RISKS: WHAT ENHANCES THE EFFECTIVENESS OF REPUTATION RISK MANAGEMENT IN OIL & GAS COMPANIES?

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ABSTRACT

The study will attempt to answer which factors enhance the effectiveness of reputation risk management (RRM) in the oil and gas industry, will define which risks are eminent from the oil and gas external environment based on PESTEL's framework analysis, as well as, will describe the competitive forces in the oil industry that determine a company's profitability. The methodology used is based on an empirical study through the development of a questionnaire distributed to employees who work in oil & gas companies. The conclusion is that stakeholder management, transparency and corporate social responsibility (CSR) initiatives are major factors enhancing the effectiveness of RRM. The survey also indicates that RRM is regarded as highly important while the main issues RRM has to deal with is unethical business practices and breach in regulations.

Keywords: Reputation risk management (RRM), risks, corporate governance, oil & gas

JEL Classification: M0

Introduction

The reputation of oil and gas companies is at stake as they are increasingly faced with a diverse range of social and environmental accountability issues (Davies, 2002; Roberta, 2013). The outcome of these issues is a negative perception of the oil sector's integrity especially in the global market. This has in-fact moved reputation to the *center of strategic thinking* and hence in a defensive light, companies must align reputation with risks (Dalton and Croft, 2003 p2). Dalton and Croft, (2003) further indicated that a company must adopt a proactive approach when assessing issues and the risks each may pose.
Oil practitioners and risk professionals (Davies, 2002; Larkin, 2003; Neef, 2003; Roberta, 2013) have come to a consensus that the reputation concept is important in the oil and gas business or in business. Companies must manage risks across the industry to effectively protect its reputation (Neef, 2003). A failure to manage these risks creates loss of share value, consumer boycotts, lawsuits and greater regulation. But despite the intensive knowledge of what reputation is and its supporting importance, the concept still has no clear-cut management principle and definition. This research argues that reputation risk management is important for oil companies to survive and be profitable. Furthermore it indicates specific factors that can enhance reputation risk management which should cut across an oil company's enterprise on an operational level (Roberta, 2013) .

Background

At an international or domestic level, risks to reputation are sensitive issues faced by the oil and gas industry (Davies, 2002). Risk is a persistent issue in the activities of major oil organizations. This persistent nature of risk to reputation arises from the fact that reputation risk incorporates all risks at all operational level of the oil and gas industry (Ong, 2006). These include processes along each industrial stage from negotiation to the abandonment stage of the oil project. These negative threats become highly visible to the society and further create a certain level of vulnerability to the international brand reputations of the multinational oil companies (Austin and Sauer 2002, Frynas, 2008). Another underpinning reason for a high exposure of reputation risk to oil companies is that most of them do not really have a choice to choose their areas of operation hence, they venture into areas with high socio-political risk while been coerced to operate in uncertain environments.

The oil and gas industry face certain exposures to risks emerging from negotiation issues, environmental damage, expropriation, corporate governance failures, complexity of business transactions, outburst of contracting out, and increased

level of competition to the rapidly changing environment (Deloitte, 2006; 2012). The industry also faces risks arising from perception issues due to its past records. Reputation is a matter of stakeholder's perception or belief which may either be positive or negative (Larkin, 2003). However, Robert *et al.*, (2007) argued that reputation is not reflected in the actual nature of a company. Hence, when a company is overconfident about its reputation status than it is in actually reality, a failure to manage that reputational standard poses a latent risk for the company. The materialization of this latent risk tends to create a negative perception in the mind of stakeholders about the company up until the time in which the company's reputation matches that of reality. This direct relationship between reputation and stakeholder perception is linked with the work of Fombrun and Van Riel, (2004). Larken, (2003) further suggested that strong reputation must be effectively managed and *resourced long-term* for strong communication and good relations with stakeholders. This strategy according to him gives the oil companies a chance to adjust in terms of crisis and creates the willingness for stakeholders to give the company a benefit of doubt in times of crisis.

Therefore, to manage the risks to reputation, Robert *et al.*, (2007) indicated that the oil industry must either do more to meet expectations or must promise less to reduce expectations. The latter might not be a good idea for the oil industry as operating communities demand more from the oil companies. This fact is further complicated with the idea that expectations and beliefs of stakeholders are precarious hence, increasing the risks to reputation for the oil industry (Robert *et al.*, 2007).

According to Walker (2010), major features are stressed in defining reputation by scholars or practitioners. These features include the fact that reputation is based on perception and is a collective perception of all of a company's stakeholders, it is comparative that is either negative or positive and it is stable and enduring. In relation to the oil and gas companies, reputation simply is the reason why governments or host governments and communities do business with companies and give them the benefit of the doubt in any case where risk to reputation cannot be managed.

Furthermore, reputation is strategically essential in conditions where host governments, operating communities, or other MNCs are deficient of information during negotiations and in oil operations. That is, circumstances where a player affected by oil activities is less informed about factors that defines the other player's strategy. For instance, Robert *et al.*, (2007) illustrates that if a company changes its policy or behavior; it may cause a stakeholder's expectation to change rapidly. The rapid change of expectation may result to risks but as mentioned early

a good reputation may give the company an adaptive chance to the changing situations presented by the stakeholder's perception (Larkin, 2003).

The oil and gas industry is typically classified as a business that combines knowledge, knowledge workers (Martin, 2012), technology, politics, environment and economics in a risky venture to extract a vital product. This business model of oil companies creates a portfolio of risks that emerges from the negotiation process of the project down to the abandonment of the oil venture (Inkpen and Moffett, 2011). Furthermore, Ong (2006) indicated that, the industry is notoriously characterized by its inefficient portfolio of risk diversification strategies resulting from its vast sources of risks. These risks and inadequate strategy or management tend to create a poor reputation for the industry. The reputation of the oil industry then faces the prospect of reputation damage due to the exposure of risks across the enterprise. However, the greatest risk to reputation as identified by Davies, (2002 p.416) stems from circumstances when one or more individuals from an organization have said or done something that can seriously damage *the perception of the organization's honesty, trustworthiness, ethics or reliability or about the quality of its goods or services or about its concern for its stakeholder or other group*. Neef (2003) further argued that the lack of knowledge and an inappropriate risk management framework may lead to risk exposures or reputation damage. For some oil companies, a weak internal coordination may be a key determinate for risk to reputation. Weak internal coordination may arise from a scenario where a particular group in a company creates an expectation which another group in that same company cannot fulfill. In such a case, the unrealistic expectation or timing of unrelated decisions could lead to a negative conclusion by the company's stakeholder (Robert *et al.*, 2007).

Many factors both external and internal in the oil and gas business environment may lead to the destruction of reputation. These factors are called risks. External risks to reputation arise from the political, environmental, social, technological, economic and legal environment which the oil company operates in. On the other hand, the internal risk is in conjunction with the idea of economist and Nobel laureate Milton Friedman who explicitly indicated in his essay that "*there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game* (Friedman, 1970 p.6)." He further explains that the rule of the game means both law and ethics or custom. However, what is the case when the game is deficient of rules? The oil company's should take responsibility to reduce negative impact on the society and increase positive benefits since it is the society that gave life to the corporation. One thing should also be clear, business is not a game, but rather it is a necessary condition for economic growth (Gavai, 2010). This

economic growth helps to improve the life of communities in which the oil company operates. Hence, as the oil industry is heavily prone to negligence, fraud and negative externalities, situations in which the business does not follow or has bent the rule of the game, it may bestow a negative impact on the society (Larkin, 2003). While according to Friedman the only social responsibility is to increase profit as long as it plays within the rules. Business must obey the law but must also operate ethically in the absence of the law and take responsibility to mitigate any damage caused by its operations (Roberta, 2013).

The purpose of this study is to investigate the factors that improve RRM. These factors as indicated by scholars include stakeholder management and corporate social responsibilities (Lewis, 2003; Fombrun *et al.*, 2000) other factors for enhancing effectiveness for RRM on a corporate social level are business ethics and corporate values, corporate governance, transparency, accountability (Gillies, 2010), community development, human rights, health and safety issues. In this research, knowledge and knowledge worker management is also proposed to enhance the effectiveness of RRM (Martin, 2012; Kimiz 2013).

Where the management board gets it wrong is when they are too focused on solving the social reputation issue listed above and they leave out environmental enhancing factors such as biodiversity management, new technology, conformance to accurate technical standards and lastly, to never misjudge the power of non-governmental organizations(Cho *et al.*, 2012). These factors of the social and environmental solutions combined together will help mitigate the origin of any risks and thus enhance the effectiveness of RRM in the oil and gas industry.
This study applied both qualitative research. As part of the quantitative analysis, an online survey was selected as most appropriate. The chosen service context is strictly oil and gas companies and draws attention to oil and gas professionals only. Generally, the theoretical frameworks applied in this study cover different subject areas of risk and strategic management.

Part of the qualitative analysis is to investigate the business environment and identify the risks to reputation affecting the industry, hence, adopting the PESTEL framework. The competitive situation in the industry which impacts the ability of companies to sustain profitability will be examined by the *porter's five forces model*. The second part of the qualitative analysis will focus on risk management principles and how they can be applied to reputation and on factors that can improve RRM.

This study adopts the definition of reputation risk from the work of Soparano *et al.*, (2010 p159) as *the risk of damaging an institution's trustworthiness in the*

marketplace. This definition was related to financial institutions buttressing all risks involved in a business environment however, this study only focuses on risks in the oil industry's external environment rather than on market, credit or liquidity risks. The term reputational risk for convenience is used in this paper to capture all those risk which could affect the reputation of the oil and gas industry. Reputation in that regard will then be a "*collective representation of the* oil and gas industry's *past actions and results that describe its ability to deliver valued outcomes and expectation to its stakeholders* (Fombrun, 2001)". Although most studies may have focused on improving RRM, it is particularly challenging to find studies that have related it to the oil and gas sector. This study examines the external and internal environment of the industry using qualitative analyses before relating the assumption of scholars or practitioners to the oil industry. Also, this study will consider the oil and gas as the same industry Inkpen and Moffett, 2011 p21) focusing on Multinational (MNCs) or International (IOCs) oil companies. For Channon and Jalland, (1979 p2) a MNC is "*a company which seeks to operate strategically on a global scale*".

An Analysis of the Oil Industry

The Oil Industry's Macro Environment- PESTEL Analysis

Shell Energy Scenarios (2008 p6) indicated that any energy system sits at the nexus of some of the deepest dilemmas of present time. These include *dilemma of development- prosperity versus poverty; the trust dilemma- globalization versus security; and the industrialization dilemma- growth versus the environment*. To understand these dilemmas, the external environment of the oil sector must be examined. The PESTEL framework is a macro level strategic analysis which is used to assess the external environment of the industry. That is, how it can impact an oil company's operations and how it eventually influences the value of the oil company (Yuksel, 2012).The PESTEL examination was found necessary because oil projects are risky due to external environmental factors. The factors are indicated in six major categories; Political, Economic, Social-cultural, Technological, Environmental and legal factors.

The oil business and politics are like dogs, you never know when they are playing together or playing against each other (Deloitte, 2009). Today, the NOCs control about 75% of the world's conventional resources. The NOCs according to Deloitte, 2009 were created by different governments to seize control of their domestic resources and as a result created fiscal policies against oil companies (IEA, 2008). The political environment in which an oil company operates in is directly linked with the supply chain of the sector. This link creates a threat to the reputation of

the company due to reasons like different government regulations and policies, nationalization of property, terrorism, civil conflicts, strikes and acts of war (Deloitte, 2006). Changing regulations and policies are challenging enough for the oil companies. This given situation compels the companies to venture into new technical and geographical regions. Thus, this creates new challenges for both the company and operating state government which may need to make critical decisions within a short time frame (Business Pulse, 2013). The critical decisions made by governments depend on geopolitical priorities on environment or economics of their nation. Globalization furthermore poses a challenge for oil companies venturing into new regions. Furthermore, in many new market opportunities, companies are faced with strong local content or ownership provisions. Ernest and Young, (2013) also explains that governments in some cases may not allow foreign companies to participate or limit participation in their domestic market in effect to service contract. As oil companies are faced with precarious geopolitical situations, their operational strategy will change and influence their reputation either positively or negatively. Honey (2009) also demonstrated that it is possible for an organization to have more than one reputation. That is, as geopolitics influences change, companies may decide to be more regulatory compliant in other to obtain a good reputation in the eyes of the operating government. Consequently, reputation is based on perception and perception depends on where stakeholders stand.

The interdependency between the oil industry and international or domestic market makes it a unique discipline. The global economy is not only reliant on continual supply of oil at reasonable prices, but also necessary for economic development. The economic situation in the oil industry is one that is subject to negative and positive externalities. The idea behind the positivity and negativity of the oil resource has been described by most economists as the resources curse (Inkpen *et al., 2011*). Furthermore, according to Inkpen *et al.,* 2011, the development dilemma lies with the fact that oil creates as well as destroys. The destructive aspect lies within the fact that if a company gets involved with a corrupt government it may be deemed corrupt itself. On the other hand, as economics of different nations are becoming complex, the complexity yields higher costs for oil companies. The companies' consequently face cost containment issues. To easy this cost containment pressure, companies result in some cases to cost cutting strategy which may in fact lead to corporate disasters (Oxford Analytica, 2013).The logic between cost cutting and reputation risk is simple. Most at times, oil companies are under pressure to cut cost and increase profit and they unfortunately neglect health, safety and environment measures. In situations where the negligence will materialize into a crisis situation, this attracts environmental activists, legal bodies, media and the public. Once regulatory bodies start a survey

of a company on several noncompliance issues, the reputation tends towards been negative (Larkin, 2003). Competitive resources also pose another challenge for the oil sector. For example, Oxford Analytica, (2013) indicated that the development of Shale oil and gas in United States is driven by energy cost and security (Bailey, 2005). Developing nations like Brazil, Russia, China and India are becoming more energy intensive as they industrialize, build infrastructure and increase transportation use. Their demand pressures will arouse competitive alternative supply. This will lead to a further competitive operating environment for integrated or international oil companies.

Shell (2008) also indicated that by 2015 oil companies will struggle to keep up with supply regardless of alternative energy sources. These factors preset oil companies with inevitable risks with the idea to reap rewards. As they constantly, venture into the voyage for the search of new resources in areas of unknowns, they tend to impact their reputation negatively.

Social-cultural environmental risk factors of the oil and gas industry needs little or no introduction. Social-cultural forces determine the norms and lifestyle of societies. The norms and lifestyle of the society in which oil companies operate in creates a certain demand from the companies. Hence, Corporate Social Responsibility (CSR) is a challenging issue faced by the oil industry due to their image. *Strategic Management* defines CSR as "the expectation that business or individuals will strive to improve the overall welfare of society (Lene and Oddny, 2004)." In the context of business, "managers must implement steps to make society better". Generally, companies need to take into consideration the needs of the community at large. As globalization increases the need for environmental and community care, companies must focus on been socially responsible. A green wash strategy involving corporate philanthropy may longer be effective. Therefore, companies must understand the impact of their project on operating communities and find ways to mitigate or eliminate risks (Lene and Oddny, 2004).

Technology is needed in the industry now more than ever to connect governance, risk and regulation compliance. In this focus, the industry continuously innovates in advance technology for deep water drilling, Information Technology and research and development in clean and renewable energy. Innovation however, creates new challenges and is not a magical bullet that will solve the industry's problem. For instance, Roberta (2013) indicated that there is an increase in recent cyber-attacks for oil companies. This is evident in cyber-attack on Saudi Aramco in August 2012 and RasGas. Furthermore, the hydraulic fracking technique for extraction of gas from shale rocks also comes with significant challenges. The

fracking process involves putting a mixture of water and chemicals down a well under a high pressure to fracture the rock and increase gas flow (Roberta, 2013). This process as indicated by Ernst and Young, (2011) carries possible risks like chemical spill and water aquifer contamination. The overall impression is that technology will determine the future development of the oil market and the sustainability. This idea is as natural resources deplete, new discoveries are constantly showing up at increasing depth of sea which are not yet technically feasible (See Ernst and Young, 2011 p16).

The inability to maintain environmental probity with oil and gas projects has led to environmental issues that now dog most projects in the oil and gas sector. The industry is considered as one of the most polluting sector in the world. This is due to oil spills and increasing pollution rates on oil platforms. Almost all companies involved in the sector are prone to environmental issues. In present discourse, environmental issues are faced with health and safety. Ernst and Young (2011) risk report indicated that Health, Safety and Environmental (HSE) issues increase the oil industries' agenda. Specifically, public outcry over environmental effects has forced government to enact new regulations thus increasing the exploration and development costs. The risk report also anticipates the fact that strict regulations will increase offshore exploration and development costs. HSE pressure is likely to make oil companies incorporate an improved management HSE system, align HSE with organizations goal, visions and governance models. Most importantly, companies with health and safety capabilities may be awarded contracts or licenses to explore and exploit resources. This is because the companies will have the capacity to contain environmental disasters and other work hazards (Ernst and Young, 2011).

The legal elements in the macro environment characterize the oil industry by a great deed. Oil companies whether domestic, international or integrated are subjected either to domestic or international laws or both. Furthermore, oil companies are required to obtain licenses or contracts either in the form of production sharing agreement, concession agreement or a service contract agreement. These agreements come with their own type of issues on tax or royalties.

The major legal elements affecting the reputation of an oil industry is been regulatory compliant. Companies within the sector must be compliant to regulations, laws and must show obligation relating to environment issues such as climate change or global warming. This cuts across international, domestic, state or local policies and regulation on the oil industry's product, project and activity.

Although, compliance may seem expensive for an oil company, a failure to do so will sustain a bad reputation for the company. Most oil companies may not find putting in place systems for been regulatory compliance important, as it is difficult to appreciate a risk that has already been avoided (Pettinger, 2002; Ernst and Young, 2011). The elements that present a threat to reputation of an oil company also present a company with strategic competitive advantages and issues. The question that arises now is how does this happen?

The Oil Industry's Structural Analysis-Competition Analysis

The profitability of an oil firm depends on how well it competes in the industry. A firm's competitive strategy is attributed to the basic competitive structure of the oil industry in general. The logic lies with the fact that the profitability of the firms is likely to depend on the prosperity of the industry. In that focus, oil practitioner are may adapt the use of the Porter's five elemental forces of competition. The purpose of the framework or analysis is to clarify the position of oil companies in its sphere of operations and also to signal various reputational issues. Furthermore, it considers how an oil company may interact with its rivals and the initiative it may consider to promote its strategic advantage. It also accounts for likely responses to such initiative for an organization (Pettinger 2002; Winn *et al.*, 2008).

The porter's analysis takes into consideration established producers in the industry, suppliers of alternatives and new entrants to the market. A firm is likely to have high returns due to two major reasons; first of all if there are significant barriers to entry and second if the firm has a significant advantage over its competitors. The analysis in this section will help investigate how the competitive situations in the industry will impact the profitability of an oil firm at present or in future.

Threat of New Entrants: Without any doubt this threat is insignificant to the oil industry despite the lucrative nature of the industry. This is due to the high barriers to entry that exist and also due to fact that the products cannot be differentiated in the oil business (Inkpen *et al.*, 2011 p176). The barriers are induced by the following;

Cost advantage is certainly an influencing factor in the oil business. It arises from the huge capital requirements (this include sunk costs and capital investments) associated with oil projects which are sited in upstream, midstream or downstream activities of the industry. Costs arise from activities such as the enormous fixed up-front investments known as sunk cost. For example, Christopher (2013) illustrated the cost of constructing an oil and gas pipeline of 15,300miles to amount to $50 billion or above. He also indicated the cost will increase over the years. Additional,

Total and BP have a competitive cost advantage in oil and gas production as at 2011 at $6.00bbl and $6.20bbl respectively while ExxonMobil and Chevon on a higher end of around $9.80bbl and $9.40bbl respectively.

Another barrier is the economics of scale. This indicates increased unit costs in exploration and production of oil gives an advantage to only international or integrated oil companies and refineries. The need to secure distribution channels is another impending barrier. The time required to build new infrastructures like gas stations, distribution stores or other activities is the issue here. This creates an obstacle for new entrants. The greatest obstacles however are from economic elements such as unprofitable government policies which favor NOCs. Experience and technology know how also divert new entries in the industry (Jeyarathnam, 2006; Inkpen, 2011).

Bargaining power of Suppliers: Most NOCs and IOCs have a complex chain of contractors. These contractors range in different field of specialty from engineering, field development down to research and development. Contractors or service companies are not the owners of oil reserves. However, they face a series of challenges arising from the new exploration areas venture by their client ranging from complexity of the project down to operation's know-how. Furthermore, clients also increase the pressure on their contractor to drive cost down. In addition to the challenges, contractors have their own suppliers who are position and profit driven. Despite these difficulties, certain factors can improve a contractor's bargaining positions in the market. These positions improve the bargaining power of the contractor; fewer input alternatives provided by the contractor to the client, quality and unrivaled input offered by contractor to client, critical and high value of the input provided by contractor to client, little or no punitive damage for the contractor regardless of his performance, inability for the client to purchase directly from contractor's supplier. These positions improve the bargaining power of the contractor to capture a higher profit share if his client earns an exorbitant profit margin in the value chain of the oil business (Inkpen *et al.*, 2011).

Bargaining power of Consumers: the interest and power of all stakeholders are ceaselessly tangled with exploration and development activities of oil companies. Stakeholders will mean certain individuals or group which have a stake in IOCs or NOCs activities. The stakeholders vary from government down to various Non-Government Organizations (NGOs). The government holds title to most of the oil reserves hence, they grant licenses for drilling to the oil companies.

Holding title to such valuable resources involves complex issues of national security, national wealth, nationalism and geopolitics. These highlighted factors

increase the bargaining power of the government. Furthermore, the recent issue of social responsibility, transparency and work ethics has also created interaction between the general public, NGOs and oil companies. Companies can now be held legally accountable for their actions in the market place. Hence, this improves the bargaining power of the consumers as opposed to weaken position of the companies' involved (Inkpen *et al.*, 2011).

Threat of Substitute products: Every industry has a substitute product which will limit profit potential and value creation for firms involved in the industry. The Oil and gas industry is faced with the threat of new energy sources due to government regulations on the harmful impact of oil on the environment. This condition creates an opening for the increase in the use of renewable and bio-fuels which emit less carbon. Another threaten product is natural gas which is cleaner than oil. Although, the gas energy mix presents new challenges like storage and transportation to the market, entrepreneurs and legal practitioners have created a strategy to combat such problems. For the transportation and storage issue has been solved by upcoming LNG product (Inkpen *et al.*, 2011). The detail of this strategy is not in the interest of this paper. However, the plot is that new products threat the power position of oil industry. In contradiction of the plot; the renewable energy market development is not likely to happen. This idea is based on the fact that governments create basic conditions for the development while the entrepreneurs carry the abilities to innovative strategies and technology necessary for renewable energy development. As the threat of the new products perturbs the market environment it is only a basic strategy not to promote the product (Ernst and Young, 2011).

Intensity of Rivalry among Competitors in the Industry: this occurs when competitors in the industry sense pressure or act to in a position to create an advantage over other players. The competitive environment in the oil industry is characterized by a few strong players known as the majors and many small players with a weaker power play position. The majors who to some extent are the IOCs have limited control over natural resources but with a high level of expertise. On the other hand, NOCs have control of their countries oil reserves but have little expertise knowledge. The NOCs however, reduced rivalry through the adoption of a cartel known as OPEC to regulate increasing price of crude oil. The effectiveness of such strategy is not the aim of this discussed and not the focus of this writing. The majors however result to alliances and mergers to reduce competitive constrains (Winn *et al*., 2008).

However, as already highlight in the PESTEL analysis section, oil companies may not be able to keep up with demand. This as a resultant effect of depleting oil and

gas reserves which will induce new technology meaning evening a huge amount of capital investments and a higher level of research and development. The task to the replace depleting reserves is not easy not in addition to the fact that government now protects resources and place restriction on areas where oil companies operate. The five forces that shape the competitive structure of the oil industry are summarized in the graph below. It shows elements that may hinder competitive advantage of firms involved within the industry.

Reputation Risk Management

Managing Risks to Reputation

Management of reputation risks, as well as, management of factors that could improve the management process of these has been examined by many researchers (Winn *et al.*, 2008; Inkpen *et al.*, 2011). Gaultier and Louisot (2006) demonstrated that an attack on reputation can be both a threat and an opportunity. They continuously indicated that the conditions depend on how well executives tackle the risks facts in a company. They also draw attention to corporate governance and stakeholder's perception as an essential factor in managing reputation risks. Risk management responds to a responsibility towards the shareholders, employees, community and the environment. It mainly focuses on actions or strategies needed to protect the company's value and investments and facilities. Risk to reputation is drawn mainly from the risks associated social cultural, political and environmental component facing the oil industry. Hence, it is *the risk of damaging an institution's trustworthiness in the marketplace* and its management is central across external factors but is critical along three above components. First and foremost, on a sociological level, the way oil companies interact with the environment and sanitary impacts can affect communities, biodiversity and the environment negatively. The political level is the second and is an indication that regulations have been put in place to monitor the oil industry's activities which company's operate within and can be held accountable. Hence, illuminates that oil companies must be complaint with regulations. Environmental impacts as the last component create the highest level of exposures for the industry. As the venture basically is a dirty business crammed with polluting elements result to adverse environmental impacts (See examples of oil disasters in Larkin, 2003).

Corporate scandals and failures arising from different roots mean that companies cannot afford a negative reputation in their work environment either due to lack of business ethics, transparency, accountability, inadequate oversight or a decline of public trust. Consequentially, good corporate governance may be needed for economic growth in the market and is a major requirement for risk management.

RRM is an indication that oil companies must be proactive rather than reactive to hedge against risks stemming from its external environment. To do this, a risk structure system must be implemented into an organizations culture to identify and control risks (Petersen, 2005). RRM involves anticipating, acknowledging and responding to changing values and behaviors on the part of stakeholders. Based on the risk perspective, frameworks to escape harmful consequences of negative exposures have been built around appropriate reputation context, hence known as Reputation Risk Management (RRM) (Koronis & Ponis, 2012). Like any other risk management technique, the framework is be built on the three major phases *risk identification, risk analysis and risk control and mitigation* (Larkin, 2003).

From the preceding section, PESTEL and five forces of competition analysis have presented the scenario analysis that show early warning and monitoring systems for reputation risks management. The identification and prioritization of risks involved in oil projects is now the initial step in the risk management process. In this case, the impact of risks on stakeholders shall be explored. This RRM framework is adopted from the work of Larkin 2003. This framework was chosen since it covered a lot of theory on the subject matter.

The companies in the oil industry face internal risks if they or their contractors act in a way which put them in or reflects the following positions; noncompliance with regulatory framework of environmental quality, emission standard and domestic, international or local regulation during insertion or abandonment of the oil project. Disruption in the customs, way of life or ancestral rights of a people, territory or biodiversity, inadequate political and remedial functions to counter socio-environmental damages, little or no compensation to reversible or irreversible socio-environmental impacts and criminal acts as a means to obtain resources. On a purely social level, other risks may be identified such as inconsistent communication, lack of transparency, trust, ethics, governance and lack of opportunity for local workers. The social exposures create room for external risks arising from conflict situations; that is struggle for land and growing presences of NGOs, high unemployment rate, perception of oil sector as capacity to solve social problems (Larkin, 2003; Robert *et al.*, 2006). These risks are mostly evident in the upstream sector of the industry. They tend to interact more with environment values. Hence, their activities may affect nature, biodiversity protection zone, parks and different preservation status. The risks to reputation for oil companies in such situation is the prospect of the occurrence of a major accidents, mega environmental damages or social impact of a high degree which will be likely to exceed the boundaries of the project location consequently impacting their reputation (Inkpen *et al.*, 2011).

Reputation risk is based on perception and perception must be measured. Therefore, companies must assess reputation based on the perception of risk. Risk is akin to the likelihood of occurrence of a certain level of impact or exposure. Risk may be assessed based on three main elements that is possible future scenarios, probabilities of occurrence and magnitude of predicted damaged. In conducting a risk analysis, the determination of the gap analysis between companies operation and stakeholder's expectation is of key importance. That is examining gap between a company's performance and its stakeholder's expectation, it requires an understanding of the gap and a risk evaluation process. For the evaluation process, questions like which people shape our reputation and how we should behave? Is asked (Larkin 2003).An example of risk analysis in the oil industry is illustrated as follows. Take for instance, an assumption that the risk of companies failing to meet environmental obligation and technical standards has risen with a medium frequency and will have a high impact, consequentially, due to the effect of this on certain environmental components the risk may be rated as a high risk. The follow up process for the management process should then be to prioritize the reputation risk factors. The oil and gas sector will need to understand the level of exposures from exploration and production operation, legal agencies, contractors, community, communication, NGOs and so on (Young & Tippins, 2000; Robert *et al.*, 2007).

Factors that Enhance the Effectiveness of RRM

Reputation risk control and mitigation in the oil industry will consider some underlining factors. These factors are the essential basis for enhancing the effectiveness of RRM in the oil industry. The first factor which is analyzed is stakeholder management. According to Friedman, (2006) stakeholder management basically involves balancing stakeholder's influence, culture and issue management. He further indicated that organizations have devoted resources to stakeholder management for reasons ranging from regulation to risk management. Stakeholder management provides corporation with valuable information about external events, market conditions, technological advances or consumer trends which may help organization understand and respond to change effectively. Reputation is based on perception and as stakeholders feel they are being ignored or that their claims are not met, this may result to a crisis situation. To control such exposures, the best mechanism to control public outrage is through stakeholder engagement. Stakeholder engagement is a *process of effectively eliciting stakeholder views on their relationship with the organization* (Friedman, 2006 p152). Friedman goes on to say that governance mechanisms have been established for engagement among which include annual general meetings (AGM) and union representation. In balancing stakeholder's satisfaction and interest, companies must take into consideration the following honesty, timeliness of communication, and

completeness of information (Strong *et al.*, 2001). Zoller also suggested that effective dialogue requires symmetrical communication, transparency of the benefits and risks, unbiased facilitation and an early start to facilitate change if need (Zoller cited from Friedman, 2006).

Transparency is another factor which is akin to reputation and as a result it must be perused as a factor on its own. Stakeholders in proximity to the operation of oil companies need to know that their health, safety and livelihoods will not be unduly affected by their presence. A best opportunity for the oil companies in this regard is to demonstrate to their stakeholders that they are capable of bringing a positive impact to their local economies. Hence, companies need to develop a more appropriate set of measures that enable them to communicate this more effectively to stakeholders either local government groups, regulatory bodies or the market. It then becomes essential for oil companies to communicate some of the benefits they are bringing to operating communities by disclosing information's or project processes or as deemed necessary by stakeholders. Ideologically, *the trust dilemma- globalization versus security* arises in this case. Due to past experiences or wider public perception of negligence of HSE activities the oil company has compounded an ill reputation. To offset this difficulty, the oil companies need to be transparent. The more transparent an organization is about its performance, and its failures, the more stakeholders will be willing to engage with that company (Ernest and Young, 2012).

Transparency is important in business, and the concept has been built on foundation for companies to be socially responsible. The idea behind business been more than just an economic institution has led to the concept of social responsibility. In opposition to the Friedman's idea (1970) on profit been the aim of business it is indicative that companies must act ethically in aspects that relate to society, economics and environment. While Friedman's idea revolves round the question of why business should be burden with the arbitrary obligation of social responsibility, Gavai (2010) argues to follow up an answer that large corporations or businesses have a far reaching impact on the society and social life and must therefore be faced with the management of moral and social issues. In Clearance Waltons view, corporation exists because society wishes them to fulfill a purpose and when a change in social purpose occurs, so will the activities of the corporation (Clearance cited from Gavai, 2010). This illustrates the basic fact that business exist for satisfying a social purpose.

One common practice by oil companies for CSR is through corporate philanthropy and community development programs. In other words, an indication of the positive impact it has had on communities, schools and so on. Nonetheless, most

NGOs have dismissed this form of CSR practice as a green washing strategy. This has infact led to controversial discourse for reputation and CSR. For instance, In Andrew Griffins words *"So, you are saying that your reputation is more important .. and one of the key tools you plan to use in this engagement is your CSR report?"*(Griffin 2007).

CSR should be a response to public consensus, and also as an intelligent and objective concern for the welfare of the society that refrains corporations behavior from destructive activities, no matter how profitable (Howard, Adolf and Keneth cited from Gavai, 2010). CSR should revolve around corporate citizenship and financial performance in the terms of binding human right codes, reputation and social responsibilities (Griffin, 2007). It may further be argued that CSR is a foundation of environment consciousness, good causes and high tolerance for culture of communities. Griffin however, argues that CSR may prove ineffective in RRM because a company's rivals, NGOs and the media, among others judge management success or failure based on how much of the actual problem still exists, and blame the company for an entire problem even where it does not have control (Griffin, 2007).

The nature of oil and gas operations includes numerous potential negative ecological impacts, especially throughout investigation and creation, including area freedom, oil spills and gas emissions (Clark, 2002). Environmental risks of oil and gas operations are increased on the grounds that oil processes are regularly found in developing economies which are close zones of high biological diversity and high ecological vulnerability, for example places with sprinkle woods, mangroves and secured national parks (Austin and Sauer, 2002). In this regard, RRM must also focus on managing biodiversity. The oil sector is constantly been pressured by key stakeholders such as NGOs, government, scientific world and local communities to prevent damage of biodiversity. The incorporation of biodiversity management into oil and gas operations is essential to minimize risks and possibilities of exposures whilst maximizing opportunities for community involvement. Poor management of biodiversity on the other hand may damage reputation of the company (Convection on Biodiversity, 2014).

An internal factor also for enhancing RRM is knowledge workers. Since the early 1990s, the oil industry has recognized themselves as a knowledge intensive enterprise (KIE). This implies that the industry is highly dependent on knowledge and as a result the management of knowledge is essential for the enterprise. The oil and gas industry is a business where superior performance is achieved through early identification and appraisal of opportunities and their speedy exploitation. The majors also rely on superior technology, innovation, superior technology and

learning capabilities for competitive advantage. For instance, Schlumberger, BP, Royal Dutch Shell, and Chevron had become recognized leaders in the field of knowledge management (Grant, 2013).

Furthermore, knowledge is a key strategy in the industry and it may exist either as scientific, technological or management knowledge which must be improved on with innovation (Martin, 2012). Innovation on the other hand could either be technological or non-technological (such as administrative innovation, organizational innovation and management innovation)and in practice very much linked to greater earning power, long lasting competitive and strategic advantage for any knowledge intensive enterprises(Hall, 2000; Czarnitzki and Kraft, 2004; Henk *et al.*, 2013). Oil and gas industries can use innovation as a generating capacity to manage knowledge. However, some factors may also improve managing innovation in its different forms. For non-technological innovation, a firm's manager and employees known as knowledge workers play a key role in improving their organization's management innovation process. As indicated by Henk *et al., 2011,* internal change comes from plant managers who on an operational level create a favorable environment for work while front line managers and supervisors implement and operate new *processes, practices and structures.* For the energy industry to manage knowledge and its knowledge workers the industry must incorporate a good knowledge management strategies into it activities. These strategies must articulate its business objectives, describe knowledge based business issues, create an inventory of accessible knowledge resources and analyze recommended knowledge points (Kimiz, 2011).

Conclusion

The macro level political, economic, socio-cultural, technological, environmental and legal factors appear to be of great importance when determining threats to reputation for an oil company. The Macro level environmental is also important in understanding and mapping out factors that aid the effectiveness of reputation risk management. The research indicated that the main exposures to risks to reputation stem from breach in regulatory frameworks and unethical practices. Stakeholder's engagement was a crucial factor in the improvement of the effectiveness of RRM but is not a guarantee in addressing all risks arising from all stakeholders' perception.

Considering the Porter's analysis, it was interesting to find out that the oil industry is characterized with a high rivalry level due to the fact that majority of companies are in the race to replenish oil resources. This particular condition creates a threat to the reputation of oil and gas companies since it exercises a need for the companies to result to cost containment policies and aggressive strategies. Also,

the framework confirmed the hypothesis that main cause of reputation risks arises from restrictive policies and practices protectionism towards foreign companies. To enhance the effectiveness of RRM in the oil and gas industry, the research indicated that the stakeholder management and CSR initiatives were crucial factors, transparency was vital but not entirely crucial according to the research. Information gotten on knowledge and knowledge workers was insufficient to draw a conclusion. However, the research concurs that it may be an important internal factor for RRM

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