Reputation Risk Management in Islamic Financial Institutions: A Case of Tabung Amanah Islam Brunei

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Abstract— *Reputation is an intangible asset to an organization. Hence, its awareness and management is as important as any other risk. This study discusses the management of reputational risk in Tabung Amanah Islam Brunei (TAIB), an Islamic financial institution in Brunei Darussalam, together with the understanding and awareness among its staffs. The main objective of the present study is to provide an overview of how TAIB views its reputational risk. An interview via e-mail was conducted with the risk management officers of TAIB. For collecting data, a questionnaire has been used. The findings have indicated that the organization believes that all types of risk are serious and thus need to be dealt with accordingly. An effective and efficient monitoring of risks ensures that any Islamic financial institution is protected from the adverse effects of reputational risk. Reputation risk and other types of risk management are considered seriously in TAIB and other Islamic financial institutions. Future research is needed to develop the areas of reputation risk management with special reference to Islamic financial institutions in Brunei as well as worldwide.*

Keywords— *Brunei Darussalam, Islamic banking and finance, Islamic financial institutions, reputation risk, risk management.*

I. INTRODUCTION

Reputation can be described simply as "an accumulation of perceptions and opinions about an organization that resides in the consciousness of its stakeholders [1, p. 1]." Reputation is viewed as an intangible asset with the potential for value creation [2, 3]. A good reputation can benefit a business in numerous ways by enhancing consumer preference, support for an organization in times of crisis or controversy, and the future value of an organization in the marketplace [4]. Further, [5] states that as reputation is extremely important, it should be considered as an organizational objective along with client satisfaction, resource acquisition, and outcome measures. Reference [6] note that reputation takes time to create, cannot be bought, and is easily damaged. Reference [7] suggests that there are two definitions of reputation, one from the company's perspective and the other from the stakeholder's perspective. The former defines reputation as an intangible asset that allows the company to better manage the expectations and needs of its various stakeholders, creating differentiation and barriers vis-à-vis its competitors. As stakeholders believe that the behaviors and communications of the organization resonate with their needs and interests and are better than competitive offerings, they will be influenced to behave toward the organization in a desirable way.

Reputation risk, the possibility or danger of losing one's reputation, presents a threat to organizations in many ways. The loss of reputation affects competitiveness, local positioning, the trust and loyalty of stakeholders, media relations, the legitimacy of operations, and even the license to exist [8]. Reputation risk not only affects individual organizations but also the entire industry [9]. Reputation risk has been added to the list of business risks that organizations must take seriously, and therefore it needs to be handled as efficiently and effectively as possible. Regardless of how fragile it may seem, Islamic financial institutions (IFIs) are still taking their leisure time in outlining the steps needed to be taken if their organization faces a sudden exposure to reputational risk. Reputation is established over a longer period and is about the integrity of an organization. Particularly, in Brunei Darussalam, where Islamic Banking is still developing, IFIs would not need to worry much about contingency planning as the government is willing to assist them during any crisis. Nevertheless, the two prevailing IFIs in Brunei should consider the worst-case scenario.

Risk appears in different forms and affects businesses and organizations. However, the question is who is better equipped at handling these risks. If the organization has an effective crisis plan, then there are a less number of issues to be concerned with. First, we will examine a type of risk that many companies and organization perceive as important during these post-crisis periods. Most managers or CEOs of organizations are now concerned about reputational risk than they were 30 years ago. After the financial crisis of 2007–2008, organizations employ more caution than they normally did. While we discuss about reputation, we are mainly addressing the face value of the organization. What do people think about a company? How do they perceive it?

An IFI is not exceptional from this risk. Reputation is an asset that any IFI should treasure with care. Why this is so? It is because an IFI has to comply with the *Shari'ah* (Islamic law) framework outlined in *Qur'an* and *Sunnah* (Prophet teachings). Being conformed to Islamic law means they are prohibited from involving in any *riba* (usury), *gharar* (uncertainty), and *maisir* (gambling) activities. The activities of an IFI are further monitored by the *Shari'ah* Board of Directors. Their failure to comply with Islamic law will affect not only them but also the industry as a whole. Furthermore, customers will be doubtful about how "Islamic" a product really is. Therefore, it is the organization's responsibility to efficiently manage risks because an organization's shareholders and owners have the liberty to switch allegiance if they feel insecure. Apart from earning a stable profit, reputation also plays a key role in keeping the company free from constant scrutiny by the public. Failure to do so will lead the company to be exposed to other losses—such as litigation and financial loss—which would just add to the costs of managing the company.

This study mainly focuses on the staff's understanding, management, and awareness of reputational risk. The issue of reputational risk affecting IFIs occurred due to the fact that consumers are more skeptical now (after the financial crisis 2007–2008) than ever before. Although Brunei does not feel much of its effects, it still raises the question whether IFIs, specifically in Brunei, can handle any damage to its reputation. The main questions intended to be answered through this study are as follows:

1. Is TAIB, an IFI, aware of the existence of the reputation risk? What is the staff's understanding regarding this type of risk?
2. How does TAIB manage its reputation risk? Is there any a crisis management plan at hand or has it planned to go with the flow once something happens?
3. Are the staffs of TAIB from all levels of the organization aware of reputation risk?

The overall objective of this study is to provide an outline regarding how TAIB views its reputational risk. The specific objectives of this study are as follows:

1. To evaluate the understanding of the personnel of TAIB regarding reputation risk.
2. To investigate the management of reputational risk by TAIB.
3. To examine the awareness of staff and officers of TAIB regarding reputation risk.

This study is organized into six sections. Following the introduction, Section 2 briefly provides background regarding TAIB organization. A review of the reputation risk literature is presented in Section 3. Section 4 describes the methodology used and data sources, followed by Section 5 that offers the results and discussion. Finally, Section 6 provides the conclusion, implications, and suggestions for possible future research.

II. A BRIEF BACKGROUND ABOUT TAIB

Currently, the Brunei's Islamic banking system is primarily served by two groups: the Bank Islam Brunei Darussalam (BIBD) and TAIB. Over the years, these two institutions have rapidly grown [10]. TAIB was established under an Emergency Act [11]. It was officially launched in September 1991. The launching of TAIB marked a new beginning for Brunei Darussalam as it was the first financial institution that conducted all its activities in accordance with the Islamic faith. Since its establishment, TAIB has two subsidiary companies: Insurans Islam TAIB (*Takaful*/Insurance) and Darussalam Holdings (*Haj/Umrah* Services, Travel Agent). TAIB has a 100% shareholding in both of its subsidiaries. The return on assets ratio (ROA) of TAIB for the past few years is presented in figure 1. It measures how effectively TAIB has yielded a return on its investment in assets over time. There were positive ROA ratios that indicated an upward profit trend, and TAIB is more effectively managing its assets to produce greater amounts of net income. A high ROA of TAIB indicates effective financial and operational performance.

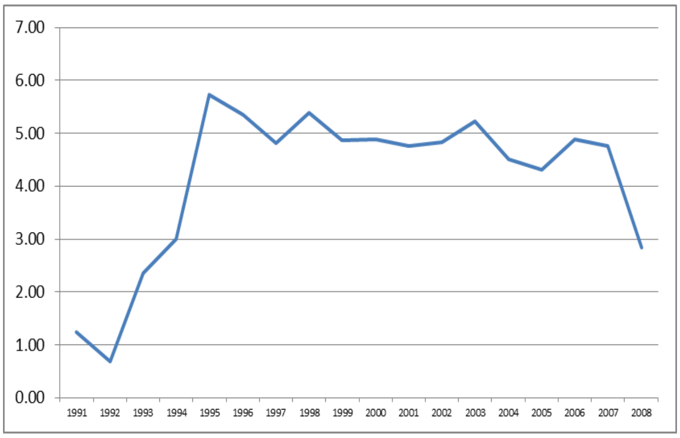

Fig. 1: Return on assets ratio of TAIB, 1991–2008.

III. LITERATURE REVIEW

Most literature highlight that reputational risk is most often overlooked in an organization. This is unlike other risks which are considered more threatening such as credit or market risks. Thus, less attention paid to it. The question here is, are the IFIs overseeing this or are they being ignorant as well. If they are concerned about reputation, are they taking the necessary steps to prevent or perhaps reduce the negative effects of a tarnished reputation? We aim to provide a clear answer to these questions at the end of this study. Thus, this study will be a pivotal point in reputational risk management for IFIs in Brunei Darussalam, specifically TAIB, by highlighting the issue as such.

From the definition above, reputational risk is something that is noticed by the consumers or general public [12]. As consumer perception is important, IFIs should and must align themselves accordingly so that they can create a good public image and hence get a good perception. Strong corporate reputation can provide important benefits such as higher market and shareholder value and market position strengthening [13].

The Basel Committee on Banking Supervision [14] has defined reputation risk as follows: "Reputational risk can be defined as the risk arising from negative perception on the part of customers, counter-parties, shareholders, investors, debt-holders, market analysts, other relevant parties, and/or regulators that can adversely affect a bank's ability to maintain existing or establish new business relationships and continued access to sources of funding." Some others such as [15, p. 57] describes reputations as strategic assets that "produce tangible benefits: premium prices for products, lower costs for capital and labor, improved loyalty from employees, greater latitude in decision making, and a cushion of goodwill when crises hit."

Reference [16] has specifically clarified the real meaning of reputational risk according to the Basel II Accords. There are certain features of corporate reputation discussed here. They identify why IFIs need to manage reputational risk and, more importantly, why it matters to the Islamic Financial industry as a whole. They have highlighted several ways regarding how to mitigate the reputational risk that includes the implementation of a proper framework for dealing with this risk. Moreover, they recommend several policies to mitigate risk, including developing awareness to understand what your reputation is worth. Reference [17] argues that reputation risk is a reflection of irresponsible behavior by a single institution that can taint the reputation of other Islamic banks in the industry. Negative publicity can have a significant impact on an institution's market share, profitability, and liquidity. The Islamic financial industry is a relatively young industry and a single case of failed institution can have a bad reputation to all others who may not be engaged in any such irresponsible behavior [16, p. 246]. Reference [18] has emphasized that companies whose reputation have gone bad will experience a difficult and uncertain recovery. He emphasizes that the focus on only measurable risks by the management of a company has resulted in reputational risk being overlooked. An organization with weak reputation tends to view matters or problems unrealistically, such as believing that the wages paid is a "compensation" for the harm done to the community. He proposed ways on developing a culture that supports reputation, laying more emphasis on the involvement of employees as a key factor.

According to [19], reputational risk is not concerned with the manufacturing process in an organization but is "the risk that a latent reputation problem will become an actual reputational problem." differentiates between reputation risk management and management from the beginning itself so that readers will be focused and not stray away from the intended meaning. His focus is mainly on the management of reputational risk. Reference [20] asserts that reputation, though considered a critical threat for an organization, is often overlooked. In contrast, growth of profits and the likes are always prominent concerns. He discusses the reasons for the need of corporate reputation audits and offers a blueprint for implementation. In a research conducted by [21], almost all the executives involved in the research agree that corporate reputation is a valuable asset that needs protection. There are three tasks involved in managing risk: establishing reputation, maintaining it, and restoring it when damaged. It is not a one department issue but considered wide ranging, involving all departments in an organization. Thus, the responsibility runs from top to bottom.

IV. METHODOLOGY AND DATA SOURCE

This study is based on qualitative data. Primary and secondary data was used throughout this research. The primary data used was based on a set of questionnaires used while conducting an interview via e-mail. The secondary data used were published books, research papers, and articles from the internet. The literature materials used were within a period of ten years.

The method used in collecting data for the purpose of this study was interview via e-mail. This method was chosen because of time constraint. A benefit of using this method was that it made the research easy by concentrating only on the required information. There was no extra or irrelevant information asked. A set of questions was prepared and forwarded to TAIB. The list of questions was divided into three sections:

1. Understanding of reputational risk.
2. Management of reputational risk.
3. Awareness of reputational risk.

V. RESULTS AND DISCUSSION

The results refer to the outcome of the interview conducted through e-mail. As already stated above, there are three sections in the list of questions. Each section will be analyzed on its own so that an evaluation can be made as to whether the research questions were successfully answered. The general questions are addressed to IFIs in Brunei, whereas the specific ones are to TAIB. An overview of the results is illustrated in chart 1.

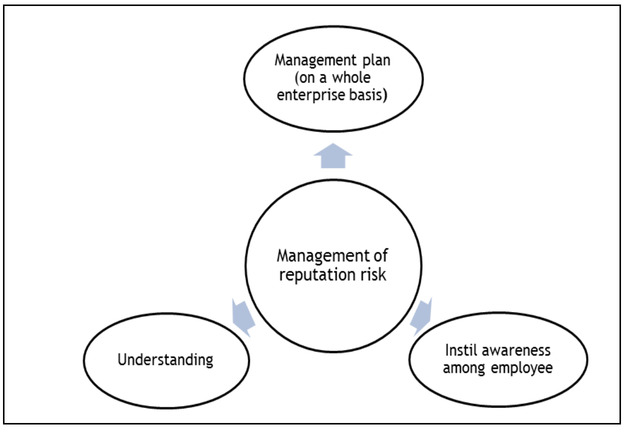

Chart 1: Steps for managing reputation risk

In the first section, the questions discuss how much the management team of TAIB understands about reputational risk. They define reputations as "the intangible asset of an institution that could offer premium value growth opportunities." Its risk is often associated with media coverage and any actions that can damage an institution's good name, brand, or image. Reputational risk could also arise from misrepresentation of financial information apart from media focus on negative information. This indicates that they do have a general idea of this risk and do understand its immediate impact on the organization as a whole.

According to the interviewee, though Brunei may be a small country, reputation still plays a key role. This is because, as Brunei Darussalam is an Islamic country, it needs to ensure that the teachings of *Qur'an* are kept intact and anything that might jeopardize the way of living (reputation) as Muslims is avoided. Moreover, maintaining and upholding positive values to alleviate reputational risk for IFIs in Brunei Darussalam is vital due to the highly competitive market with the conventional financial institutions. As highlighted earlier on in the study, TAIB is not a bank but an Islamic trust fund association. This makes it more crucial for TAIB to uphold its values and maintain a competitive nature with other financial institutions.

Currently, TAIB does not have any existing policies in preparing for, responding to, and recovering from this type of risk exposures. However, it will be managed on the whole enterprise basis by the management, assisted by existing control departments including Risk Management, Internal Audit Department and Compliance Department. Although there are no existing policies and procedures in place ruling reputational risk management, there are few vital steps employed by TAIB in assessing and managing this risk. These are as follows:

1. Understanding the value of TAIB's reputation.
2. Treat reputation as an enterprise or as a whole.
3. Understanding all available interrelationships within the business.
4. Identifying and prioritizing the main causes of reputational risk.
5. Communicating these causes to key management.
6. Have a crisis plan when everything fails.

Reputational risk will affect an institution's ability to establish new relationships and maintain existing ones. Thus, it is important for TAIB to efficiently manage and monitor the existing enterprise processes in ensuring that conflicts of interest and other legal or control breaches is avoided. This means that the internal control of TAIB has to be strong and in force in minimizing risk exposures that could lead to reputational risk. This process includes evaluating possible risk exposure for the enterprise and planning precautions. TAIB's Risk Management is still in a continuous process of establishing and developing its processes in managing its business risks. It is very important to have a continuous monitoring of risks as a whole. Effective and efficient monitoring can reduce the likelihood of risk occurrence in any processes. TAIB believes that risks should be treated seriously regardless of its impact and frequency.

Risks are consistently prioritized, controlled, and communicated throughout the organization based on its necessity. However, this type of risk has never been properly addressed to staff at all levels; thus, its awareness could be limited to certain levels only. However, TAIB has guided the organization in safeguarding and minimizing the exposure to reputational risk. A good reputation will be useful to TAIB because it can help to build new relationships with customer, develop long term relationship with them, build trust with the services provided by TAIB, and enhance the growth of TAIB's business values toward financial success. TAIB believes that it is important to treat reputational risk on its own because reputational risk can damage an institution's brand very rapidly that it could affect its business values and it might be impossible to treat or cure it. As a whole, TAIB is very conscious about what it will have to deal with if anything affects their reputation. A strong reputation can help to attract and retain high-quality employees and can deter new competitors by acting as a barrier to market entry. Perhaps, the greatest benefit of a good reputation is the buffer of goodwill it provides, which can enable a business to withhold future shocks.

VI. CONCLUDING COMMENTS AND FUTURE RESEARCH

Based on the interview conducted, TAIB realizes that reputation can be the result of many years of investment. It is an intangible asset, which cannot be insured like any other tangible assets of an organization. Thus, a proper management structure is important. In managing this risk, TAIB highlights the fact that understanding the organization's reputation is crucial. Alleviating the organization from any allegations that could prove to be damaging and also having the ability to respond rapidly and effectively to a reputation crisis is also highly commended. It is interesting to agree on what [1, p. 4] has mentioned: "A good reputation hinges on a business living the values it claims to support and delivering consistently on the promise to its stakeholders." An active and systematic management of the risk can help ensure that perception is aligned with reality and that stakeholder experience matches their expectations. For TAIB, reputational risk is as important as any other types of risk. It does not simply overlook this risk as nothing important. That is why it emphasis on continuous monitoring of risks as it will minimize the likelihood of occurrence of any risk and also help to reduce the consequences of a possible damage to reputation. Active and systematic management of the risks to reputation can help to ensure that perception is aligned with realty and that stakeholder experience matches their expectation [1, 22].

This study has raised numerous questions to take forward. In terms of theoretical/conceptual development of reputational risk within social accounting, there still remains a significant amount of research to be conducted. For instance, future research can investigate the relationship between reputation risk and corporate social responsibility. As stated by [23], the concept of reputation risk could assist in the understanding of corporate social responsibility reporting practice. Beside this, the conceptualization of reputation risk requires further investigation in the organizational literature. Reputation is a major risk issue for all IFIs and requires to be considered together with all the other major risks. Further research is also needed to help develop the topic of reputation risk management emphasizing on IFIs. Another possible area of research is a comprehensive analysis of more than one IFI in Brunei or other countries for the purpose of comparison and in-depth investigation because reputation risk is an outcome of a historic and an ongoing process of defining.

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