# The fine line of balancing risk for consumer-facing businesses

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## Scrutiny from regulators and the public mean that organisational conduct is more important than ever, but what is the cost and danger of not taking this seriously?

Growing privacy concerns and customer demands for ethical sourcing are forcing consumer-facing businesses to realign their risk management efforts. In a connected world where internal risk management failings can quickly find their way to the front page, risk management is a holistic question of culture and conduct which reaches from a business' frontline all the way up to the boardroom and back along the supply chain.

When consumer-facing businesses make headlines for all the wrong reasons, questions are asked as to whether poor business conduct can be blamed on a few 'bad apples' or whether the people at the top can actually set the tone and culture of the entire organisation.

Corporate culture can be difficult to define but it boils down to the values of the organisation, its beliefs and principles. Just as importantly, it's about how they're embedded within the organisation and put into practice.

"Managing corporate culture requires a holistic approach; it goes much deeper than looking at one product you're selling or blaming a few rogue employees," says Gary Gill, Head of Forensic at KPMG Australia.

"The mindset at the top rolls through the business and it's been said that the worst conduct which your leadership will condone can define your culture."

It's also important to realise that we are most influenced by the behaviour of our immediate manager, so conduct flows from the board all the way through to front line staff.

Consumer-facing businesses face close scrutiny from all sides, with both customers and corporate regulators holding them to account for their actions and the corporate culture which drives those actions.

"The notion of culture is not new but now we're more consciously aware of its importance and that we can shape it. The corporate regulators are also aware of the importance of culture and they're expecting businesses to do more and take on the responsibility of rectifying problems with corporate culture and conduct risk," Gill says.

## Protecting customer privacy

Data security and cybercrime are an increasing risk for consumer-facing businesses, not just the risk of the business' own sensitive data being exposed but also the data of customers. The potential for long-term brand damage from a data breach is increasing as consumers become more privacy-conscious, especially if those breaches expose an internal culture of sub-standard security when it comes to sensitive customer data.

Customer data is a valuable business tool but the more data businesses hold on their customers, the more attractive that data becomes to hackers. More than just chasing credit card details, hackers are pursuing other personal information to help them engage in identity theft scams and other sophisticated multi-stage attacks which can have a long-term impact on victims.

"Companies do obtain a lot of private information, particularly those with loyalty programs which a lot of the big retailers in Australia do operate. There is a real trust element between the consumer and the retailer and that trust can be easily broken," says Richard Cassidy, Partner, Internal Audit Risk and Compliance at KPMG Australia.

"You obviously have to be ahead of the curve when it comes to cybersecurity, Australian businesses are doing everything they can but it is an increasingly challenging and expensive cost of doing business. It can't be treated as afterthought when a breach poses such a wide range of businesses risks."

## Managing supply chain risks

The practices of supply chain partners around the world has become a much more significant risk to consumer-facing businesses and brands in recent years. Mainstream consumers have become more concerned about ethical sourcing, while the rise of social media has brought issues in developing nations to the attention of consumers around the globe.

There is definitely increased consumer awareness of the entire supply chain, says Trent Duvall, National Leader, Consumer Markets at KPMG Australia. For instance, this might include sourcing of raw materials such as palm oil, cocoa or precious metals used in electronics. Brands on the end of international supply chains need to take more of a proactive approach to assessing the risks, rather than waiting for an incident to arise and then going into damage control.

"The risk also extends through labour practices, for example the labour associated with garment manufacturing for the fashion industry – there is the potential for child labour as well as incidents like the Rana Plaza collapse in Bangladesh in which many workers were killed," Duvall says.

"Five years ago many retailers just assumed that their suppliers had appropriate controls in place to address those risks, whereas now they're taking a much more active role in assessing those risks and undertaking audits to give them greater assurance on the appropriateness of their supply chain."

The power of social media also means that businesses need to be on the front foot when it comes to product recalls, service outages and other issues which impact on their customers. Businesses need to ensure that they're seen to respond quickly, with the best interests of consumers at heart, which can require a significant cultural shift for some organisations.

There is also a business risk in how customer-facing businesses treat their employees and their suppliers, with the food and grocery sector singled out for particular attention in recent times. The introduction of the voluntary Food and Grocery Code of Conduct by the Australian Competition and Consumer Commission on July 1 presents cultural challenges which can't be addressed overnight, Duvall says.

"The key challenge at the moment is for the retailers to shape a culture throughout the organisation which acknowledges the Food and Grocery Code of Conduct and ensures that buyers dealing with suppliers are living by the virtues and intentions of the code. From a risk perspective, particularly in the food and grocery sector, it is important to ensure that code is properly absorbed into the culture of the organisation rather than just being a cosmetic change."

## Creating a great culture

Defining, assessing and reshaping business culture – both internally and in dealings with customers and the supply chain – is not a simple one-off compliance exercise, it requires ongoing tracking, says Mike Ritchie, Partner in Financial Risk Management at KPMG Australia.

Tools for assessing corporate culture can include conducting internal surveys and interviews as well as workshops. While corporate culture might be propagated by the board, it is important to objectively measure whether the organisation is actually meeting its articulated cultural objectives and to determine what success looks like in the different facets of the business.

"If you decide that putting the customer first is your primary cultural objective, what sort of things would you expect to see when you look at customer-facing activities? What about when you look at your training material, or look at the models defining the way your people are rewarded?" Ritchie says.

"You then need to marry this up with what is actually happening within the organisation, such as at the coalface in the sales area, how are your policies being executed and how are people actually behaving?"

Good business practices which help tackle conduct risk include rewarding good conduct as well as balanced performance targets, providing secure communication channels for whistle-blowers and ensuring that the board is accountable – taking responsibility for misconduct and investigating incidents in order to remediate them going forward.

Nurturing a positive business culture to combat conduct risk requires corporate self-reflection, drilling deep into the organisation to gain a clearer understanding of its culture – both in theory and in practice. It also requires mechanisms which drive that culture and processes which help people understand what behaviour is appropriate. Organisations need to understand what 'good culture' looks like – this can be difficult to describe and measure – especially using traditional KPIs.

## Managing conduct risk

Australian regulators are clear on the fact that they can't regulate culture, only conduct – or more explicitly, the results and outcomes of poor conduct.

The Australian Securities and Investments Commission defines conduct risk as a risk of inappropriate, unethical or unlawful behaviour by management or employees. This behaviour can be deliberate or inadvertent, perhaps caused by inadequacies in policies, procedures and training. Consumer-facing businesses with a poor internal culture can quickly find these shortcomings exposed to the world.

There's no simple checklist to tick off to ensure your business culture is conduct risk compliant. The process of combating conduct risk with good corporate culture requires an organisation to completely evaluate the way it does business.

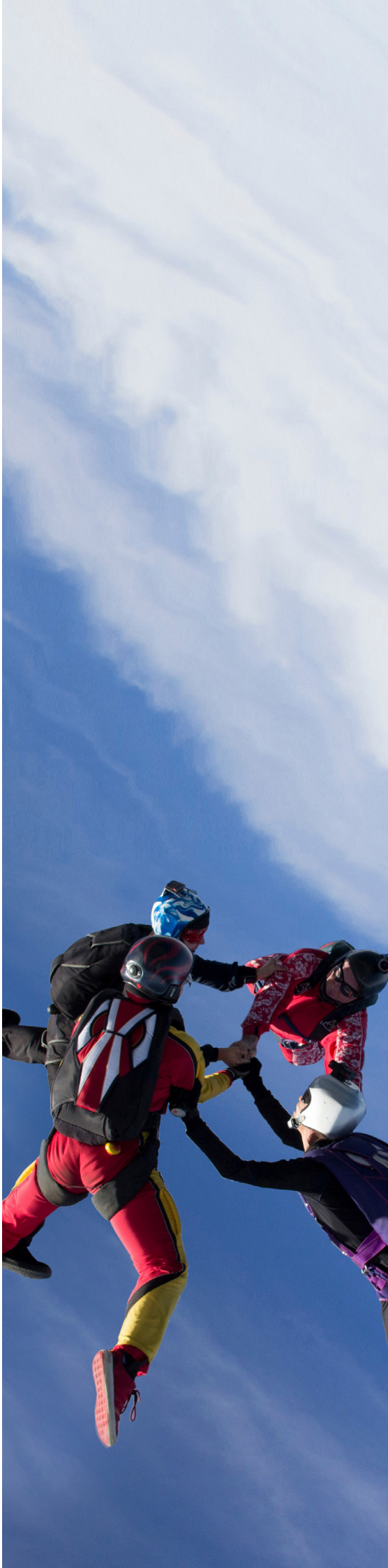
"There are a few key questions to start you on the journey towards good corporate culture, and to mitigate that risk of misconduct," Gill says.

"Have you defined your business culture, values and purpose? What communication of that culture at the top has filtered throughout the organisation? How are you ensuring that the desired culture and behaviours are reflected in your decision making?"

With a background in forensics, Gill says concern over conduct risk is not a passing fad; it does not only affect the financial services sector and it's not just relevant to sales staff. He estimates between $4 billion to $6 billion are lost each year due to misconduct, but the damage extends beyond unrecovered losses to impact on a business' reputation, employee morale and integrity of the markets.

"ASIC has recently said that they are really trying to signal to the industry more broadly that customers want to engage with corporates who have a culture that they can truly believe in," Gill says.

"It's also saying that the number of instances of misconduct indicate that it might be more than just a few bad apples but actually the tree itself, and I would maybe even extend that to say perhaps the trouble is the entire forest."



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