

Hotlines & Headlines

Examining the Relationship Between Hotline Reporting and Corporate Reputation

Synopsis: A strong speak-up culture, reinforced by effective internal reporting and incident management, can keep your company out of the headlines and off the radar of government regulators.

INTRODUCTION

Compliance professionals understand that a risk-based approach to program improvement requires some means to calculate, or at least estimate, the cost of compliance failures. Therefore, assessing organizational threats is critical to developing a better compliance program; one that effectively addresses compliance risks that are the most urgent or pose the most potential harm. But the age-old problem remains: how to identify a compliance failure before it happens; and the corollary, how to measure the value of preventing a failure in the first place.

Fortunately, there is a growing body of research available to compliance professionals that helps them approach these risk-based calculations with more confidence. Among the recent research is a 2018 paper entitled “Evidence on the Use and Efficacy of Internal Whistleblowing Systems” conducted by George Washington University and the University of Utah. This innovative study quantified the positive impact hotline reporting systems have on business outcomes. The study was conducted using anonymized hotline reporting data supplied by NAVEX Global (see box on page 8 for details on the dataset used and care taken to ensure data security and integrity).

The encouraging findings from this first of its kind study prompted further investigation into the business impact of increased internal reporting. Using the same dataset and methodology as the original investigation, the researchers examined what effect higher rates of internal reporting might have on what many would say is an organization’s most important asset: its reputation.

While the initial study is valuable now, the researcher have shared with us some additional results. This whitepaper summarizes those findings along with some observations about how compliance professionals can use this information to improve their own programs.

Executive Summary

Businesses today increasingly use empirical data to identify, asses and manage a wider range of compliance-related risks. More sophisticated, automated compliance program data collection – significantly from hotline intake and incident management systems – can inform and improve the way firms develop policies, deliver employee training, monitor third party relationships, and implement strategies to meet regulatory requirements. The 2018 study “Evidence on the Use and Efficacy of Internal Whistleblowing Systems” showed a strong association between increased hotline usage and greater profitability and productivity, higher quality corporate governance.* This research provides compliance professionals with additional, quantitative support for their risk- based program assessment and improvement.

While offering new insight, the original research covered familiar areas of risk such as legal exposure and the associated costs. A subsequent investigation focused on the less-well understood challenge of protecting against reputational risk. Specifically, the researchers tested for a relationship between hotline usage and media coverage. Using the same NAVEX Global dataset, the researchers compared the rates of a given firm’s hotline use to how that firm was portrayed in the business and financial press. The results showed a strong inverse correlation between an organization’s report volume and the amount of negative news coverage it received. The findings were both striking and encouraging: Firms that actively utilized their hotlines received, on average, 46% fewer negative news stories than business with low or infrequent internal reporting use.¹

Additional analysis was also performed to test for a correlation between hotline activity and what some researchers theorize is a consequence of heightened media attention: increased regulatory action.² Again, the data revealed a clear negative association between greater hotline usage and the number and dollar amount of fines imposed by federal and state regulators. The data also showed that even a modest increase in internal reporting activity could result in up to \$8 million in savings.³

Taken in total, these findings convey a clear message to businesses as they assess the cost/ benefit of a robust compliance program: a strong speak-up culture, reinforced by effective internal reporting and incident management, can help keep the company out of the headlines and off the radar of government regulators.

* Stephen Stubben and Kyle T. Welch, “Evidence on the Use and Efficacy of Internal Whistleblowing Systems,” SSRN Scholarly Paper (Rochester, NY: Social Science Research Network, April 29, 2019), <https://papers.ssrn.com/abstract=3273589>.

Findings Detail

Media Coverage

To measure media coverage, researchers used the [RavenPack](#) database of financial and business news publications. The dataset includes articles from Dow Jones newswires, MarketWatch, the Wall Street Journal, and Barron's dating back to January 2000. While not inclusive of all business and financial media, those tracked by RavenPack are recognized as bellwether titles representative of the broader category. Often, coverage in these sources is cited or used by other publications in their own reporting.

RavenPack assesses the tone of an article, positive or negative, through text algorithms across five criteria to assign a "composite sentiment score." It should be noted that this database is used by quantitative traders who use sentiment scores for electronic trading, and the validity of the algorithms have been validated and improved over the years. Article selections were restricted to entirely original content created by the publications themselves. Findings were controlled for variation across industry and all years to ensure an apples-to-apples comparison.

Key Finding: Active hotlines can reduce your negative news coverage by up to 46%

The data clearly shows that negative media coverage declines steadily as the number of internal reports increases. Firms in the first quintile (or bottom 20%) of hotline use, as measured by reports per employee, were approximately 1.55 times more likely to be the subject of negative news stories than those in the top quintile (see fig. 1). This drop is even more dramatic when the data is ranked by decile. Organizations in the ninth decile of internal reports were the subject of 46% fewer negative news stories than those in the second decile.

This inverse relationship between negative articles and internal reports holds true even when firms are grouped by size. Not surprisingly, researchers found that large firms (as determined by asset size) received the most negative news coverage. However, large firms experience a steeper drop in "bad press" as hotline usage increases. For

FIGURE 1

NEGATIVE NEWS BY QUINTILE OF INTERNAL WB REPORT VOLUME

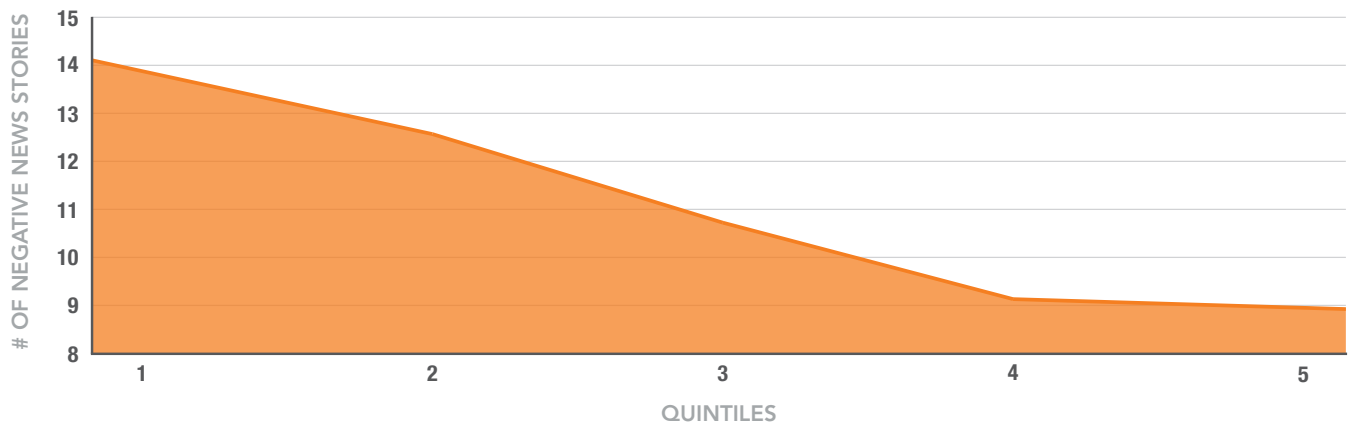
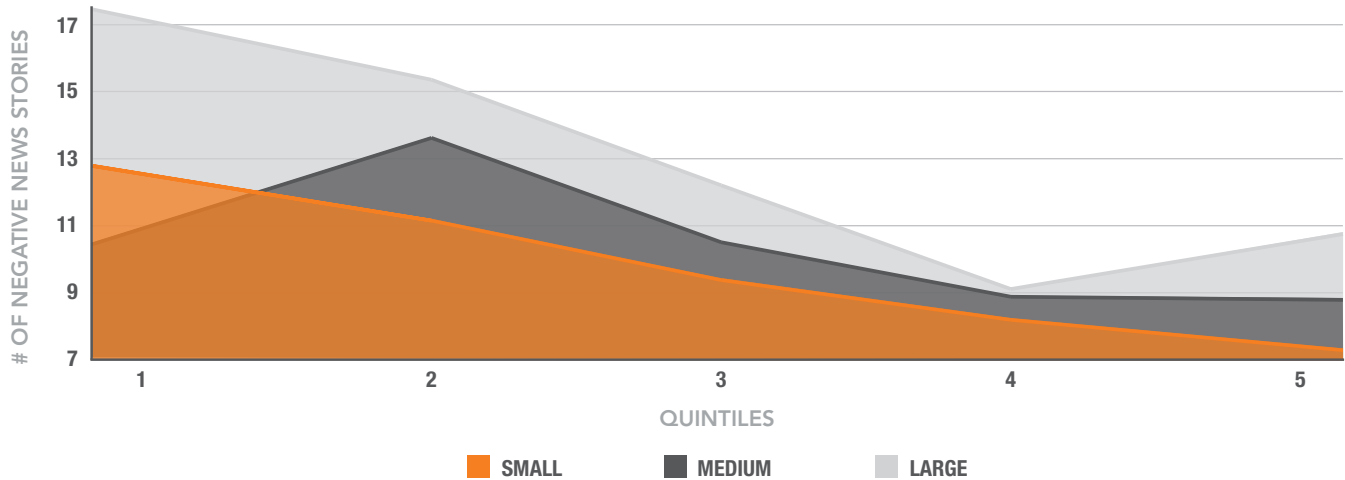


FIGURE 2

NEGATIVE NEWS BY QUINTILE OF INTERNAL WB REPORT VOLUME



example, a larger firm that moves from the first quintile of hotline usage to the third quintile is subjected to 30% fewer negative news stories per year. The decrease in negative coverage associated with more robust hotline usage for medium-sized and small firms is not as pronounced, but the trend is the same.

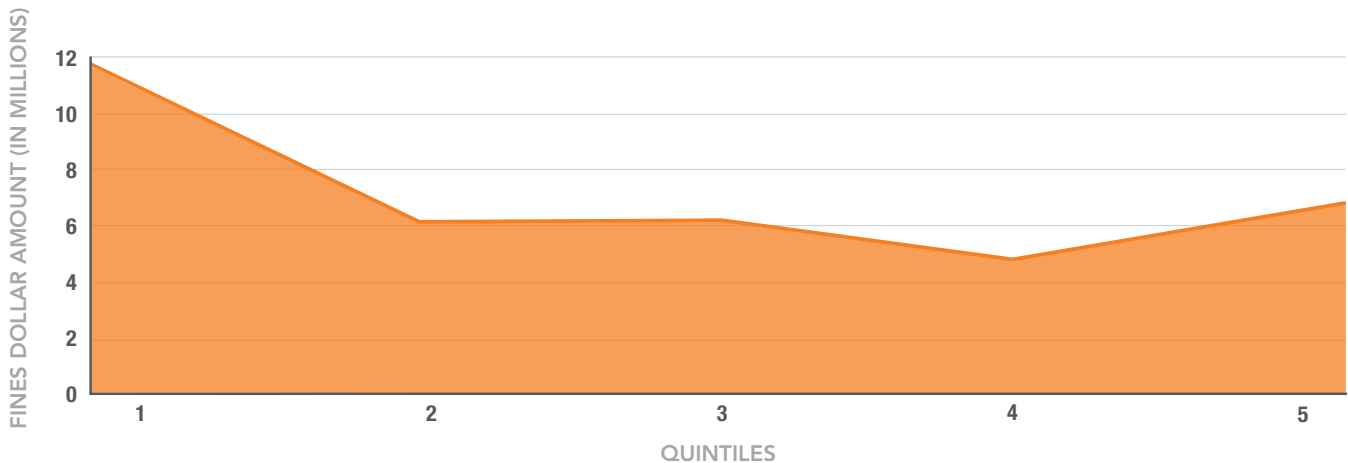
Regulatory Fines

Negative media coverage can harm a firm’s public reputation and business performance in numerous ways: decreased sales, reduced stock price and lowered employee morale to name a few. Another less obvious result of bad press is the potential for it to attract the attention of regulators. This attention may result in investigations which in turn spark more media interest (of the wrong kind). The resulting vicious cycle has the potential to become not only a major distraction, but a significant drain on resources and a hit to the bottom line. Thus, examining the linkage between hotline usage and regulatory fines can provide some insight on the true cost of a bad press.

For the purposes of this study, regulatory fines were measured by the [Violation Tracker](#) database maintained by Good Jobs First. This database monitors regulatory fines imposed by more than 40 federal agencies and all divisions

FIGURE 3

GOVERNMENT FINES BY QUINTILE OF INTERNAL WB REPORT VOLUME



of the Justice Department. The dataset goes back to 2000, and includes 368,000 civil and criminal cases with total penalties of more than \$464 billion. As with this report's study of press coverage, the analysis controls for variation in internal reporting by industry and year to produce like comparisons across all firms.

Key Finding: Active hotlines can lower regulatory fines by up to \$8M

The findings show a swift drop in the average number and dollar amount of regulatory agency fines, even with relatively little increase in internal reporting activity. Analysis shows that merely moving from the first quintile of internal reporters to the second (that is, moving from the bottom 20% of firms ranked according to their internal reporting activity to the second 20%) corresponds to more than \$4.5 million in savings (see fig. 2).

Similarly, a move from the first to second decile corresponds to approximately \$8 million in savings.

This trend holds true as we move to higher deciles of internal reporting levels, particularly with respect to the dollar amount of regulatory fines. For example, the average fine in the first quintile (lowest level) of internal reporters was \$10.7 million; for firms in the fourth quintile, the average fine was less than \$5 million. Interestingly, the total cost of fines for firms with more internal reports continues to decrease even if the number of fines does not. The reasons for this are not immediately clear, but it could be the result of early awareness and self-reporting, which helps reduce the size of the fine a firm pays for a violation. Alternatively, the presence of an effective internal reporting system could be factoring into the fine amount regulators ultimately impose for a given violation.⁴

Conclusion

This new analysis provides corporate compliance officers with additional empirical data to support what most know intuitively: robust internal reporting is a safeguard against reputational damage and helps contribute to the bottom line. Perhaps even more importantly, this study provides the most complete picture yet of what the volume of hotline reports suggests about an organization's culture. Prior to this investigation, the bulk of academic research examined the (negative) impact of external whistleblowers; those who took their issues to regulators or directly to the press. These earlier studies reinforce a narrative that higher reporting rates were inherently problematic and were indications of systemic problems. This new research dispels this myth. The researchers note:

Implication: The number of hotline reports a company receives is a measure of its success at creating a speak-up culture.

Our findings suggest that increased activity in internal [reporting] systems does not necessarily imply that companies have more severe problems. Whereas external complaints often reflect a failure of management to address issues internally, internal reports may instead reflect open communication channels between

stakeholders and management... Our results are consistent with the idea that internal [reporting] systems can be a tool for discovering and resolving issues before they become increasingly severe and costly.⁵

Put another way: the number of hotline reports a company receives is a measure of its success at creating a speak-up culture. Active internal reporting allows an organization to identify and address internal issues that are important to employees (the reporters) before they become external issues of interest to the media and regulators.

Of course, this means compliance officers must be diligent about incident management and the organization must conduct appropriate investigations and follow up on the reports received. A well supported internal reporting system affirms that management takes compliance seriously, and employees are empowered, even expected, to raise issues that concern them.

***Implication:** Active reporting allows organizations to identify and address issues internally before they merit the attention of journalists or regulators.*

These findings have real implications for how a business should view and manage its compliance program. It further suggests that an internal reporting system – and the data it collects – provides a unique view of corporate culture by uncovering workplace issues that would likely not be discovered any other way. On a practical level, the research suggests executive leadership should consider hotline data a key performance measure that can be predictive of future outcomes, both positive and negative.

Most importantly, this study should encourage companies to further explore how they can build a speak-up culture which encourages employees, managers and stakeholders to identify, report and resolve issues before they find those issues (and themselves) in the headlines.

Data Collection Methodology

To conduct this study, the researchers were granted access to the industry's largest internal whistleblowing database. This data is collected, administered and secured by NAVEX Global, the industry's leading provider of whistleblower hotline and incident management systems. After a rigorous vetting process, the researchers were given secure, anonymized access to more than 3 million internal report records from approximately 5,000 public companies – including many among the Fortune 500. Visibility was limited to specific data fields, and the confidentiality of the report content was strictly maintained. No personally or company-identifiable information is included in this report. The data examined includes hotline reports over a fourteen- year period, 2004 – 2017.

1 Organizations in the ninth decile of internal report volume (that is, firms which were ranked within the 81%-90% of internal hotline use) were subject to an average of 7 negative news stories per cycle, as opposed to an average of 13 negative news stories experienced by firms within the second decile (11%-20%) of report volume.

2 For more on this topic, please refer to The other Side: How Accountability Journalism Shapes Law Enforcement from "Law as Source: How the Legal System Facilitates Investigative Journalism," by Dr. Roy Shapira, Yale Law & Policy Review, vol. 37 (2018), pages 197-198.

3 Organizations in the third decile of internal report volume (those ranked within the 21%-30% of internal hotline use intensity) were subject to an average of \$8 million less in regulatory fines than those organizations within the first decile (1%-10%) of hotline usage.

4 According to the U.S. Department of Justice's Evaluation of Corporate Compliance programs, prosecutors are instructed to consider "whether, and to what extent, the corporation's compliance program was effective at the time of the offense" when determining what monetary penalties should be imposed for a given violation. This includes the company's internal reporting processes and protections for whistleblowers.

5 Stubben and Welch, "Evidence on the Use and Efficacy of Internal Whistleblowing Systems," pages 6-7.