Part IV: How Do Reputations Affect Corporate Performance?

A question invariably recurs in discussions about corporate reputation: are they cause, consequence, or epiphenomenon? That is: do they have an independent causal effect on corporate performance; are they a consequence of good financial performance? Or are they an incidental by-product? The second day of the conference began with a review of available evidence of the possible financial impact of corporate reputations. The following panelists discussed their prepared papers:

The Value of Corporate Reputation: Evidence from the Equity Markets
Rajendra K. Srivastava, University of Texas at Austin
Thomas H. McInish, Memphis State University
Robert A. Wood, Memphis State University
Anthony J. Capraro, University of Texas at Austin

The Effect of Financial and Media Reputations on Performance
David L. Deephouse, Louisiana State University

The Value of a Firm's Corporate Reputation: How Reputation Helps Attain and Sustain Superior Profitability
Peter W. Roberts, University of New South Wales
Grahame R. Dowling, University of New South Wales

Stock Market Valuation of Reputation for Corporate Social Performance
Brad Brown, University of Virginia

Sustainable Competitive Advantage and Firm Performance: The Role of Intangible Resources
G. Steven McMillan, The American College
Maheshkumar P. Joshi, St. Joseph's University

Has the Influence of Financial Performance on Reputation Measures Been Overstated?
A. J. Capraro, University of Texas at Austin
Rajendra K. Srivastava, University of Texas at Austin

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ENDNOTES

1 The control variables held constant in this study are both the mean and variance of market equity (log of market equity in $m), market-to-book, assets (log of assets in $m), financial leverage, payout ratio, price, and thinness. The distribution of firm size across portfolios is also equalized as much as possible. Note that while controlling for Market-to-Book equalizes the relative contribution of intangible assets (eg, intellectual property, brand value, and reputation), it also biases against seeing effects of reputation on Beta. Thus, any observed association between Beta and reputation can be interpreted as being understated.

2 Although the following discussion is strictly applicable only for diversified portfolios of firms, we will present the discussion at a firm level for two reasons. First, the intuitive value of the discussion is greater in discussing a firm's reputation rather than that of a portfolio. Second, while firms' Betas will tend to be too volatile for prediction at the individual firm level (Alexander and Chervany, 1980), it seems reasonable to consider 'average firms' whose attributes mimic the average of their portfolio as a way to explore the effects we are presenting.

3 $3bn is the average market value of the firms in the sample during the period used to calculate the Betas used in this study (1988–1990).

The Effect of Financial and Media Reputations on Performance

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INTRODUCTION

A favorable reputation is a resource that increases performance. Research supporting this argument has focussed on financial reputation. This article introduces media reputation, the favorableness of a company's media coverage, to this research. Based on a study of commercial banks, we suggest that a good media reputation may also improve company performance.

A central argument in the study of reputation is that a company's reputation influences its performance. As generally construed, reputation is the overall estimation of a company by its stakeholders (Fombrun, 1996). A favorable reputation can be a strategic resource that improves performance (Hall, 1992). Stakeholders are predisposed to favor reputable companies in their exchange relationships. This predisposition enables a company to attract quality employees, lower costs, increase prices, and create competitive barriers, resulting in higher profits and stock prices (Fombrun, 1996). Research generally has found positive correlations between reputation and performance. Most of this research measured reputation using the ratings of the largest US industrial corporations collected by *Fortune* magazine.

The general goal of the research reported here was to examine the relationship between reputation and performance in a different context than the *Fortune* ratings. We first develop the idea of media reputation, that is, the reputation of a company as portrayed in the media. Secondly, we review financial reputation, the reputation of a company's financial prospects from the perspective of the financial community. Thirdly, we measure media reputation and financial reputation in a sample of commercial banks in the Minneapolis-Saint Paul, USA, metropolitan area. We then demonstrate statistically that these two types of reputation influence financial performance, but are not identical to it.

MEDIA REPUTATION

Reputation has been defined to be the overall estimation of a company by its stakeholders (Fombrun, 1996). While this definition implies the evaluation by all of a company's stakeholders, in practice reputation is usually viewed from the perspective of specific stakeholders. Most notably, the *Fortune* ratings represent the evaluations made by business leaders (Fombrun, 1996). While reputation is supposed to represent a holistic evaluation, in practice reputation is linked to only certain company characteristics. Most notably, the *Fortune* ratings are thought by some researchers to be a reputation for financial performance (Fryxell and Wang, 1994). Reputation research may be advanced by finding a better way to evaluate a company's overall reputation that includes multiple stakeholders and multiple company characteristics.

We propose that the media provide a comprehensive way to evaluate the overall reputation of a company. The media are a forum where stakeholders and companies can debate the worthiness of a company (cf. Gamson, Croteau, Hoynes, & Sasson, 1992). Opinion stories are deliberate attempts by columnists, editors, and letter writers to influence various stakeholders. News stories inform stakeholders about a company and the assessments of it made by specialized rating institutions like Moody's or the Council on Economic Priorities. Stakeholders use information in the media when evaluating companies. Because of the importance of the media in disseminating information, we define media reputation as the overall favorableness of a company's media coverage. The favorableness of this reporting has been shown to reflect and influence stakeholder evaluations (Gamson et al, 1992; Gans, 1979). These evaluations, in turn, then influence stakeholders' exchange relationships with companies. Thus, we hypothesized:

Hypothesis 1: Companies with better media reputations have higher performance.

FINANCIAL REPUTATION

We define financial reputation as the general evaluation of a company's financial prospects made by the financial rating industry. This general evaluation is the result of expectations for profitability, stability, and growth (Fombrun, 1996). The financial rating industry consists of private, non-profit, and government agencies. To some extent, the *Fortune* ratings are an indicator of financial reputation because financial analysts are surveyed and there are high correlations between the *Fortune* ratings and performance (Fryxell and Wang, 1994).

Companies with favorable financial reputations are perceived to have good prospects for long-term financial performance. As such, these companies will be more attractive to potential exchange partners. Exchange relationships are likely to be more durable, and compensation in these relationships is likely to increase. Hence, these partners may be of higher quality, or they may accept less favorable terms of exchange initially. Both factors should lead to increased performance. Consistent with prior research, we hypothesized:

Hypothesis 2: Companies with better financial reputations have higher performance.

RESEARCH DESIGN

We investigated our hypotheses using a sample of commercial banks in the Minneapolis-St. Paul, USA, metropolitan area. The sample included all banks that had coverage in the two daily newspapers, *The Minneapolis Star Tribune* and *The Saint Paul Pioneer Press*, over the period 1988–1992. Our sample size was 265, representing the number of banks that had media coverage over the five-year period. Most of the banks in the sample were small, with fewer than four branches.

We obtained data on financial performance and financial reputation from reports that banks file with regulators. Performance was measured with ROA (Return on Average Assets), relative to the annual average for all area banks. This average controls for economic conditions in different years. Financial reputation was measured using capital adequacy and asset quality ratios. Regulators and bank rating agencies use these ratios to evaluate bank quality.

Media reputation was measured by content analyzing the two daily newspapers. All opinion stories were collected because they are deliberate attempts to influence stakeholders. A large random sample of news stories was collected to evaluate the regular coverage of a bank. Together, these sampling procedures yielded 1,277 articles. The author coded each bank in each article as favorable, unfavorable, mixed or neutral. To check the coding, a colleague was instructed to use the same coding scheme on 52 articles from the first year of coding (23 per cent of that year). The two raters agreed on 65 of the 71 codes (91.5 per cent). This agreement suggests that the coding scheme is adequate (ie, has a high level of intercoder reliability; Weber, 1990). The codes were aggregated to an annual measure amenable to hypothesis testing.

The data were analyzed using both correlation and regression analyses. Two control variables were included. The first was market share, an indicator of bank size. The second was the bank's performance in the prior year, which controlled for omitted variables.

RESULTS

The first set of results examined whether performance, media reputation, and financial reputation are distinct concepts. Results of correlation analyses suggested that they are. Capital adequacy and asset quality, the two measures of financial reputation, were correlated 0.37. Media reputation was correlated 0.01 and 0.11 with capital adequacy and asset quality, respectively. The low correlations suggest the two types of reputation are quite different. Finally, performance was correlated 0.15, 0.27, and 0.44, with media reputation, capital adequacy, and asset quality, respectively, suggesting that the concepts are related but distinct.

The second set of results examined whether media reputation and financial reputation affect performance. Regression

Table 1: Regression Results
Dependent Variable: Relative ROA

Independent Variables	*Estimated Coefficients*
Intercept	0.01
Market share	0.12**
Prior year's relative ROA	0.37***
Capital adequacy	0.20***
Asset quality ratio	0.25***
Media reputation	0.07+
R-Squared	0.48

+ $p < 0.10$
** $p < 0.01$
*** $p < 0.001$

results suggest they do, as indicated in Table 1. The estimated coefficients of the two financial reputation measures were positive and significant, as predicted by Hypothesis 2. The estimate coefficient for media reputation was positive and significant, as predicted by Hypothesis 1, even in the presence of financial reputation and the control variables.

SUMMARY AND IMPLICATIONS

This article illustrates how reputation theory can be applied outside the large companies that are evaluated by *Fortune*. The *Fortune* ratings are problematic because they measure reputation only from the perspective of one stakeholder group, business leaders. Moreover, they have been criticized for being overly influenced by one company characteristic, financial performance. We proposed that media reputation is a useful measure of overall reputation because many stakeholders and company characteristics are represented therein. The media provide a forum where reputations can be debated and affirmed. Furthermore, stakeholders use the media to evaluate companies. Financial reputation is still important to stakeholders, however. Companies with good financial reputations are more likely to provide long-term exchange relationships with increasing compensation.

The empirical analysis of commercial banks in the Minneapolis-St. Paul area suggests that both media reputation and financial reputation are important. Media reputation also influenced performance, after controlling for financial reputation. Financial reputation was also important among commercial banks, as expected from prior research. Thus, we conclude that the performance of companies with good financial reputations may be improved by having good media reputations as well.

The first implication of this article is to examine in more depth the creation and use of media reputations by companies and stakeholders. One question is how the media process company and stakeholder press releases. The media may disseminate some press releases with minimal editing. The media may alter, seek a countervailing opinion, or ignore other press releases. A second question concerns stakeholder use of the media. Some stakeholders may only read certain sections or types of stories, which would affect their evaluation of companies.

A second implication is to examine the use of financial reputations by stakeholders outside the financial community. One question is whether employees, communities, and other stakeholders consider financial reputations at all. If so, the second question is how financial reputations influence stakeholder exchange decisions.

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The Value of a Firm's Corporate Reputation: How Reputation Helps Attain and Sustain Superior Profitability

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INTRODUCTION

Although a growing body of literature supports the proposition that good corporate reputations have value, it does not directly address the question of whether a good reputation affects a firm's overall financial performance. In this article, we describe the results of an empirical study that relates the quality of a firm's reputation to its ability to attain and sustain superior financial performance outcomes over time. The theoretical foundation for the study comes from an emerging stream of strategy literature wherein firms are modeled as seeking sustainable competitive advantages which deliver sustained superior financial performance. Within this literature, resources such as corporate reputations are critical because of their potential for value creation, and because their intangible character inhibits imitation by competing firms.

CORPORATE REPUTATIONS AND FINANCIAL PERFORMANCE

Three major studies have examined the relationship between corporate reputations and financial performance. McGuire, Sundgren and Schneeweiss (1988) conclude that a firm's reputation for social responsibility has no effect on various measures of financial performance. Fombrun and Shanley (1990) question the validity of this conclusion and suggest that a different statistical analysis may lead to different conclusions. In a separate study, these latter authors find evidence of the reverse effect, namely, that accounting measures of profitability strongly affect a firm's reputation (also Brown and Perry, 1994). In a subsequent study, McGuire, Schneeweiss and Branch (1990) provide evidence indicating that the reputation-performance effect may operate in both directions: a firm's financial performance affects its reputation, but its reputation also affects its performance.

Recently, researchers have become interested in those factors which allow firms to attain and sustain superior performance outcomes (Hunt and Morgan, 1995; Jacobson, 1988; Porter, 1985). This study of how corporate reputations affect the dynamics of financial performance is grounded in the