# Corporate Reputation and Social Performance: The Importance of Fit

# Stephen J. Brammer and Stephen Pavelin

*University of Bath; University of Reading*

ABSTRACT    Utilizing data on a sample of large firms, we estimate a model of corporate reputation. We find reputation, derived from the assessments of managers and market analysts, to be determined by a firm's social performance, financial performance, market risk, the extent of long-term institutional ownership, and the nature of its business activities. Furthermore, the reputational effect of social performance is found to vary both across sectors, and within sectors across the various types of social performance. Specifically, our results demonstrate the need to achieve a 'fit' among the types of corporate social performance undertaken and the firm's stakeholder environment. For example, a strong record of environmental performance may enhance or damage reputation depending on whether the firm's activities 'fit' with environmental concerns in the eyes of stakeholders.

## INTRODUCTION

The increasing importance of the constructs of corporate social responsibility (CSR) and corporate reputation has, in recent years, been recognized within the strategic management literature by a proliferation of conceptual and empirical work (e.g. Fombrun, 1996; Hillman and Keim, 2001; McWilliams and Siegel, 2000; Podolny, 1993, 1994). The literature has paid particular attention to the relationships between both CSR and reputation and corporate financial performance (Fombrun and Shanley, 1990; Griffin and Mahon, 1997; Roberts and Dowling, 2002; Waddock and Graves, 1997), consumer perceptions of product quality (Milgrom and Roberts, 1986; Sen and Bhattacharya, 2001), employee morale, productivity, recruitment and retention (Moskowitz, 1972; Turban and Cable, 2003; Turban and Greening, 1996), company ownership characteristics (Fombrun and Shanley, 1990; Johnson and Greening, 1999), and access to capital (Cochran and Wood, 1984; Hart, 1995).

*Address for reprints*: Stephen Pavelin, Economics Department, University of Reading, Reading, RG6 6AH, UK (s.pavelin@reading.ac.uk).

In spite of this burgeoning interest in both CSR and corporate reputation, there has been very little systematic research of potential links between the two. While earlier studies identify a close relationship between corporate reputational capital and social responsibility (Fryxell and Wang, 1994; McGuire et al., 1988), much of this effort has focused upon establishing the meaning of reputational indices (the *Fortune* ranking chief among them), and conclude that they are most closely related to a firm's reputation as a financial investment (Fryxell and Wang, 1994). A seminal empirical study by Fombrun and Shanley (1990) provides evidence that social responsiveness, as measured by the level of corporate charitable donations and the presence of a separately endowed corporate charitable foundation, is positively associated with corporate reputation. Williams and Barrett (2000) provide more recent evidence in support of a link between philanthropy and firm reputation. In addition, they show that the link between philanthropy and reputation is stronger among companies that more frequently violate occupational health and safety and environmental regulations. They argue that, among other things, charitable giving can partially restore a firm's reputation after it has committed illegal acts (Williams and Barrett, 2000).

Reputation has been defined as 'a perceptual representation of a company's past actions and future prospects that describe the firm's overall appeal to all its key constituents when compared to other leading rivals' (Fombrun, 1996, p. 72). As has been highlighted, definitions such as this emphasize the aggregate or summative nature of corporate reputations that reflect the perceptions of a host of individual stakeholders. A variety of definitions of CSR proposed both in the literature and by a variety of institutions, emphasize a voluntary involvement in the solution of a variety of social issues (e.g. European Commission, 2001; McWilliams and Siegel, 2001). Though often viewed as an aggregate construct, social responsiveness is fundamentally multidimensional and embodies a large and varied range of corporate behaviour in relation to its resources, processes and outputs (Carroll, 1979; Waddock and Graves, 1997; Wood, 1991). Demonstrating a high degree of social responsibility may therefore require a diverse range of activities (including engagement in philanthropic activities, reduction of environmental impacts, and the introduction of practices that empower employees), each of which may have a separately identifiable impact upon reputation. Furthermore, stakeholder groups have differing expectations regarding firm behaviour (Fombrun and Shanley, 1990), and the salience of each stakeholder group varies across industries. Therefore, the impact of CSR activism on reputation is jointly contingent upon which type of CSR activity is undertaken, and which industrial sector the firm is primarily associated with. In this sense, the effect of a firm's social performance on its reputation is importantly determined by the fit between sector-specific characteristics of the firm's business environment and the type of social performance the firm exhibits.

This paper analyses the relationship between corporate reputation and social performance for a sample of UK companies. We use reputational data constructed

in a similar manner to the *Fortune* index (which has often been employed in previous work), and make two contributions to the literature. First, we present the first systematic analysis of the relationship between reputation and social performance that permits different elements of corporate social performance to have varying effects upon reputations. Second, we explore how the reputational effects of different types of responsiveness initiatives vary across industries. Our contribution is timely in that it echoes recent work that emphasizes the importance of the manner in which firms implement their social responsiveness initiatives (Porter and Kramer, 2002).

In the next section, we introduce a conceptual model of the link between social performance and corporate reputation and introduce our hypotheses. The third section describes the data; the fourth section reports the results, and a final section offers some concluding remarks and suggestions for practice.

## THE DETERMINANTS OF CORPORATE REPUTATION

In this section we develop a model of the influences on corporate reputation and outline a number of hypotheses. Our starting point is Fombrun and Shanley's seminal model which hypothesizes that corporate reputations are summative representations of stakeholders' opinions of firms which depend on their success in meeting the expectations of those stakeholders (Fombrun and Shanley, 1990). A firm's current reputation is determined by the signals that publics receive concerning its behaviours, whether directly from the firm or via other information channels, such as the media or the stock market. Stakeholders are expected to have diverse preferences over firm actions, process and outcomes and reputational assessments depend upon the congruence between the apparent behaviours of the firm and the preferences of those publics (Fombrun and Shanley, 1990).

Following Fombrun and Shanley (1990), we differentiate between various types of signals that relevant publics may receive concerning companies, and which may influence their perceptions of the firm. Such signals vary according to whether they originate within or outside the company, and with respect to the type of information they contain. Our framework hypothesizes that a firm's reputation is determined by signals concerning social responsibility and financial performance, product quality, ownership composition, size, media visibility and industry. We will discuss each of these in turn.

### The Link between Corporate Reputation and Social Performance

Existing work has argued that social responsiveness can play a significant role in promoting favourable relationships with primary stakeholder groups. Stakeholders (such as shareholders, employees, consumers, pressure groups, Government and regulators) that do not view the firm as legitimate have the power to either arrest

power from managers, or to at least hamper the execution of corporate strategy (Mitchell et al., 1997). Such 'salient' stakeholder groups demand attention from corporate management and, to the extent that firms behave in accordance with their expectations, they will be willing to continue to participate in the activities of the firm. To the extent that social responsiveness helps managers encourage constructive contributions from stakeholders, we should expect it to augment the firm's reputation since the expectations of both managers and other stakeholders are satisfied (Donaldson and Preston, 1995).

According to an alternative view, CSR activism represents a wasteful discretionary act of management, born of altruistic impulse or the desire for self-aggrandisement (Bartkus et al., 2002; Navarro, 1988). Within this view, one would expect social performance to damage the financial performance and reputation of the firm (Friedman, 1970). Indeed, it may have a detrimental effect simply because of a tendency for social investment to crowd out investment in other projects (McWilliams and Siegel, 2001). That is, even if social performance would, ceteris paribus, enhance the reputation of the firm, this effect is outweighed by the opportunity costs associated with diverting resources away from other activities that would do more to enhance corporate reputation (Russo and Fouts, 1997). However, given evidence that is suggestive of the strategic use of CSR policy (Porter and Kramer, 2002; Saiia et al., 2003), we expect the overall tendency to be for social responsiveness to augment reputation, and propose the following hypothesis.

*Hypothesis 1*: There is a positive relationship between corporate social performance and reputation.

The strength and direction of the relationship between corporate reputation and social performance may be contingent upon the activity a company is engaged in since industry environments are correlated with significant pressure from institutional, and other, stakeholders (Pfeffer and Salancik, 1978; Scott, 1987, 1995). This suggests that industry may play a moderating role in the relationship between reputation and social performance because of the presence of industry-specific stakeholder pressures for improved social responsiveness from primary stakeholders such as employees, customers, communities, and legal and regulatory bodies. Such pressures typically arise because of the close association between some economic activities and severe social and environmental externalities that lead to the increased salience of particular issues in ways that lead to increased pressure on companies to respond (Berman et al., 1999; Miles, 1987; Rowley and Berman, 2000). Moreover, satisfying the demands of these constituencies for improved social responsiveness is in the interests of companies because firms are typically dependent upon them for resources that are necessary to their continuing survival and success (Clarkson, 1995; Hillman and Keim, 2001; Mitchell et al., 1997). In

light of the heightened relevance of social responsiveness for meeting the expecta-
tions of multiple stakeholders in some sectors relative to others, we hypothesize
that:

*Hypothesis 2*: Industrial sector moderates the relationship between social perfor-
mance and reputation, such that the relationship is stronger in sectors that are
associated with salient social and environmental issues.

Existing contributions have argued that understanding the wants of stakeholders is
of primary importance when attempting to design organizational responses to them
(Frooman, 1999), and that stakeholders are most likely to be galvanized into action
in circumstances where they share a clear preference for a particular action in a
context where the source of the concern is easily identifiable (Rowley and Berman,
2000). Therefore, it is likely that the overall reputational impact of social respon-
siveness is jointly contingent upon which dimension of social responsiveness is under
consideration, and which business sector the firm is primarily associated with.

   Existing evidence suggests that the nature of focal social issues varies systemati-
cally across different industries. For example, earlier empirical work has identified a
number of sectors as having particularly high environmental impacts, e.g. the
metals, resources, paper and pulp, power generation, water, and chemicals sectors
(Bowen, 2000; Clemens, 2001; Hoffman, 1999; Morris, 1997; Sharma, 1997;
Sharma et al., 1999). Other industries are associated with alternative issues, for
example, the tobacco and alcoholic drinks industries are associated with highly
visible social issues. They are thought to produce large social externalities (e.g. crime
and health) and are subject to strong regulatory regimes (competition, safety and
taxation). Similarly, the defence and pharmaceutical industries receive particular
attention from ethical pressure groups, and the profile of workplace health and safety
concerns is relatively high in the construction and resource extraction sectors.

   Since the reputational benefits of improved social responsiveness arise out of
meeting the expectations of stakeholders for the mitigation or reparation of social
issues, it follows that demonstrating good social performance that is perceived to
bear little or no relation to a firm's activities may be thought of as wasteful
managerial excess, and so harm reputation, whereas examples perceived as rel-
evant are likely to be more favourably viewed. Hence, we hypothesize that the fit
between a corporation's social performance activities and its business environment
influences the link between social performance and reputation.

*Hypothesis 3*: Industrial sector and type of social performance interact to influ-
ence the relationship between social performance and reputation, such that the
link between reputation and community (employee; environmental) perfor-
mance is stronger in sectors that are associated with salient social (employee;
environmental) issues.

## METHOD

Our sample consists of 210 UK PLCs chosen largely according to the availability of reputation data (see below[1]). Therefore, this sample, while drawn from a wide range of industrial sectors, is not randomly selected. Instead, there is a focus upon the largest firms within each industrial sector, including 90 per cent of FTSE 100 companies. Nevertheless, there is considerable variation in reputational scores both within and between industrial sectors.

### Corporate Reputation

To measure corporate reputation we utilize the 'Britain's most admired companies' survey from *Management Today*, 2002, which employs a similar methodology to that used to construct the *Fortune* index, a commonly-used measure of the reputations of US firms (e.g. Fombrun and Shanley, 1990; Fryxell and Wang, 1994; McGuire et al., 1988). The chairmen, managing directors and selected main board directors of the 10 largest companies in 24 industrial sectors were surveyed, as were analysts at a selection of leading investment companies. Participants were asked to rate each company in their sector (excluding their own company) on a scale of zero (poor) to 10 (excellent) for their performance in nine criteria: quality of management; financial soundness; ability to attract, develop and retain top talent; quality of products/services; value as a long term investment; capacity to innovate; quality of marketing; community and environmental responsibility; and use of corporate assets. The assessments received for each firm were averaged across criteria and respondents to produce a single reputational score.

   Given our focus upon the role of social performance as a determinant, rather than component, of reputation, it would be preferable to remove a score for perceived social (community and environmental) responsiveness from these reputational scores. Unfortunately, we cannot do this. However, we believe that this component, which contributes only one ninth of the score, is dominated by other aspects of reputation. Furthermore, as mentioned previously, there is evidence that similarly constructed aggregated measures of reputation speak most directly to a firm's reputation as an investment.

### Social Performance

Social performance data were obtained from the Ethical Investment Research Service (EIRIS), who specialize in the measurement of corporate social performance against a consistent and objective set of criteria, principally for the consumption of investors. EIRIS survey firms concerning their social performance, but also undertake their own research. As a result, they are able to provide social performance scores for a firm irrespective of whether it participates in an EIRIS

survey. They offer the largest and most complete multidimensional social performance coverage of UK firms, covering issues relating to employment, the environment, community, human rights and supply chain management. Due to the limited availability of data regarding the last two of these, we will restrict our attention to the first three dimensions of social performance.

Our indicator of employee responsibility is based upon five separate components relating to health and safety systems, training and development, equal opportunities practices, employee relations and job creation and security. Similarly, our indicator of environmental responsiveness is based upon four separate components relating to the quality of environmental policies, systems, reporting and performance. Our indicator of community responsiveness is entered as a single measure by EIRIS. Following the general approach used by Graves and Waddock (1994) for KLD data,[2] we translated the EIRIS text-grade rating for each measure into a number-grade rating. Each environmental measure has five text categories; the employment measures have three text categories, while community has four. We coded each of the environment text scales into five point scales, each of the employee responsibility text scales into three point scales and created a four point scale for community responsiveness. In each case, the codes began with a value of 1 and larger numbers indicated more social responsiveness. To summarize, our measures of the three dimensions of social performance are:

- Community performance graded 1 to 4.
- Environmental performance: policies; systems; reporting; and performance. Each category graded 1 to 5. Environmental impact score out of 20.
- Employee performance: health and safety; training and development; equal opportunities; employee relations; job creation; and job security. Each category graded 1 to 3. Employment responsibility score out of 18.

To arrive at a single aggregate measure (termed social performance) we summed the three scores having normalized each to a 1 to 4 grading. This generates an overall score out of 12.

## Control Variables

Corporate reputation is partly formed by signals concerning current financial performance whether such signals arise out of accounting data or stem from movements in stock prices (Fombrun and Shanley, 1990). Strong financial performance generally signals an effective corporate strategy, good management, and good resource allocations, and so helps a firm establish or maintain a good reputation (Roberts and Dowling, 2002; Sabate and Puente, 2003), particularly among groups of financial stakeholders such as creditors, investors, and external analysts (Fama, 1970; Fombrun and Shanley, 1990). While external agents view financially successful companies favourably, they tend to be risk-averse. Therefore, if two

firms exhibit similar levels of financial performance, it should be the firm that appears to offer less risk that gains the better reputation (Fombrun and Shanley, 1990). In addition, a higher degree of leverage should, ceteris paribus, bring lower reputational assessments, as it constitutes a burden upon future returns that may threaten the medium- and/or long-term viability of the firm.

A measure of each firm's profitability (measured by the ratio of pre-tax profits to total assets) and corporate leverage (measured by the ratio of total debt to total assets) were extracted from accounting data courtesy of *DataStream*. Data concerning the market performance of sample companies was obtained from Barra Inc., a leading risk specialist. We employ a $\beta$ measure of the risks associated with stock ownership that gauges the expected response of a stock to the overall market. A $\beta$ is an analytical tool, commonly employed by investors, to measure the volatility or risk of stocks. It measures the extent to which the price of a given stock varies with respect to the market as a whole. A $\beta$ coefficient is derived from a regression analysis that estimates the effect, over a period of time (say, five years), of weekly or monthly percentage changes in a market index on weekly or monthly percentage changes in the price of an individual stock.

Broadly speaking, firms grow as a result of some measure of effectiveness in their corporate strategic history, and so larger firms should be expected to garner a better reputation than smaller rivals. Larger firms also tend to be more visible to external agents, i.e. agents will tend to hold more information regarding the activities of larger firms – an imbalance which may bias their assessments of corporate reputation. Also, media exposure not only increases the stock of available information, but also sets the context within which it is viewed. For both reasons, one should expect the extent of media exposure to influence assessments of corporate reputation. A measure of each firm's size (the natural logarithm of the value of total assets) was extracted from accounting data courtesy of *DataStream*.

Many empirical studies employ firm size as a measure of visibility to external agents (e.g. Adams and Hardwick, 1998; Bowen, 2000; Damanpour, 1987). However, Bowen (2000) argues that size is an unsatisfactory proxy because it captures much more than an organization's visibility. Regarding an alternative measure, Saiia (2000) argues for the use of readily available secondary data. Consistent with these arguments, our approach is to use the incidence of news media coverage of the firm as a measure of visibility.[3] This information was obtained form the *Factiva* database, which provides searchable archives of news content from over 8000 global sources. We gathered data for each of the calendar years 1998–2002 inclusive, and used the natural logarithm of the average number of annual news hits as our measure of corporate visibility.

Recent evidence suggests that the composition of a firm's shareholder constituency, across a broad spectrum of investor groups, exerts a significant influence on various aspects of firm behaviour. Institutional investors are motivated to become more engaged with corporate management because of their increased visibility and

because they are 'tied in' to their investments in the sense that, given their size, they have reduced flexibility to sell investments without significantly damaging their value (Ryan and Schneider, 2002). A strong presence of institutional shareholders may therefore signal to other stakeholders that the firm's performance is keenly monitored and deemed to be satisfactory by these relatively well-informed and experienced investors. Ownership data were drawn in June 2002 from a share ownership analysis database of more than 2000 listed UK firms managed by one of the UK's largest company registrars. Derived from records of share trading on the London Stock Exchange, the database disaggregates share ownership according to 32 different types of beneficial owner. Following Ryan and Schneider (2002) and Johnson and Greening (1999), we employ a variable that equals the sum of the proportions of firm equity held by long-term institutional investor groups, i.e. pension funds, insurance companies and life assurors.

A link has often been drawn between a firm's reputation and the perceived quality of its product range, such that firms perceived to produce high quality goods tend to enjoy better reputations (Fombrun and Shanley, 1990). In light of this, one should expect corporate reputation to be augmented by those activities most closely associated with the vertical differentiation of products: technological advancement and the cultivation of a strong brand image. Accordingly, we hypothesize that reputation is increasing in a firm's research and development (R&D) and advertising intensities. A measure of each firm's R&D intensity (the ratio of R&D expenditures to total assets) was extracted from accounting data courtesy of *DataStream*. As there is no statutory obligation to disclose such expenditures, firm-level advertising data are difficult to obtain for UK firms. However, media research agencies monitor the incidence of advertisements at the brand level throughout the main advertising media (TV, newspapers, magazines, radio, posters, etc) and estimate the levels of expenditure incurred. We construct a dummy variable on the basis of identification, by *Marketing* magazine in 2002, of a firm as one of the 'Top 100 Advertisers' or as an owner of one of the 'Biggest Brands' in the UK. Given that the levels of expenditure on advertising tail off dramatically at the foot of these rankings we are confident that our methodology allows us to capture the vast majority of the firms for which advertising is a key competitive tool.

Finally, it may be that, even controlling for financial performance and all the other firm attributes we have discussed, reputation varies systematically across sectors. This is to say, some business activities may predispose a firm to a better reputation than do other activities. Each firm's principle business activity (approximately equivalent to the three-digit NACE industry) was extracted from accounting data courtesy of *DataStream*. Using the *DataStream* industry classification, we allocated each firm to one of twelve sectors: business services, chemicals,[4] construction, consumer products, engineering, finance, high technology, publishing, resources, retail, transportation, and utilities.

## RESULTS

We present OLS regression results for an econometric model of corporate reputation that incorporates the explanatory variables described in the previous section. Table I presents descriptive statistics and a correlation matrix for key variables. Diagnostic testing provides evidence of heteroscedasticity in all but one of the regressions presented. In light of this, we employ White's method to correct for bias in statistical inference. In the presence of heteroscedasticity, White's method adjusts standard errors to facilitate the drawing of sound inferences concerning statistical significance (White, 1980). We note that heteroscedasticity does not bias parameter estimates, but that more efficient parameter estimates can be obtained through the use of either weighted least squares or MLE if the sources of the heteroscedasticity are identified. Unfortunately, we can make no such identification. To test for simultaneity in the relationships between corporate reputation and both social performance and financial performance, we carried out Durbin–Wu–Hausman tests as suggested in Davidson and MacKinnon (1993). In both cases, we found no evidence of simultaneity and conclude that the estimates provided by ordinary least squares are consistent. We first present results that restrict social performance to a reputational effect that is the same in all sectors. We also impose the constraint that all types of social performance must have the same effect on reputation. Both of these restrictions are subsequently dropped as we progress towards our preferred model specification.

### Selecting the Most Suitable Model Specification

Table II presents the results for three specifications. All three use a single measure of social performance. The first omits the set of sectoral dummy variables that are included in the second and third regressions. The third also includes interaction between social performance and the sectoral dummies, thereby permitting the reputational effect of social performance to vary systematically across sectors.

Regression 1 provides a point of departure with the existing literature by examining a set of explanatory variables that overlaps considerably with those employed by Fombrun and Shanley (1990). Consistent with Fombrun and Shanley's results, we find that firm reputation is positively associated with current financial performance, as measured by profitability (p = 0.026), with the degree of long-term institutional ownership (p = 0.000), and negatively associated with market risk (p = 0.009). These results provide further confirmation of the findings of Fryxell and Wang (1994) which suggest that reputational indices are highly correlated with facets of corporate financial performance. In contrast with Fombrun and Shanley (1990), we find corporate media visibility to have a significant positive effect on reputation (p = 0.041).

Taking these three regressions together, we can draw some conclusions about the suitability of each specification. That significant coefficients are associated with a

Table I. Descriptive statistics and correlation matrix

| | Variable | mean | st. dev. | min. | max. | Correlation matrix |||||||||||||
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | i | ii | iii | iv | v | vi | vii | viii | ix | x | xi | xii |
| i | Corporate reputation | 53.1 | 8.01 | 30.1 | 73.0 | – | | | | | | | | | | | |
| ii | Financial performance | 5.65 | 10.8 | −56.8 | 35.4 | 0.307[b] | – | | | | | | | | | | |
| iii | Market risk | 0.95 | 0.32 | 0.17 | 1.86 | −0.150 | −0.325[b] | – | | | | | | | | | |
| iv | Leverage | 24.6 | 16.9 | 0.00 | 83.7 | −0.103 | −0.250[b] | −0.095 | – | | | | | | | | |
| v | Firm size | 14.6 | 1.75 | 11.1 | 19.7 | 0.163[b] | −0.184[b] | 0.138 | 0.097[b] | – | | | | | | | |
| vi | Media exposure | 6.35 | 1.20 | 4.03 | 9.41 | 0.200[b] | −0.138[a] | 0.255[b] | 0.068 | 0.792[b] | – | | | | | | |
| vii | R&D intensity | 1.45 | 4.15 | 0.00 | 35.0 | 0.037 | 0.072[a] | 0.179 | −0.159 | −0.217 | −0.021 | – | | | | | |
| viii | Advertising intensity | 0.20 | 0.40 | 0.00 | 1.00 | 0.100 | −0.001 | −0.179[b] | 0.066 | 0.200[b] | 0.398[b] | −0.097 | – | | | | |
| ix | Institutional ownership | 30.0 | 9.32 | 4.80 | 57.4 | 0.265[b] | 0.151[b] | 0.108 | −0.051 | 0.028 | −0.017 | 0.004 | −0.026 | – | | | |
| x | Social performance | 4.03 | 2.49 | 0.00 | 8.67 | 0.242[b] | 0.006 | −0.004 | 0.093 | 0.675[b] | 0.688[b] | −0.078 | 0.278[b] | 0.063 | – | | |
| xi | Community performance | 1.46 | 0.99 | 0.00 | 3.00 | 0.289[b] | −0.032 | 0.045 | 0.070 | 0.626[b] | 0.660[b] | −0.043 | 0.272[b] | 0.036 | 0.891[b] | – | |
| xii | Environmental performance | 4.77 | 3.58 | 0.00 | 12.0 | 0.176[b] | 0.063 | −0.096 | 0.131[a] | 0.594[b] | 0.564[b] | −0.120 | 0.259[b] | 0.078 | 0.900[b] | 0.663[b] | – |
| xiii | Employee performance | 5.89 | 3.92 | 0.00 | 14.0 | 0.164[a] | −0.042 | 0.089[a] | 0.009 | 0.541[b] | 0.595[b] | −0.015 | 0.174[b] | 0.042 | 0.819[b] | 0.674[b] | 0.603[b] |

**Some units of measurement**

(ii) the ration of pre-tax profits to total assets; (iv) the ration of total debt to total assets; (v) the natural logarithm of the value of total assets; (vi) the natural logarithm of the average number of annual news hits 1998–2002; (vii) the ratio of R&D expenditures to total assets (as a percentage); (ix) the percentage of firm equity held by institutional investors.

[a] and [b] indicate that the correlation coefficient is significantly different from zero at a 95% and 99% level of confidence, respectively.

Table II. Regression results without decomposition of social performance

| Variable | Model specification | | |
|---|---|---|---|
| | *1* | *2* | *3* |
| Constant | 39.20*** | 36.59*** | 42.93*** |
| Financial performance | 0.165** | 0.137* | 0.133* |
| Market risk | −5.013*** | −7.500*** | −6.885*** |
| Leverage | −0.027 | −0.055 | −0.044 |
| Firm size | −0.016 | 0.849 | 0.353 |
| Media exposure | 1.801** | 1.201 | 1.703* |
| R&D intensity | 0.106 | 0.185 | 0.160 |
| Advertising intensity | −0.665 | −1.210 | −1.146 |
| Institutional ownership | 0.208*** | 0.175*** | 0.176*** |
| *Nature of business activities* | | | |
| Chemicals | | −5.827*** | −11.78*** |
| Construction | | −0.504 | −2.803 |
| Consumer products | | −5.629** | −13.16*** |
| Engineering | | 3.914 | 6.713** |
| Finance | | −9.789*** | −17.21*** |
| High technology | | −2.904 | −5.528* |
| Publishing | | −3.286 | −1.366 |
| Resources | | −4.570 | −21.14*** |
| Retail | | −2.799 | −3.846 |
| Transportation | | −2.138 | −12.32*** |
| Utilities | | −14.82*** | −16.89** |
| *Social performance* | 0.230 | 0.691*** | −0.572 |
| → Chemicals | | | 1.879* |
| → Construction | | | 1.092 |
| → Consumer products | | | 2.284* |
| → Engineering | | | −0.700 |
| → Finance | | | 2.239** |
| → High technology | | | 0.914 |
| → Publishing | | | −0.189 |
| → Resources | | | 3.276*** |
| → Retail | | | 0.676 |
| → Transportation | | | 2.510** |
| → Utilities | | | 1.164 |

*Notes:* For regressions 1, 2 and 3, the dependent variable is corporate reputation.
1: N = 210; $R^2$ = 0.240; Adjusted $R^2$ = 0.206; Breusch-Pagan test statistic (9df) = 11.6 (p = 0.2343).
2: N = 210; $R^2$ = 0.430; Adjusted $R^2$ = 0.369; Breusch-Pagan test statistic (20df) = 43.5 (p = 0.0017).
3: N = 210; $R^2$ = 0.491; Adjusted $R^2$ = 0.403; Breusch-Pagan test statistic (31df) = 57.4 (p = 0.0027).
*, **, *** denote significance at the 90%, 95% and 99% level of confidence, respectively.
In regressions 2 and 3, the omitted sectoral dummy variable is 'business services'.
→ indicates interaction between social performance and a sectoral dummy variable.

number of the sectoral dummy variables in regressions 2 and 3, justifies their inclusion in the model. Similarly, the inclusion of the interaction variables is justified by a number of significant associated coefficients in regression 3. Therefore, of the first three regressions, the third seems to represent the most suitable specification. Indeed, we note that as the specification is developed by adding industry effects and interactions, the adjusted R-squared statistic rises from 0.206 to 0.403. The pattern identified across the sectoral dummy variables suggests, consistent with earlier observations, that it is important to control for industry in studies of corporate reputation, particularly when measures of reputation are industry-specific in the sense that respondents are asked to rate firms relative to industry peers (Fombrun and Shanley, 1990).

Table III also presents results for three specifications, but in each case social performance is disaggregated into its constituent parts. Following the same pattern as Table III, regression 4 omits a set of sectoral dummy variables that are included in regressions 5 and 6, the latter of which also includes interaction between the various dimensions of social performance and a selection of sectoral dummies. This selection was obtained from an iterative procedure, which began with each dimension of social performance being interacted with all (but one) of the sectoral dummies (see the appendix for regression results for this full model). This specification brought a huge increase in the number of parameters to be estimated (from 22 to 55). To recover some degrees of freedom, we undertook a process of refinement that sought to isolate just those interactions for which evidence could be found. Accordingly, the least significant of these interaction variables was omitted and the regression re-run. This procedure was repeated until all remaining interaction variables were significant at the 90 per cent level of confidence. Only 9 of the 33 interactions secured a place in the final specification.

Again, that significant coefficients are associated with a number of the sectoral dummy variables in regressions 5 and 6, and a number of the interaction variables in regression 6, justifies their inclusion in both cases. As the specification is developed by adding industry effects and selected interactions, the adjusted R-squared statistic rises from 0.233 to 0.481. Therefore, of these three model specifications, it is that used in regression 6 that appears the most suitable. Furthermore, significant variation across the various types of social performance (as shown in regressions 4, 5 and 6) indicates that regression 6 should be preferred to regression 3, and so is the most suitable of all the specifications presented – as reflected in its superior explanatory power relative to the other specifications.

Regression 6 provides good evidence in support of roles in determining reputation played by a number of our control variables: financial performance, market risk and long-term institutional ownership.[5] However, we find no significant roles for leverage, firm size, media exposure, R&D intensity and advertising intensity. As mentioned above, there is also strong evidence that reputation varies systematically across sectors. The greatest predisposition to a good

Table III. Regression results with decomposition of social performance

| Variable | Model specification | | |
|---|---|---|---|
| | 4 | 5 | 6 |
| Constant | 39.91*** | 37.53*** | 44.06*** |
| Financial performance | 0.173** | 0.141* | 0.131* |
| Market risk | −5.308*** | −7.782*** | −6.905*** |
| Leverage | −0.023 | −0.052 | −0.043 |
| Firm size | −0.017 | 0.695 | 0.298 |
| Media exposure | 1.645* | 1.305 | 1.100 |
| R&D intensity | 0.088 | 0.143 | 0.138 |
| Advertising intensity | −0.832 | −1.183 | −1.247 |
| Institutional ownership | 0.214*** | 0.184*** | 0.179*** |
| *Nature of business activities* | | | |
| Chemicals | | −4.918*** | −8.030*** |
| Construction | | 0.707 | 1.564 |
| Consumer products | | −4.953** | −10.35*** |
| Engineering | | 4.817** | 9.376*** |
| Finance | | −9.152*** | −16.79*** |
| High technology | | −2.501 | −2.686 |
| Publishing | | −4.289 | −3.590 |
| Resources | | −3.373 | −23.26*** |
| Retail | | −3.048 | −2.019 |
| Transportation | | −1.683 | −9.456** |
| Utilities | | −13.83*** | −10.68*** |
| *Community performance* | 2.441*** | 2.957*** | 2.468*** |
| → Engineering | | | 3.144** |
| → Finance | | | 5.093*** |
| → Resources | | | −3.998*** |
| *Environmental performance* | −0.308 | −0.219 | −0.475** |
| → Chemicals | | | 0.760* |
| → Consumer products | | | 1.275*** |
| → Engineering | | | −1.829*** |
| → Resources | | | 4.109*** |
| → Transportation | | | 1.384** |
| *Employee performance* | −0.141 | −0.063 | 0.032 |
| → Resources | | | −0.642* |

*Notes:* For regressions 4, 5 and 6, the dependent variable is corporate reputation.
4: N = 210; $R^2$ = 0.273; Adjusted $R^2$ = 0.233; Breusch-Pagan test statistic (11df) = 19.4 (p = 0.0541).
5: N = 210; $R^2$ = 0.464; Adjusted $R^2$ = 0.401; Breusch-Pagan test statistic (22df) = 49.3 (p = 0.0007).
6: N = 210; $R^2$ = 0.558; Adjusted $R^2$ = 0.481; Breusch-Pagan test statistic (31df) = 58.9 (p = 0.0013).
*, **, *** denote significance at the 90%, 95% and 99% level of confidence, respectively.
In regressions 5 and 6, the omitted sectoral dummy variable is 'business services'.
→ indicates interaction between a dimension of social performance and a sectoral dummy variable.

reputation lies in engineering and construction; the greatest predisposition to a bad reputation resides in the resources, finance and utilities sectors.

## DISCUSSION

In describing our findings, we will of course ultimately draw upon the specification we have selected as the most suitable. However, some lessons regarding the effect of social performance can be gleaned from the manner in which its effect varies across the regression results as a whole. For example, the first regression attributes no significant effect to social performance, but once reputation is permitted to vary systematically across sectors, there is evidence of a significant role. Specifically, the second regression shows that, when taking all sectors together, reputation is increasing in social performance. However, the third regression shows that this relationship is subject to significant cross-sector variation. Indeed, the significant role is restricted to the chemicals, consumer products, finance, resources and transportation sectors, where the effect is positive in all cases.

Regressions 4 and 5 imply that the significance of social performance for reputation resides only within community performance. However, once the impact of the environmental and employee dimensions of social performance is permitted to vary across sectors (as reported in regression 6), both are found to have statistically significant effects on reputation. Environmental performance is predicted to harm reputation ($p = 0.019$) in all but the chemicals, consumer products, resources and transportation sectors, where it has a positive reputational effect ($p = 0.063$, $p = 0.006$, $p = 0.000$, and $p = 0.033$, respectively). Three of these sectors (chemicals, resources, and transport) are commonly identified as industries with salient environmental issues within the environmental management literature (Bowen, 2000; Clemens, 2001; Halme and Huse, 1996; Sharma et al., 1999).

Employee performance is predicted to influence reputation only in the resources sector, where it has a detrimental effect ($p = 0.064$). The comparatively low overall significance of employee responsibility in regression 6 may reflect the fact that employee responsibility is, relative to other dimensions of social performance, comparatively invisible from outside the organization and therefore has only a muted impact on the impressions external agents have of companies. Alternatively, it may be that employee responsibilities play only a minor role in influencing reputations because they are associated with legal compliance issues to which all companies are subject.

The positive overall effect of community performance, shown in regressions 4 and 5, is reflected in the results for regression 6 in all but one sector, resources, where there is a significant negative effect ($p = 0.000$). Thus, we find a significant positive impact of community responsiveness that operates in 11 of the 12 industrial sectors examined in our study. It is this dimension of CSR policy that exerts the influence on reputation that is most widely felt across industrial sectors. This significant role for

community involvement is consistent with the evidence for philanthropic expenditures identified by Fombrun and Shanley (1990) and Williams and Barrett (2000). Furthermore, while there is a general tendency for community performance to build reputation in these 11 sectors (p = 0.000), the greatest effect is found in two of them: Engineering (p = 0.023) and Finance (p = 0.000).

We can use these findings to evaluate Hypotheses 1, 2, and 3. Regressions 3 and 6 provide evidence in support of Hypothesis 2 (that the relationship between social performance and reputation varies across sectors). Hypothesis 3 also receives support, as regressions 4, 5 and 6 indicate that this relationship varies across the types of social performance. As previously implied, we interpret this support for Hypotheses 2 and 3 as reason to select regression 6 as the most suitable for evaluation of the other hypotheses.

The evidence relating to Hypothesis 1 is somewhat mixed. Hypothesis 1, that there is a positive reputational effect, receives support in respect of community performance in all but the resources sector, and for environmental performance in the chemicals, consumer products, resources and transportation sectors. However, there is a negative reputational effect for community performance in the resources sector, for environmental performance in all but the four sectors listed above, and for employee performance in the resources sector.

It is worth reflecting upon how these findings relate to our previous discussion concerning the perceived relatedness of social performance to the activities of the firm. Consistency with that discussion would imply: that community performance is perceived to be keenly relevant in all but the resources sector; that environmental performance is primarily associated with the chemicals, consumer products, resources and transportation sectors; and that no activity is perceived to be closely related to employee performance. In response, we note, somewhat tentatively, that the resources sector operates without close proximity to final consumers, and that there is significant environmental impact in, at least some parts of, the chemicals, consumer products, resources and transportation sectors.

## CONCLUSION

Using data on a sample of large UK firms, we present a model of corporate reputation. The analysis focuses upon the relationship between corporate social performance and reputation and is distinctive in two respects. First, we differentiate between overall corporate social performance and its constituent parts. Second, the varying influence of these factors on firm reputation across industries is examined. We find that different types of social performance have varying reputational impacts and that these impacts are contingent upon which industry the firm operates in.

In finding that social performance influences corporate reputation, we echo the findings of previous work and provide further support for the notion that

social responsibility influences a firm's market valuation. However, we reveal significant variation in this reputational effect across business activities and various dimensions of social performance. In particular, our results demonstrate the need to achieve a 'fit' between the type of corporate social performance and the firm's stakeholder environment. For example, a strong record of environmental performance may enhance or damage reputation depending on whether the firm's activities 'fit' with environmental concerns in the eyes of stakeholders. Community involvement, by contrast, is shown to have a more generally positive impact upon corporate reputations, suggesting that good community performance is expected by stakeholders in almost all industrial contexts.

Given the competitive importance of social responsibility and reputation, our work is suggestive of a need to explore the role the concept of 'fit' plays in determining the effectiveness of social responsibility initiatives. Our results suggest that 'fitting' social performance to an industrial context implies good performance in areas where stakeholders hold a general expectation of companies, such as seems to be true of community performance, and demonstrating sensitivity to any industry-specific issues, such as environmental impacts. Recognizing the importance of 'fit' may help to resolve the inconclusive findings in the literature concerning the relationship between social performance and financial performance (Griffin and Mahon, 1997).

Much of the literature regarding corporate reputation has centred on empirical study of US firms. Our analysis contributes to the small, but growing, body of work focused upon other countries (e.g. Kitchen and Laurence, 2003; MacMillan et al., 2002; Wiedmann, 2002) and offers an opportunity to examine the international robustness of US findings. Broadly, our results are consistent with earlier work in that we find reputation to be affected by a firm's financial performance, market risk, the extent of long-term institutional ownership, and the nature of its business activities. These results suggest that the determinants of reputation, derived from the assessments of managers and market analysts, are relatively robust across countries.

This study suffers from limitations that could be addressed in future work (see also Heugens, 2004). First, our analysis is cross-sectional in nature and future attempts to examine the patterns we have identified within a longitudinal framework would both help to resolve remaining issues concerning causality and shed more light on the evolving relationship between philanthropy and reputation among UK firms. Second, our study, in common with much of the empirical work in the area conducted in the UK, would benefit from an improved availability of data, particularly regarding corporate reputation. We would welcome time-series reputational data for a consistent and large sample of companies, derived from alternative methodologies, such as those proposed by Gardberg and Fombrun (2002).

## NOTES

[1] We have reputation data for 240 firms. However, restricted availability of other data (principally regarding institutional ownership) necessitated the loss of 30 of these firms from the sample.
[2] Kinder, Lindenberg, Domini and Company (KLD) are a social choice investment advisory firm that objectively rates (mainly US) firms on nine dimensions of social performance.
[3] The chemicals sector includes pharmaceuticals. We tested the sensitivity of our findings to this aggregation and found the omission of pharmaceutical companies from the chemicals sector brought no material change in the results.
[4] Meznar and Nigh (1995) adopt a similar approach to measuring organizational visibility. They measured visibility as the number of stories concerning a firm in five US national daily newspapers over a 15 month period.
[5] The statistical significance of each of these findings is indicated by the following p values: 0.078, 0.001 and 0.000, respectively.

## APPENDIX

Regression results with decomposition of social performance and full interaction

| Variable | Regression 6a | Variable | Regression 6a |
|---|---|---|---|
| Constant | 46.77*** | *Environmental performance* | −0.711 |
| Financial performance | 0.128 | → Chemicals | 0.852 |
| Market risk | −6.774*** | → Construction | 0.614 |
| Leverage | −0.042 | → Consumer products | 1.961** |
| Firm size | 0.116 | → Engineering | −1.302 |
| Media exposure | 1.254 | → Finance | −0.394 |
| R&D intensity | 0.129 | → High technology | 0.266 |
| Advertising intensity | −1.733 | → Publishing | −0.202 |
| Institutional ownership | 0.206*** | → Resources | 4.425*** |
| *Nature of business activities* | | → Retail | 0.592 |
| Chemicals | −10.60*** | → Transportation | 1.285 |
| Construction | −2.287 | → Utilities | −0.992 |
| Consumer products | −12.17*** | *Employee performance* | 0.117 |
| Engineering | 6.974*** | → Chemicals | −0.009 |
| Finance | −17.76*** | → Construction | −0.458 |
| High technology | −6.018** | → Consumer products | −0.138 |
| Publishing | −3.883 | → Engineering | −0.255 |
| Resources | −25.24*** | → Finance | −0.090 |
| Retail | −3.773 | → High technology | 0.166 |
| Transportation | −11.21** | → Publishing | −0.476 |
| Utilities | −1.923 | → Resources | −0.738 |
| *Community performance* | 0.698 | → Retail | 0.047 |
| → Chemicals | 2.395 | → Transportation | −0.133 |
| → Construction | 3.402 | → Utilities | −0.815 |
| → Consumer products | 0.487 | | |
| → Engineering | 4.879* | | |
| → Finance | 8.468*** | | |
| → High technology | 1.902 | | |
| → Publishing | 2.890 | | |

Regression results with decomposition of social performance and full interaction *Continued*

| Variable | Regression | Variable | Regression |
| --- | --- | --- | --- |
| | 6a | | 6a |
| → Resources | −2.410 | | |
| → Retail | 0.315 | | |
| → Transportation | 3.042 | | |
| → Utilities | 4.815 | | |

*Notes:* For regression 6a, the dependent variable is corporate reputation.

6a: N = 210; $R^2$ = 0.581; Adjusted $R^2$ = 0.432; Breusch-Pagan test statistic (55df) = 71.2 (p = 0.0698).

*, **, *** denote significance at the 90%, 95% and 99% level of confidence, respectively.

The omitted sectoral dummy variable is 'business services'.

→ indicates interaction between a dimension of social performance and a sectoral dummy variable.

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