

CHARACTER, CONFORMITY, OR THE BOTTOM LINE? HOW AND WHY DOWNSIZING AFFECTED CORPORATE REPUTATION

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The aim of this study is to illuminate reputational change processes and identify the underlying theoretical mechanisms. We draw upon extant literature to develop three distinct explanations for reputational change, respectively emphasizing criteria of organizational “character,” symbolic conformity, and technical efficacy. We evaluate these explanations by examining the reputational consequences of corporate downsizing. Our results show that downsizing exerted a strong, negative effect on reputation, consistently with the character explanation. However, significant moderation of this negative effect by other factors, including stock market reaction and downsizing’s overall prevalence, indicates the need for a multitheoretical approach to reputational change.

Corporate reputation is an important asset (or liability) bestowed upon a firm by external audiences (Fombrun, 1996). Observers form opinions that coalesce and adhere to organizations, affecting their future outcomes for better or worse (Roberts & Dowling, 2002). Much prior research has noted that these reputational ascriptions are enduring and “sticky” (Fombrun & Van Riel, 2004; Schultz, Mouritsen, & Gabrielsen, 2001). It is because of this stickiness that reputation (which can be defined as a subjective evaluation of a firm’s overall quality relative to its peers) is widely seen as a valuable resource (Fombrun, 1996; Roberts & Dowling, 2002). However, reputation, like other “stock” variables, is amassed and depleted through temporal “flow” sequences. Audiences do tend to reproduce a firm’s reputation over time, yet they also change their evaluations, sometimes quite significantly. This study focuses on these changes and on firm actions that may precipitate them. In so doing, it seeks to identify the underlying *mechanisms* responsible for reputational change.

Because of the asset-like qualities of reputation, much theory has focused on its sociological or economic foundations, and empirical studies have

tended to examine its relationship with other stock-like variables (Davies, Chun, Da Silva, & Roper, 2003; Dowling, 2001; Fombrun, 1996; Fombrun & Shanley, 1990; Fombrun & Van Riel, 2004; Fryxell & Wang, 1994; Rindova, Williamson, Petkova, & Sever, 2005). Relatively less work has addressed important and at least partially distinct theoretical questions about reputational ebbs and flows and the actions that may cause them (for exceptions, see Flanagan and O’Shaughnessy [2005], Staw and Epstein [2000], and Williams and Barrett [2000]). Important issues also remain open on the “audience side” of reputational change processes. Although reputation is, in an important sense, *possessed* by an organization, the reality of reputational change reminds us that it must be *granted* by external audiences on an ongoing basis. However, prior research has provided incomplete and sometimes conflicting insights about what might lead people to change their opinions of a firm’s overall quality. It is known that audiences grant reputation in response to various “signals” that firms send, but it is not known which of the many (and sometimes conflicting) signals that a firm conveys are the most likely to be received and to enhance or damage its existing reputation. The basic evaluative logic that people use in interpreting these signals and adjusting reputations is also not clearly understood. For instance, do they reward firms whose actions favor their parochial interests and values, or do they tend to apply more universalistic criteria? We believe that these issues are practically, as well as theoretically, important ones. Although constructing a good reputation is no doubt a critical strategic prob-

We wish to thank Ruth Aguilera, Kevin Corley, David Deephouse, John Dencker, Don Lange, and Jim Westphal, as well as seminar participants at the University of Illinois and Purdue University, for their helpful comments on earlier versions of this study. We also thank the Harvard Business School division of research for research funding, and Abhijeet Vadera for research assistance. Both authors contributed equally to the article.

lem, firms also need to find ways to improve their existing reputations and avoid unintentionally damaging them. Thus, research that examines “reputational flows” identifies corporate actions that precipitate those flows, and probes the underlying mechanisms responsible for reputational change can help provide such knowledge.

In response to this perceived need, in this study we identify and examine three distinct explanations for reputational change. Each suggests that reputation granters tend to respond to particular signals and to employ a distinct evaluative logic as they encode a firm’s actions into its reputation. We distilled these explanations from three overarching perspectives that exist within the broader literature on reputation. One of these casts corporate reputation as a reflection of organizational “character” (Davies et al., 2003; Dowling, 2001; Fombrun, 1996). A second emphasizes the importance of symbolic conformity with cultural expectations (Rao, 1994; Staw & Epstein, 2000). The third suggests that reputation is largely reducible to technical efficacy concerns (e.g., financial performance) (Brown & Perry, 1994; Fryxell & Wang, 1994; Shapiro, 1982, 1983). Although these three perspectives have been used primarily as accounts of reputation’s foundations (as is consistent with the central tendency in the literature), each also suggests a possible mechanism through which reputational change may occur.

We looked for evidence of these three proposed mechanisms by examining the reputational consequences of corporate downsizing among *Fortune* 100 firms throughout the period 1985–94. In particular, we looked at how firms’ adoption of this practice affected their standing in *Fortune*’s “Most Admired Companies” rankings. This context is a particularly appropriate one in which to address the questions raised above, for at least three reasons. First, downsizing in the study period was a controversial practice that sent multiple and conflicting signals to reputation-granting audiences. It conveyed, for instance, an obvious concern with efficiency and shareholder value creation. But it also signaled opportunism. Firms that violated commitments to employees might not be trusted to keep their commitments to other constituencies in the future. Both of these signals are highly consequential within the alternative accounts of reputational change that we distill. Second, the audiences who ascribe *Fortune* reputations (stock analysts and peer firm executives) are known to share economic interests and cultural beliefs that distinguish them from other firm constituencies and may lead them to approve of downsizing firms. Their actual responses to the practice would thus provide valu-

able insight into how (and how much) people’s parochial interests and beliefs color their reputational judgments. Finally, we were able to examine downsizing in conjunction with other signals that also have strong and theoretically founded effects on reputational change. In particular, our analysis included powerful measures of contemporaneous change in firm performance and performance prospects (e.g., annual changes in profitability, changes in market capitalization, changes in analysts’ earnings forecasts). Including these measures allowed us to assess the degree to which downsizing’s effects on reputation are distinct from those of performance change and to examine how downsizing interacted with performance factors in producing reputational change during the study period.

In our study, we elaborate the three aforementioned explanations for reputational change. Next, we use these three accounts in developing two sets of hypotheses about downsizing’s overall effect on reputation. Our first set of hypotheses (1a, 1b, and 1c) posits competing predictions about downsizing’s main effect (positive, negative, null). These hypotheses are in one-to-one correspondence with the three theoretical explanations themselves. Our purpose in testing these hypotheses is to identify the “dominant mechanism” most responsible for explaining downsizing’s reputational consequences. The second set of hypotheses identifies factors that may moderate downsizing’s main effect, regardless of its direction or strength. Though reputation granters may be primarily attentive to a particular signal that downsizing sends, they may also respond to other, secondary signals that accompany it and employ multiple evaluative logics in ascribing reputations.

LITERATURE REVIEW AND THEORY

Looking into the literature, we can identify at least three distinct perspectives on reputation. While these perspectives have been primarily developed as accounts of reputation’s foundations (as is consistent with the core focus of the literature), each can also be used to generate predictions about reputational change and the mechanisms through which it occurs. More specifically, these perspectives suggest distinct insights into the types of actions likely to enhance (or damage) reputations, the types of signals that reputation-granting audiences attend to, and the basic evaluative logic that audiences use in updating their reputational assessments.

Organizational Character

One central theme in the reputation literature is the idea that audiences assign positive reputations to firms that appear to possess desirable character traits (Davies et al., 2003; Dowling, 2001; Fombrun, 1996; Fombrun & Van Riel, 2004; Markham, 1972). Two key premises appear to underlie this influential account of reputation. The first is that people tend to anthropomorphize organizations (Davies et al., 2003; Dowling, 2001)—that is, they view organizations as coherent and purposive social entities (i.e., as conscious actors or “wholes”) rather than mere social aggregates or collectivities (Hamilton & Sherman, 1996; Whetten & Mackey, 2002). The second premise is that constituencies are especially concerned with organizations’ suitability as exchange partners and thus tend to admire firms that appear to possess character traits such as trustworthiness and reliability (Fombrun, 1996). These traits are particularly valued because they provide a basis for predicting a firm’s future behavior (i.e., the likelihood that it will honor its obligations) (Fombrun, 1996; Fombrun & Van Riel, 2004). From this perspective, organizational actors that make clear commitments and uphold them over time are expected to garner admiration and reciprocal commitment. In contrast, firms that appear opportunistic or unreliable are expected to be less well reputed. The idea that constituencies strongly value trustworthiness and reliability also figures prominently in several other literatures, including those on social exchange theory (Blau, 1964; Homans, 1958), the old institutionalism (Selznick, 1957, 1969), stakeholder theory (Freeman, 1984; Jones, 1995), organizational ecology (Hannan & Freeman, 1984), and game theory (Weigelt & Camerer, 1988). Microlevel research has also emphasized the positive effects of displayed commitment and the negative reactions that opportunism can provoke. Scholars have argued that individuals react to such displays at an emotional and preconscious level (Frank, 1988; Haidt, 2007; Hauser, 2006; Nesse, 2001).

This perspective points to one specific mechanism through which reputations may change. Specifically, it suggests that audiences will evaluate corporate actions as indicators of a firm’s underlying character. In other words, they will view actions as occasions for attributing traits to the organization and for revising their existing character attributions. Corporate actions that send signals regarding the firm’s trustworthiness and credibility are likely to be particularly germane to these revisions. For example, when firms make critical decisions that are consistent with their espoused values

and historical commitments, audiences should hold them in higher esteem. Conversely, corporate decisions perceived as connoting opportunism, unreliability, or a lack of integrity should damage reputations to the extent that this “organizational character mechanism” drives reputational change.¹

Symbolic Conformity

A second perspective offers a very different way to think about the sources and dynamics of reputation. In this view, reputational assessments are shaped by an organization’s symbolic conformity with external, socially constructed standards and categories that are less universal and more context-specific than those featured in the character perspective (Rao, 1994; Staw & Epstein, 2000). Scholars employing a symbolic conformity perspective see organizations and evaluators as mutually embedded within larger cultural systems (Rao, 1994: 31). Accordingly, they come to share understandings and expectations about the structures and practices that are locally appropriate and culturally desirable. These shared understandings are thought to lead firms to adopt culturally correct practices and to affect constituent audiences’ evaluations as well. Specifically, audiences are expected to confer good reputations on firms that exemplify cultural stipulations and ideals and to penalize firms that fail to display appropriate symbols. From this perspective, an organization’s cultural fitness (rather than its apparent traits as a social actor) is the primary criterion for audience approval and esteem.

This second perspective draws on neoinstitutional theory, which holds that organizations are situated within broader institutional environments and focuses especially on the cultural processes that operate within such environments (or “fields”) (DiMaggio & Powell, 1983; Meyer & Rowan, 1977; Scott, 2001). This perspective emphasizes that organizations often adopt structures and practices in response to field-level pressures and suggests that

¹ Importantly, this line of argument does not imply that corporate actions provide a window into a firm’s essential traits (or even that firms possess essential traits). Anthropomorphizing organizations may be an irrational approach to judgment, and audiences may fall victim to the fundamental “attribution error” in applying it (Ross, 1977). They may also read too much into actions that provide little indication of the firm’s real propensities and predispositions (Ross, 1977; Winter & Uleman, 1984). The point here is that people tend to apply these criteria and to look for such traits, regardless of whether firms actually “possess” them.

they gain legitimacy and support in return for this conformity (Ruef & Scott, 1998; Tolbert & Zucker, 1983; Westphal, Gulati, & Shortell, 1997). Although the concepts of legitimacy and reputation cannot be equated, scholars have productively used this perspective to study reputational processes (cf. Deephouse & Carter, 2005; King & Whetten, forthcoming; Rao, 1994; Staw & Epstein, 2000).

A specific implication of this perspective is that audiences will evaluate corporate actions as symbolic indicators of a firm's cultural fitness and adjust their reputational assessments accordingly. A study by Staw and Epstein (2000) provides a compelling example of this proposed "symbolic conformity mechanism." They found that firms enhanced their reputations by adopting various popular management practices (e.g., total quality management, employee empowerment, and teams). They argued that this effect occurred because these practices embodied the normative values and cultural beliefs of the audiences who ascribed the reputations. Interestingly, this reputational enhancement occurred even though the practices did not appear to improve corporate financial performance.

Technical Efficacy

A third distinct argument is that reputations are tightly coupled to consequences and tangible organizational outputs. At the core of this view is the idea that reputation reflects a firm's ability to fulfill evaluating audiences' material needs. The perspective thus leads to predictions that strong reputations accrue to firms that, for example, produce superior products and services or deliver superior financial results (Shapiro, 1982, 1983). Within this view, firms are seen not as anthropomorphized social actors or as inhabitants of a shared culture, but more as a means to audiences' parochial ends. Empirical research showing that perceptions of product quality strongly affect consumers' reputational assessments (Fombrun & Van Riel, 2004) has supported this perspective. Studies showing that financial performance exerts a powerful (perhaps overwhelming) influence on reputational judgments made by stock analysts and peer executives (Brown & Perry, 1994; Fryxell & Wang, 1994) have provided even stronger support.

This third perspective implies a "technical efficacy mechanism" that may account for reputational change. Specifically, it suggests that audiences will alter reputations in response to observed changes in valued organizational outputs. The direction and degree of reputational change should correspond with these performance changes. A "strong form" of this argument implies that reputational change

effectively reduces to performance change and that firm actions (such as downsizing) are actually epiphenomenal to the process. In empirical terms, these actions' reputational effects should be null once relevant, observable outcome changes are adequately accounted for. A "weak form" of this argument is that actions may themselves affect reputation, but only because of their (believed) implications for technical efficacy. This argument converges with the strong form in sharing the assumption that reputation granters are fundamentally concerned with performance, broadly defined. However, it also suggests that audiences are likely to view some firm actions as signals of expected future performance in their own right and to respond to them accordingly. As such, their reputational judgments are expected to be more loosely coupled to the observable performance changes that either accompany or result from a given firm action.² Table 1 summarizes these three accounts of reputational change.³

STUDY CONTEXT AND HYPOTHESES

Downsizing has been defined as the intentional reduction of personnel in an effort to improve efficiency or effectiveness (Freeman & Cameron, 1993). Downsizing gained notice in the early 1980s as large U.S. industrial firms began to reduce personnel in ways that were clearly distinct from traditional practices such as furloughs and layoffs (Kiechel, 1985; Nielsen, 1985; Tomasko, 1987). Historically, personnel reductions had been capacity-balancing actions most often taken in response to lowered demand during business downturns (Freeman & Cameron, 1993; McKinley, Mone, & Barker, 1998). Though such reductions often affected many employees, they were typically temporary and predominantly affected production personnel at spe-

² Although this weak-form technical efficacy argument is theoretically distinct, it becomes entangled with the other two mechanisms we have posited when we attempt to move it into the empirical realm. Audiences who are "ultimately" concerned with performance may still visibly react to displays of trustworthiness and/or symbolic conformity.

³ The reputation literature also describes other perspectives and mechanisms, notably those that emphasize the quality of a firm's *external associations* and those that suggest *prominence* and *visibility* are important components of reputation (Deephouse, 2000; Rindova et al., 2005). We have elaborated on the character, conformity, and efficacy perspectives because of their prominence in the literature and their direct relevance to our specific study context.

TABLE 1
Summary of Different Accounts of Reputational Change

Mechanism	Organizational Character	Symbolic Conformity	Technical Efficacy
Basis of organizational appeal/esteem	Perceived trustworthiness and reliability.	Conformity to cultural rules, norms, and beliefs that exist at the field level.	Delivery of outputs valued by audiences (products, services, financial performance).
Assumptions about audience	Prospective exchange partner looking forward into uncertain future.	Coparticipant in larger cultural system, or field.	"Needy" and narrowly focused on quality and quantity of desired organizational outputs.
Evaluative logic used	Firm anthropomorphized and judged on attributed character.	Evaluators employ logic of cultural appropriateness; piecewise evaluation of firm's actions.	Evaluators employ instrumental logic; firm evaluated on the basis of outputs produced.
Attributes of reputation-enhancing actions (signals)	Reveal and affirm character; signal trustworthiness, reliability, commitment.	Symbolize conformity with cultural rules, norms, and beliefs.	Strong form: Actions are epiphenomenal. Weak form: Actions increase technical efficacy on dimensions valued by audience.
Attributes of reputation-damaging actions (signals)	Apparent opportunism; inconsistency with past commitments.	Deviate from cultural rules, norms and beliefs.	Strong form: Actions are epiphenomenal. Weak form: Actions decrease technical efficacy on dimensions valued by audience.
Theoretical roots and relationships	Old institutionalism, stakeholder theory, game theory; attribution theory; evolutionary psychology.	Neoinstitutionalism, symbolic interactionism.	Utilitarian theories in economics and other social sciences.

cific sites (Thurow, 1986). In contrast, downsizing efforts often had a more strategic intent, aiming to "permanently" improve companywide efficiency and effectiveness through changes such as reducing bureaucracy and layers of management (Budros, 2002; McKinley et al., 1998). Many downsizings were of unprecedented scope and scale, involving thousands of employees, including managers (Bau-mol, Blinder, & Wolff, 2003).

Although the downsizing trend started among heavy manufacturing firms, it subsequently spread widely and rapidly. By the beginning of our study period in 1985, downsizing had already been implemented in hundreds of firms (Nielsen, 1985), including 24 percent of the firms in our sample. By the end of the study period in 1994, most large firms reported that they had downsized at least once during the past five years (AMA, 1994). Overall, the *Fortune* 100 firms we study downsized their workforces by millions of employees during the 1980s and 1990s (Nohria, Dyer, & Dalzell, 2002). Downsizing decisions were explained with reference to a variety of specific circumstances and gen-

eral logics. Notable among these were the need to respond to increasing global competition (Lamertz & Baum, 1998; Useem, 1993) and the accompanying characterization of large U.S. firms as "fat" and overstaffed (Thurow, 1986; Tomasko, 1987). Early downsizings were most often initiated in reaction to performance declines, but proactive downsizings became common by the end of the 1980s (Budros, 2004; McKinley et al., 1998).

Downsizing's Overall Effects on Reputation: Competing Hypotheses

Organizational character mechanism. The organizational character explanation for reputational change suggests that audiences will view downsizing as an occasion for trait attribution. The question they are likely to ask is what downsizing says about the character of a firm as a whole, particularly its trustworthiness and reliability. Downsizing should have a negative effect on reputational change, to the extent that this perspective's proposed mechanism is dominant. By downsizing, firms broke commit-

ments and reneged on implicit “psychological contracts” with their employees (see Cappelli, Bassi, Katz, Knoke, Osterman, & Useem, 1997; De Meuse & Tornow, 1990; Heckscher, 1995; Noer, 1993). Though downsizing was perfectly legal and widely advocated as an efficient business practice, it connoted opportunism and signaled that a firm was an untrustworthy actor that might not be counted on to meet its commitments in the future. Employees clearly interpreted downsizing as a betrayal and characterized downsizers as untrustworthy (see Brockner, Grover, Reed, DeWitt, & O’Malley, 1987; Gordon, 1996; *New York Times*, 1996; Noer, 1993). Many writers, critics, and politicians shared this interpretation and broadcast the same message (see De Meuse & Tornow, 1990; Gordon, 1996; *New York Times*, 1996). Downsizing also conveyed many other signals, of course, and it is possible that the analysts and peer executives who ascribed *Fortune* reputations were more responsive to those signals. Nonetheless, to the extent that organizational character considerations drive people’s reputational evaluations, we should expect even these audiences to negatively react to downsizing firms. Analysts and executives were not personally betrayed by downsizing, and they may have had little empathy with displaced employees, but a firm’s dealings with that particular constituency may have sent an important signal concerning its likely behavior in future dealings with them. There is also some empirical support for the proposition that downsizing might negatively affect reputation. Specifically, Flanagan and O’Shaughnessy (2005) showed that layoffs (rather than downsizings) had a negative effect on reputation, in an analysis of a different sample during a later time period than the one we examine here. We discuss their study in more detail below and also elaborate its differences from our own. Thus, we propose:

Hypothesis 1a. Downsizing negatively affects a firm’s ascribed reputation.

Symbolic conformity mechanism. If the symbolic conformity mechanism is dominant, reputation-granting audiences will likely attend to different signals and thus respond quite differently to downsizing firms than they will if another mechanism is dominant. Specifically, they should evaluate the practice of downsizing on the basis of its consistency with their own cultural values and beliefs, and they should reward downsizing firms to the extent that they conform with those sector-specific prescriptions (Staw & Epstein, 2000). This mechanism is also a plausible one, because downsizing was deeply consistent with the expressed and revealed beliefs of the analysts and peer executives

who ascribe *Fortune* reputations. Downsizing decisions were uniformly presented as efforts to improve the corporate bottom line, and it is known that these two audiences particularly value efficiency and financial performance. More importantly, members of these audiences vocally advocated downsizing and publicly praised downsizing firms during our study period (Kiechel, 1985; Useem, 1993). Analysts and institutional investors were particularly vocal in their support, with some even pressuring corporate boards to replace executives who resisted their entreaties to downsize (Nohria et al., 2002; Useem, 1993, 1996). Additionally, several prominent executives (notably Jack Welch at General Electric and Al Dunlap at Scott Paper) publicly sang downsizing’s praises, portraying it as crucial to improving large American firms’ competitiveness (see Tichy & Sherman, 1993).

Popular models of corporate management that pervaded American business culture during the 1985–94 study period appear to have further increased downsizing’s symbolic value. In particular, the shareholder value model (Davis, Diekmann, & Tinsley, 1994; Jensen & Meckling, 1976; Useem, 1993) and the “lean and mean” model (cf. Budros, 2002; Kiechel, 1985; Peters & Waterman, 1982) both portrayed the practice as central to effective management in general, and to improved efficiency and effectiveness specifically. The former did so by emphasizing that downsizing, through reducing purportedly excessive managerial overhead, was an important technique used to align corporate staffing levels with shareholder interests (Thurow, 1986; Useem, 1993, 1996). The latter did so by suggesting that downsizing, as a core part of efforts to flatten the corporate pyramid and eliminate bureaucratic work, was a powerful means to the metaphorically appealing end of a “healthy” and “lean” organization (Budros, 2002; McKinley et al., 1998).

A final supporting indicator of downsizing’s cultural standing is its widespread (and growing) use during the study period. As noted, hundreds of firms (including 24 percent of our sample) had downsized at the outset of our study period (1985), and the vast majority of the sample downsized in the subsequent decade. The notion that the prevalence of a practice reflects its cultural appropriateness is widely accepted in neoinstitutionalism, from which the symbolic conformity mechanism is drawn (Edelman, 1992; Tolbert & Zucker, 1983; Westphal et al., 1997). Indeed, previous research on downsizing itself has concluded that the practice acquired legitimacy as it spread (Lamertz & Baum, 1998; Love, 2000; McKinley et al., 1998). Although these prior studies have not specifically shown that downsizing *firms* gained increased approval by employing the practice, this prediction is quite consistent with their basic logic. It is

also consistent with prior research that has directly shown that firms can improve their reputations by adopting popular management practices (Staw & Epstein, 2000). Taken together, these diverse indicators provide powerful evidence concerning downsizing's symbolic appropriateness within the particular cultural milieu of analysts and executives, despite the controversy that surrounded the practice in the broader popular discourse. To the extent that the symbolic conformity mechanism is dominant, we should thus expect downsizing to positively affect firm reputation:

Hypothesis 1b. Downsizing positively affects a firm's ascribed reputation.

Technical efficacy mechanism. The technical efficacy explanation also provides insights into downsizing's likely effects. The strong form of this account, which we articulated above, posits that reputational change effectively reduces to performance change. In other words, the argument is that downsizing has no independent effect on reputational change after contemporaneous, observable measures of performance change are sufficiently accounted for. Buttressing this prediction is the argument of prior research that corporate reputations (particularly *Fortune* reputations) are dominantly driven by financial performance (Brown & Perry, 1994; Fryxell & Wang, 1994). This research provides no obvious reason to predict that downsizing and like actions would, in themselves, affect a firm's reputation. Thus, we propose:⁴

Hypothesis 1c. Downsizing has no effect on a firm's ascribed reputation, after contemporaneous performance changes are accounted for.

Moderating Effects: Complementary Hypotheses

Though tensions clearly exist between the three explanations we have posited, there is no reason to

presume a zero-sum relationship between them. Reputation granters may be primarily attentive to a particular signal that downsizing sends, yet they are also likely to respond to other, secondary signals that accompany it and may employ multiple evaluative logics in ascribing reputations. With this in mind, we also develop hypotheses that explore the three mechanisms' conjoint operation and seek to identify complementarities among them.

The moderating effect of market reaction. Even if reputational change does not reduce to changes in technical efficacy, as Hypothesis 1c posits (that is, even if audiences respond to actions that signal trustworthiness and/or cultural conformity), there is still reason to predict that the technical efficacy of such actions will be consequential in determining their reputational consequences. One particular performance measure that seems quite likely to moderate a downsizing's reputational effect is the stock market's initial reaction to it (i.e., the "excess returns" [Brown & Warner, 1985] associated with it). The reputation-granting audiences in our study are known to be highly attentive to the short-term movements in stock prices, and research has established that equity market valuations strongly influence reputations in general (Brown & Perry, 1994; Fombrun & Shanley, 1990). Thus, excess returns associated with downsizing may condition whatever independent effects the practice has on reputation. Market reactions may be important moderators not only because they are an important outcome (i.e., because they create and destroy wealth), but also because they serve as a summary judgment of a firm's decisions. In other words, the stock market may act as a sort of "information intermediary" (Pollock & Rindova, 2003) that helps reputation-granting audiences interpret and evaluate various corporate actions.

Hypothesis 2. Short-term market reaction to downsizing positively moderates its effects on a firm's ascribed reputation.

The moderating effect of recent firm performance. As we mentioned earlier, a salient and controversial feature of downsizing is that firms often cut personnel during good financial times (McKinley et al., 1998). If the organizational character mechanism is operative, we should expect these "proactive" downsizings to be less well received (even if the character mechanism is not dominant overall). Firms that downsized without apparent financial need (for instance, while performance was improving) may have appeared to be particularly opportunistic and untrustworthy (Gordon, 1996). In contrast, downsizing firms that were manifestly in trouble may have been partially ex-

⁴ The weak form of the technical efficacy argument might also be used to predict a direct effect of downsizing on reputational change. However, it is not possible to develop such a hypothesis without first making strong assumptions concerning the beliefs of audiences about downsizing's technical efficacy (i.e., whether they believe it is performance-enhancing or not). Developing a weak-form hypothesis also clearly requires one to assume that audiences look beyond available performance data in ascribing reputation. Thus, any hypothesis developed from this argument would be significantly entangled with those flowing from the prior two perspectives. Therefore, we focus exclusively upon the strong form argument in testing the technical efficacy perspective. We reconsider the weak form as we interpret and discuss our results at the end of this article.

empted from their implied commitments to their employees and thus less likely to incur reputational damage. Declining performance may have made their obligations to financial constituencies more salient. Two observations made by corporate executives during the study period lend substantial plausibility to this prediction. One longtime Ford executive stated, "When you've just reported a \$1.5 billion net loss, nobody wonders why you have to cut back." In contrast, another executive noted that "the toughest thing to explain is why you see a need to trim your sails [i.e., downsize] when your markets are booming" (both quotations are from Fisher [1988: 42]). Research on organizational trust itself, which has shown that extenuating circumstances can justify actions normally connoting opportunism (Kramer & Tyler, 1996), also supports this hypothesis.

Hypothesis 3. Recent changes in a firm's performance negatively moderate downsizing's effects on the firm's ascribed reputation.

The moderating effect of prior reputation. An additional implication of the organizational character perspective is that a firm's prior reputation should affect audiences' interpretations of its actions. To the extent that good reputations are sticky and enduring assets amassed through a history of making and meeting commitments, we should expect them to mitigate any reputational damage that downsizing may otherwise cause. People should be inclined to give the benefit of the doubt to firms with a record of "good behavior" and to be less quick to attribute opportunism on the basis of a single strategic decision. The same logic implies that marginal firms lacking a strong history of reliability may suffer greater reputational damage from downsizing. This prediction would not seem to follow from the conformity or efficacy perspectives, both of which cast reputation as somewhat more tightly coupled to recent signals and less affected by a particular firm's historical pattern of behavior.

Hypothesis 4. Prior reputation positively moderates downsizing's effects on a firm's ascribed reputation.

The moderating effect of downsizing's prevalence. Downsizing's growing cultural appropriateness may have also moderated its reputational consequences, even if the symbolic conformity mechanism did not dominate overall. Downsizing was not uncommon at the outset of our study, and it enjoyed significant cultural support even then (Kiechel, 1985; Love, 2000). However, the practice diffused widely and gained increasing cultural

standing and acceptance across our study period (McKinley et al., 1998). The idea that a practice's prevalence is a telling indicator of its symbolic appropriateness is well established in previous reputational scholarship (Staw & Epstein, 2000) and in the broader body of neoinstitutional research (cf. DiMaggio & Powell, 1983; Tolbert & Zucker, 1983, 1996). Building on this logic, we would expect audience response to downsizing firms to become more favorable (or less negative) as a function of the practice's increasing prevalence over time:

Hypothesis 5. Downsizing's prevalence positively moderates its effects on a firm's ascribed reputation.

A close corollary of Hypothesis 5 is that downsizing's growing prevalence will make local performance contingencies less consequential as moderators of its reputational effects. As the practice spreads and acquires growing symbolic value, it should be seen as more universally appropriate, and audiences should attend less to the firm-specific factors that initially justified its use (Tolbert & Zucker, 1983; Westphal et al., 1997). Therefore, the moderating effects discussed in Hypotheses 2 and 3 (stock market reaction and recent performance changes, respectively) should dissipate as the number of sample firms that have previously downsized increases. Thus, we propose:

Hypothesis 6. Downsizing's prevalence weakens the moderating effects of the performance contingencies specified in Hypotheses 2 and 3.

Cultural differences between audiences. Downsizing's reputational consequences may be moderated not only by cross-temporal variation in its cultural appropriateness, but also by cultural variation across audiences. In the larger scheme, executives and analysts are remarkably similar audiences (when compared with consumers, labor groups, the media, political organizations, academic observers, etc.). They are clearly within the same field or cultural milieu. For this reason, it makes much sense to group them together, as we have done thus far and as other reputation researchers have also done (Fombrun & Shanley, 1990; Staw & Epstein, 2000). Nonetheless, these audience groups have potentially important cultural differences. We have noted that many analysts vocally advocated downsizing and even publicly celebrated downsizing firms. Although the practice also enjoyed cultural support from many prominent executives, there was much expressed ambivalence within this group (Nohria et al., 2002; Useem, 1996). Further, the financial community appeared to em-

brace the shareholder value model (which legitimated downsizing) more rapidly and unequivocally than managers (Useem, 1996). This was perhaps to be expected, given that analysts' roles culturally constitute them as shareholder representatives (Zuckerman, 1999). In contrast, executives' roles are much more complex; executives are simultaneously embedded in multiple institutional domains and must answer to both investors and a range of nonfinancial stakeholders. For these reasons, downsizing should be seen as a more unambiguously appropriate symbol from the cultural perspective of stock analysts. Therefore, analysts should react more positively (or less negatively) to the firms employing the practice:

Hypothesis 7. Downsizing has a more positive (less negative) effect on a firm's reputation as ascribed by stock analysts than on its reputation as ascribed by peer firm executives.

METHODS AND DATA

Sample and Study Period

Our sample was the 100 largest industrial firms in the United States as identified by *Fortune*. This sample is particularly appropriate because these highly visible firms are closely monitored by corporate audiences and were among those most affected by downsizing (Baumol et al., 2003). We sampled the *Fortune* 100 as of 1977 because this year clearly predated the start of the downsizing trend. We subsequently collected comprehensive data on all downsizings conducted by these firms through 1994. The *Fortune* survey "Most Admired Companies" was not initiated until 1983, and full data necessary for testing our hypotheses did not become available until 1985. Thus, our study examines downsizing's effects on reputation during the period 1985–94. This period incorporates much of downsizing's diffusion. In 1985, 24 percent of our sample firms had downsized, and by 1994 over 70 percent had done so. Within this sample and time frame, the *Fortune* survey data were available for an average of 71 firms each year, and data for all variables was available for 616 firm-years.⁵ Our analytical approach, described below, enables us to treat the rankings of analysts and peer firm executives independently within the same data set. Thus, our final data set contains two distinct observations in each firm-year, for a total of 1,232 observations.

Theoretical Variables

Dependent measure. We used the *Fortune* survey, "Most Admired Companies," to assess reputational change. *Fortune* annually surveys several

thousand securities analysts and executives who rate firms in the industries that they cover or work in. Respondents evaluate the ten largest firms in their industry on eight disparate dimensions. The dimensions are management quality, product quality, innovativeness, value as a long-term investment, financial soundness, ability to attract, develop, and retain personnel, community and environmental responsibility, and use of corporate assets. *Fortune* averages these eight items into a single reputation score for each firm and publishes these scores in their annual "most admired companies" rankings. These rankings reflect observers' beliefs about a firm's overall, subjective appeal relative to its peers, in keeping with the definition of reputation we use (Fombrun, 1996). Although *Fortune* reputations do not capture the opinions of all relevant publics, the audiences who ascribe them are knowledgeable and influential ones. Much prior research has employed the *Fortune* survey in studying corporate reputation (e.g., Brown & Perry, 1994; Fombrun & Shanley, 1990; Roberts & Dowling, 2002; Staw & Epstein, 2000). Our theory takes explicit account of its known idiosyncrasies (for instance, the specific audiences it surveys and its well-known association with financial performance).

Although prior research on *Fortune* reputations has focused on observers' ratings of firms (raw scores), we used *within-industry rankings* of firms as our dependent measure. This approach is particularly advantageous, given that *Fortune*-ascribed reputations are highly relational, as is the broader concept of reputation itself. In its annual reputation issue, *Fortune* uses firms' raw reputation scores to create reputational hierarchies within industries. Further, the rating process itself also has a relational character, in that respondents are only given the opportunity to rate comparable firms (i.e., the ten largest firms in a given industry). To facilitate interpretation, we created inverted ranking scores that range from 10 for the top-ranked firm in the industry in a particular year to 1 for the lowest. Thus, covariates that enhance reputation have positive signs. Because of our interest in possible differences between audiences, we disaggregated analysts' and executives' rankings and included each group's ranking as a separate observation. Given our core concern with reputational flows, we included the prior year's ranking in all models. Consequently, the coefficients in our models reflect the independent variables' effects on year-to-year reputational change.

Independent variables. We constructed a dichotomous indicator of *downsizing*, which is our main independent variable. Large publicly held

firms typically announce significant personnel reductions and describe their key features. Accordingly, we searched full-text articles of the *New York Times*, the *Wall Street Journal*, and several wire services for announcements of companywide personnel reductions that aimed to improve efficiency or effectiveness, consistently with the definition and distinctive features of downsizing introduced earlier. To avoid including announcements affecting very small numbers of employees, we required that the personnel reductions affect at least 1 percent of employees.⁵ After applying this screen, we found qualifying downsizing events in 103 of the firm-years for which *Fortune* survey and other data were available. We subsequently dropped 12 events that were announced in December, as these appeared to have occurred after the annual (late autumn) *Fortune* survey. This procedure left us with 91 firm-years wherein downsizings were announced.

All subsequent hypotheses (Hypotheses 2–7) posited moderating relationships and were therefore tested using interaction terms. To assess whether short-term stock market reaction to downsizing moderated its effects on reputation (Hypothesis 2), we interacted the downsizing indicator with a measure of *stock market reaction* (“downsizing \times stock market reaction”). We assessed market reactions using the standard excess market returns approach (Brown & Warner, 1985). This approach measures the change in a specific firm’s stock price, net of broader market movements, during a short window of a few days surrounding an event (here, the downsizing announcement). We constructed a beta-adjusted measure of excess returns as described by Brown and Warner (1985: 28), using data from the Center for Research in Security Prices (CRSP) and an 11-day event window (day -5 to $+5$) around a downsizing announcement. Excess returns measured across other windows (3 days and 1 day) produced similar results.

To examine whether recent firm performance changes moderated downsizing’s effect on reputation (Hypothesis 3), we interacted the downsizing indicator with a measure of *change in profitability* (“downsizing \times profitability change”). We mea-

sured change in profitability as the difference between return on book assets in the downsizing year (t) and in the prior year ($t - 1$). Hypothesis 3 predicts a negative coefficient based on the idea that declines in profitability would provide a justification for downsizing. It posits that increasing profitability would have the opposite effect, as observers would see the practice as less necessary for financially healthy firms.

Hypothesis 4 predicts that prior reputation would ameliorate downsizing’s effect on firm reputation. We tested this hypothesis with the interaction term “downsizing \times prior ranking,” in which *prior ranking* is measured in the previous year. To aid interpretation, we centered the prior ranking variable before multiplying it by the downsizing indicator (Jaccard, Turrisi, & Wan, 1990). Note that we did not center the stock market reaction or profitability change variables, because their values (particularly their zero points) have substantive meaning, and because their means were already close to zero (Jaccard et al., 1990).

To assess whether the prevalence of downsizing moderated its reputational consequences (Hypothesis 5), we constructed the interaction term “downsizing \times prevalence.” *Prevalence* is the percentage of firms in the sample that had downsized in prior years (including between 1977 and 1985). As with prior ranking, we centered this variable. To assess the corollaries of the prevalence hypothesis described in Hypothesis 6, we used triple interaction terms, “downsizing \times profitability change \times prevalence” and “downsizing \times stock market reaction \times prevalence,” respectively. Hypothesis 6 predicts that the moderating effects in Hypotheses 2 and 3 will dissipate as prevalence increases. Therefore, it predicts a positive coefficient for the first triple interaction term and a negative coefficient for the second.

To assess whether analysts and executives responded differently to downsizing firms (Hypothesis 7), we constructed an indicator variable, *analysts*. We multiplied this binary term by the downsizing indicator (for “downsizing \times analysts”).

Control Variables

Prior ranking. Because of our central concern with how observers change their reputational rankings from one year to the next, we included a (centered) prior year’s ranking in all models. This procedure had the effect of specifying the model itself as one of reputational change.

Contemporaneous performance change measures. The strong form of the technical efficacy argument states that reputational change effectively

⁵ We operationalized downsizing dichotomously rather than continuously, as was consistent with our theoretical emphasis on the event as a discrete signal. However, we also estimated models in which we replaced the dichotomous downsizing indicator with a (logged) measure of a downsizing’s announced size. All hypotheses that received support in the analysis presented here also received support in this alternative analysis (results are available from the authors upon request).

reduces to performance change. This argument is the basis for Hypothesis 1c, which predicts that downsizing will have a null effect on reputational change after contemporaneous performance changes are adequately accounted for. To test Hypothesis 1c, we included three measures of contemporaneous performance change. The first measure, *market capitalization change* $t-1$ to t , captures changes in a firm's total market valuation in the current year. More specifically, it reflects the annual percentage change in the market value of equity and the book value of debt ($t-1$ to t). The second measure, *profitability change* $t-1$ to t , captures change in return on assets between the current and the prior year. This variable is also the base term for the downsizing by profitability change term (Hypothesis 3). The third measure, *earnings expectations change* $t-1$ to t , captures changes in analysts' estimates of the firm's next fiscal year performance. We constructed this measure using the IBES (Institutional Broker's Estimate System) database. Using all earnings estimates provided by analysts during a specific year, we tallied the number of upward revisions, subtracted the number of downward revisions, and divided the resulting number by the total number of earnings estimates provided. This measure varies between 1 (if all earnings estimates are upward revisions) and -1 (if all estimates are downward revisions). Although changes in earnings expectations do not reflect performance per se, they are particularly meaningful because they reflect analysts' changing beliefs about a firm's future technical efficacy and thus go beyond directly observable measures of current performance. Financial theory similarly suggests that changes in market capitalization reflect future performance expectations, in addition to being outcomes in their own right.

Performance change measures in the prior year. We included the same three measures of performance change for each *prior* year, on the assumption that changes in reputation may lag behind performance increases or decreases. These measures (*market capitalization change* $t-2$ to $t-1$, *change in ROA* $t-2$ to $t-1$, and *earnings expectations change* $t-2$ to $t-1$) allowed us to account more completely for the effects of performance change in producing reputational change, as was necessary for testing Hypothesis 1c.

Additional performance measures. We included three other performance measures that have been found to be important predictors of *Fortune* reputation in prior studies (Brown & Perry, 1994; Fombrun & Shanley, 1990). Specifically, we controlled for (1) average ROA for the current and two preceding years (*average ROA three years*), (2) average sales growth over the same period (*average sales growth three years*), and (3) a logged measure

of *firm size* (sales-based). Though these measures do not directly or exclusively capture performance change, we included them in order to provide the strongest possible test of Hypothesis 1c.

A final control variable, *announcement in prior December*, is a dummy variable set equal to 1 for firm-years in which a firm had announced a downsizing in the prior December. As noted above, we excluded December events from our downsizing indicator.

ANALYSIS

We used rank-ordered logistic regression analysis to test our hypotheses (see Allison & Christakis, 1994; Beggs, Cardell, & Hausman, 1981). This analytic technique has two advantages. First, it is specifically designed for situations such as ours, in which the dependent variable is raters' *relative ranking* of objects within a group (firms in an industry, in our case). We have explained the theoretical advantages of focusing on rankings. The technique is also advantageous because it allows separate rankings from multiple raters (in our case, analyst and executive groups) to be incorporated into the same model. It has been used, for example, to explore multiple human resource managers' relative rankings of the same job candidates (vanBeek, Koopmans, & vanPraag, 1997), and to explain different consumers' relative rankings of competing products (e.g., Hausman & Ruud, 1987).

Although we are confident of the appropriateness of this somewhat novel approach, its use presents some issues that require brief discussion. Since the dependent variable is a relative ranking *within a group*, variables that are invariant within groups (e.g., those that define the groups) are controlled for by construction. It is neither necessary nor possible to include such variables in rank-ordered logistic regression models. In our analysis, a "group" is a particular industry, as assessed by a particular audience in a particular year (e.g., firms in the automobile industry, as assessed by analysts in 1987). Thus, all of our models implicitly control for industry, year, and rater. The result is quite similar to that occurring in fixed-effects models, wherein between-group variance is "fixed" in the intercept term. The group structure of the data has important implications for testing interactions in rank-ordered logistic regression models. Specifically, base terms for some interactions cannot (and need not) be included because construction of the groups controls for them (see Allison and Christakis [1994] and Beggs et al. [1981] for further

discussion).⁶ Given the relative novelty of the rank-ordered logistic regression technique, we also tested our hypotheses using more conventional fixed-effect models. These models, which are presented in the Appendix, reveal substantively identical results.

Because of the panel structure of our data, the possibility also exists that within-industry rankings for firms will not be independent across years. We compensated for this possibility by estimating standard errors using the Huber-White sandwich (robust) technique and by adjusting the standard errors for correlations within industry-year groups using STATA's cluster option.

RESULTS

Table 2 presents descriptive statistics and correlations. Table 3 presents results from the rank-ordered logistic regressions. Model 1 of Table 3 examines downsizing's main effect on reputational rankings. The downsizing coefficient in model 1 is significant ($p < .001$) and negative. Thus, Hypothesis 1a is supported. The $-.71$ coefficient indicates that downsizing firms lost more than two-thirds of a position in the *Fortune* rankings, on average.

This finding is clearly supportive of Hypothesis 1a and directly at odds with Hypothesis 1b (which predicted a positive effect); its implications for Hypothesis 1c (which predicted a null effect, after contemporaneous performance change is accounted for) requires more discussion. First, it is important to note that model 1 includes all the measures of contemporaneous performance change that we described above (changes in market capitalization, profitability, and earnings expectations). We included these measures for both the current and prior year. Model 1 also includes other performance measures featured in prior reputation research. Our finding of a strong downsizing effect net of these factors casts serious doubt upon the argument that reputational change effectively reduces to performance change and upon the related idea that the audiences who ascribe *Fortune* reputations are single-mindedly concerned with financial outcomes. These findings also cast doubt upon the weak form of the technical efficacy argument, though they cannot rule it out. It remains pos-

sible to argue that evaluators penalized downsizing firms because they believed downsizing would ultimately harm performance, or because they saw it as a signal of looming financial problems. However, changes in their beliefs about firms' future performance prospects should have been well reflected in earnings expectations changes and stock price changes. This is particularly true for analysts.⁷

Models 2 through 6 in Table 3 test hypotheses subsequent to Hypothesis 1 by separately adding interaction terms to model 1. Model 2 examines whether stock market reaction to downsizing positively moderated the practice's main effect on firm reputation, as was posited in Hypothesis 2. The coefficient for the interaction of downsizing and stock market reaction is highly significant ($p < .001$) and positive, supporting Hypothesis 2. This moderating effect is substantial. A market reaction to a downsizing that is one standard deviation above the mean ($+5.3\%$) is associated with a ranking loss of only 0.30, whereas a market reaction one standard deviation more negative than the mean (-8.6%) is associated with a much larger ranking loss of 1.11. The downsizing coefficient (-0.61) is the practice's estimated main effect when the stock market reaction to the downsizing is zero. This coefficient is only slightly reduced from its -0.71 value in model 1. Thus, although our test of Hypothesis 2 affirms the idea that downsizing's technical efficacy moderated its reputational consequences, it simultaneously provides further evidence that its effects cannot be *reduced* to performance concerns.

Model 3 examines whether recent changes in a firm's performance moderate downsizing's

⁶ Consider the downsizing \times analysts interaction used to test Hypothesis 7 as one example. *Analysts* does not vary within a given industry-rater-year group; it is always 1 or 0 for any such group. Thus, constructing the rankings implicitly controls for this variable, and its independent effect on rankings cannot be modeled. However, it is possible to examine its interactive effects because the downsizing \times analysts term does vary within groups (as a result of variance in the downsizing variable itself).

⁷ We conducted two additional analyses that also address the potential validity of the weak-form technical efficacy argument. First, we analyzed downsizing's effect in the absence of performance controls and found a coefficient of -0.86 . The relatively modest decrease in the size of this coefficient when financial controls are included (to -0.71 , as in model 1) suggests that performance factors did not dominate audiences' evaluations of downsizing firms. Second, we ran supplementary models that controlled for a firm's *future* (i.e., postdownsizing) performance, in addition to prior and contemporaneous performance. If downsizing firms as a group had relatively poor economic prospects that were not sufficiently accounted for by our other controls, we reasoned that these prospects would be realized in future years. We included measures of firm performance in each of the three years following the downsizing year and found that the main effect of downsizing remained essentially unchanged. This finding also undermines the idea that performance expectations can explain downsizing's overall effect on reputation.

TABLE 2
Means, Standard Deviations, and Correlations^a

Variable	Mean	s.d.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
1. Within-industry ranking	5.70	2.94																			
2. Downsizing	0.15	0.36	-.05																		
3. Downsizing \times stock market reaction	-0.24	2.72	.06	-.21																	
4. Downsizing \times profitability change	-0.002	0.03	-.03	-.24	.09																
5. Downsizing \times prior ranking	0.000	1.07	.35	.00	.00	-.13															
6. Downsizing \times prevalence	0.000	0.05	.01	.18	-.25	.06	.03														
7. Downsizing \times market reaction \times prevalence	-0.03	0.28	-.01	-.27	.03	.04	-.08	-.07													
8. Downsizing \times profitability change \times prevalence	0.00	.00	.02	.06	.05	-.09	.03	-.27	.08												
9. Downsizing \times analysts' ranking	0.07	0.26	-.06	.68	-.14	-.16	-.05	.13	-.18	.04											
10. Prior ranking	0.00	2.93	.88	.05	-.01	-.06	.37	.02	-.04	.02	.02										
11. Profitability	-0.002	0.04	.01	-.11	.04	.46	-.06	.03	.01	-.04	-.07	-.07									
12. Profitability change t_{t-1} to t	-0.002	0.04	.00	-.15	.06	-.21	.03	-.10	.12	.03	-.10	-.04	-.16								
13. Market capitalization change t_{t-2} to $t-1$	0.07	0.22	.13	-.06	.06	.04	.01	-.06	.01	.04	-.04	.09	.01	.04							
14. Market capitalization change t_{t-1} to t	0.07	0.24	.15	-.09	-.01	.05	.04	-.05	.05	-.03	-.06	.10	.17	-.01	-.05						
15. Earnings expectations change t_{t-2} to $t-1$	-0.07	0.17	.12	-.25	.07	.22	-.05	-.02	.07	-.03	-.17	.00	.45	.14	.27	.21					
16. Earnings expectations change t_{t-1} to t	-0.07	0.16	.16	-.16	.01	.00	.02	-.08	.09	-.01	-.11	.09	-.05	.41	.09	.28	.33				
17. Average ROA, 3 years	0.15	0.06	.33	-.07	.06	-.03	.09	-.02	.00	-.03	-.04	.31	-.13	.00	.08	.06	.12	.28			
18. Average sales growth, 3 years	0.01	0.08	.26	-.17	.01	.10	.08	-.03	.08	-.04	-.11	.23	.02	.13	.18	.28	.18	.37	.26		
19. Firm size	9.30	0.85	.34	.08	-.04	-.03	.11	.04	-.06	.01	.06	.34	-.07	-.10	.04	.06	.07	.08	.13	.20	
20. Announcement in prior December	0.02	0.14	.00	.01	-.02	-.01	-.01	.03	-.04	-.07	.03	.01	-.03	-.08	-.03	-.06	-.07	-.13	-.03	-.04	.10

^a $n = 1,232$.

TABLE 3
Results of Rank-Ordered Logistic Regression Analysis of Influence of Downsizing on Within-Industry Fortune Rankings^a

Hypothesis	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9
Downsizing × stock market reaction ^b	−0.71*** (0.14)	−0.61*** (0.13) 0.06*** (0.02)	−0.76*** (0.13)	−0.83** (0.18)	−0.80*** (0.17)	−0.50** (0.19)	−0.62*** (0.17) 0.08*** (0.02)	−0.57** (0.19) 0.09*** (0.02)	−0.59*** (0.18) 0.08*** (0.02)
Downsizing × profitability change			−11.9*** (3.5)				−11.9** (4.2)	−11.5** (4.0)	−10.8*** (3.22)
Downsizing × prior ranking				0.22*** (0.04)			0.20*** (0.05)	0.22*** (0.05)	0.20*** (0.06)
Downsizing × prevalence ^b					3.05* (1.71)		3.57* (1.75)	3.60* (1.80)	3.78** (1.64)
Downsizing × analysts' ranking ^b						−0.42 [†] (0.24)	−0.42 [†] (0.25)	−0.42 [†] (0.25)	−0.44 [†] (0.26)
Prior ranking								0.21 (0.21)	79.4* (46.6)
Profitability change $t-1$ to t	0.77*** (0.04) .56 (2.17)	0.77*** (0.04) 0.53 (2.14)	0.78*** (0.04) 3.18 (2.22)	0.75*** (0.04) 0.96 (2.20)	0.77*** (0.04) 0.77 (2.18)	0.77*** (0.04) 0.62 (2.13)	0.77*** (0.04) 3.60 (2.26)	0.77*** (0.04) 3.44 (2.25)	0.77*** (0.04) 3.33 (2.21)
Profitability change $t-2$ to $t-1$	0.64 (1.56)	0.27 (1.52)	−0.18 (1.62)	0.55 (1.52)	0.51 (1.56)	0.65 (1.59)	−1.05 (1.74)	−0.96 (1.74)	−0.90 (1.77)
Market capitalization change $t-1$ to t	0.99** (0.32)	0.83* (0.35)	1.04** (0.33)	0.98** (0.32)	1.02** (0.33)	0.99** (0.32)	0.86* (0.35)	0.83* (0.36)	0.90** (0.36)
Market capitalization change $t-2$ to $t-1$	0.58 (0.52)	0.67 (0.49)	0.48 (0.50)	0.56 (0.52)	0.57 (0.50)	0.58 (0.52)	0.59 (0.47)	0.58 (0.46)	0.60 (0.46)
Earnings expectations change $t-1$ to t	1.68* (0.69)	1.62* (0.68)	1.75** (0.67)	1.70* (0.68)	1.74** (0.66)	1.70* (0.68)	1.80** (0.64)	1.81** (0.65)	1.80** (0.63)
Earnings expectations change $t-2$ to $t-1$	2.05*** (0.44)	2.20*** (0.43)	2.27*** (0.49)	2.12*** (0.48)	2.15*** (0.44)	2.05*** (0.46)	2.56*** (0.55)	2.54*** (0.54)	2.66*** (0.58)
Average ROA, 3 years	6.09*** (0.96)	6.20*** (0.91)	5.91*** (0.95)	6.14*** (0.95)	6.11*** (0.97)	6.05*** (0.99)	5.97*** (0.88)	5.96*** (0.88)	6.32*** (0.94)
Average sales growth, 3 years	0.64 (1.01)	0.52 (1.02)	0.75 (1.03)	0.68 (1.01)	0.56 (1.00)	0.59 (1.02)	0.50 (1.03)	0.51 (1.02)	0.55 (1.04)
Firm size	0.31** (0.10)	0.34*** (0.11)	0.33*** (0.11)	0.31** (0.10)	0.30** (0.10)	0.31** (0.10)	0.34*** (0.10)	0.35*** (0.10)	0.34*** (0.10)
Announcement in prior December	−0.24 (0.67)	−0.18 (0.61)	−0.25 (0.64)	−0.22 (0.62)	−0.31 (0.69)	−0.24 (0.66)	−0.22 (0.55)	−0.15 (0.53)	−0.11 (0.67)
Log-likelihood	−492.49	−488.35	−488.26	−487.78	−490.42	−491.75	−476.07	−475.55	−474.12

^a $n = 1,232$. Standard deviations are in parentheses.

^b The base terms for prevalence and analysts' ratings are controlled for through the group structure of the data. Consequently, they (correctly) do not appear in these models. The Analysis section of the text discusses this in more detail. There is also no base term for stock market reaction, as this term's definition implies the presence of a downsizing event.

[†] $p < .10$

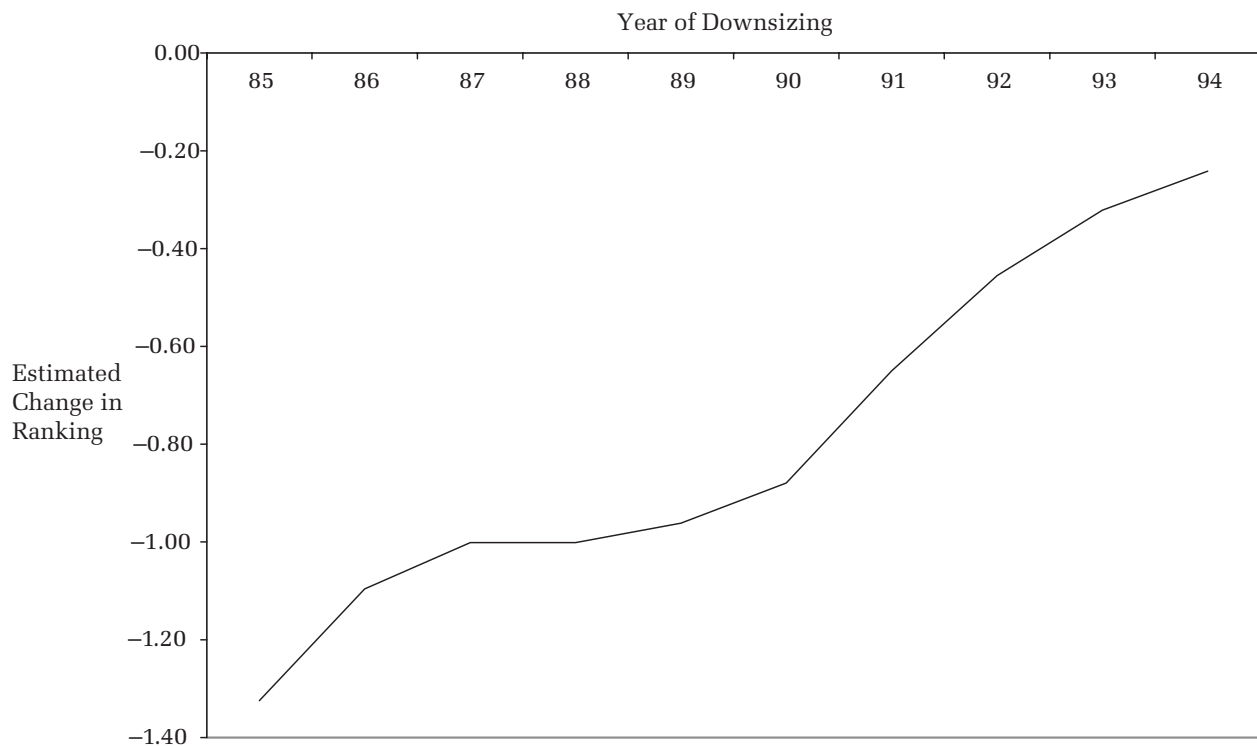
* $p < .05$

** $p < .01$

*** $p < .001$

One tailed tests where a hypothesis was made and the resulting coefficient was in the predicted direction, two-tailed tests in other cases.

FIGURE 1
Estimated Change in Industry Ranking after Downsizing



reputational impact. The coefficient for the interaction of downsizing with performance change is negative and highly significant ($p < .001$). This result strongly supports Hypothesis 3, which predicted that reputation-granting audiences will evaluate a downsizing firm less negatively if its recent performance was declining, and vice versa. The size of the coefficient indicates that a one standard deviation drop in ROA during the downsizing year (i.e., an ROA decline of 3.5%) is associated with a 0.42 ($11.9 \times 3.5\%$) reduction in downsizing's impact on a firm's ranking. This reduction is substantial—it is more than half the average ranking loss (0.71, from model 1) sustained by firms in our sample.

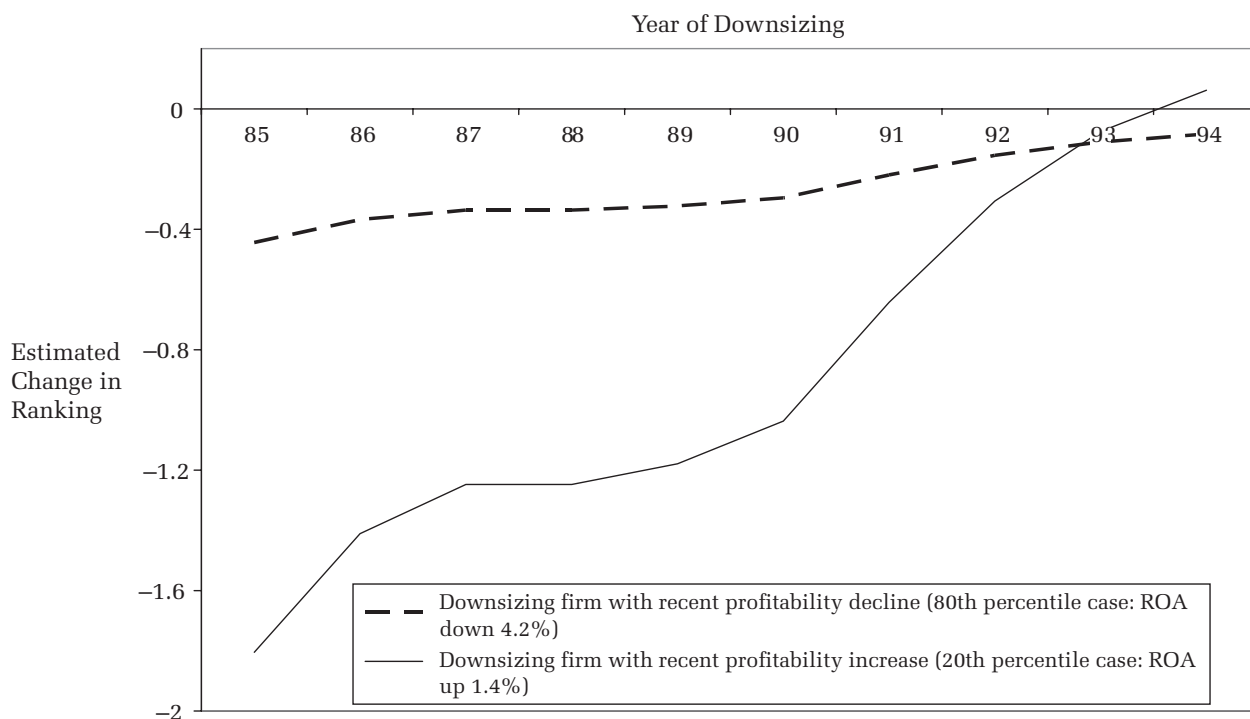
Model 4 examines whether a firm's prior reputational ranking conditioned the main effect of downsizing. The coefficient for this interactive term (downsizing \times prior ranking) supports Hypothesis 4, which posited a positive moderating effect. Highly ranked firms experienced less reputational damage from downsizing. Each one-position increase in prior ranking was associated with a 0.23 reduction in ranking loss. Thus, a downsizing firm ranked two positions above the mean in its industry is predicted to experience a 0.25 loss in reputation ($0.71 - 0.46 = 0.25$), and a firm ranked two positions below the mean will experience a 1.17

loss ($0.71 + 0.46 = 1.17$). The magnitude of this effect is considerable, and its direction is also noteworthy. The simple logic of regression to the mean might predict that high-ranked firms would experience greater loss merely because they have further to fall. Model 4 does not support this prediction.

Model 5 assesses whether downsizing's prevalence moderated its reputational impact. The coefficient for the downsizing by prevalence term is both positive and significant, supporting Hypothesis 5. Downsizing's effects on corporate reputation became strikingly less negative as the practice spread over time, with the predicted ranking loss changing from -1.33 ($p < .001$) in 1985 to only -0.25 (n.s.) in 1994 (significance levels given are from similar models with the zero point of the prevalence term shifted to 1985 and 1994, respectively). Figure 1 presents a graphical representation of this shift.

Model 6 tests Hypothesis 7, which predicts that analysts' evaluations of downsizing firms will be more positive than those of executives. The coefficient for the interaction of downsizing and analysts (-0.42) indicates that, contrary to prediction, analysts' reactions were *more* negative than executives' were. The downsizing coefficient in model 6 (at -0.50) now represents the average postdownsizing change in executives' rankings (as they are the omitted class), whereas the average change in

FIGURE 2
Estimated Change in Industry Ranking after Downsizing^a



^a Note that the ROA percentage amounts reflect the 80th and 20th percentile case of downsizing firm-years within the sample, rather than the sample as a whole.

analysts' rankings is the sum of the two coefficients ($-0.42 + -0.50 = -0.92$). It is necessary to be cautious in interpreting these results, however, as this effect was not hypothesized and as the -0.42 coefficient is only marginally significant ($p < .09$ under the appropriate post hoc two-tailed test). However, given analysts' vocal advocacy of downsizing, the fact that they were marginally more negative than executives is perhaps less important than the fact that they were negative, *in general*.

Model 7 simultaneously incorporates the five interaction variables from models 2 through 6. The results change little when these interactions are simultaneously estimated. This model also serves as a baseline for models 8 and 9. These two models incorporate triple interaction terms as a test of Hypothesis 6's prediction that the moderating effects of stock market reaction and recent firm performance changes will dissipate as downsizing grows more prevalent. Model 8 shows an insignificant coefficient for the downsizing by market reaction by prevalence term, indicating no support for Hypothesis 6 where stock market reaction is concerned. Audiences apparently continued to incorporate stock market reactions into their evaluations, even as downsizing became widespread. However, model 9 shows a positive and significant

coefficient for the triple interaction term downsizing by profitability change by prevalence, supporting Hypothesis 6. Figure 2 graphically illustrates this finding. It shows that recent performance changes strongly moderated downsizing's reputational impact early in the study period, but had essentially no moderating effect by 1994, when downsizing had become widespread.

DISCUSSION

Our purpose in this study was threefold. We set out to examine reputational flows, to identify firm actions that precipitate them, and to elucidate the underlying theoretical mechanisms responsible for reputational change. We identified three prominent perspectives in previous research (reputation as character, as symbolic conformity, and as technical efficacy) and used them to develop distinct explanations for reputational change. Each of the three accounts offered its own insights about the types of actions likely to enhance or damage reputation, about the types of signals reputation-granting audiences attend to, and about the core evaluative logic they use in evaluating a firm and encoding its actions into its reputation. We used these three explanations to develop both competing and comple-

mentary hypotheses about downsizing's effects on reputation. Three competing hypotheses (Hypotheses 1a–1c) sought to identify the “dominant mechanism” behind downsizing's reputational consequences. In our subsequent integrative hypotheses, we posited moderating relationships and drew upon multiple theoretical explanations, working from the idea that audiences may attend to secondary signals and employ multiple logics.

Our study's core finding is that downsizing exerted a significant, negative effect on year-to-year reputational change. Downsizing firms lost an average of over two-thirds of a position (0.71) in intraindustry rankings, net of all control variables. This core finding is strongly supportive of the character explanation, according to which audiences highly value trustworthiness and respond negatively to opportunistic acts. At one level, this effect is not particularly surprising or noteworthy. The reputation-as-character perspective is well established in the literature and clearly leads to prediction of this result. However, this central finding is more remarkable when we observe it through the lens of the other two perspectives we elaborated. Downsizing fairly clearly signaled a lack of commitment to constituencies, but this was neither the only message it conveyed nor the most obviously relevant one. Similarly, although it is not theoretically surprising that some people attributed opportunism to downsizing firms, it is quite surprising that these particular evaluators appeared to do so. Downsizing enjoyed a very high level of symbolic appropriateness within the cultural milieu of analysts and executives, and many prominent figures in this field explicitly advocated it. Nonetheless, members of this field lowered their opinions about the overall quality of the firms that adopted the practice. As our results show, this effect cannot be attributed to downsizings' observable performance antecedents or consequences. It appears to be largely independent of performance factors.

Our study's overall pattern of results also suggests a theoretical contribution that belies the simplicity and intuitiveness of its main finding. Although analysts and executives clearly took character into account in adjusting the reputations of downsizing firms, it was not the only signal they considered, and they did not weight it equally in all times and all cases. As Figure 1 shows, downsizing had a strongly negative effect at the outset of the study period: this effect almost completely dissipated by 1994. This large decrease in effect suggests that changing cultural norms may play a key role in determining what counts as an opportunistic act. Though downsizing never acquired the positive reputational valence posited under the symbolic

conformity explanation, it did appear to shed its negative connotations as it became more and more ubiquitous. Proactive downsizings also appeared to become more acceptable over time, in keeping with the symbolic conformity logic of Hypothesis 6. Stock market reaction to downsizing events also strongly conditioned their effects on reputation. Downsizers with excess returns that were one standard deviation above the mean lost only 0.30 places in their intraindustry rankings, on average. In contrast, those with excess returns one standard deviation below the mean lost an average of 1.11 positions. Downsizing's increasing symbolic appropriateness did not mitigate this effect, contrary to Hypothesis 6. Thus, it is evident that our audiences did take downsizing's technical efficacy into account, if only as a secondary criterion. This finding suggests that the reputational damage that results from violating commitments may be substantially meliorated provided that the violation produces valued results for evaluators. But it is important to note that this mitigation is far from complete. Controlling for market reaction only slightly reduces the main effect of downsizing on reputation. Further, negative performance consequences appear to exacerbate reputational damage from opportunism.

Our tests of moderating hypotheses also revealed additional support for the character account of reputational change. Notably, we found that proactive downsizings exerted a more negative effect on reputation, while declining performance mitigated damage. These findings are consistent with the character perspective, which suggests that violating commitments is more permissible in the presence of a clear need, but particularly problematic in its absence. Our finding that downsizing exerted less damage on highly reputed firms is also consistent with the character perspective, as articulated in the rationale for Hypothesis 4. Finally, the character perspective is also at least implicitly bolstered by the observed lack of support for Hypothesis 7, which posited that the idiosyncratic cultural beliefs and parochial interests of analysts would cause them to react more favorably to downsizers. This finding seems to suggest that our two audiences applied similar logics and responded to the same signals.⁸

⁸ Arguments can also be made that analysts and executives may attend to different signals and employ distinct evaluative logics in ascribing reputations. For example, analysts may be more focused on financial outcomes than executives are. If so, the technical efficacy mechanism might be relatively more influential in shaping analysts' reputational ascriptions, and the organiza-

It is necessary to give separate attention to the technical efficacy account in interpreting our study's overall pattern of results. According to the strong form of this perspective, reputational change effectively reduces to performance change. This argument implies that downsizing and other like actions are themselves epiphenomenal. Their effects on reputation should be null, once observable measures of performance change are accounted for. We believe our results very effectively refute this argument. We found that downsizing exerted a strong and independent effect after we had controlled for the powerful measures of performance change discussed above.

The weak form of this argument is considerably more difficult to evaluate. It merely implies that audiences will respond positively to actions that they *believe* will enhance future performance. We neither claim nor aspire to refute this interpretation; however, we do wish to make two important comments about it. First, it hinges on the notion that audiences have beliefs about the efficacy of particular practices that are, at least to some extent, independent of observable performance data. Second, it becomes deeply entangled with other explanations when one attempts to apply it empirically. The beliefs about the efficacy of a practice held by evaluators who are "ultimately concerned" with performance may form as a direct result of the cultural processes featured in the symbolic conformity perspective. Similarly, these evaluators may revile opportunistic firms because they believe they are likely to be bad investments or business partners. It is because of these complexities that we focused on the strong-form argument in developing our competing hypotheses. That argument has clear empirical implications that are readily separable from the other two. Some of our results might be interpreted as consistent with the weak-form explanation. However, we are reluctant to embrace the latter, because it says nothing about the ultimate source of beliefs regarding downsizing's efficacy,

tional character mechanism might be relatively less so. We did not develop hypotheses along these lines, in part because the rationales for them are somewhat intertwined between the different theoretical perspectives. However, we did perform additional analyses to explore this issue empirically. We found that analysts and executives were not differentially responsive to stock market reaction (Hypothesis 2) or to recent firm performance changes (Hypothesis 3) associated with downsizings. These (non-)results provide further evidence that the two audiences applied similar logics and responded to the same signals (analyses are available from the authors upon request).

and because it makes assumptions about actors' motivations that we cannot directly verify. Neither of the other two explanations denies that evaluators are concerned with technical efficacy. But they do not reduce reputational judgments to narrow self-interest, and they have the added advantage of providing insights about why audiences might believe downsizing is or is not efficacious.

Our study, clearly aimed at the reputation literature, may also have some significant implications for the large literature on downsizing and personnel reductions more generally. Several prior studies have concluded that firms often downsized to gain financial constituents' support (Useem, 1993, 1996) and have further emphasized that the practice gained substantial legitimacy as it spread (Lamertz & Baum, 1998; McKinley et al., 1998). Our findings seem to introduce an interesting and ironic wrinkle into this account. Specifically, they suggest that while firms may have *offered* downsizing as a symbol of their cultural conformity and propriety, it was typically *received* in a very different spirit. Flanagan and O'Shaughnessy's (2005) recent study of the (negative) reputational effects of personnel reductions may provide further evidence of this irony. These authors studied a different sample of firms over a later time period and focused on layoffs, rather than on the more specific phenomena of downsizing. Nonetheless, their results were similar in some basic ways to ours, further supporting the idea that audiences may react negatively to actions undertaken with the apparent intention of winning their favor.⁹

Our study's findings may be significantly context-bound. Downsizing was obviously a controversial practice and a somewhat unique one. Although other firm decisions may also evoke strong emotional re-

⁹ Flanagan and O'Shaughnessy (2005) did not explicitly engage the institutional literature on downsizing's diffusion and legitimation, and they also did not consider the reputation as character perspective that our study centrally features and supports. Rather, they offered an explanation that approximates the weak-form technical efficacy view. Specifically, they suggested that audiences responded negatively to layoffs because they believed that layoffs typically have negative performance results. It is also important to emphasize the critical distinction between downsizing and layoffs. We identified over 1,000 layoff events in collecting data for this study. Fewer than 10 percent of these met our criteria for a downsizing (firmwide, permanent, affecting >1 percent of employees, strategically oriented versus capacity balancing). Our theoretical and empirical efforts have focused specifically on this narrower category of events and would not apply to layoffs, in general.

sponses, it is likely that technical efficacy and symbolic conformity concerns play a more central role in determining the reputational consequences of many organizational actions. Future research might productively examine how changes in corporate governance, mergers, new product launches, and/or the formation of strategic alliances affect reputational change. Such studies could shed further light upon reputational flows, the actions that precipitate them, and the mechanisms underlying reputational change. We believe that our study may provide a useful methodological and theoretical template for such research. It highlights the benefits of fully dynamic designs that examine the time-contingent effects of particular actions. It also demonstrates the gains to be realized by bringing distinct perspectives on reputational change to bear in the effort to explain the effects of a given action. Future studies employing this template may substantially further reputation scholarship and help bridge the gap between reputation theory and related theoretical perspectives, most notably the institutional analysis of organizational legitimacy.

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APPENDIX

Alternative Analysis

We conducted an alternative analysis in which the dependent variable was the raw *Fortune* ratings, rather than the intraindustry rankings that we used in our main analyses. We used the conventional fixed-effects modeling approach in these analyses. The models include the same variables as the best-fitting model in Table 3 (model 9) and also include dummy variables for each year. We modeled executives' and analysts' ratings separately in models 1 and 2 and combined them into a single dependent variable in model 3. This combined score is the one that *Fortune* actually published for each firm. Accordingly, the *n* in all three models is 616, rather than the 1,232 in Table 3. The downsizing by analyst interaction is also omitted, as it cannot be estimated without separate observations for the two groups.

All three models produce results very similar to the main analyses. All hypotheses that were supported in Table 3's analyses receive at least marginally significant support in the first two models of Table A1. These same hypotheses were all supported at the $p < .05$ level in the third (published ratings) model. The striking similarities between the two sets of analyses provide strong evidence that the findings of our rank-ordered logistic regression models are robust.

TABLE A1
Cross-Sectional Time Series Fixed-Effects Models of Influence of Downsizing on
Fortune Reputational Ratings^a

Variables	Hypothesis	Model 1	Model 2	Model 3
		Executives' Ratings Only	Analysts' Ratings Only	Combined (Published) Ratings
Downsizing	1	-0.18*** (0.04)	-0.30*** (0.06)	-0.21*** (0.04)
Downsizing × stock market reaction	2	0.009** (0.005)	0.010 [†] (0.007)	0.011** (0.005)
Downsizing × profitability change	3	-2.31** (0.95)	-1.73 [†] (1.33)	-2.27** (0.95)
Downsizing × prior ranking	4	0.07* (0.04)	0.12* (0.05)	0.20*** (0.05)
Downsizing × prevalence	5	0.46 [†] (0.35)	0.81* (0.48)	0.74* (0.34)
Downsizing × profitability change × prevalence	6	16.6* (8.3)	28.9** (11.4)	22.3** (8.1)
Prior ranking		0.66*** (0.03)	0.49*** (0.03)	0.66*** (0.03)
Profitability change $t-1$ to t		1.36** (0.52)	1.07 (0.71)	1.25* (0.51)
Profitability change $t-2$ to $t-1$		-0.14 (0.47)	-0.39 (0.64)	-0.04 (0.46)
Market capitalization change $t-1$ to t		0.17* (0.07)	0.28** (0.10)	0.18** (0.07)
Market capitalization change $t-2$ to $t-1$		0.27*** (0.06)	0.32*** (0.09)	0.27*** (0.06)
Earnings expectation change $t-1$ to t		0.28* (0.11)	0.81*** (0.16)	0.48*** (0.11)
Earnings expectation change $t-2$ to $t-1$		0.52*** (0.12)	0.48*** (0.16)	0.48*** (0.11)
Average ROA, 3 years		2.48*** (0.57)	2.84*** (0.77)	2.28*** (0.56)
Average sales growth, 3 years		0.31 (0.25)	-0.19 (0.34)	0.06 (0.25)
Firm size		-0.19* (0.08)	-0.04 [†] (0.11)	-0.15 [†] (0.08)
Announcement in prior December		-0.07 (0.10)	0.17 (0.14)	0.04 (0.10)
<i>n</i>		616	616	616

^a One-tailed tests where a hypothesis was made and the result was in the expected direction, two-tailed tests otherwise. Year dummies included but not shown.

[†] $p < .10$

* $p < .05$

** $p < .01$

*** $p < .001$



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