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Corporate Reputation and Philanthropy: An Empirical Analysis

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ABSTRACT. This paper analyzes the determinants of corporate reputation within a sample of large UK companies drawn from a diverse range of industries. We pay particular attention to the role that philanthropic expenditures and policies may play in shaping the perceptions of companies among their stakeholders. Our findings highlight that companies which make higher levels of philanthropic expenditures have better reputations and that this eect varies significantly across industries. Given that reputational indices tend to reflect the financial performance of organizations above other factors (Fryxell, G. E. and J. Wang: 1994, *Journal of Management* **20**, 1–14) and that elements of the literature emphasise that discretionary aspects of social responsibility, including corporate donations, may not be in the financial interests of organizations (e.g. Friedman, M.: 1970, "The Social Responsibility of Business is to Increase its Profits", *New York Times Magazine*, September 13), this is a significant finding. It suggests that philanthropic expenditures may play a significant role in stakeholder management and may, in particular, lead to stakeholders holding more positive impressions of philanthropic corporations.

KEY WORDS: corporate philanthropy, corporate reputation, corporate social responsibility

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Introduction

Recent evidence suggests that the level of philanthropic donations made by large U.K. businesses has grown significantly over the last 20 years (Arulampalam and Stoneman, 1995; Campbell et al., 2002). The most recent statistics indicate that the largest 100 U.K. firms collectively contributed over £630 M in 2002/3, a rise of 26% on the previous year, and that the proportion of profits given to charities by these companies approximately doubled between 2001 and 2003.[1] The increasing importance of corporate philanthropy is reflected in the proliferation of recent articles in the academic literature, many of which chart the chronological development of corporate philanthropy in the United States or the United Kingdom or examine the correlates of philanthropy (Adams and Hardwick, 1998; Arulampalam and Stoneman, 1995; Bartkus et al., 2002; Campbell et al., 2002; Himmelstein, 1997; Moore, 1995; Porter and Kramer, 2002; Saiia, 2000, 2002; Saiia et al., 2003; Siefert et al., 2003).

A variety of motivations for firms making philanthropic donations have been advanced in the existing literature (see Siefert et al., 2003, pp. 195–196 for a useful overview). Among these alternative motivations, a central path paints philanthropy both as a way for companies to demonstrate their social responsiveness to the communities in which they operate (Berman et al., 1999; Wood and Jones, 1995), and as an activity that stimulates goodwill towards companies within those communities. Earlier work has argued that corporate philanthropy influences the perceptions of the firm in the eyes of a variety of stakeholders including investors[2], customers[3], suppliers, actual or potential employees, and the voluntary sector (Himmelstein, 1997; Saiia, et al., 2003; Smith, 1994). Philanthropic donations may, therefore, serve both the needs of communities, and enhance the long-run financial performance of the firm.

Corporate reputation, the collective opinion of an organization held by its stakeholders, has been identified as a construct of growing importance (Kitchen and Laurence, 2003; MacMillan et al., 2002). Among other factors, reputation has been identified as playing a significant role in improving firm value (Fombrun and Shanley, 1990; Gregory, 1991), enhancing consumer perceptions of product quality (Grewal et al., 1998; Milgrom and Roberts, 1986), raising employee morale, productivity and improving recruitment and retention (Garbett, 1988; Gregory, 1991; Turban and Cable, 2003), and permitting access to cheaper capital (Beatty and Ritter, 1986). The existing literature has identified a close relationship between corporate reputational capital and social responsibility (e.g. Fryxell and Wang, 1994; McGuire et al., 1988) and has focused considerable attention on evaluating the meaning of reputational indices (the *Fortune* ranking chief among them) concluding that such indices "speak most directly to their "reputation" as an investment" (Fryxell and Wang, 1994, p. 13).

In spite of the apparently strong orientation of commonly available metrics of corporate reputation towards the financial performance of organizations, a small, but developing body of work has sought to understand the relationship between social responsiveness and corporate reputation thus defined. Fombrun and Shanley's seminal study of the influences on the reputations of large US companies found that a positive association between corporate reputation and the level of corporate charitable donations and the presence of a separately endowed corporate charitable foundation (Fombrun and Shanley, 1990). More recently, Williams and Barrett (2000) provide further evidence in support of a positive link between philanthropy and firm reputation. In addition, Williams and Barrett find evidence that the link between philanthropy and reputation is stronger among companies that more frequently violate occupational health and safety and environmental regulations, arguing that, among other things, "charitable giving appears to be a means by which firms may partially restore their good name following the commission of illegal acts" (Williams and Barrett, 2000, p. 348). Notably, neither Fombrun and Shanley (1990) nor Williams and Barrett (2000) permit the effect of philanthropy on firm reputation to vary across industries.

This paper contributes to the developing stream of research that focuses on the relationship between corporate reputation and social philanthropy. Contributions from the social issues in management field have argued that social responsiveness is a fundamentally multidimensional construct that 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). In the context of philanthropy, earlier work has primarily focused on the importance of cash giving by firms (Adams and Hardwick, 1998; Fombrun and Shanley, 1990; Navarro, 1988) but some work has begun to examine the significance of both other forms of corporate resources and corporate policies concerning philanthropy (Brammer and Millington, 2003). Brammer and Millington (2003) highlight the significant degree of variation across organizations in the existence and nature of policies that govern the distribution of philanthropic expenditures across stakeholder groups. As yet, empirical work has not examined the link between philanthropic expenditures and policies and corporate reputation in any detail. Specifically, earlier studies have failed to account for the possible impacts of the diversity of community involvement policy in addition to the impact of the size of expenditures.

This paper makes three contributions to the literature. First, the analysis is the first to distinguish between the impact of level of philanthropic expenditures and corporate policies concerning the focus of their philanthropic initiatives on corporate reputation. Given that policies offer some indication of the destination of philanthropic expenditures, the analysis investigates whether how firms manage their philanthropy affects their reputations. Second, in contrast to earlier studies, the analysis permits the impact of philanthropy upon reputation to vary across industries. Philanthropy is expected to have different impacts on reputation according to how closely it is linked to the social consequences of individual firms. Our analysis investigates whether philanthropy has a more significant impact on the reputations of some firms than others. Third, the evidence presented is among the first evidence concerning the drivers of corporate reputations in the U.K. context. Much of the existing literature in the reputation field is U.S.-based, as are the only existing studies of the link between reputation and social performance; our study sheds some light on the extent to which regularities observed there are internationally robust.

The paper is structured as follows. The next section discusses the determinants of firm reputation, paying particular attention to philanthropy and philanthropic policies. Section ''Method'' introduces the sample and data sources. Section ''Results'' reports the results of the empirical analysis before a final section concludes.

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 hypothesises that corporate reputations ''represent publics' cumulative judgements of firms over time'' which, in turn, hinge on ''relative success in fulfilling the expectations of multiple stakeholders'' (Fombrun and Shanley, 1990, p. 235). Stakeholders are expected to have diverse preferences over firm actions, process and outcomes, and these ''different publics attend to different features of firm's performance'' (Fombrun and Shanley, 1990, p. 235). From this it follows that a firm's current reputation is related to the signals that publics have received, whether directly from the firm or via other information channels such as the media or stock markets, concerning its behaviours, and the congruence between firm behaviours 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 hypothesises that firm reputation in the eyes of stakeholders is related to signals concerning philanthropic activities, and to signals relating to financial performance, ownership and board composition, size, media visibility, and industry. We will discuss each of these in turn.

Reputation and philanthropy

Existing work has argued that social responsiveness can play a significant role in promoting favourable relationships with primary stakeholder groups upon whom ''the survival and continuing prosperity of the organization depends'' (Clarkson, 1995, p. 107). Hillman and Keim (2001) argue that effective stakeholder management can create ''intangible, socially complex resources that may enhance firms' ability to outperform competitors in terms of long-term value creation'' (Hillman and Keim, 2001, p. 127) and highlight communities as a key member of the group of primary stakeholders. Consistent with these views, a growing literature argues that philanthropy plays a significant role in establishing and developing favourable relationships with community stakeholders (Adams and Hardwick, 1998; Berman et al., 1999; Wood and Jones, 1995). The strength of the signal that such philanthropic activities send to stakeholders may be expected to have become stronger recently in the U.K., where increasingly detailed information concerning the philanthropic activities of leading companies has been made available through the national news media and through the publications of socially oriented pressure groups such as the PerCent Club and Business in the Community. The Guardian began publishing its ''giving list'', an examination of patterns of corporate giving among the U.K.'s leading companies, in

November 2001 with the stated aim of "naming and shaming" (The Guardian Giving List, 5th November 2001, p. 2) British corporations into accepting increased social responsibility. Therefore we hypothesise that

Hypothesis 1

> There is a positive relationship between the level of a firm's philanthropic expenditures and its reputation.

Frooman (1999) argues that understanding the wants of stakeholders is of primary importance when attempting to design organizational responses to them. Therefore, the reputational impact of philanthropy may be expected to vary according to whether it is focused upon activities that are broadly congruent with the expectations and preferences of social stakeholders or not. Brammer and Millington (2003) highlight three societal trends that are expected to play a role in shaping philanthropic activities of companies in the U.K. First, participation in organized political and democratic activities has declined as evidenced by the decline in the level of electoral turnouts and the low the levels of membership of political parties by historical and international standards (Mair and van Biezen, 2001). Second, the significant decline in recent decades in churchgoing, particularly among Christian churches. The Church of England has suffered a 27% fall in membership since 1980. A MORI poll in April 2000 reported that 50% of those interviewed never went to churches except for weddings and funerals and only 16% of those surveyed attended church at least once a fortnight. The decline in the importance of religion is particularly marked among the young, with only 54% of 18–24-year-old believing that Jesus actually lived compared to 80% of the over 65s. Third, the significant growth in the perceived importance of social issues, particularly education, within society as evidenced by the growth in the proportion of opinion poll respondents highlighting education as one of the most significant issues facing Britain from around 15% in 1990 to over 30% by 2000 (in fact, the proportion was as high as 49% around the time of the 1997 general election). These developments in social beliefs and preferences are expected to have conditioned the link between philanthropic expenditures and firm reputation such that the link is more strongly positive if firm philanthropy programmes are consistent with these preferences in that they exclude political and religious causes and prioritise educational causes.

Recent contributions have argued that in addition to the, more usual, focus on pressure for social responsiveness from external stakeholder groups such as pressure groups and consumers, firms also face very considerable pressure from employee stakeholders concerning their CSR (Smith, 2003; Waddock et al., 2002). Recent survey evidence suggests that employees prefer to work for socially responsive organizations, and are more likely to be loyal to them. In response to these pressures, organizations have developed a range of mechanisms by which they involve their employees in their social responsibility initiatives. Several of the most common of these concern corporate philanthropy, including the operation of schemes that facilitate charitable giving by employees out of their salaries, the matching of such individual philanthropic activities by companies, and support for employee volunteering. These initiatives are expected to be positively related to firm reputation because they help to attract, retain, and motivate employees which, in turn, are expected to have beneficial long-term effects on the organization. Based on these discussions, we hypothesise that:

Hypothesis 2

> Firms that involve employees in their philanthropic activities have better reputations.

Hypothesis 3

> Firms that focus their philanthropic expenditures upon causes that are congruent with broad societal preferences have better reputations.

Industry environments vary according to the nature of salient social responsibility issues and, therefore, in terms of the expected corporate responses to those issues. For example, earlier empirical work has identified a number of sectors as having 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). In contrast, other industries, particularly newer manufacturing industries and the service sector have significantly lower environmental impacts and are associated with fewer highly visible environmental issues. 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 are subject to considerable pressure from ethical pressure groups and the profile of workplace health and safety concerns is higher in the construction and resource extraction sectors.

We propose that the perceived relatedness between philanthropy and the prevailing responsibility issues in a firm's industry conditions the relationship between philanthropy and reputation. Philanthropy should arguably have a lower impact on firm reputation in industries with significant environmental impacts because it fails to address the primary concerns of stakeholder groups (i.e. to reduce environmental impacts). For this reason, it may also be that, in these industries, philanthropy is viewed as a waste of corporate resources, thus incurring the displeasure of financial, as well as societal, stakeholders. In other industries, philanthropy can be seen to bear a much more direct relationship to the social externalities generated by businesses. Funding alcohol awareness programmes, drug rehabilitation schemes, and other community initiatives is more likely to be interpreted by stakeholders as a direct form of atonement for the harmful side-effects involved in their commercial activities. For firms in these industries, philanthropy is significantly more likely to provide a reputational payoff. Therefore we hypothesise that

Hypothesis 4

> The link between reputation and philanthropy is stronger in industries that have significant social externalities

Financial performance and corporate reputations

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 may be interpreted by external agents as a signal of effective corporate strategy, good management, and good resource allocations, and is therefore expected to help a firm establish or maintain a good reputation particularly among groups of financial stakeholders such as creditors, investors, and external analysts that make use of such data (Fama, 1970; Fombrun and Shanley, 1990). In addition, the impressions, assessments and reports of these, comparatively well informed stakeholders, are expected to influence the perceptions of companies in the eyes of other groups of stakeholders (Shrum and Wuthnow, 1988). Furthermore, since many of the important influences on reputation are embedded within the firm (Dowling, 2001), external agents may "rely on previous financial performance outcomes as signals of a firm's overall esteem" (Roberts and Dowling, 2002, p. 1079). This suggests that financial performance attributes may play both direct and indirect roles in influencing the perceptions of a variety of agents concerning firm reputations. Consistent with this view, an extensive empirical literature finds evidence of a positive association between reputation and financial performance characteristics, although the direction of causality appears to be ambiguous (see Roberts and Dowling, 2002; Sabate and Puente, 2003). While external agents view financially successful companies favourably, they tend to be risk-averse and therefore of two firms exhibiting 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). Such market risks may be linked to industry and may be related to corporate leverage since more indebted companies may face higher levels of insolvency risks.

Hypothesis 5

> The better is a firm's current financial performance, the better its reputation.

Hypothesis 6

> The greater is a firm's market risk, the worse its reputation.

Hypothesis 7

> The greater is a firm's degree of leverage, the worse its reputation.

Ownership characteristics, board composition, and reputation

Recent evidence suggests that ownership exerts a significant influence on a diverse range of phenomena including impacts on firm financial performance (Shleifer and Vishny, 1997; Thomsen and Pedersen, 2000), strategic decisions concerning internationalization and diversification (Tihanyi et al., 2003), firm R&D and innovation (Bushee, 1998; David et al., 2001), CEO compensation (David et al., 1998), and their influence on corporate social performance (Graves and Waddock, 1994; Johnson and Greening, 1999). Institutional investors have been 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 sell investments without significantly damaging their value (Ryan and Schneider, 2002). If this is the case, the dissatisfied institutional investor has an incentive to seek modification of corporate strategy (rather than sell-up), and management has an incentive to give such a request due heed. Thus, it is avoidance of a mutually damaging outcome, the drop in share price, that grants institutions a position of influence. The presence of significant institutional shareholdings may therefore send a strong signal to other stakeholders that poor corporate performance will not be tolerated. This may, in turn, lead to a positive relationship between the extent of such ownership and firm reputation that arises both out of the positive influence of shareholder activism on firm performance and through the indirect mechanism of this signal influencing the perceptions of other stakeholders.

Board composition is also thought to play a key role in affecting firm behaviour through the introduction of increased diversity and via the import of agents who are more strongly aligned with external stakeholder interests than managers (Wang and Dewhirst, 1992; Zahra et al., 1993). The presence of outside directors may provide 'additional windows on the world' (Tricker, 1984, p. 171). Their role is to inform and advise executive decision-makers, drawing upon specialist knowledge and/or experience. If this input contributes to the effectiveness of corporate strategy, as it is designed to, then it may also augment the company's reputation.

Hypothesis 8

> The greater is the degree of long-term institutional ownership, the better is a firm's reputation.

Hypothesis 9

> The more non-executive directors as firm has, the better its reputation.

Firm size, media visibility and reputation

Broadly speaking, firms grow as a result of the effectiveness of their corporate strategy, and so larger firms should be expected to have better reputations than smaller rivals because size is one measure of success. It is also relevant here that larger firms tend to be more visible to external agents. The larger scale of their activities makes more numerous and significant their interactions with relevant external publics. Thus, agents will tend to hold more information regarding the activities of larger firms, an imbalance which may bias their assessments of corporate reputation.

The media acts as an agenda-setter, and not merely a mediator, in the relationship between companies and their stakeholders (Adler and Milne, 1997; Brown and Deegan, 1998). Media coverage "influences the preferences of the populace and helps set the public agenda" (Erfle and McMillan, 1990, p. 123). Organizational visibility affects perceptions of organizations both by the provision of information on specific issues and by introducing availability biases whereby "firms frequently and non-negatively touted by the media might therefore develop better reputations" (Fombrun and Shanley, 1990, p. 240). Thus, media exposure increases the stock of available information, and 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.

Hypothesis 10

The larger the firm, the better its reputation.

Hypothesis 11

A firm's media exposure influences its reputation.

Industry and reputation

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.

Hypothesis 12

A firm's reputation is partly determined by the nature of its principle business activities.

Method

Sample

The main data constraint in our analysis is the availability of data relating to corporate reputations. To measure corporate reputation we utilise the "Britain's most admired companies" survey from *Management Today*, 2002. The *Management Today* reputational survey is very similar methodologically to the *Fortune* data often analysed in empirical work concerning corporate reputations. 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; use of corporate assets. The assessments received for each firm were averaged across criteria and respondents to produce a single reputational score.

This provides a reputational score (REPSCORE) for each of 240 U.K. PLCs. It should be noted that, because of the method employed in the construction of reputational data, these companies, while drawn from a wide range of industrial sectors, are not necessarily representative of the general run of economic activity in the U.K. In addition, the focus is clearly upon the firms with the most favourable reputations within each industrial sector. However, there is still considerable variation in the range of reputational scores both within and between industrial sectors and the scope of the sample embodies many of the largest firms in the U.K. including 90% of the FTSE 100.

Data on philanthropic expenditures and policies

The 1985 U.K. Companies Act obliges companies to disclose donations to charities of over 200 pounds in the directors' report. Data on the level of philanthropic expenditures are therefore readily available in the U.K. context and were collected using *DataStream*. Using this data, we constructed a variable, CHARITY, which equals the level of firm philanthropic giving in 2002 measured in thousands of pounds. Data concerning corporate community involvement policies was based primarily on published data. The Directory of Social Change (DSC) publishes a biennial *Guide to U.K. Company Giving*. The guide, designed as a tool for fundraising organizations, provides detailed information relating to corporate charitable and community involvement policies and management on a firm by firm basis. The DSC compiles each firm's entry in the guide by integrating financial data from published annual reports with information obtained from a questionnaire or interview survey. Earlier studies have emphasized that the codification of written CSR policy is only one form of corporate response to pressure to demonstrate social responsibility (Robertson and Nicholson, 1996; Wood, 1991) and that policy commitments are not necessarily well correlated with implementation (Ryan, 1994). Nevertheless, several studies have used corporate communications to make inferences concerning stakeholder responsiveness (Robertson and Nicholson, 1996) and the interface between CSR and corporate strategy (Moore, 1995).

Each firm's entry in the guide also provides a detailed breakdown of a range of policies concerning the firm's community involvement activities. Specifically, the guide describes the extent and nature of employee involvement in community activities and statements concerning prioritized and excluded areas of community involvement. These data were supplemented by information from two additional sources. First, the PerCent club publishes an annual benchmarking report with entries for each firm that returns a postal survey. In 1999, 115 PerCent club members participated in the benchmarking exercise. This report provides additional contextual and practical information relating to the participant's community involvement. Secondly, an increasing number of firms disclose details of their community involvement directly through annual reports and websites. This material was used to supplement and validate other sources of data.

Community involvement policies were analyzed through a number of binary variables that reflect the presence of corporate policies concerning philanthropic activities. In the detailed discussions of their involvement policies many firms identified elements that involved their employees in the company's activities. Typically, firms identified whether or not they: (a) operated a payroll giving scheme that facilitates direct contributions to charity by employees (PROWAGE), (b) matched individual donations to charity with company donations (PROMATCH), and (c) supported employee volunteering to community initiatives on company time (PROVOL). A binary variable was constructed for each of these dimensions which took a value of 1 if the company supported the particular initiative and zero otherwise.

Areas of community involvement that were prioritized or excluded by firms were identified by examination of the firm's detailed disclosures. Once again, a set of binary variables was constructed to facilitate analysis. The complete set of priorities and exclusions was established through open coding and subsequently restricted to the most commonly expressed preferences. Binary variables were constructed that took a value of one if the firm excluded religious (ANTIREL) or political (ANTIPOL) causes from their community involvement and if they prioritized educational charities (PROED) for each identified priority or exclusion and zero otherwise.

Data on other firm characteristics

A measure of each firm's size (SIZE) (the natural logarithm of the value of total assets), principle activity (approximately equivalent to the three-digit NACE industry), the number of outside (non-executive) company directors (NONEXEC), firm profitability (measured by the ratio of pre-tax profits to total assets, ROTA), and corporate leverage (measured by the ratio of total debt to total assets, LEVERAGE) were extracted from accounting data courtesy of *DataStream*. Using the *DataStream* industry classification, we allocated each firm to one of twelve sectors: business services, chemicals, construction, consumer products, engineering, finance, high technology, publishing, resources, retail, transportation, utilities. We also created two dummy variables: SOCIAL took a value of one if the firm operated in an industry with significant social externalities[4] and zero otherwise, ENV[5] took a value of one if the firm operated in an industry with significant environmental impacts and zero otherwise. Much of the previous empirical work employs firm size as a measure of visibility to external agents (e.g. Adams and Hardwick, 1998; Bowen, 2000; Damanpour, 1987). However, as Bowen (2000) notes, organizational size is an unsatisfactory measure of organizational visibility because it captures much more than an organization's visibility. Saiia (2000) argues that the use of a commonly accepted metric is necessary for consistent and replicable analysis of corporate visibility or exposure. He concludes that the best measures should incorporate 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[6]. 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 (VISIBILTY).

Data concerning the market performance of sample companies was obtained from Barra Inc, a leading risk specialist. We include BETA, a gauge of the expected response of a stock to the overall market, as a measure of the risks associated with stock ownership. Market perceptions concerning stock performance were captured through the inclusion of two composite variables obtained from Barra Inc. GROWTH is a variable that is based on two dimensions of corporate growth: growth in assets and earnings both measured over a 5 year period. VALUE is a composite variable that is based upon three performance ratios: earnings to price, book value to price, and cash flow to price. High values of these ratios can signal the presence of assets that are currently undervalued by the market and can form the basis of trading strategy.

Ownership data were drawn in June 2002 from a share ownership analysis database of more than 2000 listed U.K. firms managed by one of the U.K.'s largest company registrars. Ownership data is continually updated to incorporate underlying beneficial ownership changes and investment managers' holdings from share trading information recorded daily 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 created a variable, LONGTERM, that equalled the sum of the proportion of firm equity held by long term institutional investors. Pension funds, insurance companies and life assurors were classified as long term investors.

Results

Table I presents descriptive statistics and correlation coefficients for the key variables. The magnitudes of the correlation coefficients indicate that multicolinearity is unlikely to present significant statistical difficulties. Table II reports the primary regression results. Reflecting our earlier discussion, the dependent variable is the firm reputation score as reported in Management Today. Overall, the model explains approximately half of the variance in the dependent variable which is reasonable in the context of a cross-sectional model and is equivalent to the explanatory power of existing models.

Model 1 provides a point of departure with the existing literature by examining a set of explanatory variables roughly equivalent to those employed by Fombrun and Shanley (1990). Consistent with Fombrun and Shanley's results, we find that firm reputation is positively influenced by current financial performance, as measured by profitability (p = 0.031), with the degree of ownership by long-term financial institutions (p = 0.0001), and with current market performance (as reflected by the positive coecient on GROWTH (p = 0.041) and the negative coecient on VALUE (p = 0.036)). 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. Contrary to Fombrun and Shanley (1990), we find that corporate media visibility is strongly positively associated with firm reputation (p = 0.016).

Model 2 extends Model 1 by introducing a set of industry effects. Many of the results identified for Model 1 are robust to the introduction of the industry dummy variables, and the importance of controlling for industry discussed earlier is underlined by the significant variation in reputational scores across industries and the coincident leap in the explanatory power of the empirical model. Model 3 introduces the level of firm charitable donations as an explanatory variable and demonstrates that the level of firm donations is strongly positively associated with firm reputation (p = 0.000). That charitable activities appear to have a positive impact upon firm reputation is significant given the strong emphasis of financial performance within the construction of reputational indices (Fryxell and Wang, 1994) and may suggest that philanthropic activities are increasingly viewed as an important part of corporate responsibility strategies (Porter and Kramer, 2002; Saiia, 2000, 2002; Saiia et al., 2003).

Model 4[7] develops Model 3 by including six variables that capture the most common policies that apply to corporate community involvement initiatives in addition to the level of corporate donations. Broadly, the findings suggest that community involvement policies have no significant impact upon corporate reputations. Neither, exclusions from unpopular religious or political affiliations nor prioritizations for educational causes or employee involvement initiatives seem to have any material

TABLE I

Descriptive statistics and correlations

	Mean	SD	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)
(1) SIZE	14.48	1.85	–																
(2) REPSCORE	52.83	7.87	0.07	–															
(3) ROTA	5.34	10.98	−0.05	0.31	–														
(4) LEVERAGE	24.36	16.85	−0.02	0.00	−0.11	–													
(5) NONEXEC	5.34	2.34	0.59	0.14	−0.03	0.00	–												
(6) LONGTERM	29.76	9.43	−0.07	0.19	0.13	−0.04	−0.04	–											
(7) CHRITY	2,220.23	8,208.89	0.42	0.33	0.13	−0.10	0.45	−0.02	–										
(8) BETA	0.96	0.32	0.15	−0.14	−0.40	−0.11	0.16	0.11	0.03	–									
(9) GROWTH	−0.18	0.80	0.04	0.25	−0.04	−0.16	−0.12	−0.17	−0.12	−0.24	–								
(10) VALUE	0.42	0.82	−0.06	−0.32	−0.07	0.13	−0.16	−0.12	−0.17	−0.12	−0.24	–							
(11) VISIBILITY	6.33	1.22	0.74	0.15	−0.06	0.06	0.57	−0.09	0.43	0.25	−0.06	−0.13	–						
(12) PROED	0.62	0.49	0.18	0.20	0.17	−0.03	0.09	0.01	0.20	−0.02	−0.12	−0.08	0.34	–					
(13) PROWAGE	0.42	0.50	0.38	0.07	0.04	0.02	0.21	−0.06	0.17	−0.08	−0.15	0.07	0.46	0.31	–				
(14) PROVOL	0.29	0.46	0.27	−0.024	0.01	0.00	0.14	−0.07	0.14	−0.11	−0.10	0.07	0.30	0.24	0.48	–			
(15) PROMATCH	0.36	0.48	0.31	0.08	0.03	0.10	0.16	−0.03	0.19	0.04	−0.10	−0.08	0.41	0.27	0.49	0.43	–		
(16) ANTIPOL	0.60	0.49	0.15	0.10	0.18	0.01	0.00	0.08	0.05	−0.19	−0.18	0.04	0.21	0.37	0.33	0.25	0.25	–	
(17) ANTIREL	0.61	0.49	0.28	0.00	0.08	−0.01	0.11	0.03	0.11	−0.10	−0.12	0.05	0.31	0.27	0.36	0.31	0.22	0.69227	–

TABLE II

The determinants of corporate reputation

Independent variables	Dependent variable = REPSCORE				
	Model 1	Model 2	Model 3	Model 4	Model 5
ONE	40.976*** (5.420)	37.187*** (6.448)	39.839*** (6.642)	50.994*** (7.765)	39.419*** (6.732)
SIZE	0.055 (0.585)	0.891 (0.704)	0.785 (0.701)	−0.126 (0.762)	0.708 (0.690)
ROTA	0.151** (0.070)	0.118 (0.075)	0.102 (0.072)	0.057 (0.061)	0.104 (0.072)
LEVERAGE	−0.031 (0.038)	−0.065* (0.036)	−0.046 (0.034)	0.003 (0.042)	−0.039 (0.035)
BETA	−6.461*** (1.770)	−9.344*** (2.129)	−8.464*** (2.182)	−7.632*** (2.886)	−8.441*** (2.189)
GROWTH	1.411** (0.686)	1.515*** (0.581)	1.523** (0.585)	2.670*** (0.802)	1.929*** (0.630)
VALUE	−1.351** (0.640)	−2.192*** (0.592)	−2.199*** (0.592)	−2.670*** (0.682)	−2.195*** (0.621)
NONEXEC	0.034 (0.278)	−0.107 (0.257)	−0.271 (0.263)	−0.004 (0.261)	−0.264 (0.257)
LONGTERM	0.210*** (0.053)	0.169*** (0.048)	0.184*** (0.048)	0.135** (0.060)	0.187*** (0.048)
VISIBILITY	1.842** (0.756)	1.936** (0.901)	1.625* (0.894)	1.530 (1.054)	1.825** (0.873)
CHAITY			0.00019*** (0.00005)	0.00017*** (0.00006)	0.00019*** (0.00005)
PROVOL				−3.019** (1.484)	
PROWAGE				2.076 (1.423)	
PROMATCH				0.208 (1.216)	
PROED				0.508 (1.109)	
ANTIREL				0.309 (1.359)	
ANTIPOL				0.822 (1.404)	
HIGH TECHNOLOGY		−2.571 (1.704)	−2.894 (1.783)	−0.215 (2.297)	−3.032* (1.788)
ENGINE		5.205*** (1.659)	4.685*** (1.622)	4.204** (1.889)	4.565*** (1.611)
PUBLISHING		−3.607 (2.503)	−4.563* (2.584)	−7.334*** (2.266)	−4.751* (2.533)
CHEMICALS		−4.559*** (1.694)	−5.185*** (1.763)	−4.808* (2.630)	−6.797*** (2.353)
RESOURCES		−1.885 (2.361)	−2.533 (2.247)	3.270 (2.486)	−2.514 (2.218)
RETAIL		−2.935 (1.799)	−2.872 (1.893)	−1.061 (2.492)	−2.778 (1.889)
UTILITIES		−11.650*** (2.295)	−11.287*** (2.336)	−9.812*** (2.687)	−13.547*** (3.006)
FINANCE		−8.834*** (2.249)	−9.077*** (2.221)	−5.836** (2.556)	−8.967*** (2.208)
TRANSPORT		0.728 (1.987)	0.896 (1.983)	3.080 (2.322)	0.812 (2.023)
CONSUMER PRODUCTS		−5.682*** (1.989)	−5.105** (2.022)	−1.561 (2.730)	−2.588 (2.752)
CONSTRUCTION		2.034 (1.533)	1.638 (1.573)	2.949 (1.846)	1.790 (1.587)
ENV					3.946 (2.413)
SOCIAL					−5.618* (3.123)
ENV*CHARITY					−0.0014 (0.001)
SOCIAL*CHARITY					0.0005*** (0.0002)
n	209	209	201	140	201
R^2	27.49%	47.74%	50.59%	53.51%	52.19%
F-statistic	8.39***	8.59***	8.73***	4.78***	7.64***

Notes: Figures in parentheses are standard errors; *, ** and *** indicate variable significance at the 10%, 5% and 1% level, respectively.

effect on firm reputation[8]. The exception is the significantly negative effect of support for staff volunteering on company time on reputation (p = 0.044). Given that there is likely to be little direct benefit to corporations of allowing their sta to volunteer during company time, this finding may suggest that such activities are viewed as a waste of corporate resources and, therefore, as being incompatible with the financial objectives of the firm.

Model 5 extends the analysis further by introducing two industry effects, ENV and SOCIAL, which reflect a firm's activity in industries associated with significant environmental or social externalities respectively. Model 5 also includes interaction terms between firm charitable donations and membership of these environmentally and socially damaging industries and therefore permits the impact upon reputation of being in a sensitive industry to vary with the level of corporate philanthropy. The results suggest that operating in an environmentally sensitive industry is not associated with a lower corporate reputation but that firms in industries with significant social externalities have significantly poorer reputations (p = 0.073). Furthermore, on average, the negative impact of operating in a socially damaging industry is equivalent to more than 10% of the mean reputational score. However, the negative reputational eect of operating in a socially damaging industry is found to be significantly influenced by the level of corporate philanthropic expenditures (p = 0.002) suggesting, that philanthropy helps to mitigate the negative reputational consequences of operating in controversial business sectors. This finding is consistent with Williams and Barrett's (2000) evidence that the link between philanthropy and reputation is stronger among companies that more frequently violate occupational health and safety and environmental regulations.

Discussion and conclusion

This paper has analyzed the determinants of corporate reputation within a sample of large U.K. companies drawn from a diverse range of industries. We have paid particular attention to the role that philanthropic expenditures and policies may play in shaping the perceptions of companies among their stakeholders. Our findings highlight that companies which make higher levels of philanthropic expenditures have better reputations and that this effect varies significantly across industries. Given that reputational indices tend to reflect the financial performance of organizations above other factors (Fryxell and Wang, 1994) and that elements of the literature emphasise that discretionary aspects of social responsibility, including corporate donations, may not be in the financial interests of organizations (e.g. Friedman, 1970), this is a significant finding. It suggests that philanthropic expenditures may play a significant role in stakeholder management and may, in particular, lead to stakeholders holding more positive impressions of philanthropic corporations.

Additionally, our analysis also suggests that the impact of philanthropic expenditures on corporate reputations is, to some extent, industry specific. We find that philanthropy has a significantly larger effect on reputations in industries that exhibit significant social externalities, such as the alcoholic drink and tobacco sectors, than it does in other sectors. This suggests, consistent with the findings of Williams and Barrett (2000), that philanthropy may help companies to atone for socially irresponsible behaviours and that these expenditures may help to protect corporate reputations against these negative stakeholder perceptions. The fact that this effect doesn't appear to operate within environmentally sensitive industries may suggest that stakeholders perceive philanthropy to be unrelated to environmental performance.

Distinctively, our analysis permits us to evaluate whether the reputational impact of corporate philanthropy is contingent upon two factors: (i) how the philanthropy is implemented – gifts in cash versus with the involvement of employees, and (ii) the destination of philanthropic expenditures. Concerning the first issue, we find that cash giving generates more significant reputational payoffs than does involving employees through matched giving or volunteering. Therefore, our analysis suggests that firms seeking to maximise the reputational impacts should make more cash donations. This observation is consistent with the external bias present in the construction of reputational data such as those we have analysed. Employee involvement initiatives appear not to influence the perceptions of the firm in the eyes of external stakeholders but might play a significant role in motivating internal stakeholders

(Peterson, 2004). Future work might explore these issues in more detail.

Turning to the destination of philanthropic expenditures, we find no strong evidence that community involvement policies have any direct or indirect effect on corporate reputation; neither failing to exclude unpopular causes, nor including popular ones appears to have any impact on reputation. There is much discussion in the voluntary sector about the relationships between companies and charitable organizations that centres on the difference between attractive and unattractive (viewed from the perspective of companies) causes and highlights that many worthy, but unattractive causes, find it very difficult to attract corporate funding. Perhaps, in light of our findings, firms can be more confident about supporting unpopular or unattractive causes given that there is no reputational loss associated with doing so.

In other respects, our findings are consistent with elements of the existing literature. Specifically, we find evidence that firm reputation is positively influenced by current financial performance (whether measure by accounting or market methods), and with the degree of ownership by long-term financial institutions. We also find that reputations vary systematically across industries, confirming the need to control for industry in studies of reputation, particularly when operationalizations of reputation are industry specific in the sense that respondents are asked to rate firms relative to industry peers (Fombrun and Shanley, 1990)

This study suffers from limitations that could be addressed in future work. 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 U.K. firms. Second, our study, in common with much of the empirical work in the area conducted in the U.K., would benefit from the improved availability of data, particularly in the context of measuring corporate reputation that would permit richer analyses. We would welcome the availability of reputational data that is consistently available for a large sample of companies that is derived from alternative methodologies, such as those proposed by Gardberg and Fombrun (2002).

Notes

[1] See The Guardian's 2003 Giving List.

[2] Making in excess of £50,000 per year in charitable donations is a condition of membership of the FTSE4 Good index, the first socially responsible investment index launched in the U.K.

[3] Nearly a third of British consumers had bought a product or service because the firm had a link with a charitable organization (Business in the Community, 2001)

[4] The alcoholic beverage, tobacco, defence and pharmaceutical industries were defined as having significant social externalities.

[5] The chemical, resource extraction, and utilities sectors were defined as having high environmental impacts.

[6] 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. They specifically excluded the *Wall Street Journal* from this list because ''of its strong emphasis on economic issues'' (Meznar and Nigh, 1995, p. 983).

[7] The number of observations falls significantly (from around 200 to 140) when the policy variables are introduced. We conducted consistency checks to ensure that other results were robust to the reduction in sample size, but preferred to report the results for the largest samples available because of the increase in degrees of freedom.

[8] We estimated alternative variants of the model that permitted the impact of policies to vary across different firm sizes and for different levels of corporate philanthropy, but, perhaps because of the reduction in the number of degrees of freedom, no significant patterns were identified.

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