# The board of directors and corporate reputation: an empirical analysis

# El consejo de administración y la reputación corporativa: un análisis empírico

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## Abstract

**Purpose** – The purpose of this paper is to test the association between board of director characteristics and corporate reputation.

**Design/methodology/approach** – Logistic and multivariate regressions are performed to analyse whether the board of director characteristics are associated with the level of corporate reputation. The sample is composed of listed companies in the Madrid Stock Exchange (Índice General de la Bolsa de Madrid) at least once during the period 2004-2010. Corporate governance data were manually extracted from governance reports released by Spanish companies. The data for the design of a corporate reputation measure were obtained from the Monitor Español de Reputación Corporativa (MERCO) institute web site.

**Findings** – Results from the empirical analysis show that Spanish companies that appear high up in terms of ranking in the reputation index provided by MERCO tend to have a higher percentage of independent directors as well as more female directors on their board. Firm size and the image of the president of a firm are also linked to corporate reputation.

**Originality/value** – The results have direct implications for the management of corporate governance mechanisms by shareholders who should take into account their role in the creation and maintenance of corporate reputation.

**Keywords** Corporate reputation, Corporate governance, Board of directors

**Paper type** Research paper

## Resumen

**Objetivo** – El objetivo de este trabajo es analizar la asociación entre las características de los consejos de administración y la reputación corporativa.

**Metodología** – La metodología empleada se basa en el uso de regresiones logísticas y multivariantes. Nuestra muestra se compone de las empresas que cotizaron en el Índice General de la Bolsa de Madrid (IGBM) durante el período 2004-2010. Los datos sobre gobierno corporativo se obtuvieron manualmente a partir de los informes de gobierno corporativo publicados por las empresas españolas.

La información para diseñar la medida de la reputación corporativa se obtuvo de la página web de MERCO (Monitor Español de Reputación Corporativa).

**Resultados** – Los resultados del análisis empírico muestran que las empresas españolas que aparecen en las posiciones más altas del ranking de reputación corporativa proporcionado por MERCO tienden a tener un mayor porcentaje de directores independientes y de mujeres en sus consejos de administración. El tamaño de la empresa y la reputación del presidente también están relacionados con la reputación corporativa.

**Originalidad** – Los resultados tienen implicaciones directas para la gestión de los mecanismos de gobierno corporativo por parte de los accionistas, que deberían considerar el papel de los consejos de administración en la creación y mantenimiento de la reputación corporativa.

**Palabras clave** Reputación corporativa, Gobierno corporativo, Consejo de administración

## 1. Introduction

Corporate governance mechanisms seek to protect investors and maximize corporate value, as well as increase confidence in capital markets. Previous empirical research has investigated the relationship between corporate governance and information quality, earnings management or internal controls (Cohen *et al.*, 2004; Dávila and Peñalva, 2006; Klein, 2002; Li *et al.*, 2008; Monterrey Mayoral and Sánchez Segura, 2008). An appropriate design of corporate governance practices helps guarantee the integrity of the accounting function (Monterrey Mayoral and Sánchez Segura, 2008), and strong corporate governance mechanisms are related with a reduced likelihood of negative financial outcomes (Carcello *et al.*, 2011). Both academics and regulators have claimed for the need to improve corporate governance controls. In recent years, corporate governance codes have been issued by international organisms, especially after the corporate failures in capital markets because of the lack of transparency in the financial reporting process.

Firms tend to set up governance mechanisms in order to comply with these codes, but in many countries the level of corporate governance mechanisms is low (Santiago-Castro *et al.*, 2009). Nevertheless, given that corporate governance mechanisms seek to build confidence in capital markets, companies also find incentives to improve them voluntarily. We expect that companies with better governance practices have a better image and are more valued in terms of reputation. In particular, the aim of this paper is to test the association of the characteristics of boards of directors with corporate reputation.

The board of directors is crucial for the control and monitoring of the most important decisions to be taken in a company. Boards are relevant mechanisms in the oversight of managerial actions (Fama and Jensen, 1983) and lead to potential benefits for companies. Both agency theory and resource dependence theory have been commonly used to explain the functions of the board of directors (Hillman and Dalziel, 2003). According to agency theory, the basic function of the board of directors is to monitor management and protect shareholders (Fama and Jensen, 1983). The resource dependence theory indicates that directors provide valuable resources to companies (Wernerfelt, 1984). These theories suggest that the board of directors can help reduce information asymmetries and improve outcomes of a firm, thereby enhancing investors' confidence.

To establish the link between corporate governance and firm reputation, our analysis is based on the reputation building model by Fombrun and Shanley (1990). These authors see the firm as serving multiple stakeholders that judge the corporate effectiveness – and, hence, reputation – according to various information signals about the firms' activities, achievements and prospects. We incorporate this multidimensional

nature of corporate reputation by using the MERCO ranking, a ranking that is constructed from surveys of Spanish managers and evaluations by experts such as financial analysts, consumer associations, labour unions and others, and therefore incorporate the assessment of multiple stakeholders.

According to this theoretical conception, an improvement in stakeholders' perceptions about a firm leads to an improvement in corporate reputation, and this would bring important benefits to the firm. Reputation builds competitive advantage (Hall, 1993; Fombrun and Shanley, 1990; Weigelt and Camerer, 1988) and improves financial performance (Fernández and Luna, 2007; Roberts and Dowling, 2002). More relevant for the purpose of this research, several authors have pointed out that the ultimate responsibility for the achievement and maintenance of a good reputation lies with the board of directors and the CEO (Dowling, 2004; Kitchen and Laurence, 2003; Mintzberg, 1983; Tonello, 2007). However, as far as we are concerned, little research exists on the relationship between corporate governance and reputation.

Our sample is composed of listed companies in the Madrid Stock Exchange (Índice General de la Bolsa de Madrid, IGBM) at least once during the 2004-2010 period. Corporate governance data were manually extracted from governance reports released by Spanish companies. The data for the design of a corporate reputation measure were obtained from the Monitor Español de Reputación Corporativa (MERCO) institute web site.

Results from the empirical analysis show that both the proportion of independent directors and the percentage of women on the board are associated with the level of corporate reputation. Companies that are ranked high up in the reputation ranking published by MERCO tend to have a higher percentage of independent directors and a higher percentage of women on their board.

These results have implications for shareholders who must be aware of the fact that an adequate management of corporate governance mechanisms will help in the creation and maintenance of corporate reputation and as a result increase the value of their investments.

The remainder of the paper is organized as follows. The literature regarding reputation and corporate governance is reviewed in the next section, where the hypotheses are formulated. Section 3 describes data collection, the sample and explains the research method. Section 4 discusses the results of the empirical analysis and sensitivity tests are included in Section 5. Finally, Section 6 summarizes the contributions of the paper.

## 2. Previous literature and hypothesis development

Following Fombrun (1996, p. 72) reputation can be defined as "a perceptual representation of a company's past actions and future prospects that describe the firm's overall appeal to all its key constituents when compared to other leading rivals". In today's turbulent economic environment, reputation and trustworthiness have become a major issue for the stakeholders to rely on the company. Previous research shows that a good reputation has valuable benefits for the companies as it sustains competitive advantage (Hall, 1993; Fombrun and Shanley, 1990; Weigelt and Camerer, 1988), improves financial performance (Deephouse, 2000; Fernández and Luna, 2007; Kotha *et al.* 2001; McGuire *et al*, 1990; Roberts and Dowling, 2002; Sabate and Puente, 2003), lowers costs (Fombrun, 1996) and attracts the best talents (Hill and Knowlton, 2008; Fombrun, 1996), among others.

The literature on corporate reputation is extensive, but there is no unifying conceptual framework, as numerous theories have been used to examine corporate reputation. The most commonly used theories are institutional theory, signalling theory and resource-based view. Institutional theory has been used when research focuses on building reputation, signalling theory is applied to understand the process of building, maintaining and defending a reputation, and, finally, the focus of the resource-based view is on the outcome, as it examines reputation as a rare and valuable intangible resource that leads to sustained competitive advantage (Walker, 2010, pp. 376-377).

For the purpose of this paper, we follow the theoretical considerations of Fombrun and Shanley (1990). According to these authors, reputation is built from stakeholders' perceptions and represents the public's cumulative judgements of the firm over time. These perceptions are formed using market and accounting signals indicating performance, institutional signals indicating conformity to social norms and strategy signals indicating strategic postures.

Corporate governance mechanisms are established to protect investors and secure value maximization, increasing confidence on the functioning of capital markets. Previous empirical research has investigated the influence of corporate governance on information quality, earnings management or internal controls, among other variables (Cohen *et al.*, 2004; Dávila and Peñalva, 2006; Klein, 2002; Li *et al.*, 2008; Monterrey Mayoral *et al.*, 2008). However, as far as we are concerned, the relationship between corporate governance and reputation has not been fully explored yet.

Corporate governance recommendations are established in corporate governance codes all over the world. According to Aguilera and Cuervo-Cazurra (2004, p. 417), these codes are "a set of best practice recommendations regarding the behaviour and structure of a firm's board of directors". Recommendations are similar in most of the governance codes. In the European Union, a comparative study of corporate governance codes was undertaken at the beginning of the previous decade (European Commission, Internal Market Directorate General, 2002). The conclusions of this study show that the code recommendations are fairly similar and serve as a converging force. The codes express remarkable consensus on issues relating to board structure, roles and responsibilities, as well as issues on board independence.

Boards of directors are responsible for the governance of their companies (Brown *et al.*, 2011). In addition, the board of directors is crucial for decision making within a firm, and it is responsible for setting objectives, monitoring and controlling the firm's activities (Fama and Jensen, 1983). Internationally, the main recommendations in the codes of good governance refer to the board of directors, regarding its composition, frequency of meetings, a minimum number of non-executive and independent directors, the separation between the roles of chairman and CEO, etc. (Zanotti and Cuomo, 2008). Our empirical analysis explores how these board of director characteristics are related to the reputation of the company. Agency theory argues that the board of directors must protect shareholders and reduce agency conflicts (Fama and Jensen, 1983; Hillman and Dalziel, 2003). Resource dependence theory emphasizes that directors bring a variety of valuable resources to a company (Barroso *et al.*, 2011; Wernerfelt, 1984). According to these theories, more effective boards should mitigate the conflict of interests between the company and outsiders, and enhance the outcomes of a firm. Therefore, we expect that these board of director characteristics may increase confidence in terms of a company and hence, its reputation. Good governance will be positively perceived by the various stakeholders if it is a signal of the board's

commitment to corporate success. We see the establishment of a particular board structure as a signal that indicates performance, conformity to social norms and strategic postures in the sense of Fombrun and Shanley (1990) model.

### 2.1 Board and CEO independence and corporate reputation

Several authors have pointed out that the ultimate responsibility for the achievement and maintenance of a good reputation lies with the board of directors and the CEO (Dowling, 2004; Kitchen and Laurence, 2003; Mintzberg, 1983; Tonello, 2007). Hill and Knowlton consultancy company[1] has been regularly undertaking analyses of corporate reputation which produces a report named Corporate Reputation Watch (CRW). The CRW highlights, over several years, the importance of corporate reputation and the relevance of the role played by the CEO and other board members in managing reputation. The findings in the study by Kitchen and Laurence (2003)[2] on business executives' opinions suggest that for most of the companies the primarily responsible person for managing reputation is the CEO. Financial analysts interviewed by the CRW 2006 report[3] (Hill and Knowlton, 2006) also consider that the CEO's reputation is crucial when making their judgements.

CEO duality has been used as an indicator of the CEO's power and board independence (Bailey and Peck, 2013; Zhang, 2012). CEO duality occurs when the CEO is the same person as the chairman of the board. The separation of the two positions reduces CEO influence over the board and enhances the independence of the board (Zhang, 2012). Theoretically, the separation of the titles of CEO and chairman will help maintain impartiality, reduce agency costs in corporations and improve economic consequences for firms (Donelly and Mulcahy, 2008). Therefore, an independent CEO may influence the perception of external agents that a board will function more effectively.

On the other hand, outside or independent directors are perceived as a tool for monitoring behaviour and reducing managerial opportunism (Ho and Wong, 2001; Klapper and Love, 2002; La Porta et al., 2000). Independent directors tend to protect shareholders' interests and mitigate agency conflicts, and they may be more likely to follow ethical conducts (Prado Lorenzo et al., 2009; Rodríguez-Ariza et al., 2014; Zhang, 2012). In addition, independent directors are professionals without a managerial role who have incentives to defend or build their reputation as expert monitors (Jensen and Meckling, 1976; Patelli and Prencipe, 2007). They provide expertise and contacts, advice on the public presentation of the activities of a company and hence, it may be expected they help improve the prestige and image of a company in society (Haniffa and Cooke, 2005).

Considering the previous arguments, the next hypotheses are formulated:

*H1a.* There is a positive association between CEO duality and the reputation of the company.

*H1b.* There is a positive association between board independence and the reputation of the company.

### 2.2 Board gender and corporate reputation

Prior literature about the role of women in the boardroom also draws on agency theory and resource dependence theory. Female directors are expected to increase board independence since women may ask questions and provide new insights that would not

come from directors with more traditional backgrounds (Carter *et al.*, 2003). Following an agency approach, women often bring a fresh perspective to complex issues, and this can improve strategy formulation and decision-making processes that protect investors (Francoeur *et al.*, 2008). Furthermore, women provide important resources that can increase a firm's competitive advantage. According to Campbell and Mínguez-Vera (2008, pp. 439-440), greater diversity promotes a better understanding of the marketplace by matching the diversity of a firm's directors to the diversity of its potential customers and employees. In addition, diversity increases creativity and innovation.

The presence of women on boards can increase corporate reputation not only because of the benefits indicated above, but also if the various stakeholders sense that it is a sign of the firm's sensitivity to pressures from the general public for increasing participation of women on corporate boards (Daily *et al.*, 1999). This can also indirectly affect reputation, as the presence of women on boards can influence perceptions about corporate effectiveness (Brammer *et al.*, 2009).

Bilimoria and Wheeler (2000, p. 139) indicate how institutional investors and other shareholders' associations exert pressure on corporate boards to increase the representation and use of women directors. In the Spanish context, a new organic law (Ley Orgánica, 2007) was introduced in 2007 aimed at achieving effective equality for women and men at all levels. Regarding corporate governance, article 75 of this law establishes that those firms that cannot publish their income statement in the abbreviated format should try to include on their board of directors a number of women that allows for achieving a balanced representation of women and men in a maximum of eight years after the approval of the law.

The previous arguments lead us to think that the presence of women on boards may lead to important benefits for a company and improve the stakeholders' judgements regarding the response of the firm to the claims from society for the increased presence of women corporate directors. Improved stakeholders' perceptions will then lead to increased reputation. Therefore, the next hypothesis is proposed:

*H2.* There is a positive association between the percentage of female directors on the board and the reputation of the company.

### 2.3 Board activity and corporate reputation

The intensity of board activity is a value-relevant attribute in improving the effectiveness of a board. Previous research has generally used the number of board meetings as a measure of board activity. Board activity contributes towards a better monitoring activity of managers' decisions (Brick and Chidambaran, 2010). Therefore, the number of board meetings may mitigate agency costs and can be perceived in the market as a sign of responsible company behaviour. Vafeas (1999) studies the association between board activity and firm performance and he argues that directors on boards that meet more frequently are more likely to perform their duties in accordance with shareholders' interests. On the other hand, in well-functioning organizations board activity is suggested to be relatively low (Jensen, 1993). However, boards should increase their activity in the presence of problems and as a response to poor performance (Vafeas, 1999). These arguments suggest that board intensity is a mechanism to minimize agency costs and increase firm outcomes, and this may improve the image of a company in a given society. Therefore, the next hypothesis is formulated:

*H3.* There is a positive association between board activity and company reputation.

### 3. Empirical analysis

*3.1 Sample and data description*

Our initial sample was composed of the non-financial listed companies in the IGBM at least once during the 2004-2010 period. This sample was made up of 406 firm-year observations (including 76 companies).

The empirical analysis required the design of a measure for corporate reputation, the selection of the variables about board of director characteristics, and also the collection of some financial data for the design of control variables.

Reputation is an intangible concept based on perceptions, and therefore difficult to measure. The problems in the measurement of corporate reputation are one of the main concerns in this branch of literature (Walker, 2010). In order to design a measure of corporate reputation, information from the MERCO[4] institute was considered. Since the year 2000, MERCO annually publishes a ranking of the most reputable firms in Spain. This ranking is a reference for large companies in Spain in the assessment and management of their reputation (Fernández and Luna, 2007). The ranking is elaborated in several steps, from the results of a survey applied to Spanish managers and evaluations by experts (such as financial analysts, consumer associations, labour unions, etc.), and verified by an audit firm. Different dimensions that determine a company's reputation are evaluated: economic and financial results, information reporting quality, product and service quality, respect for the consumers' rights, environmental and social responsibility, etc. As a result, the most reputable companies are ranked with a score from 0 to 10,000. This ranking is similar to the one published by *Fortune* magazine, which has been widely used in academic journals to measure corporate reputation in the USA (Chung *et al.*, 2003; Gallego *et al.*, 2010; Lee and Roh, 2012; Roberts and Dowling, 2002).

The reputation data were downloaded from the MERCO web site. All the corporate governance variables were manually collected by analysing annual reports and corporate governance reports and examining directors' biographies. Osiris database was used to obtain financial data.

There were companies in the sample that were listed on the IGBM, but that did not appear in the reputation rankings. For that reason we also worked with the sample of companies that were listed on the IGBM and at the same time appeared in the MERCO ranking. This sample included 145 firm-year observations (including 31 companies).

*3.2 Research design*

The aim of this paper is to analyse the relationship between corporate governance and reputation of Spanish listed firms. We expect that the board of director characteristics are associated with corporate reputation. A general explanatory model is proposed, where corporate reputation is the dependent variable, and several board of director characteristics are considered independent variables. Moreover, certain control variables with potential effects on companies' reputations were included in order to complete the model. All these variables are presented in Table I.

A two-step analysis was performed to study the link between board of director characteristics and corporate reputation. First, we examined whether those characteristics are associated with the inclusion of a company in the ranking elaborated by MERCO. A dummy variable named reputation rank was initially considered to capture corporate reputation. Reputation rank (*REP_RANK*) is assigned a value of 1 if a company appears in the ranking of most reputable firms, and 0 otherwise. Second, a continuous variable,

| Name | Description | Definition |
|------|-------------|------------|
| *Corporate reputation* | | |
| REP_RANK | Reputation ranking | Dummy variable: 1 if the firm is included in the MERCO index; 0 otherwise |
| REP_VALUE | Reputation value | Value relative to the mean value by MERCO, that is considered as 100 points |
| *Corporate governance* | | |
| B_IND | Board independence | Percentage of independent directors on the board |
| CEO | CEO independence | Dummy variable: 0 if the chief executive officer is also the president; 1 otherwise |
| B_WOM | Board gender | Percentage of female directors on the board |
| B_ACT | Board activity | Number of board meetings in a year |
| *Control variables* | | |
| SIZE | Firm size | Total assets (in million of euros) |
| ROA | Profitability | Return on assets |
| REP_PRESD | Reputation of the president | Dummy variable: 1 if the president of the company is included in MERCO Líderes and 0 otherwise |
| LEV | Firm leverage | Ratio of total debt to total asset |

**Table I.**
Variables description

named reputation value, was designed in order to measure the level of reputation for every company that was included in the MERCO rankings, by considering the average reputation as a reference. Reputation value (*REP_VALUE*) is a relative measure to the average reputation value in the MERCO index, which is assigned 100 points. This variable leads us to examine the association between the characteristics of the boards of directors and the level of corporate reputation.

As discussed in the previous section, several board of director characteristics were examined: board independence, CEO duality, gender diversity and board activity. Board independence (*B_IND*) is measured by the proportion of independent directors on the board. CEO duality (*CEO*) was a dummy variable with a value of 0 if the chief executive officer is also the chairman and 1 otherwise. Gender diversity (*B_WOM*) is measured by the proportion of female directors on the board. Board activity is measured by the number of meetings held in a year (*B_ACT*).

Various control variables were also included in the statistical models, such as firm size (*SIZE*), profitability (*ROA*), the reputation of the president of the company (*REP_PRESD*) and firm leverage (*LEV*)[5]. Firm size may enhance a company's ability to sustain a competitive advantage, and profitability can also increase corporate reputation (Roberts and Dowling, 2002). However, most of the stakeholders are not only concerned with financial benefit and the attributes of reputation encompass different firm-related aspects. According to Lee and Roh (2012), these reasons can justify that profitability is not consistently associated with corporate reputation. Firm size was measured by total assets divided into one million, and profitability by return on assets. As pointed out before, several international reports agree on the fact that the *CEO* also determines a firm's reputation. Data on *CEO*'s reputation was not available, but the reputation of the president of the company was measured by a ranking provided by the MERCO institute, named MERCO Líderes, which measures the reputation of the presidents of the boards of directors of Spanish companies. In particular, various presidents of companies from our sample were also the *CEO* of the firm. Firms with a higher leverage tend to have better reporting practices to satisfy creditors' needs and

minimize conflicts of interests (Jensen and Meckling, 1976). As a result, an improvement in their image and corporate reputation can be expected. On the other hand, leverage has traditionally been used as a proxy for financial risk (Amran *et al.*, 2009), and this can negatively affect corporate reputation.

A statistical analysis was performed based on the following models, where the reputation measures were the dependent variables, and the corporate governance characteristics were considered as explanatory variables:

$$REP\_RANK_{it} = \alpha + \beta_1 B\_IND_{it} + \beta_2 CEO_{it} + \beta_3 B\_WOM_{it} + \beta_4 B\_ACT_{it}$$
$$+ \beta_5 SIZE_{it} + \beta_6 ROA_{it} + \beta_7 REP\_PRES_{it} + \beta_8 LEV_{it} + \varepsilon$$

$$REP\_VALUE_{it} = \alpha + \beta_1 B\_IND_{it} + \beta_2 CEO_{it} + \beta_3 B\_WOM_{it} + \beta_4 B\_ACT_{it}$$
$$+ \beta_5 SIZE_{it} + \beta_6 ROA_{it} + \beta_7 REP\_PRES_{it} + \beta_8 LEV_{it} + \varepsilon$$

## 4. Results

Our first analysis examines the association between the board of directors and the inclusion of a company in the MERCO ranking. *REP_RANK* is employed as a dependent variable. This study includes the whole sample of the listed companies on IGBM, regardless whether they were in the ranking elaborated by MERCO or not, which represents 406 firm-year observations.

Descriptive statistics are shown in Table II. The mean of *REP_RANK* is around 0.5; therefore, half of the selected companies are also included on the list of reputable companies. *B_IND* mean is over 35 per cent, and it represents that more than one-third of the directors on the board are independent, which indicates that the companies in the sample comply with the recommendation in the Spanish code of good governance (Comisión Nacional del Mercado de Valores (CNMV), 2006). We also highlight the low

| Variable | Mean | SD | Minimum | Maximum |
|---|---|---|---|---|
| REP_RANK | 0.52 | 0.50 | 0 | 1 |
| B_IND | 35.18 | 17.65 | 0 | 87.50 |
| CEO | 0.65 | 0.48 | 0 | 1 |
| B_WOM | 6.23 | 8.63 | 0 | 44.44 |
| B_ACT | 9.58 | 3.40 | 3 | 27 |
| SIZE | 34.55 | 145.92 | 0.24 | 1,226.83 |
| ROA | 4.04 | 10.38 | −49.31 | 56.84 |
| REP_PRESD | 0.29 | 0.45 | 0 | 1 |
| LEV | 0.66 | 0.192 | 0.047 | 1.082 |

**Notes:** *REP_RANK*, reputation rank is a dummy variable with a value of 1 if a company is included in MERCO ranking and 0 otherwise; *B_IND*, board independence indicates the percentage of independent directors on the board; *CEO*, CEO independence is a dummy variable, with a value of 0 if the *CEO* is also the chairman and 1 otherwise; *B_WOM*, board women indicates the percentage of women on the board; *B_ACT*, board activity indicates the number of board meetings in a year; *SIZE*, firm size is measured by total assets (in million of euros); *ROA*, return on assets; *REP_PRESD*, reputation of the president is a dummy variable, with a value of 1 if the president of the company is included in MERCO Lideres and 0 otherwise; *LEV*, ratio of total debt to total assets. 406 firm-year observations (years 2004-2010)

**Table II.**
Descriptive statistics

presence of women on the board, since the average value is around 6 per cent. Almost two-thirds of the *CEO*s did not occupy the role of chairman of the board and around 30 per cent of the presidents were included on the list of most reputable managers published by MERCO. The number of annual meeting was extremely variable. Finally, although the sample is composed of listed companies, size values and profitability show high variability. The average total debt to total assets ratio is 0.66.

A panel data study for 2004-2010 was carried out through a logistic regression analysis in order to determine the association between board of director characteristics and the likelihood of being included in the reputation ranking. The Hausman test determined the application of a fixed-effect model, and the results are presented in Table III.

First, only control variables are included in the model. Firm size appears as a decisive factor for corporate reputation. Larger companies are more exposed to the market and visibility can be associated to reliability and trustworthiness. Therefore, these companies tend to have a better image, since they are more visible and better

| Explanatory variables | Predicted sign | *REP_RANK* | *REP_RANK* |
|---|---|---|---|
| *Intercept* | | −2.775*** | −3.306*** |
| | | (−4.69) | (−3.58) |
| *B_IND* | + | | −0.004 |
| | | | (−0.38) |
| *CEO* | + | | 0.320 |
| | | | (0.90) |
| *B_WOM* | + | | 0.058*** |
| | | | (3.52) |
| *B_ACT* | + | | 0.005 |
| | | | (0.09) |
| *SIZE* | + | 0.120*** | 0.127*** |
| | | (3.87) | (3.96) |
| *ROA* | ? | 0.021 | 0.025* |
| | | (1.64) | (1.70) |
| *REP_PRESD* | + | 3.236*** | 3.169*** |
| | | (8.78) | (8.39) |
| *LEV* | ? | 1.271 | 1.217 |
| | | (1.45) | (1.22) |
| Pseudo $R^2$ | | 0.493 | 0.517 |
| LR $\chi^2$ statistic | | 277.40 | 290.81 |
| (Prob. $> \chi^2$) | | (0.000) | (0.000) |

Fixed effects model: $REP\_RANK_{it} = \alpha + \beta_1 B\_IND_{it} + \beta_2 CEO_{it} + \beta_3 B\_WOM_{it} + \beta_4 B\_ACT_{it} + \beta_5 SIZE_{it} + \beta_6 ROA_{it} + \beta_7 REP\_PRES_{it} + \beta_8 LEV_{it} + \varepsilon$

**Notes**: *REP_RANK*, reputation rank is a dummy variable with a value of 1 if a company is included in MERCO ranking and 0 otherwise; *B_IND*, board independence indicates the percentage of independent directors on the board; *CEO*, CEO independence is a dummy variable, with a value of 0 if the *CEO* is also the chairman and 1 otherwise; *B_WOM*, board women indicates the percentage of women on the board; *B_ACT*, Board activity indicates the number of board meetings in a year; *SIZE*, firm size is measured by total assets (in million of euros); *ROA*, return on assets; *REP_PRESD*: reputation of the president is a dummy variable, with a value of 1 if the president of the company is included in MERCO Lideres and 0 otherwise; *LEV*: ratio of total debt to total assets. 406 firm-year observations (years 2004-2010). *,**,***Significant at 10, 5 and 1 per cent levels, respectively. *p*-values for the variables with an expected sign are one-tailed, the *p*-values for the other variables are two-tailed

**Table III.**
Logistic regression analysis

known to the public (Rose and Thomsen, 2004). Second, the reputation of the
president of a company is also a decisive factor in terms of its inclusion in the MERCO
ranking. Previous studies document that the CEO is responsible for the creation and
maintenance of corporate reputation (Kitchen and Laurence, 2003; Mintzberg, 1983).
Our evidence sheds some light on the importance of the role of a company's president
since s/he can affect the perceptions of investors and other stakeholders, thus
influencing the global corporate reputation.

Second, the variables regarding the board of directors are also considered
(full model). At this stage, the companies with a high presence of women in their
boardroom are more likely to appear in the reputation ranking. Female directors can
give a new perspective and improve strategy formulation. Agency conflicts may also
be minimized by increased levels of gender diversity, thereby improving a firm's
outcomes. In addition, the role of women in society has become an increasingly relevant
issue, and the need for their presence in boards of directors has been emphasized by
both academics and policymakers (Terjesen *et al.*, 2009). Companies with a higher
number of women in the board of directors may improve the market's perception and
thus influence corporate reputation. The association between the control variables
and corporate reputation remains constant, and the explanatory power of the
model increases.

The second stage of our empirical analysis aims to determine whether the board of
director characteristics are associated with the level of corporate reputation. The
dependent variable *REP_VALUE* measures a company's level of the reputation.
For this study, a regression analysis was performed, considering only firms that were
listed on IGBM and also included in the MERCO index. As a result, the final sample is
made up of 145 firm-year observations.

Table IV shows the descriptive statistics for this reduced sample. Descriptive
statistics of corporate governance variables are similar to the numbers in Table II.
The mean of the variable reputation of the president indicates that 80 per cent of the

| Variable | Mean | SD | Minimum | Maximum | VIF |
|---|---|---|---|---|---|
| REP_VALUE | 118.14 | 65.94 | 35.75 | 299.65 | |
| B_IND | 36.62 | 16.36 | 6.67 | 80 | 1.332 |
| CEO | 0.80 | 0.40 | 0 | 1 | 1.141 |
| B_WOM | 7.51 | 8.91 | 0 | 33.33 | 1.175 |
| B_ACT | 10.01 | 3.89 | 4 | 27 | 1.329 |
| SIZE | 26.97 | 33.92 | 0.25 | 155.86 | 1.360 |
| ROA | 5.28 | 7.27 | −21.68 | 43.53 | 1.252 |
| REP_PRESD | 0.80 | 0.40 | 0 | 1 | 1.049 |
| LEV | 0.73 | 0.136 | 0.269 | 0.975 | 1.351 |

Notes: *REP_VALUE*, reputation value is a relative measure which takes the average reputation value
as a reference of 100 points; *B_IND*, board independence indicates the percentage of independent
directors on the board; *CEO*, CEO independence is a dummy variable, with a value of 0 if the *CEO* is
also the chairman and 1 otherwise; *B_WOM*, board women indicates the percentage of women on the
board; *B_ACT*, board activity indicates the number of board meetings in a year; *SIZE*, firm size is
measured by total assets (in million of euros); *ROA*, return on assets; *REP_PRESD*: reputation
of the president is a dummy variable, with a value of 1 if the president of the company is included in
MERCO Lideres and 0 otherwise; *LEV*: ratio of total debt to total assets. 145 firm-year observations
(years 2004-2010)

Table IV.
Descriptive statistics

presidents of firms that are in the corporate reputation rankings are included in MERCO Líderes. This value is significantly higher than that obtained for the whole sample in Table II, and consequently, a clear effect of the president of a firm on its corporate reputation is initially found. The VIF coefficients are presented in Table IV and, since their value ranges from 1.049 to 1.360, the lack of multicollinearity among the variables is confirmed.

Table V summarizes the results of the multivariate regression analysis. The Hausman test confirmed that the application of a fixed-effect model is better than an approach based on random effects. The model was estimated for panel data for seven years (2004-2010) using intercept dummies for individual years to capture fixed effects (Greene, 1997, p. 621) and therefore minimize temporal effects.

Initially, only the control variables are included in the regression analysis (Model 1 in Table V). Bigger companies and companies with a president that is included in MERCO líderes rank higher in the reputation index. These findings corroborate the results found in the previous analysis. Firm size and the image of the president of a company consistently appear as determinants of corporate reputation.

The inclusion of the variables related to the board of directors enhances the explanatory power of the model up to 34.1 per cent (Model 2 in Table V). Both board independence and board gender are positively associated to the level of corporate reputation. The value of the coefficient on the $B\_IND$ is 0.449, significant at 5 per cent and the value on the $B\_WOM$ variable is 1.287, also significant at 5 per cent. The significance of these variables indicates that the characteristics of the boards of directors that are in line with the recommendations of the codes of good governance are positively associated with corporate reputation. Companies that are on top of MERCO rankings tend to have a higher percentage of independent directors and more female directors on their boards. Previous research has found that directors provide valuable expertise, advice, counsel to firms and can also increase a firm's credibility (Lester *et al.*, 2008). In particular, independent directors are more likely to protect stakeholders' interests. They can help minimize agency conflicts and achieve better outcomes, and therefore companies with a higher proportion of independent directors are more valued in terms of reputation. These results are consistent with *H1b*. Our results also suggest a positive association between the presence of women on the board and corporate reputation, as discussed above. Companies with a higher percentage of female directors are not only more likely to appear in the reputation ranking, but these companies also receive a greater reputation score. These results confirm *H2*.

Furthermore, endogeneity issues were addressed in order to enhance the study's internal validity. One of the most common solutions is to use instrumental variables (Larcker and Rusticus, 2010). The applicability of a two-stage estimation procedure was studied, but this method had to be discarded due to the impossibility of finding appropriate instruments associated with the board variables but not with the reputation variable. As Wintoki *et al.* (2012) indicate, it is very difficult to find strictly exogenous instruments in corporate governance research.

An alternative solution is the generalized method of moments, which has been widely used in the literature to solve endogenity issues (Acero and Alcalde, 2012a, b; García-Ramos and García, 2011; Wintoki *et al.*, 2012). However, it was not possible to use it in our case due to the limited sample size.

Finally, the endogenity issue was addressed by accounting for the fact that a firm's corporate governance history affects its current reputation. A third model was introduced in Table V where the board variables are lagged. Model 3 in Table V shows

| Explanatory variables | Predicted sign | Model 1 | Model 2 | Model 3 |
|---|---|---|---|---|
| *Intercept* | | 90.685*** | 57.040* | −44.900 |
| | | (3.28) | (1.85) | (−1.62) |
| B_IND | + | | 0.449** | |
| | | | (2.24) | |
| CEO | + | | −1.372 | |
| | | | (−0.21) | |
| B_WOM | + | | 1.207** | |
| | | | (2.41) | |
| B_ACT | + | | −0.687 | |
| | | | (−0.08) | |
| B_IND$_{t-1}$ | + | | | 0.414** |
| | | | | (1.75) |
| CEO$_{t-1}$ | + | | | −0.481 |
| | | | | (−0.07) |
| B_WOM$_{t-1}$ | + | | | 1.004* |
| | | | | (1.66) |
| B_ACT$_{t-1}$ | + | | | −0.612 |
| | | | | (−0.55) |
| SIZE | + | 0.528*** | 0.409*** | 0.416*** |
| | | (4.58) | (3.35) | (3.34) |
| ROA | ? | −1.368 | −1.06 | −2.367 |
| | | (−1.60) | (−1.26) | (−2.61) |
| REP_PRESD | + | 18.260*** | 14.069** | 17.440*** |
| | | (2.90) | (2.19) | (2.37) |
| LEV | ? | 7.954 | 28.396 | 24.972 |
| | | (0.24) | (0.82) | (0.69) |
| Adjusted $R^2$ | | 0.280 | 0.341 | 0.425 |
| $F$ (*p*-value) | | 10.72 | 6.85 | 18.27 |
| | | (0.000) | (0.000) | (0.000) |
| White's test ($\chi^2$) (*p*-value) | | 14.77 | 48.62 | 48.40 |
| | | (0.322) | (0.223) | (0.230) |

Fixed effects model: Model 1: $REP\_VALUE_{it} = \alpha + \beta_1 SIZE_{it} + \beta_2 ROA_{it} + \beta_3 REP\_PRES_{it} + \beta_4 LEV_{it} + \varepsilon$
Model 2: $REP\_VALUE_{it} = \alpha + \beta_1 B\_IND_{it} + \beta_2 CEO_{it} + \beta_3 B\_WOM_{it} + \beta_4 B\_ACT_{it} + \beta_5 SIZE_{it} + \beta_6 ROA_{it} + \beta_7 REP\_PRES_{it} + \beta_8 LEV_{it} + \varepsilon$
Model 3: $REP\_VALUE_{it} = \alpha + \beta_1 B\_IND_{it-1} + \beta_2 CEO_{it-1} + \beta_3 B\_WOM_{it-1} + \beta_4 B\_ACT_{it-1} + \beta_5 SIZE_{it} + \beta_6 ROA_{it} + \beta_7 REP\_PRES_{it} + \beta_8 LEV_{it} + \varepsilon$

**Notes:** *REP_VALUE*, reputation value is a relative measure which takes the average reputation value as a reference of 100 points; *B_IND*, board independence indicates the percentage of independent directors on the board; *CEO*, CEO independence is a dummy variable, with a value of 0 if the CEO is also the chairman and 1 otherwise; *B_WOM*, board women indicates the percentage of women on the board; *B_ACT*, board activity indicates the number of board meetings in a year; *B_IND*$_{t-1}$, board independence in the year *t*-1; *CEO*$_{t-1}$, CEO independence in the year *t*-1; *B_WOM*$_{t-1}$, board women in the year *t*-1; *B_ACT*$_{t-1}$, board activity in the year *t*-1; *SIZE*, firm size is measured by total assets (in million of euros); *ROA*, return on assets; *REP_PRESD*, reputation of the president is a dummy variable, with a value of 1 if the president of the company is included in MERCO Líderes and 0 otherwise; *LEV*, ratio of total debt to total assets. 145 firm-year observations for Models 1 and 2; 113 firm-year observations for Model 3 (years 2004-2010). A White's test is used to test the null hypothesis that the variance of the residuals is homogeneous. *,**,***Significant at 10, 5 and 1 per cent levels, respectively. *p*-values for the variables with an expected sign are one-tailed, the *p*-values for the other variables are two-tailed

**Table V.**
Multivariate analysis

how corporate reputation of the current year is influenced by governance structures from the previous year. The results confirm that a higher percentage of independent directors and female directors in the previous year is positively associated with the level of corporate reputation in the current year. In addition, the possible simultaneity is solved in Model 3 as it is impossible that current reputation affects past board characteristics. In addition, control variables in the current year will not be associated with past board characteristics.

## 5. Sensitivity analyses and additional tests

As a sensitivity analysis, additional measures of size and firm performance were considered. A total sales (*SALES*) variable was used as a proxy for firm size, and the market-to-book ratio (*MTB*) was employed to measure financial performance. Table VI presents the results of this analysis for the logistic and the multivariate regressions. These new variables were both individually and simultaneously included in the regressions, and the results remained constant.

In addition, a more in-depth analysis was performed in order to study how firm size and profitability interact with the board of director variables. Table VII shows the results of this analysis for both the logistic regression and the multivariate regression. The results from the logistic regression indicate that firm size and profitability clearly moderate the relationship between the board of director characteristic and corporate reputation. The inclusion of a firm in the reputation ranking is highly determined by its size. The board of directors of bigger companies appears as a non-significant variable for the determination of corporate reputation. Regardless of the structure of their board of directors, larger firms take advantage of their visibility to influence the perception that the markets have of them and maximize their reputation. On the other hand, the boards of directors in firms with a better profitability play a more important role in the determination of corporate reputation. Board independence, as well as gender diversity, contributes to the inclusion of a firm in the reputation ranking. For these companies, the boards of directors appear to be more visible and influential in terms of corporate reputation.

However, the results from the multivariate regression are slightly different. In general, the isolated effect of board variables is greater that the joint effect together with firm size and profitability. Board independence, and specially gender diversity, are decisive factors relating to a firm's level of reputation, regardless its size and profitability.

## 6. Concluding remarks

The aim of this paper was to test the association between corporate governance characteristics and corporate reputation. Based on agency theory and resource dependence theory several board of director characteristics were selected. The reputation ranking provided by MERCO was used to measure corporate reputation. Logistic and multivariate regression analyses were performed in order to determine whether the board of director characteristics could be associated with both the likelihood of the company being included in the reputation ranking published by MERCO and the level of corporate reputation.

The most reputable companies are more likely to have more female directors on their board. Results also show that companies that appear on top of the reputation ranking tend to have a higher percentage of independent directors and more female

| Explanatory variables | Predicted sign | Logistic regression (406 firm-year observations) | | | Multivariate regression (145 firm-year observations) | | |
|---|---|---|---|---|---|---|---|
| | | REP_ RANK | REP_ RANK | REP_ RANK | REP_ VALUE | REP_ VALUE | REP_ VALUE |
| Intercept | | −3.952*** | −2.337*** | −3.244*** | 41.422*** | 34.228 | 15.792 |
| | | (−4.12) | (−2.61) | (−3.45) | (1.35) | (1.38) | (0.65) |
| B_IND | + | −0.000 | −0.006 | −0.003 | 0.510** | 0.456** | 0.518** |
| | | (−0.08) | (2.27) | (−0.28) | (2.53) | (2.27) | (2.56) |
| CEO | + | 0.178 | 0.308 | 0.169 | −0.707 | −0.710 | 0.102 |
| | | (0.49) | (0.87) | (0.46) | (−0.11) | (−0.11) | (0.02) |
| B_WOM | + | 0.058*** | 0.059*** | 0.060*** | 1.277** | 1.265** | 1.365*** |
| | | (3.45) | (3.57) | (3.47) | (2.50) | (2.52) | (2.68) |
| B_ACT | + | 0.044 | −0.000 | 0.043 | −0.090 | −0.073 | −0.097 |
| | | (0.83) | (−0.01) | (0.81) | (−0.10) | (−0.08) | (−0.11) |
| SIZE | + | | 0.133*** | | | 0.401*** | |
| | | | (4.07) | | | (3.24) | |
| SALES | + | 0.449*** | | 0.462*** | 0.825*** | | 0.781*** |
| | | (4.64) | | (4.76) | (2.82) | | (2.62) |
| ROA | ? | 0.019 | | | −1.204 | | |
| | | (1.25) | | | (−1.40) | | |
| MTB | ? | | −0.476 | −0.389 | | 4.346 | 4.268 |
| | | | (−1.44) | (−1.17) | | (0.69) | (0.67) |
| REP_PRESD | + | 3.267*** | 3.057*** | 3.170*** | 14.632*** | 13.573** | 14.086** |
| | | (8.49) | (8.31) | (8.52) | (2.24) | (2.10) | (2.14) |
| LEV | ? | 1.200 | 0.554 | 0.700 | 46.300 | 48.317 | 69.215** |
| | | (1.17) | (0.55) | (0.67) | (1.35) | (1.61) | (2.36) |
| Adjusted $R^2$ | | 0.535 | 0.516 | 0.535 | 0.322 | 0.334 | 0.312 |
| $F$ ($p$-value) | | 300.81 | 290.31 | 300.80 | 6.29 | 6.64 | 6.01 |
| | | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) | (0.000) |

**Notes:** REP_RANK, reputation rank is a dummy variable with a value of 1 if a company is included in MERCO ranking and 0 otherwise; REP_VALUE, reputation value is a relative measure which takes the average reputation value as a reference of 100 points; B_IND, board independence indicates the percentage of independent directors on the board; CEO, CEO independence is a dummy variable, with a value of 0 if the CEO is also the chairman and 1 otherwise; B_WOM, board women indicates the percentage of women on the board; B_ACT, board activity indicates the number of board meetings in a year; SIZE, firm size is measured by total assets (in million of euros); ROA, return on assets. SALES, firm size is measured by total sales (in million of euros); MTB, market-to-book ratio; REP_PRESD, reputation of the president is a dummy variable, with a value of 1 if the president of the company is included in MERCO Líderes and 0 otherwise. LEV, ratio of total debt to total assets. *,**,***Significant at 10, 5 and 1 per cent levels, respectively. $p$-values for the variables with an expected sign are one-tailed, the $p$-values for the other variables are two-tailed

**Table VI.**
Sensitivity analysis
– logistic and
multivariate
regressions (years
2004-2010)

directors on their board. In addition, firm size is associated with corporate reputation. Larger firms are more visible and better known by society, and this can influence their image in the market. The image of the president of a company is also linked to the reputation of the company itself.

These findings shed some light on the value of board of directors. Companies may have incentives to improve corporate governance mechanisms since corporate reputation is an intangible resource associated with many potential benefits for firms. The results have direct implications for the management of corporate governance mechanisms by shareholders who should take into account its role in the creation and

| Explanatory variables | Logistic regression (406 firm-year observations) | | Multivariate regression (145 firm-year observations) | |
|---|---|---|---|---|
| | REP_RANK | REP_RANK | REP_VALUE | REP_VALUE |
| Intercept | −2.745*** | 0.002** | 75.161*** | 78.513*** |
| | (−4.55) | (2.40) | (2.83) | (3.46) |
| B_IND × SIZE | 0.002 | | 0.008*** | |
| | (1.54) | | (3.52) | |
| CEO × SIZE | 0.026 | | 0.047 | |
| | (0.41) | | (0.31) | |
| B_WOM × SIZE | 0.000 | | 0.017* | |
| | (0.18) | | (1.72) | |
| B_ACT × SIZE | 0.005 | | −0.006 | |
| | (0.93) | | (−0.049) | |
| B_IND × ROA | | 0.002** | | 0.005 |
| | | (2.40) | | (0.22) |
| CEO × ROA | | −0.053* | | −0.461 |
| | | (−1.71) | | (−0.54) |
| B_WOM × ROA | | 0.004** | | 0.079* |
| | | (2.56) | | (1.53) |
| B_ACT × ROA | | −0.001 | | −0.143 |
| | | (−0.52) | | (−1.48) |
| SIZE | | 0.110*** | | 0.495*** |
| | | (3.63) | | (4.21) |
| ROA | 0.021 | | −0.996 | |
| | (1.57) | | (−1.20) | |
| REP_PRESD | 3.192*** | 3.418*** | 19.153*** | 17.695*** |
| | (8.45) | (8.62) | (3.16) | (2.81) |
| LEV | 1.133 | 2.218** | 30.849 | 23.809 |
| | (1.25) | (2.23) | (0.97) | (0.73) |
| Adjusted $R^2$ | 0.503 | 0.518 | 0.358 | 0.303 |
| $F$($p$-value) | 283.12 | 291.59 | 8.52 | 6.64 |
| | (0.000) | (0.000) | (0.000) | (0.000) |

**Notes:** REP_RANK, reputation rank is a dummy variable with a value of 1 if a company is included in MERCO ranking and 0 otherwise; REP_VALUE, reputation value is a relative measure which takes the average reputation value as a reference of 100 points; B_IND, board independence indicates the percentage of independent directors on the board; CEO, CEO independence is a dummy variable, with a value of 0 if the CEO is also the chairman and 1 otherwise; B_WOM, board women indicates the percentage of women on the board; B_ACT, board activity indicates the number of board meetings in a year; SIZE, firm size is measured by total assets (in million of euros); ROA, return on assets. REP_PRESD, reputation of the president is a dummy variable, with a value of 1 if the president of the company is included in MERCO Líderes and 0 otherwise. LEV, ratio of total debt to total assets. *,**,***Significant at 10, 5 and 1 per cent levels, respectively

**Table VII.**
Interaction analysis – logistic and multivariate regressions (Years 2004-2010)

maintenance of corporate reputation and therefore in the value of their investments. Furthermore, our evidence extends previous findings in this research area, by highlighting the role that the president of the company may play in the market's perception of her or his firm.

This paper provides interesting insights into the association between corporate governance and corporate reputation. However, a number of potential future research lines can be identified. The impact of specific company director traits (such as CEO experience or directors' expertise) and ownership structure on corporate reputation may be an interesting line of future research.

## Notes

1. www.hillandknowlton.com/about

2. The analysis was actually performed by Hill and Knowlton in 2001. More than 1,000 questionnaires were completed by business executives from eight nations.

3. The analysis was performed through 282 telephone interviews with buy and sell-side analysts, from all over the world, with over two years experience.

4. www.merco.info/es/countries/4-es

5. Additional variables were also considered (industry and firm age) but they appeared as non-significant variables. Furthermore, due to multicollinearity problems, they were excluded from the statistical models.

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