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Buy the Book But Not the Stock: The Relationship Between Human Resource Reputation and Corporate Performance

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In the end, it appears that it is more important to utilize one's human resources effectively than it is to be included on the "best" or "most admired" lists of the various business observers who create and disseminate these reputation signals. Indeed, the vast majority of the corporate and human resource reputation signals studied had no effect on either short or long term performance. However, a human resource management effectiveness indicator (net income per employee) was observed to be positively related to the annual shareholder return performance measure suggesting that it is better to be good than to just look good.

Keywords

CAHRS, ILR, center, human resource, studies, advance, relationship, management, financial performance, shareholder, employee, manage

Comments

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**BUY THE BOOK BUT NOT THE STOCK:
THE RELATIONSHIP BETWEEN HUMAN RESOURCE REPUTATION
AND CORPORATE PERFORMANCE**

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WORKING PAPER #92-32

This paper has not undergone formal review or approval of the faculty of the ILR School. It is intended to make results of Center Research, conferences, and projects available to others interested in human resource management in preliminary form to encourage discussion and suggestions.

Abstract

Building upon the tenets of Signaling Theory, Spence (1974), this paper introduces the concept of human resource management reputation signals and examines the effects of these signals on the financial performance of over 500 organizations. Numerous human resource, and overall corporate, reputation signals which have appeared in the popular business press are examined to ascertain their effects on two performance measures, the abnormal shareholder returns which occur either side of the announcement of these signals and the annual returns to shareholders in the year in which they are made public.

In the end, it appears that it is more important to utilize one's human resources effectively than it is to be included on the "best" or "most admired" lists of the various business observers who create and disseminate these reputation signals. Indeed, the vast majority of the corporate and human resource reputation signals studied had no effect on either short or long term performance. However, a human resource management effectiveness indicator (net income per employee) was observed to be positively related to the annual shareholder return performance measure suggesting that it is better to be good than to just look good.

Digital Equipment Corporation announces its first ever layoffs; about 3,500 expected by mid-year (Wall Street Journal, January 10, 1991). Merck is named as the most admired corporation in America for the fourth straight year (Fortune, February 11, 1991). Herman Miller is cited in two best selling employment guides.

Signals such as these abound in the marketplace, but the question is, do they matter, and to whom? Do they influence the attitudes and behaviors of a company's stockholders, applicants, employees, customers, potential owners, owners, or security analysts? On the other hand, do observers discount this information, or dismiss it altogether, because it is common knowledge or originates from unknown or unreliable sources?

This study examines whether any relationship exists between an organization's human resource reputation and its financial performance by examining the effects of an array of corporate and human resource reputation signals on corporate performance. To explore the effects that reputation has on performance, this research invokes a signaling perspective (Spence, 1974). Consider the case of an organization "officially designated" as a "great" place to work. As a result, would potential owners, owners, and security analysts reason that the firm would be able to attract a broader and deeper applicant pool from which to select employees? Would they surmise that this increased selectivity will translate into an improved work force and, in turn, better financial performance at the individual, group, business unit, or firm level? Most importantly, would the prospect of improved performance induce potential owners to pay more for a share of stock, while current owners simultaneously increase their selling prices, resulting in increased demand, decreased supply, and, thus, a higher equilibrium price?

We examined this relationship with three goals in mind: (1) to review a set of related theoretical perspectives that pertain to reputation and evaluate their usefulness for understanding the concept of reputation in general, and extend them to include human resource reputation, (2) to scrutinize the conjecture found in the business press--which asserts that reputation and financial

performance are inextricably linked, and (3) to extend the reputation-performance model by examining the relationship between human resource reputation and corporate performance.

Theoretical perspectives on organizational reputation emanate from a host of social science and managerial disciplines. For example, accountants use the concept of goodwill to explain and value reputation (Munn, 1983), marketers manage reputations through institutional advertising (Borden, 1942), and economists examine the role of reputation as a controlling and optimizing mechanism (Carmichael, 1984; Fama, 1980; Spence, 1974).

The business press, too, cites the need for companies to create and maintain good reputations (Fortune, 1983-1991). Indeed, business pundits assert that a favorable reputation will attract employees, customers, lenders, and stockholders, while an unfavorable reputation will send these parties fleeing to the competition.

Several empirical studies of reputation have been reported recently. Most have focused primarily on the determinants of corporate reputation (Fombrun & Shanley, 1990; McGuire, Schneeweis, & Branch, 1990). These researchers have struggled with both the definition and measurement of reputation. To date, all of the published studies rely on one, single-item measure of reputation--created, measured, and collected by Fortune (1983-1991). The effect that reputation has on corporate performance, however measured, remains a riddle.

This study is markedly different from the earlier research. First, it calls upon a number of theoretical perspectives in the social sciences. Then, it coalesces around one suggesting that reputation announcements are signals (Spence, 1974), signals that help alleviate bounded rationality problems by reducing decision maker's information searches and lessening their cognitive loads (Simon, 1957). Second, it moves beyond relying on Fortune's single-item measure of corporate reputation to include other pertinent reputation signals including designations such as: "a best company for working mothers," "a best company for women," and "a best company for blacks." Third, this study employs an event study methodology to estimate the reputation-

performance relationship more precisely. This methodology⁰ captures the immediate impact of reputation signals on stock market performance.

Fourth, we analyze the most recent reputation data available. Through an agreement¹ with the publishers of Fortune, reputation data for 1983-1989 were obtained and incorporated into this analysis.

Equation 1 expresses the generic model that under girds this study. It represents the relationship between human resource reputation and corporate performance while controlling for the effects of: overall corporate reputation, human resource performance, and corporate accounting performance.

$$(1) CP_{t_0-t+n} = f(HRR_{t_0}, CR_{t_0}, HRP_{t-1}, CP_{t-1})$$

where:

CP_{t_0-t+n} = Corporate Financial Performance succeeding a HR reputation signal announcement (t_0-t+n)

HRR_{t_0} = Human Resource Management Reputation Signal(s) at t_0

CR_{t_0} = Corporate Reputation Signal(s) at t_0

HRP_{t-1} = Human Resource Management Performance at $t-1$

CP_{t-1} = Corporate Accounting Performance at $t-1$

In the sections that follow, we review the three relevant literatures that address the reputation signaling phenomenon (theoretical, practical, and empirical). They all hold that (1) reputation is influential, (2) favorable reputations generate positive outcomes, and (3) unfavorable reputations invoke negative ones. Then we explicate our model and the study's three hypotheses.

⁰See: Brown and Warner, 1980, 1985; Fama, Fisher, Jensen, and Roll, 1969; Bowman, 1983; Ball and Brown, 1968.

¹Fortune writes, "We cannot grant permission for you to reprint the material in its entirety, either by individual year or historically, as 1983-1989."

The research design is outlined next and the results follow. In the final section we present our conclusions, revisit and recast the theoretical perspectives employed, and raise future research issues.

THE IMPORTANCE OF REPUTATION

Corporate reputation has been defined as the collective judgment of the organization's overall character by groups of similarly interested and informed people that are based primarily on the past actions of the firm (DiMaggio and Powell, 1983; Fombrun and Shanley, 1990). Some scholars suggest that the varied, multiple constituencies of individual managers (e.g., superiors, peers, and subordinates) and operating units like the human resource management department (e.g., line managers, union officials, and government agencies) render reputation assessments too (Tsui, 1984; 1987; 1990). Moreover, there is some evidence that reputational effectiveness, when it is not interpreted a measure of performance itself, is positively related to other, more conventional, measures of performance (Tsui, 1984; 1987). All to say, reputation, be it that of an individual, a business function, or an organization, has been a topic of interest of late and throughout history.

The origins of the notion of reputation are murky, but it is often referred to. Cicero claimed, "To disregard what the world thinks of us is not only arrogant but utterly shameless,"² Napoleon noted that, "a great reputation is a great noise: the more there is made, the farther off it is heard,"³ and Proverbs proclaims (22:1), "a good name is more desirable than riches." Individuals, groups, and societies, understandably, define reputation for their own purposes. Websters (1979) defines reputation as follows:

²Stevenson (1988, p. 1700)

³Ibid.

Reputation n 1 a: overall quality or character as seen or judged by people in general b: recognition by other people of some characteristic or ability <has the ~ of being clever > 2: a place in public esteem or regard: good name.

The business press, often expresses corporate reputation in what appears to be multidimensional terms. For example, Fortune's (1983-1991) annual, intra-industry survey obtains reputation assessments on eight dimensions from some 8,000⁴ executives, directors, and security analysts. These eight dimensions are: Quality of Management; Quality of Products or Services; Innovativeness; Social Responsibility; Long-term Investment Value; Financial Soundness; Use of Corporate Assets; and Ability to Attract, Keep, and Develop Talent. This survey provides the data for an annual "Most Admired Companies in America" feature story.⁵ Indeed, Fortune's reputation rankings, for the 10 largest firms in 30 industries, appear to be salient, indeed important, to the business community, especially those ranked among the best.

Not surprisingly, these highly ranked companies bring this favorable information to the attention of their owners, investors, employees, and job applicants. Merck, for example, touts its stellar image whenever and wherever possible. In one annual report (Merck, 1987), the company revealed that it: was named as America's most admired corporation for the second year in a row (Fortune, January 18, 1988), had been designated the most innovative company in the pharmaceutical industry (Forbes, January 11, 1988), was recognized as one of the five best managed companies (Business Month, December 1987), had one of its products selected as a product of the year (Fortune, December 7, 1987), had its sales force named the best in the pharmaceutical industry (Sales and Marketing Management, June 1987), had been cited as one of the best U.S. companies for working mothers (Working Mother, August 1987), and was described as one of the best companies in public service (Business Week, January 11, 1988).

⁴The response rate for this survey averages about 50%, some 4,000 responses. If these are equal across industries, there are approximately 133 replies for each industry group (e.g. retailing, furniture, etc.)

⁵Published in mid-January annually since 1983.

Merck communicates this information through other media as well. Job applicants across the country receive copies of Fortune's "most admired" article and an excerpt from the 100 Best Companies to Work For book. There is even a billboard outside Merck's corporate headquarters in recognition of the company being named *the* most admired corporation for five years running (1986-1991).

Academic researchers have also examined the notion of corporate reputation. To date, they have focused more on the determinents side of the equation and have concluded that reputation is, in part, a function of financial performance. In summary, a wide array of business participants, observers, and researchers have addressed the corporate reputation issue and they all share two basic conclusions: reputation *should* be important and often *it is*.

Why HR Reputation Might Be Important

Importance to prospective employees. Stigler (1962), in his work on the acquisition of information in the labor market, claims that job applicants face a "problem of how to acquire information on the wage rates, stability of employment, conditions of employment, and other determinants of job choice, and how to keep this information current" (p. 94). Newspaper advertisements and "the myriad forms of pooling of information" (p. 102) are among these sources.

Undoubtedly, this demand for labor market information is manifest in the recent publication of a host of employment guides including: The Best 100 Companies to Work For (Levering, Moskowitz, and Katz, 1984), The Best Companies for Women (Zietz and Dusky, 1988), "The Best Companies for Blacks" (Black Enterprise, February 1982; 1986), and "The N.S.B.E. 100" (National Society of Black Engineers, November 1990).

The sales of these guides and the reputation afforded to the organizations who make these "lists" provides some evidence that HR policies influence corporate reputation judgments. These works evaluate companies on different sets of criteria such as equal employment, compensation, benefits, employee relations, recruitment, selection, and promotional opportunities.

Furthermore, there is some empirical evidence that suggests that corporate image affects employee attitudes and behaviors (Acito and Ford, 1980). A related study reported that people were more likely to pursue employment with "high" image companies than with "low" image ones (Belt and Paolillo, 1982).

Importance to employers. Some posit that cultivating a good reputation in the mind's eye of employees and prospects helps firms attract broader and deeper applicant pools (Rynes and Barber, 1990). For example, I.B.M. recently commissioned a study to examine its reputation in contrast to those of its competitors (Towers, Perrin, Foster, & Crosby, 1989).

Importance to others. To be sure, employees, job applicants, and competitors are not the only parties rendering and reacting to reputation judgments. Customers and potential customers are also among those who factor information pertaining to firms' human resource policies and practices into their reputation judgments. Indeed, some suggest that these judgments may, or should, influence the decision to buy (Lydenberg, Marlin, and Strub, 1986).

THE CONCEPT OF REPUTATION IN THE SOCIAL SCIENCES

The Effects of Reputation

Theorists from a variety of academic disciplines all posit that reputation impacts the affairs of individuals and organizations. In general, they concur on another premise as well: favorable reputations evoke positive outcomes and unfavorable ones have the opposite effect.

For example, the notion of goodwill (see Munn, 1983) holds that as the reputation of the firm improves, so too will the premium that investors are willing to pay for an ownership stake. Conversely, a tarnished reputation will erode or eliminate this premium. In the worst scenario, short of going out of business, the equities markets affix a lower value to the firm than the accurately and reliably computed value of its physical assets.

In the employee selection process, signaling theory (Spence, 1974) suggests that in the absence of observable factors, candidates who possess and resonate superior reputations stand to improve their employment chances. Alternatively, if reputation is a phenomenon that is observable and measurable, screening theory also suggests that a favorable reputation will increase the likelihood of being hired (see Stiglitz, 1975). Furthermore, Fama (1980) asserts that the labor market has a built-in mechanism to reward those with good reputations and punish those without.

On the other hand, when prospective employees look at an organization, the firm's reputation may serve as a substitute for an explicit contract between the corporation and its employees (Carmichael, 1984; Rousseau, 1990). Reputations influence consumers too--and favorable reputations are likely to translate into improved sales (Borden, 1942). He also suggests that corporate advertising helps remedy public relations problems and improves employee morale. Corporate partners, when assessing the value to be gained from coordinating their efforts, also render reputation judgments (Pfeffer, 1976). Individuals, too, make judgments about one and other, based on reputations. Indeed, some believe that favorable reputations translate into power, prestige, and influence (Carnegie, 1936; Goffman, 1959; Jones, 1964; Jones and Wortman, 1973; and Wortman and Linsenmeier, 1977).

Reputation from the Signaling Perspective

It should be clear by now that various theoretical perspectives in the social sciences help to explain why and how HR reputation might matter in the affairs of an organization. Among these different perspectives, signaling theory (Spence, 1974) appears to be the most parsimonious in that it is easily applied at the organization level, holds that reputation plays a role in exchanges between organizations and individuals, and predicts that favorable reputations will be related to positive outcomes and unfavorable reputations will be associated with negative ones.

Signaling theory's (Spence, 1974) basic premise is that sometimes complete and accurate information for the prediction of an individual's future productivity is unobtainable. So, people

undertake certain actions that are observable and measurable to signal, albeit imperfectly, their value. Creating and maintaining a favorable reputation may be one such action.

Specifically, Spence (1974) posited that an investment in education could serve as a signal. In such a setting, a job applicant sends what he hopes will be a favorable, informative signal (the acquisition of a college degree, for example) to an employer who, in turn, receives, interprets, and acts upon this signal. Essentially, the employer formulates a set of beliefs about the relationship between the applicant's educational accomplishment and his future productivity, and then makes a wage offer based on education level. Therefore, prospective employees invest in education to signal their ability and to enhance their competitive position. The degree to which these signals confirm the employer's presuppositions over time determines the weight the employer will affix to them in the future.

In this study, the original roles are switched. Here, it is the organization that creates and maintains reputation signals, and it is the stakeholders who receive, interpret, and act upon the signals. As noted, job applicants and shareholders are but two of the stakeholder groups these signals influence. Also, note that extending the notion of signaling to an organization is not new. Others have suggested that organizations create and send signals to various constituencies. For instance, Meyer (1979) argues that an organization's structure sends a signal to its external parties. Likewise, Kihlstrom and Riordan (1984) identify corporate advertising as a viable mechanism for firms to use to signal to their various constituencies.

It is imperative to mention one fundamental assumption for this study, the efficient markets hypothesis⁶ (Fama, 1970). This paradigm, which focuses on the release and dissemination of new information, suggests that any reputation signal that carries new information to the capital, labor, or product markets *will* influence the behaviors of market participants and it will do so immediately. All to say, positive (negative) changes in reputation that make their way

⁶Arguments in favor of the efficient markets hypothesis abound. Fama's is the clearest and, probably, the most widely cited. For a summary of studies which have allegedly weakened this hypothesis see Bromiley, Govekar, and Marcus (1988).

to the markets should immediately raise (lower) the value of the firm's stock in financial markets, increase (decrease) its attractiveness as an employer in labor markets, and increase (decrease) its sales in product markets.

THE CONCEPT OF REPUTATION IN THE BUSINESS PRESS

Reputation, and the assertion that it may have a tangible value, has taken on increased importance in the business and managerial press in the last decade (Rock, 1984).⁷ Prescriptive guides, written to help build and maintain corporate reputations, and descriptive assessments, developed to measure and compare reputations, have appeared in ever increasing numbers. Table 2 lists some of the corporate and HRM reputation signals that have appeared in the business press.

Prescriptive Works

Corporate reputation "how to" manuals began to emerge in the 1980's. These works, which have originated primarily in advertising and public relations (Dowling, 1986; 1988; Gray, 1986; Garbett, 1988), often substitute the term "image" for "reputation." Collectively, they maintain that organizational reputation is an asset that must be managed. They provide prescriptions for the creation, tracking, maintenance, and improvement of corporate reputation. Not surprisingly, each volume proposes a related, yet somewhat unique, set of strategies for building an exemplary corporate reputation. Specific suggestions for reputation embellishment include: changing the name of the company (Garbett, 1988), conducting a reputation audit among employees and customers (Dowling, 1986), and instituting effective external communications programs (Gray, 1986).

⁷Rock, the publisher of Mergers and Acquisitions, poses and calls for dialogue on a fundamental question, "Can any portion of corporate value be attributed to a company's public posture--its image, reputation, visibility, or recognition factor?"

Table 2 Conjecture in the press.

Corporate Reputation Signals	Source	Format	Sample	Criteria	Scale ¹	Year(s) ²
<u>All Stakeholders</u>						
"Most Admired"	<u>Fortune</u>	Periodical	300	8	0-10	1983-91
"Recognizable & Reputable"	<u>Wall Street Journal</u>	Newspaper	800	4	1-5	1984-91
"Excellent"	Peters & Waterman	Book	43	7	0,1	1982
"Best Managed"	<u>Business Month</u>	Periodical	5	1	0,1	1972-90
"Quality Management"	US Dept. Commerce	Ceremony	6	7	0,1	1988-91
"Best & Worst"	<u>Mother Jones</u>	Periodical	20	1	0,1	1985
"Most Important"	Peters	Newspaper	20	1	0,1	1988
<u>Customers</u>						
"Winners"	Brouillard	Report	45	18	0-5	1988
"Socially Responsible"	Lydenberg et al.	Book	200	7	0-4	1986
"Best Service"	Zemke & Schaaf	Book	101	1	0,1	1989
"Best Sales Forces"	<u>Sales & Mktg. Mgmt.</u>	Periodical	100	7	1-10	1984-90
<u>Owners</u>						
"Best to Own"	Walden	Book	100	5	0,1	1989
"Best for Shareholders"	United Shareholders	Report	1000	3	1-1000	1989-90

¹ In spite of some of these assessments using several criteria, the essential reputation signal is inclusion on a "best" list. Thus the 0,1 designation.

² If more than one year is indicated then the reputation signal is released annually. Otherwise, the year indicated is the first one in which the signal appears.

Table 2 Conjecture in the press (continued.).

HR Reputation Signals	Source	Format	Sample	Criteria	Scale ¹	Year(s) ²
<u>All Stakeholders</u>						
"Most Admired"	<u>Fortune</u>	Periodical	300	1	0-10	1983-91
"Most Innovative HRM"	Kravetz	Book	150	many	H,M,L	1988
"Best in HRM"	Towers et al.	Report	10	18	1-10	1990
<u>Employees</u>						
"Best to Work For"	Levering et al.	Book	100	5	0,1	1984
"Best for a Career"	<u>Business Today</u>	Periodical	150	20	varies	1985-90
<u>Women</u>						
"Best for Women"	Zietz & Dusky	Book	52	1	0,1	1988
"Best for Working Mothers"	<u>Working Mother</u>	Periodical	75	4	0,1	1986-90
"Family Friendly"	Galinsky et al.	Book	188	1	1-188	1991
"Best for Women"	Catalyst	Ceremony	3-4	1	0,1	1991
<u>Other Groups</u>						
"Best for Blacks"	<u>Black Enterprise</u>	Periodical	25	1	0,1	1982, 86
"Best for Engineers"	<u>Graduating Engineer</u>	Periodical	25	1	0,1	1982-90
"Best for Black Engineers"	<u>N.S.B.E.</u>	Periodical	100	1	0,1	1989-90
"Best to Sell For"	Birnes & Markman	Book	100	4	0,1	1985

¹ In spite of some of these assessments using several criteria, the essential reputation signal is inclusion on a "best" list. Thus the 0,1 designation.

² If more than one year is indicated then the reputation signal is released annually. Otherwise, the year indicated is the first one in which the signal appears.

Descriptive Assessments

Clearly, numerous publications provide corporate reputation assessments to an array of interested audiences including job applicants, customers, and investors. In addition, throughout the 1980's business observers conducted numerous investigations, employing varied degrees of rigor, to discover and describe organizations with the best HRM reputations, companies employing the "best" people and treating them "right." IBM, for instance, appeared on many of these "best" lists (Black Enterprise, 1982, 1986; Fortune, January 10, 1983; Levering et al., 1984; Zietz and Dusky, 1988), as did little, and little-known, Herman Miller (Fortune, January 6, 1986; Levering et al., 1984; Zietz and Dusky, 1988). Increasingly, specialized human resource reputation assessments are being rendered. Indeed, it is abundantly clear that many business publications consider HR reputation to be important also; in that they provide information on this topic to numerous constituencies including females, minorities, professionals, and salespeople.

To summarize, it appears that there are various reasons for creating corporate and human resource management reputation signals (to influence job applicants, employees, and customers) and various means for communicating these signals (including customized reports, articles in periodicals, and employment guides). The recent spurt in the number and proliferation of reputation signals provides some evidence that the unfulfilled needs for corporate and HR reputation assessments are increasingly being identified and fulfilled.

THE CONCEPT OF REPUTATION IN THE RESEARCH LITERATURE

Research on corporate reputation has emerged in finance (McGuire, Schneeweis, and Branch, 1990; Sobol and Farrelly, 1988), strategic management (Chakravarthy, 1986; Fombrun and Shanley, 1990; Weigelt and Camerer, 1988), and economics (see: Camerer, 1985; Wilson, 1985). Regardless of the discipline, they model reputation as a factor that contributes to organizational success. The influence of HRM reputation on firm performance, however, has

been practically ignored. This is the case, despite a burgeoning literature that argues that the successful management of human resources provides an organization with a competitive advantage. Indeed, some posit that this HR driven advantage translates directly into organizational success (Beer, Spector, Lawrence, Mills, & Walton, 1984; Dyer and Holder, 1988; Kanter, 1983, 1989).

Contemporaneous Relationships

To date, only a few studies have moved beyond simple bivariate correlations to analyze the relationship between reputation and performance.

Fortune's annual analyses into the relationship between reputation and performance, which invariably report that companies with better reputations perform better, are the first exception. For example, in an analysis of 1987 performance (Fortune, January 18, 1988), they reported that the median ten-year average return to shareholders for the ten "most admired" firms was 22.5%. This exceeded, by a factor of 37, the median return for the ten least admired firms (.6%). However, Fortune's selective reporting of information over the years (e.g., the fact that the performance criteria analyzed often change from year to year--for instance, R.O.E. in one year and shareholder return the next) and its cross-sectional comparisons leave Fortune's conclusions open to some skepticism and criticism.

A recent Johnson and Johnson study examined organizations with a corporate credo and reported that they have performed better than those firms without one (Johnson and Johnson, October 5, 1988)⁸. The company's CEO even claimed that a 35-year investment in a stock portfolio made up 15 select firms with credos would have generated a return over four times greater than that obtained by investing a like amount in a portfolio composed of the Dow Jones Industrials. His analysis is, however, somewhat limited. A matched pairs control group was not utilized, and other appropriate statistical controls were not employed. In addition, it does not measure whether these firms actually adhere to the tenets set forth in their credos.

⁸Johnson and Johnson has had a credo since the 1947.

Brouillard Communications (1988) also explored the relationship between reputation and sales performance, via a survey of over 1,200 affluent customers, corporate executives, brokerage research directors, and portfolio managers. They found that people are between two to three times more likely to *buy* from or *recommend* the products of firms with "winning" reputations (those with scores of 5 or 6 on their 0-6 point reputation scale). Furthermore, individuals indicated that they would be nearly twice as likely to *invest* in companies with "winning" reputations. This exploration has several noteworthy problems including: the use of unanchored reputation scales and an arbitrary threshold for "winners," the use of hypothetical outcomes (as opposed to actual corporate performance measures), and the ever so subtle punch line of the report--that "winners" advertise more than "losers" (which brings the self-serving nature of reports like this into focus).

Security analysts, particularly those attuned to the social investment theme, have also examined the relationship between reputation and performance. For instance, shortly after the publication of the 100 Best Companies to Work for in America (Levering et al., 1984) book, Franklin R&D, a self-proclaimed socially conscious investment advisement group, compared the 10-year performance of these "100 Best" companies with the Standard and Poors index (a conventional measure of stock market performance). They found that the value of the "100 Best" group rose 479% between 1975 and 1985 while the S&P 500 rose only 112% (Insight, 1985). In a subsequent report, they opine that "positive work relations are a variable often overlooked by traditional investors, but one that we think is key to economic health" (p. 1). In short, they suggest that acting in a manner which merits inclusion on the "100 Best" list translates into superior financial performance. Several caveats are in order. First, it is not clear that those firms who made the "100 Best" list in 1984 would have been named to such a list in 1975, 1979, or 1982. Second, some of the firms in the "100 Best" list were not publicly traded during this period. Finally, some firms may appear in both the "best" and S&P indices being compared. If this is the case, the sets are not mutually exclusive.

Others in the investment community have analyzed the relationship between reputation and performance as well. Investment Advisors at Dean Witter Reynolds, in a report entitled "Socially Responsibly Investing: The Financial and Socio/Economic Issues," found that the publicly traded "100 Best" companies outperformed the S&P 500 by 17.69% (cited in Levering, 1988, p. 259). This analysis shares many of the same criticisms. It is not clear whether some companies reside in both groups. Furthermore, there are no justifications given for the time period studied or the single performance measure used.

Kanter (1983), in her book The Changemasters, also examined the reputation -- performance relationship. She reported that the 47 firms deemed to be "progressive" on the human resource management dimension significantly outperformed a matched set of "non-progressive" companies. She reports that this is a robust finding that held for a variety of firm performance measures. Between 1976 and 1980, for instance, the return on equity for her "progressive" firms (17.8%) was statistically, and economically, greater than that of the "non-progressive" firms' (15.4%). By using the matched firms as a control group, Kanter's analysis takes on some of the properties of a quasi-experiment. Furthermore, by accounting for three dimensions of HRM in her definition of "progressiveness," the ability to invent, incorporate, and promulgate human resource management innovations, she does a better job of measuring the construct. She acknowledges, however, that her sample of "progressiveness" judges was severely restricted. Only 65 (5%) of 1,250 executives, or executive teams, surveyed responded.

More recently, Kravetz (1988) derived his own means for ranking firms according to their HRM progressiveness. First, he sampled the Fortune 500 and an assortment of privately held firms on their HRM policies and practices. Then, he divided the 150 companies who responded into three groups according to his measure of human resource "progressiveness." In the end, he concludes that "highly progressive" firms outperform "less progressive" firms on a number of performance indicators including: five year sales growth (17.5% to 10.7%) and five year profit growth (10.8% to 2.6%). Kravetz's methodology for categorizing companies on the HRM

progressiveness dimension leaves his conclusions open to skepticism. First, he mailed surveys to the Forbes 500 and to 42 financial institutions and received only 150 usable surveys. Then, he arbitrarily divided these self reports into three groups of 50. Lastly, he does not disclose the representativeness of his sample and subgroups.

In sum, these contemporaneous analyses--though interesting and intuitively appealing--are beset by some problems including: the validity and reliability of the categorization schemes, the selective presentations of findings, and inappropriate, or nonexistent, controls. In spite of their shortcomings, these investigations do offer some tenuous evidence to support the proposition that reputation and performance go together.

Predictive Relationships

Recently, several studies have examined the reputation -- performance hypothesis using more appropriate research designs and statistical techniques. Take, for example, McGuire, Schneeweis, and Branch (1990), who analyzed the relationships between lagged corporate performance, corporate reputation, and subsequent corporate performance. They studied the relationships between lagged performance (sales growth and market riskiness), reputation (as reported in the Fortune survey), and subsequent performance. They found that lagged performance explained 22% to 44% of the variance in reputation. When predicting subsequent performance from present reputation, however, they reported that reputation explained no more than 5% of the variance in subsequent performance.

Earlier, Sobol and Farrelly (1988) posited that reputation was a function of financial performance and used lagged performance indicators to predict *each* of the eight Fortune reputation dimensions individually. Earnings per share (E.P.S.), the price/earnings (P.E.) ratio, net income (N.I.), and several other performance variables explained between 28.9% and 38.3% of the variance in each of the eight "different" reputation scores. However, given that it has since been established that the Fortune measures load on a single factor (McGuire, Schneeweis, and Branch, 1990, p. 170), the impact of these findings is diminished. Nevertheless, the results

obtained for any one of the measures support the general proposition that corporate reputation and lagged performance are related.

In a study that focused solely on one Fortune measure, social responsibility (SR), and its effect on performance, McGuire, Sundgren, and Schneeweis (1988) found that lagged SR reputation had little effect on firm performance. In retrospect, given the high correlation (.78)⁹ between corporate reputation and SR reputation¹⁰ and the finding that corporate reputation has little predictive power, it is not surprising that a relationship between SR reputation and corporate performance was not detected.

Recently, Fombrun and Shanley (1990) moved the focus back to the determinants of corporate reputation. In addition to the conventional financial and accounting determinants, they added sets of institutional variables (including the firm's ownership profile--institutions or individuals, philanthropic contributions, size, quantity of media exposure, quality media exposure) and strategic variables (advertising intensity, degree of diversification into unrelated businesses). This elaborated reputation prediction model doubled the amount of variance explained from the 20% - 40% range observed in the previous studies to between 43% - 60%. In the end, they claim that their analysis was designed to "emphasize the social community within which firms themselves are imbedded and the central role played by firms, constituents, and the media in influencing the informational context within which reputation judgments are made" (p. 252).

It is clearly evident that business observers and academic researchers have considered and explored the relationship between corporate reputation and corporate performance. Reporters in the business press have centered on the contemporaneous relationship between reputation and performance and reported a positive association. Researchers have used their models to

⁹The authors did not provide a correlation matrix in this study, but they did report that a factor analysis was done. The .78 correlation value is what they reported in their subsequent study published in 1990.

¹⁰Noted on the previous page. Our factor analysis confirmed the single factor finding. We observed an intercorrelation of .97 between HRM reputation, and overall reputation, the mean of the other seven measures. Therefore, these measures are collinear, nearly singular. As such, it was impossible to parcel out the HRM reputation component from overall reputation and treat the two as separate measures.

reasonably predict corporate reputation from lagged corporate performance. However, identifying the relationship between reputation and current or future performance remains problematic.

The limited empirical analyses, the apparent difficulty researchers have had in addressing this problem, and the limited empirical analyses conducted to date served as the genesis for this study, which has three goals. First, it reexamines the relationship between reputation signals and corporate performance utilizing a number of new and previously untested reputation measures. Second, it uses an improved, alternative methodology to explore the reputation -- performance relationship. Last, and most important, it addresses the neglected association between HR reputation signals and corporate performance.

MODEL OF HUMAN RESOURCE MANAGEMENT REPUTATION

Model

The reputation -- performance model developed for this study examines the relationship between HRM reputation and financial performance while controlling for the effects of corporate reputation, human resource management performance, and corporate accounting performance.

$$(1) CP_{t_0 - t+n} = f(HRMR_{t_0}, CR_{t_0}, HRMP_{t_0}, CP_{t_0})$$

where:

$CP_{t_0 - t+n}$ = Corporate Financial Performance for a pre specified period ($t_0 - t+n$) succeeding an HRM reputation signal.

$HRMR_{t_0}$ = Human Resource Management Reputation Signal(s) at t_0

CR_{t_0} = Corporate Reputation Signal(s) at t_0

$HRMP_{t-1}$ = Human Resource Management Performance at $t-1$

CP_{t-1} = Corporate Accounting Performance at $t-1$

Hypotheses

Our hypotheses are based on the theoretical, practical, and empirical literatures reviewed previously, especially Spence's (1974) notion of signaling which suggests that a company's reputation affects the behaviors of people facing decisions to join, invest in, or buy from an organization. Moreover, both the anecdotal and research evidence suggest that favorable reputations and positive outcomes are related. Screening theory (see: Stiglitz, 1975) and Fama's (1980) labor market premise also support this contention. Indeed, Carmichael (1984) argues that firms with favorable reputations will attract more, and better qualified, applicants (Carmichael, 1984).

Conversely, the literatures hold that an unfavorable reputation signal will have a negative effect. For instance, Munn (1983) implies that the value of a firm attributable to the goodwill it engenders will decrease as a result of unfavorable reputation news. Furthermore, Pfeffer (1976) posits that a firm with a poor reputation may have a more difficult time forming strategic alliances with other institutions.

Accordingly, the following hypotheses examine the effects of reputation signals on financial performance.

H₁ New, favorable (unfavorable) human resource management reputation signals at t_0 will have an immediate, positive (negative) effect on corporate performance at t_0 and beyond.

H₂ New, favorable (unfavorable) corporate reputation signals at t_0 will have an immediate, positive (negative) effect on corporate performance at t_0 and beyond.

Socrates said, "The way to gain a good reputation is to endeavor to be what you desire to appear." Perhaps HR performance, observable and measurable, is an antecedent to improved financial performance, rather than the reputation glow of the organization. In other words, are organizations that efficiently manage the relationships between sales, revenues, employee

productivity, and labor cost the ones that are the most attractive to investors? Our third hypothesis addresses the HR performance -- financial performance relationship.

H.3 *Human resource performance (measured in terms of net income per employee) at t_0 will be positively related to financial performance (measured in terms of total shareholder return) at t_0*

METHODS, MEASURES, AND DATA

Methods

Two independent methodologies were used to test the reputation--performance hypotheses. First, an ordinary least squares regression methodology was employed to estimate the effects of lagged and concurrent HR reputation signals on an *annualized* measure of financial performance, total shareholder return. This method was also used to study the effects of corporate reputation signals and HR performance. In addition, an event study methodology was utilized as a supplement to precisely examine the *immediate* impact of the HR and corporate reputation signals on another financial measure, abnormal shareholder return. Abnormal returns on the event day (or month) and the accumulated abnormal returns over several, post-event days (or months) were computed, aggregated, and analyzed.

Ordinary Least Squares (OLS) Regression. Multivariate OLS Regression was used to analyze the relationships presented in the general model (eq. 1). This technique has also been utilized in each of the empirical studies that have examined the reputation -- performance relationship to date (Fombrun and Shanley, 1990; McGuire, Schneeweis, and Branch, 1990; and Sobol and Farrelly, 1988).

In our study, a sequential, four-step, simultaneous approach was employed to predict annual shareholder return. In Model 1, several accounting-based measures of corporate performance (CP_n) and industry (I) type were introduced. In Model 2, a measure of HRM performance (HRP), income per employee, was incorporated. In Model 3, several corporate

reputation signals (CR_n) were added. Finally, in Model 4, several HR reputation signals (HRR_n) were included. The complete model appears below:

$$(2) CP_{to} = a + b_1 CP_{1,t-1} + b_2 CP_{2,t-1} + b_3 CP_{3,t-1} \\ + b_4 HRP_{1,t-1} \\ + b_5 CR_{1,to} + b_6 CR_{2,to} + b_7 CR_{3,to} + b_8 CR_{4,to} + b_9 CR_{5,to} \\ + b_{10} HRR_{1,to} + b_{11} HRR_{2,to} + b_{12} HRR_{3,to} + b_{13} HRR_{4,to} + b_{14} HRR_{5,to} \\ + I + \varepsilon$$

where:

CP_{to}	= Total Shareholder Return
$CP_{1,to}$	= Net Sales
$CP_{2,to}$	= Total Assets
$CP_{3,to}$	= Common Equity
$HRP_{1,to}$	= Income per Employee
$CR_{1,to}$	= "In search of Excellence" Signal
$CR_{2,to}$	= "Best Managed" Signal
$CR_{3,to}$	= "Most Admired" Signal
$CR_{4,to}$	= "Worst" Signal
$CR_{5,to}$	= "Most Important" Signal
$HRR_{1,to}$	= "Best for Blacks" Signal
$HRR_{2,to}$	= "Preferred Employer" Signal
$HRR_{3,to}$	= "100 Best to Work For" Signal
$HRR_{4,to}$	= "Best for Working Mothers" Signal
$HRR_{5,to}$	= "Best for Women" Signal
I	= Industry

Recall that firm size is inherently controlled for, in that only the ten largest firms (as measured in terms of annual sales) in each of thirty industries comprise the Fortune "most

admired" sample. Also, note that industry type was controlled through the use of dummy variables. The original thirty sectors were consolidated into 15 groups.¹¹

In accordance with H₁, the regression coefficients for HRR₁, HRR₂, HRR₃, HRR₄, HRR₅, should be positive. Signaling theory and the efficient markets hypothesis both suggest that once these favorable corporate reputation signals go public, they should have a positive effect on firm performance. Likewise, the correlation coefficients for CR₁, CR₂, CR₃, CR₅ are expected to be positive in accordance with H₂. Clearly, all of these designations are favorable reputation signals and, thus, should be positively associated with firm performance.

Alternatively, the regression coefficient for CR₄, the "worst company" signal, should be negative in accordance with H₂, which holds that unfavorable corporate reputation signals will be associated with decreased financial performance.

In accordance with H₃, the correlation coefficient for HRP₁ should be positive. Superior HR performance should be related to superior financial performance.

Event Studies. To ascertain the effect of HRM reputation signals on the financial performance of the firm more precisely, a widely accepted and applied financial economics methodology known as the event study was adopted. Event studies have been used primarily to study stock market reactions to news about a firm or group of firms. Examples of event studies include analyses of the effects of takeovers (on both the suitor and the target), stock repurchases, and common or preferred stock offerings.¹²

Essentially, the event study methodology isolates an "abnormal" shareholder return component, which has an expected value of zero. This abnormal component is simply the difference between the *actual* change in share price and the *predicted* change on a given day, where the predicted value is generated by modeling the performance of the security to that of the stock market as a whole over some period preceding the event.

¹¹The industry sectors were grouped because of their natural tendency to compete in the same labor and capital markets.

¹²See, for example, Jensen and Smith's (1985) summary.

Recently, several researchers employed this technique to study human resource management announcements. Abowd, Milkovich, and Hannon (1990) studied the effects of HRM announcements, including newsworthy changes in compensation policies and staffing levels. They found that shutdown and layoff announcements generated negative returns to shareholders. For instance, in 1980, firms that experienced shutdowns realized a .56% decrease in their share prices the day after these announcements.

Other examples of HR/IR related event studies have focused on: strikes (Neumann, 1980; Becker and Olson, 1986; and Tracy, 1987, 1988), collective bargaining agreements (Abowd, 1989), executive succession outcomes (Etebari, Horrigan, and Landwehr, 1987; Lubatkin, Chung, Rogers, and Owers, 1989), and executive compensation plans (Brickley, Bhagat, and Lease, 1985; Tehranian and Waegelein, 1985).

All event studies incorporate five general steps (see: Bowman, 1983; Brown & Warner, 1980, 1985; and Schwert, 1981). They are (a) identification of the event(s) of interest, (b) modeling the normal (expected) total shareholder return, (c) estimation of the abnormal (unexpected) total shareholder return, (d) grouping of the abnormal returns, and (e) analysis of abnormal return summary statistics.

Event Identification. An "event" may come in the form of a single action that affects all, or a subset of, publicly traded firms. The enactment of a new equal employment regulation is one example. Alternatively, certain event types, plant shutdowns for instance, affect many different firms at many different times.

Regardless of the event type, it is imperative to accurately date the event. Precise event dating is essential because of the event study's reliance on the efficient markets hypothesis (Fama, 1970) which holds that stock returns are neither serially correlated nor serially cross-correlated. Accordingly, on any given date, a sample of abnormal (unexpected) shareholder returns has a predicted mean of zero. Similarly, the mean for a sample of cumulative abnormal returns (abnormal returns summed over a given period) should be zero.

This study defines an event as the public announcement that an organization had been included on one of the various "best company" lists that have emerged in the recent past. These lists have been publicly disseminated in daily newspapers, monthly periodicals, occasional reports, or books. Admittedly, some of these announcements may not emanate from the most reputable or unbiased of sources. Moreover, the assertion that investors rely on some of these sources for timely news may be a stretch. In addition, we recognize that the event windows for these events may not be precisely specified. Note that these and the other limitations which affect this study are addressed our concluding section.

To reiterate, if a study detects significant, positive (negative) abnormal (or cumulative abnormal) returns for a company or group of companies when HRM reputation announcements occur, then one can conclude that the market judged this information to be favorable (unfavorable). These non-zero, abnormal returns may be attributed to the event alone, because other influences on shareholder return are essentially controlled due to the aforementioned absence of serial correlation and cross-correlation in stock market returns.

Modeling the normal (expected) shareholder return. To predict normal (expected) shareholder returns for the event day (or month) and the so-called "window" of days (or months) surrounding it, the total shareholder returns for the firm in a preceding period of days, or months, are usually related to an index of total shareholder returns that represent the entire stock market over the same period. Following convention, the market portfolio return for this study (the baseline) is the New York Stock Exchange value-weighted portfolio, including dividends (Center for Research in Security Prices, 1990). The intercept and slope were estimated over a 1-year period of 250 trading days, or 60 months for announcements in monthly periodicals, preceding the event (the estimation period).

Estimation of the abnormal return. The intercept and slope parameters were then used to predict shareholder returns for the day (month) of, and days (months) around, the event as a function of market performance. In the daily analyses, the post-event windows were one, two,

three, and four days long, and in the monthly analyses, they were one, two, and three months in duration. As is the case for most event studies, the price per share was adjusted to reflect the effects of stock splits and stock dividends.

Grouping of the abnormal returns. Average cumulative abnormal returns (average CARs) were also calculated for each sample. In accordance with hypotheses H₁ and H₂, *a firm* that experiences a favorable reputation signal (e.g., being named one of America's "five best managed" firms) is expected to realize a statistically and economically significant positive abnormal return on or around the event day (month). Conversely, an unfavorable reputation signal (e.g., being named one of America's ten "worst" companies) is expected to result in a statistically and economically significant, negative abnormal return for the firm¹³.

Likewise, in accordance with hypotheses H₁ and H₂, the average abnormal return for *a group of firms* experiencing a favorable reputation signal is expected to be positive and both statistically and economically significant. Conversely, the average abnormal return for a group of firms experiencing an unfavorable reputation signal is expected to be negative and both statistically and economically significant.

In the end, the event study model accounts for all of the requisite elements presented in Equation 1. Through the capture of the abnormal component of the change in stock price--which is attributable to the announcement alone, the relationship between the disclosure of a reputation signal and subsequent performance may be ascertained.

Measures

OLS Regression. The *dependent* variable in the OLS analyses, corporate performance, was defined in terms of annual total shareholder return. Total shareholder return was measured as a percentage and computed as follows:

¹³The relationship between HRM performance, income per employee, and financial performance addressed by H₅ was not tested using the event study methodology.

$$(14) \quad \text{TSR}_{t0} = \frac{\text{Dividends}_{t0} + (\text{Share Price}_{t0} - \text{Share Price}_{t-1})}{\text{Share Price}_{t-1}}$$

where:

TSR_{t0} = Total Shareholder Return

$\text{Dividends}_{t0}^{14}$ = Dividends paid during the year

$\text{Share price}_{t-1}^{15}$ = Beginning share price

$\text{Share price}_{t0}^{16}$ = Ending share price

Net Sales, Total Assets, and Common Equity, three accounting-based, corporate performance measures, and Industry served as the *control* variables in the OLS analyses. Net Sales¹⁷ (CP₁) was included to further control for the effects of firm size. Recall that firm size is already partially controlled because the firms that make up this sample are the ten largest in their respective industries. Total Assets¹⁸ (CP₂) and Common Equity¹⁹ (CP₃) were included to control for the financial capital of the firm.

Included among the *independent* variables are the eleven reputation signals listed in Table 3 and briefly described below.

¹⁴Computation using Compustat data items: Data26/Data27. (Dividends per share/Adjustment Factor.)

¹⁵Computation using Compustat data items Data24/Data27. (Share Price/Adjustment Factor.)

¹⁶Computation using Compustat data items Lag Data24/Lag Data26. (Lagged Share Price/Adjustment Factor.)

¹⁷Compustat data item 12. "This item represents gross sales (the amount of actual billings to customers for regular sales completed during the period) reduced by cash discounts, trade discounts, and returned sales and allowances for which credit is given to customers."

¹⁸Compustat data item 6. "This item represents current assets plus net plant plus other non-current assets (including intangible assets, deferred items, and investments and advances)."

¹⁹Compustat data item 60. "This item represents the common shareholders interest in the company."

TABLE 3 Reputation signals examined in OLS analyses.

Signal	Year						
	1982	1983	1984	1985	1986	1987	1988
<u>HR Reputation</u>							
"Best for Blacks"	New	Carry	Carry	Carry	New	Carry	Carry
"Most Preferred"	New	Carry	New	Carry	New	Carry	New
"100 Best to Work For"			New	Carry	Carry	Carry	Carry
"Best for Working Mothers"					New	New	New
"Best for Women"							New
"Best for Black Engineers"							Future
<u>Corporate Reputation</u>							
"Excellent"	New	Carry	Carry	Carry	Carry	Carry	Carry
"Best Managed"	New	New	New	New	New	New	New
"Most Admired"		New	New	New	New	New	New
"Worst"			New	Carry	Carry	Carry	Carry
"Most Important"							New
<i>New--New Reputation Signal, C--Carryover Reputation Signal, F --First Occurrence, 1989</i>							

In August of 1982, and again in February 1986, Black Enterprise magazine published a list of the 25 best firms for blacks in an article entitled, "In Good Company: 25 Best Places for Blacks to Work" (Black Enterprise, 1982; 1986).

In March of 1982, Graduating Engineer magazine published a list of the *25 most preferred companies* among engineering students (Graduating Engineer, March 1982). Generated every March in even numbered years thereafter, the most recent of these lists was published in 1990.

On May 6, 1984, the New York Times published a partial list of those companies cited in the book, *The 100 Best Companies to Work for in America* (Levering et al., 1984), which had recently been published.

In October of 1986, Working Mother magazine listed 30 firms that comprised its first annual survey of "*The Best Companies for Working Mothers*" (p. 25). Its most recent list was published in October, 1990. In addition, on September 20, 1989, the Wall Street Journal published the names of the top 10 firms for working mothers according to the 1989 survey.

On April 25, 1988, USA Today published the complete list of those companies that had been cited in the book, *The Best Companies for Women* (Zietz & Dusky, 1988). One company, Proctor & Gamble, was also cited in a Wall Street Journal article of December 21, 1988, as being in jeopardy of losing this designation.

In November of 1989, National Society of Black Engineers magazine published a list of the 100 firms deemed the *best for black engineers* (N.S.B.E., 1989).

The *In Search of Excellence* designation (Peters and Waterman, 1984) was the earliest overall corporate reputation signal studied using OLS. An "excellent" company list was not found in the popular press, though, so this signal was not studied using the event study methodology.

Since 1972, Dun's Business Month has selected five companies each year and tabbed them the "*best managed*" (Business Month, December 1972-88).

Likewise, Fortune's (1983-1988) annual "*Most Admired*" scores were included in the OLS analyses, but these announcements were not studied using the event study methodology.²⁰

²⁰Fombrun and Shanley (1990) have found significant abnormal returns for those firms at the high and low extremes of the rankings around the dissemination of this information.

In June of 1985, Mother Jones magazine published a list of the "best" and "worst" companies (Mother Jones, June 1985). An article listing the 10 best firms also appeared in the Wall Street Journal on May 6, 1985.

On June 6, 1988, management expert Tom Peters made public his choices for America's "most important" companies (Peters, June 6, 1988).

The other explanatory variable included in the OLS analyses was a measure of HR performance, *income per employee* (HRP_1). This was measured in dollars and computed as follows:

$$(5) \text{ Income per Employee} = \frac{\text{Net Income}}{\text{Employees}}$$

where:

Net Income²¹ = Annual Net income

Employees²² = Total employees

Event Studies. The *dependent* variable in the event studies was abnormal total shareholder return. Values were computed for the event day (month) itself and over several windows, as long as 4 days (or 3 months) after the event. Recall that the abnormal return is the difference between the firm's actual return for the day and its predicted value for that day. Also, note again that the design of the event study effectively controls for any influences other than the change attributable to the release of the new information, the reputation signal.

Table 4 highlights the *independent* variables, six HR and four corporate reputation signals, examined using the Event Study methodology--which isolates the immediate effects of new

²¹Compustat data item 20. "This item represents income before extraordinary items and discontinued operations less preferred dividend requirements and is adjusted for the additional dollar savings due to common stock equivalents as outlined in Accounting Principles Board Opinion No. 15."

²²Compustat data item 29. "This item represents the number of company workers as reported to shareholders."

reputation signals on stock prices, in contrast to the OLS analyses that focus on the year in which these signals were released.

TABLE 4 Reputation signals examined in event studies.

Signal	Year							
	1982	1983	1984	1985	1986	1987	1988	1989
<u>HR Reputation</u>								
"Best for Blacks"	New	---	---	---	New	---	---	---
"Most Preferred"	New	---	New	---	New	---	New	---
"100 Best to Work For"			New	---	---	---	---	---
"Best for Working Mothers"					New	New	New	New
"Best for Women"							New	---
"Best for Black Engineers"								New
<u>Corporate Reputation</u>								
"Best Managed"	New	New	New	New	New	New	New	---
"Best"				New	---	---	---	---
"Worst"				New	---	---	---	---
"Most Important"							New	---
<i>New--New Reputation Signal, --- No new signal this year</i>								

Data

OLS Regression. The data used in the OLS analyses were formed when information from a variety of primary data sources was collected and combined. The key variable used to merge these data was the firm-specific, Center for Uniform Security Pricing identifier, the CUSIP.

First, corporate reputation scores for the period 1985-1989 were obtained through a private agreement with Fortune. These data, which include reputation scores for about 300 firms, serve as the core for the OLS analyses.²³ They were reduced when only those firms with complete data for all the performance measures were retained. Corporate reputation, as defined by Fortune, is the equally weighted mean of the eight measures. Second, a set of descriptive reputation assessments, originally developed for those participants in various labor, investment, and product markets, produced dichotomous measures (1, included, and 0, excluded) for the HR and Corporate reputation signals. Third, firm-level corporate and human resource management performance measures were extracted from Standard and Poors' COMPUSTAT data. Then, the three subsets were merged by CUSIP to form the comprehensive reputation-performance database.

Data for the fiscal years 1982-1988 were analyzed using ordinary least squares regression. Complete data were available for between one-half and three-quarters of the approximately 300 firms in each of the annual Fortune data sets.

Event Studies. The event study data were obtained from a stock returns data base compiled and maintained by the Center for Uniform Security Pricing at the University of Chicago. Once again, the firm-specific CUSIP served as the key variable and it was used to extract the requisite information for each company.

The event study sample sizes are a function of three things: the number of firms afforded a particular "best" designation, whether these firms are publicly traded, and the exchange on which they are traded. One complication is the fact that many of the firms named to these various "best" lists are *not* publicly traded. Boston's Beth Israel Hospital, which has been frequently recognized (Working Mother, 1990; Zemke and Schaaf, 1989), is one such example. Accordingly, some of the samples were smaller than the original lists from which they were drawn. The most extreme

²³The ten largest firms in 30 industries are rated each year. With movements on and off these lists the reputations of some 477 entities were rated at one time or another between 1983 and 1990.

example of this is the list of "America's Ten Best Companies" that appeared in Mother Jones (June, 1985) and the Wall Street Journal (May 6, 1985) where only two of the ten "best companies," Kollmorgen and Wang, were publicly traded on the NYSE at the time of this announcement.

On the other hand, data were available for all but a few companies for many of the reputation signals, especially those that recognize the largest firms. For example, data were available for sixty-eight of the seventy-five companies afforded Dun's Business Month's best managed designation over the 25 year period.

In total, fifteen event studies were conducted. The results from the 52 primary tests, two of which (4%) were significant at the .05 level, and the results from the OLS analyses follow.²⁴

RESULTS

OLS Analyses

Descriptive Statistics. Recall that the time periods under study in the OLS section of this analysis are the fiscal years 1982-1988. In 1988, the requisite data were available for 226 of the 305 firms in Fortune's "most admired" survey.

In the 1988 sample, the companies range from the likes of Merck, named to the "100 Best Companies to Work For," "Best Companies for Women," and "Best Companies for Working Mothers" lists and named *the* "most admired," to Bank America Financial Corp., absent from all the reputation signals' lists and named *the* "least admired." In between, there are firms like

²⁴The results for all of the event studies conducted, some 121 in total, are available from the authors. Analyses were also conducted to ascertain whether the public recognition of a few companies on a "best list" would prompt investors to obtain the entire list and revalue all the firms included on the original list. We found that all companies did not benefit from the recognition of a few. In addition, we tested to see whether events easily pinned to a certain day might have had an impact throughout the month or over several months thereafter. This was not the case.

Monsanto, which did not make any of the "best" lists but did garner an average "most admired" score.

Table 5 provides select descriptive statistics for the 1982-1988 samples. In 1988, average annual total shareholder return was 18.45% and the median shareholder return was 15.82%. Note that this compares to the median return for Fortune's Industrial 500, 14.10%, during the same period.

The median sales level for the 1988 sample was \$4.804 billion. Median assets were \$4.664 billion and median common equity was \$1.571 billion. Between 1982 and 1988, the sample's median sales ranged from \$3.558 billion to \$5.378 billion. During the same period, assets ranged between \$2.972 billion and \$4.888 billion. Likewise, equity varied from \$1.256 billion to \$2.168 billion. The lowest values for each of these variables came in 1982 then they peaked in 1983, dipped in 1984, and steadily climbed through 1988.

Recall that HR was measured in terms of income per employee. The median income per employee for the 1988 sample was \$7,290; and between 1982 and 1988, this measure ranged between \$4,790 and \$7,290.

One of the corporate reputation signals examined was Fortune's corporate reputation score, which averaged 6.35 on a 10-point scale in 1988. This variable was very stable during this seven-year period. It ranged between 6.33 and 6.51.

TABLE 5 Select descriptive statistics for 1988-1982¹.

Variables		1988	1987	1986	1985	1984	1983	1982
Total Shareholder Return (TSR %)	med.	15.82%	3.30%	18.98%	28.63	1.90%	25.11%	30.56
	mean	18.45%	5.31%	16.97%	31.11%	2.80%	28.38%	37.59
	s.d.	(27.50%)	(33.24%)	(27.22%)	(26.48%)	(21.65%)	(28.66%)	(56.00)
Total Shareholder Return <u>Fortune</u> 500 Industrials (TSR %)	med.	14.10%	6.60%	15.50%	26.31%	-.75%	30.21%	21.22%
<u>Fortune</u> "Most Admired" score (0-10 scale)	med.	6.38	6.35	6.41	6.59	6.41	6.29	na
	mean	6.35	6.33	6.35	6.51	6.44	6.25	na
	s.d.	(.93)	(.91)	(.87)	(.81)	(.83)	(.93)	na
HRM Performance Income/employee (\$ thousands)	med.	7.29	6.11	5.61	5.57	5.77	5.22	4.79
	mean	7.84	7.39	6.62	7.55	9.14	7.44	6.51
	s.d.	(55.17)	(14.82)	(12.44)	(12.05)	(15.16)	(10.25)	(11.81)
Net Sales (\$ millions)	med.	4,804	4,851	4,631	5,024	5,010	5,378	3,558
	mean	7,772	7,797	7,455	9,330	9,149	9,592	6,593
	s.d.	(10,018)	(11,022)	(10,543)	(15,047)	(14,820)	(14,787)	(12,244)
Total Assets (\$ millions)	med.	4,664	4,272	3,915	4,091	4,025	4,888	2,972
	mean	12,000	11,315	10,981	11,996	11,189	12,178	7,696
	s.d.	(18,634)	(17,795)	(17,921)	(19,122)	(17,827)	(17,338)	(13,922)
Common Equity (\$ millions)	med.	1,571	1,462	1,374	1,764	1,782	2,168	1,256
	mean	2,823	2,907	2,999	3,356	3,196	3,582	2,313
	s.d.	(4,331)	(4,502)	(4,581)	(5,177)	(4,717)	(4,911)	(3,887)
Sample Size	n	226	227	211	167	164	135	135

¹All financials are in terms of 1988 dollars.

Table 6 highlights the correlations among the accounting and financial performance indicators, interval measures, and the corporate reputation variable, an ordinal measure, for 1988²⁵. The dichotomous reputation signals, of course, are not presented in this table.

²⁵Tables 8.3a through 8.3f (for the years 1987-1982) are available from the authors.

TABLE 6 Correlations among reputation and performance for 1988.

Variables	TSR	"Most Admired"	Income/employee	Net Sales	Total Assets	Common Equity
Total Shareholder Return (TSR)	1					
Fortune "Most Admired" score	-.117	1				
HRM Performance Income/employee	.228	.217	1			
Net Sales	.032	.176	.091	1		
Total Assets	.172	.031	.124	.581	1	
Common Equity	-.011	.283	.121	.852	.562	1

n = 226 p < .05 when r > .17

Unexpectedly and contrary to conventional wisdom, Fortune's corporate reputation signal was invariant with Total Shareholder Return in 1988.²⁶ As hypothesized, however, the first order correlation between HR performance and Total Shareholder Return was positive and significant ($r=.228$).²⁷ In spite of the volatile and sometimes counterintuitive relationship between Fortune's corporate reputation signal and corporate performance, this reputation signal was positively related to HR performance ($r=.217$). Finally, the relationships among the three accounting-based performance measures were significant and positive as expected. The association between assets

²⁶The relationship between corporate reputation and total shareholder return was evaluated for the years 1983-1987. It appears that this relationship has fluctuated over the years. It was significant and *negative* in 1983, *not significant* in 1984 and 1985, *positive* and significant in 1986, and *not significant* in 1987. Previous studies, the most recent of which have used data only as recent as 1985 (McGuire, Schneeweis, and Branch, 1990) and 1986 (Fombrun and Shanley, 1990), understandably have not picked up on this. All to say, the relationship between the Fortune reputation measure and performance is unstable. Maybe it is not the enduring characteristic it has been asserted to be.

²⁷This was the case in each of the years between 1984 and 1988. In 1983, however, a surprising negative relationship ($r=-.244$) was observed.

and equity ($r=.562$), assets and sales ($r=.581$), and equity and sales ($r=.852$), all attest to the widely acknowledged interdependencies among these variables.²⁸

Inferential Analyses. Recall that a sequential approach was adopted for this study. Table 7 highlights the results obtained for 1988²⁹. Note that the four models examine the same dependent variable, annual total shareholder return, and each one builds upon its predecessor.

In Model 1, several accounting-based performance measures and industry type were regressed against financial performance. In Model 2, a human resource performance measure was incorporated. In Model 3, several corporate reputation signals were added. In Model 4, our completed model, various HR reputation signals were included.

Recall the first hypothesis, *New, favorable (unfavorable) human resource management reputation signals at t_0 will have an immediate, positive (negative) effect on financial performance at t_0 and beyond.* Contrary to signaling theory, the favorable HRM reputation signals studied, be they concurrent or lagged, were *not* positively related to corporate performance. Therefore, hypothesis H₁ was not supported.

Hearken back to the second hypothesis, *New, favorable (unfavorable) corporate reputation signals at t_0 will have an immediate, positive (negative) effect on financial performance at t_0 .* Unexpectedly, neither Fortune's corporate reputation signal ($\beta = -.0450$, $t = -1.91$, $p = .058$), nor any of the other corporate reputation signals, were positively related to financial performance in 1988. Therefore, H₂ was not supported.

²⁸Very similar relationships were detected in each of the other years under study (1982-1987). It appears that these are stable relationships.

²⁹Tables 8.4a through 8.4f (for the years 1987-1982) are available from the authors.

TABLE 7 The relationship between HR reputation, corporate reputation, HR performance, and corporate performance in 1988.

Explanatory Variables	Model 1	Model 2	Model 3	Model 4
"Best Blacks"	. (.)	. (.)	. (.)	-.0104 (.0929)
"Most Preferred"	. (.)	. (.)	. (.)	.0131 (.0994)
"100 Best"	. (.)	. (.)	. (.)	.0088 (.0581)
"Best for Working Mothers"	. (.)	. (.)	. (.)	.0148 (.1079)
"Best for Women"	. (.)	. (.)	. (.)	-.0555 (.0789)
"Excellent"	. (.)	. (.)	.0001 (.0578)	.0000 (.0616)
"Best Managed"	. (.)	. (.)	.0625 (.1425)	.0727 (.1475)
"Most Admired"	. (.)	. (.)	-.0449 + (.0226)	-.0450 (.0236)
"Worst"	. (.)	. (.)	-.0841 (.1400)	-.0935 (.1427)
"Most Important"	. (.)	. (.)	-.0982 (.1389)	-.0871 (.1510)
Income per Employee	. (.)	.0012 *** (.0003)	.0013 *** (.0003)	.0013 *** (.0003)
Sales	.07E-5 (.41E-5)	-.11E-5 (.40E-5)	-.10E-5 (.40E-5)	-.06E-5 (.43E-5)
Assets	.72E-5++ (.22E-5)	.72E-5+++ (.21E-5)	.64E-5++ (.21E-5)	.65E-5++ (.22E-5)
Equity	-1.5E-5 (.86E-5)	-1.5E-5 (.84E-5)	-1.0E-5 (.89E-5)	-1.0E-5 (.92E-5)
Intercept	.1717 (.0872)	.1704+ (.0850)	.4471++ (.1630)	.4449++ (.1964)
F/R ²	2.68/.111	3.29/.155	2.80/.155	2.27/.136
OBS	226	226	226	226

+ p < .05 two-tailed ++ p < .01 two-tailed +++ p < .001 two-tailed * p < .05 one-tailed ** p < .01 one-tailed *** p < .001 one-tailed

Model 1: $CP_{10} = a + b_1 CP_{1,t-1} + b_2 CP_{2,t-1} + b_3 CP_{3,t-1} + I + \epsilon$
 Model 2: $CP_{10} = a + b_1 CP_{1,t-1} + b_2 CP_{2,t-1} + b_3 CP_{3,t-1} + b_4 HRP_{1,t-1} + I + \epsilon$
 Model 3: $CP_{10} = a + b_1 CP_{1,t-1} + b_2 CP_{2,t-1} + b_3 CP_{3,t-1} + b_4 HRP_{1,t-1} + b_5 CR_{1,t0} + b_6 CR_{2,t0} + b_7 CR_{3,t0} + b_8 CR_{4,t0} + b_9 CR_{5,t0} + I + \epsilon$
 Model 4: $CP_{10} = a + b_1 CP_{1,t-1} + b_2 CP_{2,t-1} + b_3 CP_{3,t-1} + b_4 HRP_{1,t-1} + b_5 CR_{1,t0} + b_6 CR_{2,t0} + b_7 CR_{3,t0} + b_8 CR_{4,t0} + b_9 CR_{5,t0} + b_{10} HRMR_{1,t0} + b_{11} HRMR_{2,t0} + b_{12} HRMR_{3,t0} + b_{13} HRMR_{4,t0} + b_{14} HRMR_{5,t0} + I + \epsilon$

Prior to this study, researchers, using earlier data and not controlling for any other reputation signals found a slight positive correlation between corporate reputation and corporate performance (McGuire, Branch, & Schneeweis, 1990).

The Effect of HRM Performance

Organizations that control costs and increase productivity simultaneously can be expected to reap greater profits in both the short and long term. This adage is reflected in our hypothesis addressing to HR performance, *Human resource management performance (measured in terms of net income per employee) at t_0 will be positively related to financial performance (measured in terms of total shareholder return) in the same period (t_0)*. As expected, we found that HR performance was positively related to financial performance ($p=.0013$, $t=3.66$, $p=.0003$).

In short, for the "average" company in this sample, doubling of the income per employee, from \$7,290 to \$14,380 (a .13 standard deviation change) should result in a 9.47 point increase in total shareholder return, from 18.45% to 27.92%. This positive and significant relationship was observed in five of the seven years studied. The results for the HR performance variable over the last five years support H₃. The ramifications of this finding are discussed in further detail in our concluding section.

Event Studies

Recall that the event study methodology controls right up to the event day (or month) for industry, accounting performance, HR performance, and corporate reputation. Accordingly, only the first two hypotheses, the reputation signaling hypotheses, were examined in the event study analyses.

As depicted in Table 8, a plethora of evidence for a positive relationship between favorable HRM reputation signals and financial performance was *not* detected using the event study methodology. Indeed, five of the six HRM reputation signals proved to be invariant with financial performance.

TABLE 8 Abnormal Shareholder Returns for the Reputation Signals

Reputation Signal	Release	Returns (firms)	Period 0	Period 0 to +1	Period 0 to +2	Period 0 to +3
HR Reputation						
Best Companies for Blacks	Feb. 1982 Feb. 1986	monthly (30)	.0291 (.0230)	.0320 (.0325)	.0207 (.0398)	--- ---
Engineers' Top 25 Preferred Employer	Mar. 1982, 84 Mar. 1986, 88	monthly (80)	-.0232 (.0172)	-.0085 (.0243)	-.0045 (.0298)	--- ---
100 Best Companies to Work For	6 May 1984	daily (15)	.0023 (.0060)	.0095 (.0085)	.0091 (.0104)	.0063 (.0120)
Best Companies for Working Mothers	Aug. 1986, 87 Oct. 1988, 89	monthly (74)	.0270* (.0151)	.0233 (.0213)	.0484* (.0262)	--- ---
Best Companies for Working Mothers	20 Sep. 1989	daily (4)	.0064 (.0070)	.0066 (.0099)	.0400 (.0122)	.0091 (.0141)
Best Companies for Women	25 Apr. 1988	daily (24)	.0008 (.0104)	.0036 (.0147)	.0071 (.0180)	.0245 (.0208)
Best Companies for Women - Threatened Removal	21 Dec. 1988	daily (1)	.0043 (.0100)	.0088 (.0142)	.0066 (.0174)	.0023 (.0200)
Best Companies for Black Engineers	Nov. 1989	monthly (67)	-.0010 (.0217)	.0277 (.0301)	--- ---	--- ---
Corporate Reputation						
America's Five Best Managed Companies	Dec. 1982-88	monthly (66)	.0091 (.0237)	-.0496 (.0335)	-.0492 (.0410)	--- ---
America's Best Companies	June 1985	monthly (2)	-.0244 (.0818)	-.0578 (.1157)	-.0306 (.1417)	--- ---
America's Worst Companies	June 1985	monthly (10)	.0135 (.0294)	-.0170 (.0416)	-.0212 (.0510)	--- ---
America's Best Companies	6 May 1985	daily (2)	-.0170 (.0220)	-.0212 (.0311)	.0095 (.0381)	.0180 (.0440)
America's Most Important Companies	6 June 1988	daily (10)	.0114 (.0143)	.0396* (.0203)	.0416 (.0248)	.0315 (.0286)

One noteworthy relationship, however, was observed. Those firms named as the "Best for Working Mothers" between 1986 and 1989 realized an unexpected return of 2.7%, on average, in the month that these announcements were made ($t=1.79$, $p<.05$). During the period that encompassed the event month and the next 2 months thereafter, these firms realized an unexpected 4.84% increase in their stock ($t=1.85$, $p<.05$), on average. This is the only signal whose results support hypothesis H₁.

Evidence for a negative relationship between unfavorable HRM reputation signals and financial performance was not detected for the one signal studied. The announced threat, in the Wall Street Journal (December 21, 1988), that Proctor and Gamble might be eliminated from future editions of the Best Companies for Women (Zietz and Dusky, 1988) for failing to promote a woman to a vice presidential post, had no effect on the firm's stock price-- on the day of the announcement or over any period surrounding the announcement. This finding does not support the negative relationship outlined in Hypothesis H₁.

Similarly, evidence for a positive relationship between favorable corporate reputation signals and firm performance was not detected using the event study technique. Indeed, two of the three corporate favorable reputation signals were invariant with corporate performance.

One confirmatory relationship, however, was observed. Those firms cited in Tom Peters' syndicated column identifying "America's Most Important Companies" (Peters, June 6, 1988) realized a positive, significant ($t=1.97$, $p<.05$) change in their share prices on the order of 2.6% the day after this column appeared. In the window that encompassed the event day (t_0) and 1 trading day thereafter (t_1), the share prices for these companies increased 3.96%, on average ($t=1.95$, $p<.05$). Although this finding supports Hypothesis H₂, the other corporate reputation signals did not provide any additional support for this hypothesis.³⁰

³⁰A subsequent analysis of Peters' weekly column in its first year of existence, 1985, detected no relationship between a firm's being mentioned and the accumulation of positive abnormal returns to its shareholders.

Evidence for a negative relationship between an unfavorable corporate reputation signal and financial performance was not detected either. Being named as one of America's 10 Worst companies in Mother Jones (June, 1985) had no effect on these firms' stock prices in the event month or any window of pre- or post-event months. This finding does not support Hypothesis H₂.

To summarize, the results of this study provide little evidence to suggest that favorable reputation signals are positively related to corporate performance; thus, neither H₁, *New, favorable (unfavorable) human resource management reputation signals at t_0 will have an immediate, positive (negative) effect on financial performance at t_0 and beyond*, nor H₂, *New, favorable (unfavorable) corporate reputation signals at t_0 will have an immediate, positive (negative) effect on financial performance at t_0* , were supported. The vast majority of favorable reputation signals were not positively associated with the financial performance of the firm. Nor did the few unfavorable reputation signals that were examined produce any evidence whatsoever to suggest that they are negatively related to shareholder returns.

CONCLUSIONS

The evidence from this study suggests that the relationship between reputation and corporate performance is a tenuous at best, and more likely, nonexistent. Only two of ten signals were at all related to changes in shareholder value. Frequently, corporate and HRM reputation signals had no effect on corporate performance whatsoever. Table 9 summarizes the findings of this study. Relationships in the expected direction were observed for only one HR and one corporate reputation signals.

TABLE 9 Summary of findings for the prediction of corporate performance.

Explanatory Variables	Methodology	
	O.L.S.	E.S.
<u>HRM Reputation Signals</u>		
"Best for Blacks"	ns (1982-88)	ns (1982,1988)
"Most Preferred"	ns (1982-88)	ns (1982,1984,1986,1988)
"100 Best to Work For"	ns (1984-88)	ns (1985)
"Best for Working Mothers"	ns (1986-88)	pos (1986,1987,1988)
"Best for Women"	ns (1988)	ns (1988)
"Best for Black Engineers"	--	ns (1989)
<u>Corporate Reputation Signals</u>		
"Excellent"	ns (1982-88)	--
"Best Managed"	ns (1982-88)	ns (1982-88)
"Most Admired"	mix (1983-88)	--
"Worst"	ns (1985-88)	ns (1985)
"Best"	--	ns (1985)
"Most Important"	ns (1988)	pos (1988)
<u>HR Performance</u>		
Income per Employee	pos (1983-88)	--

ns - no significant relationship detected pos - significant positive relationship mix - significant pos. and neg. relationships

Table 10 focuses on the most important explanatory variable identified in this study, HR performance. Over a five-year period, a significant positive relationship between HRM performance and financial performance is evident.

TABLE 10 Summary of findings for HRM performance as an explanatory variable.¹

	1988	1987	1986	Year 1985	1984	1983	1982
HR Performance beta (Standard Error)	.0013*** (.0003)	.0035* (.0016)	.0090*** (.0018)	.0051** (.0021)	.0040*** (.0011)	-.0053 (.0031)	.0063 (.0053)
Avg. HR Perf. (\$)	7,840	7,390	6,620	7,550	9,140	7,440	6,270
Std. Deviation (\$)	55,170	14,820	12,440	12,050	15,160	10,250	10,130
Avg. T.S.R. (%)	18.45%	5.31%	16.97%	31.11%	2.80%	28.38%	37.59%
Amount of a .1 std. deviation change in HRM performance (\$) and predicted change in T.S.R. (%)	5,517 7.18%	1,482 5.20%	1,244 12.00%	1,205 6.16%	1,516 6.08%	----- -----	----- -----
Amount of a .25 std. deviation change in HRM performance (\$) and predicted change in T.S.R. (%)	13,792 17.9%	3,705 13.0%	3,110 30.0%	3,013 15.4%	3,790 15.2%	----- -----	----- -----
Amount of a .50 std. deviation change in HRM performance (\$) and predicted change in T.S.R. (%)	27,585 35.8%	7,410 26.0%	6,220 60.0%	6,025 30.8%	7,580 30.4%	----- -----	----- -----

* $p < .05$ one-tail, ** $p < .01$ one-tail, *** $p < .001$ one-tail

¹ Estimated using the comprehensive model, Model 4, which includes accounting performance, HRM performance, corporate reputation, and HRM reputation. (see pg.)

For example, were the "average" company in this sample to have improved its income per employee value by .1 standard deviation in 1988, its total shareholder return would have increased from 7.18 points, from 18.45% to 25.63%; nearly a 40% increase. If the same were true in 1987, the increase would have been 5.20 points, nearly a 100% increase from 5.31% to 10.51%.

In that we control for the firm's other resources, its assets, equity, sales, and reputation, the most telling result of this study is our finding that companies who generate more income with fewer people will reap sizable rewards.

Table 11 summarizes our results which: (1) provide a shred of tenuous evidence for the theoretical notion that reputation matters to corporations and their shareholders, (2) call into question the conjecture of the business press--where it is held that reputation influences performance, and (3) build upon the findings derived in the previous empirical analyses.

TABLE 11 Summary of hypothesis tests.		
HYPOTHESES	OLS	EVENT STUDIES
<u>HRM Reputation</u>		
H ₁ New, <i>favorable</i> HRM reputation signals will have an immediate, <i>positive</i> effect on corporate performance.	No Support	Weak Support "Best for Working Mothers"
New, <i>unfavorable</i> HRM reputation signals will have an immediate, <i>negative</i> effect on corporate performance.	Not Tested	No Support
<u>Corporate Reputation</u>		
H ₂ New, <i>favorable</i> corporate reputation signals will have an immediate, <i>positive</i> effect on corporate performance.	No Support	Weak Support "Most Important"
New, <i>unfavorable</i> corporate reputation signals will have an immediate, <i>negative</i> effect on corporate performance.	No Support	No Support
<u>HRM Performance</u>		
H ₃ Human resource management performance will be <i>positively</i> related to corporate performance.	Strong Support Income per Employee	Not Tested

In the final analysis, maybe it is *not* "better to look good than to feel good." In this study, the "look good" signals demonstrated little, if any, association with corporate performance. On the other hand, one measure of efficiency and healthiness, HR performance, did emerge as a useful predictor of financial success. To be sure, this study raises some new research issues and, more fundamentally, generates some questions about the theoretical underpinnings it relied upon.

Quite simply, these results call into question the appropriateness of applying signaling theory and the efficient markets hypothesis to the reputation-performance problem. In the end, numerous favorable reputation signals did not generate positive shareholder returns on or around their release date or in the fiscal year in which they were released.

Recall that signaling theory suggests that in the absence of complete and accurate information, decision makers rely on observable factors, or signals, as substitutes; and the efficient markets hypothesis holds that stock prices reflect all available information. The designations identified and isolated in this study, if they are meaningful reputation signals that provide new information, should influence stock prices. Most of the new reputation signals, however, did *not* have either an immediate or even a delayed effect on share prices. This finding raises at least two questions: When is a signal not a signal, and when will it have no effect whatsoever on stock prices?

Perhaps, a signal is not a signal when it emanates from an ill-informed or self-interested source. This may be the case for the reputation signals studied here, many of which emanate from consultants, journalists, or some combination thereof. All to say, the quality of a signal may determine its power.

A simpler explanation is that these ostensibly new signals are really old news. The increased attention to human resource management of late has led to a proliferation of information regarding the policies and practices of organizations. Perhaps, the information marketplace has simply become overloaded.

Of course, the results of this study do not refute signaling theory or the efficient markets hypothesis altogether. They do, however, seem to suggest that the quality of reputation signals varies and that some reputation signals, even those that have face validity, may amount to nothing more than noise in an already loud arena.

Merits to this Study. The first contribution of this work is the introduction of the concept of HR reputation. This led to the development of a general model of HR reputation that we tested using ordinary least squares regression and an event study methodology. The second contribution of this study is the fact that it moves beyond describing HR reputation to an examination of the contemporaneous relationship between HR reputation and corporate performance using widely accepted, rigorous scientific methods. The use of the event study methodology to address this problem is our third contribution. Previous examinations into this issue have only examined the effect of reputation signals on annual shareholder return using OLS regression that does not isolate and calculate the *immediate* effects of these or other signals. A fourth contribution of this study is its reliance on multiple measures of reputation. Prior to this, researchers have only utilized Fortune's single item measure of corporate reputation. Here, ten reputation signals, six HR and four corporate, were identified, isolated, and tested.

Limitations of this Study. It is imperative to note some of the inherent shortcomings with the reputation signals studied; especially those which may diminish the likelihood of detecting a relationship between reputation and performance. Broadly speaking, the limitations of this study can be placed in two categories: issues surrounding the genesis of these reputation signals and their dissemination.

One liability that affects some of these reputation signals, the Fortune "most admired" assessment for instance, is the fact that the reputation measures are not independent.³¹ In

³¹This assertion is based on a review of the limited information provided by the WSJ, a partial report for the third quarter of 1989 that the author obtained from the Editors of the Journal. It consists of the first three pages (Introduction, About this Survey, and Respondent Profile) and the survey results (twelve different points in time--two per year over a six year period) for one anonymous company.

addition, the criteria, criterion weights, and scores that distinguish winners from losers may be amorphous, selectively divulged, or withheld altogether. For example, it wasn't until Dun's 1987 report (Business Month, December 1987) that both the criteria (profit growth, size, operating efficiency, reputation, and corporate strategy) and the judges (a panel of 20 business experts) were revealed for the very first time.

In addition, some of these "best" lists are solely the outgrowth of their originators' subjective judgments. Peters' "most important" list is obviously such a case. It is devoid of uniform measures. Another criticism leveled against some of these lists is that they lack face validity. Their members appear to be too different on too many dimensions to be grouped together.

Moreover, in certain cases, the purveyors of these lists stand to gain from including certain companies on them (e.g., their: clients, advertisers, or contributors). For instance, there appears to be an association between involvement with N.S.B.E., sponsor of the N.S.B.E. 100 list, and inclusion on the list. N.S.B.E. reports that "All 26 members of it's Board of Corporate Affiliates made the survey, with 13 of them appearing in the top 15" (1990, p. 42).

Those who create and translate reputations are not always able to collect all of the requisite, in some cases proprietary, data they need (Lydenberg et al., 1986). When this is true, the data collected are at best incomplete and at worst misleading. Other sampling problems include: unreported or low response rates, on the order of 20%, (Sales and Marketing Management, 1988; 1990); a lack of standardization in the evaluation process--for instance, in Working Mother's inaugural survey, (1986) 30 companies were evaluated on 3 criteria and in the most recent survey (1990) 75 companies were evaluated on 4 criteria; and potential response bias--for example, the "best for engineers" survey relies on responses to a questionnaire that is placed in Graduating Engineer (1982-1990).

Although the selection processes for some "best lists" may be rigorous,³² questions are increasingly being raised as to whether the force and focus has moved from the original purpose of these designations (to foster quality improvement, for instance) to merely making a list or winning an award (Quality Progress, March, 1990).³³

Another drawback is the fact that it may be difficult to isolate the exact day or month that these reputation signals reached the financial markets. For example, the Best Companies for Women book had an "official publication date" of April 1988. It was released to bookstores approximately six weeks prior, advertised and promoted before this, and was, in the form of galley proofs, in circulation even earlier. In our study, this limitation was addressed by examining a variety of time horizons. For example, the effect of the "best companies for women" signal on annual, monthly, and daily financial performance was evaluated using the OLS and event study methodologies. In addition, multi-period cumulative abnormal returns were evaluated for the signals.

Some HR reputation signals might have a difficult time even making it to market participants. Many of these signals appear only in practitioner journals with small circulations and limited audiences. If they do appear in national outlets, such as the Wall Street Journal (which is seldom), often this information is not presented in its entirety and it usually receives less than prominent placement.

Clearly, there are a number of possible explanations for not detecting a relationship between the corporate and HR reputation signals and financial performance. It is not clear, though, that these limitations are sufficient enough to mask the reputation -- performance relationship altogether.

³²See: Electronic Business (October 15, 1990) and Fortune (April 23, 1990).

³³For an interesting discussion of the merits of this award and some new problems, one of which is the use of past and future judges as advisors to applicants, see: Training (February, 1991).

Implications for Future Research

There are abundant opportunities to further investigate the topic of HRM reputation. It appears that the causes, consequences, and conditions of human resource management reputation are all issues that merit further investigation.

For example, the effects of HRM reputation signals on other financial performance measures could be studied. Specifically, one might want to study the effects of these signals on long-run returns to shareholders (average financial performance over five or ten years). Alternatively, measures of accounting performance such as sales or income could be examined.

Similarly, the effects of HR reputation signals on HR performance measures such as employee attraction, retention, satisfaction, and productivity may also prove to be fruitful. In somewhat the same vein, the effects of HR reputation signals on other corporate performance measures might also be informative. The effect that these signals have on customers, measured in terms of market share and customer satisfaction, is an example.

Studying the effects of additional HR reputation signals on corporate performance may be also prove worthwhile. Most, if not all, of the HR reputation signals in existence have been included in this analysis. Still, others are virtually certain to emerge over time.

Recall that the determinants of corporate reputation have been widely studied. Likewise, examining the determinants of HR reputation may also be of interest, especially in light of the attention these various designations generate.

Case studies to determine and dissect the HR policies and practices of the HR reputation leaders, likely to be interesting unto themselves, may also provide some insights into how companies create and manage HRM reputations. Examining the role of HR reputation in settings other than America and studying the importance of HR reputation for the multinational company may also prove to be interesting .

To be sure, at least two major challenges remain. First, is it possible to aggregate these HR reputation signals to create a comprehensive "HR reputation index." Such a measure could

serve as a dependent variable for those interested in studying the antecedents of HR reputation or an explanatory variable to examine the effects of HR reputation. Second, we need to explore why the *reputation--enlarged applicant pool--better hires--improved short- and long-term performance* scenario breaks down, in spite of the anecdotal evidence that reputation affects the behaviors of job applicants (Wall Street Journal, October 10, 1989; December 18, 1989).

To summarize, signaling theory, the efficient market hypothesis, conjecture, and, even, intuition suggest that reputation signals should be related to corporate performance. In this study, this was seldom the case. For some, this finding may not come as a surprise. Indeed, it may easily be explained by making the case that investors never receive these HR reputation signals, they already know the best firms, or they attach little weight to the judgments of various, potentially self-interested, business observers, journalists and consultants. For others, particularly those who have invested heavily in building a reputation and promoting it, this finding may be quite disturbing--even costly.

Whatever the case, the results of this study suggest that the wisest counsel is to go ahead and buy these "best company" communiqués if you like, but don't use them to guide your stock investment decisions.

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