

# Building Corporate Reputation through Corporate Governance

ČEDOMIR LJUBOJEVIĆ

*Faculty for Service Management Doboj, Bosnia and Herzegovina*

GORDANA LJUBOJEVIĆ

*Higher School of Professional Business Studies Novi Sad, Serbia*

The authors of the article deal with mutual relations of corporate governance and corporate reputation. The aim of this paper is to show that corporate governance design is in the function of better corporate reputation and to test the perceived relation between corporate governance and corporate reputation. The research expect to show: the necessity for integration of corporate strategy into business strategy (this issue will be even more present in the future) and to prove the opinion of consumers and corporations who claim that corporate governance is a necessity for corporate reputation development.

*Key words:* corporate governance, reputation, competitive advantage

## Literature Survey

A company achieves its competitive advantage when it succeeds to implement the strategy of value creation which is not possessed by its competitors on the market or in the industry. The sustainable competitive advantage may be achieved by disposing mechanisms that protect their competitive advantage from imitation. The established sustainable competitive advantage is the basis for the realization of superior organizational performance, survival and development. The theory of strategic management suggests that positive reputation may create competitive advantage and influence corporate performance.

Market efficiency determines the role of corporate reputation, and on an efficient market, the reputation plays the role of strategic property. There is a problem of identifying strategic resources in comparison to non-strategic ones, therefore it is best to say that strategies resources are the ones that significantly contribute to creating sustainable competitive advantages (Fombrun 1996).

According to Fombrun corporate reputation consists of four characteristics: credibility, reliability, responsibility and trustworthiness (Fombrun 1996).

According to Widerman and Buxel (2005), corporate reputation helps the companies to get good employees, attract consumers, increase consumers' loyalty, which may be implemented as a factor of competitive performance and useful in obtaining the capital.

Without good reputation it is very difficult for a company to survive or to make progress. The key role of corporate governance has to be the improvement and protection of corporate reputation. Kitchen and Laurence (2003) have proven that reputation of a CEO and reputation of a company are linked to each other.

Good reputation is impossible to maintain without internal organization support. Argenti and Druckenmiller define corporate reputation as 'a collective presentation of all participants image, built through the time and based on programs of company identity, its performance and perceptions of its behavior' (Argenti and Druckenmiller 2004). The authors argue that organizations recognize the significance of corporate reputation in business goals achievements and in the function of competitive advantage maintenance.

The corporate reputation is a part of company's assets along with tangible property, in balance sheet, workforce, social property (relations with suppliers, relations with consumers, local community and regulative institutions), and environmental property (energy, material resources, clean water, air and local environment; see Harrison 2007).

We talk about good reputation when consumers prefer the products and services of a company to available products of the competition that are similar in prices and quality. Good reputation is the key condition of stakeholders' support to a company in competitive relations, and it is an important factor of value of organization on the financial markets. In spite of being intangible, the researches show that reputation provides sustainable competitive advantage.

Corporate reputation may be divided in factors that dominate its content. These are: the company's ethics, employees (the way a company treats them, possible talented employees, etc.), financial performance, leadership, management, social responsibility, and focus on consumers, quality, reliability, emotional appeal, and communication.

According to Barnett, Jermier, and Lafferty (2006) corporate reputation includes basic components, such as the image and quality. Identity is determined as a perception of the company's nature by its employees and managers; the image is a perception of external parameters of the company. Reputation of corporation may be observed in the sphere of awareness (image and perceptions) and it

includes general awareness of stakeholders, without judgments. In the sphere of evaluation, there are definitions that show that stakeholders are included in the evaluation of company status (expectations and opinions). At the end, reputation is observed as a property: when definitions that consider it as something valuable and important for a company are incorporated.

Company identity consists of characteristics which are by the employees considered to be of a central significance for a company because they make a company unique in comparison to other companies, and at the same different to some permanent characteristics that link the past and present to the future of a company (Cornelissen and Harris 2001).

Corporate identity is an apprehension of the self and very similar to apprehension of one's personal identity. Corporate identity is the reality and peculiarity of the organisation. Its components are presented by strategy, philosophy, culture and structure of a company organisation. Identity includes means by which a company wants to present itself on the market or to pose a product on the market.

The major part of definition focuses on feelings and beliefs about the company that are present in the audience (Berstein 1992). The image which a company creates in its environment is highly determined by the nature of its products or services, the nature of organisation, by surrounding culture and the members of organisation, and, in addition, by the market segment.

The image building and managing are linked to several main areas of image usage:

- strategic positioning;
- successful market penetration;
- availability of different resources and cost reduction;
- focus on the behaviour that increases motivation and productivity;
- easier recruitment of employees;
- attracting creative employees;
- increasing the company value;
- higher profits.

Besides that, the image is very important in the process of shaping consumers' expectations and for better perception of service quality. The image is a filter that affects the perception of company service operations. Positive image of an organisation with a perfect service that communicates clear values leads to positive attitudes of employ-

ees. This enables a company to attract such workforce that might be in short supply on the labour market.

Good and recognisable image does not happen by chance. In order to build it, the procedure requires creativity and firm determination of corporate management. Corporate image and corporate reputation management have two primary aims. The first is the creation of 'the intentional image' in the minds of all key constituents in a company. This means creating a widespread name recognition between target stakeholders, accompanied by spontaneous identification.

The second aim in the managing process is the creation of positive reputation in the minds of key stakeholders. A prominent corporate image may be developed through coordinate image building campaign. This includes a formal communication system: name, logo, corporate advertising and public relations. On the other side, building a good reputation requires more than effective communication efforts. It demands extraordinary identity that can be modelled only by consistent performance throughout many years. Coordinated communication programs can, however, strengthen and improve company's reputation.

Company competitive advantage depends on its distinctive capabilities, strategic excellency and market structure. According to Kay (1993), there are three sources of distinctive competitive advantages that may be, depending on a market, used to create and maintain competitiveness. These refer to architecture, reputation and innovativeness. Architecture is in this case a network of contractual relations inside and outside of the organisation. Innovativeness is the capability of an organisation to create and collect new ideas successfully.

Reputation is the next distinctive capability that assumes a series of company's attributes that are excerpted from other actions of the company. Corporate reputation is public evaluation of organisation resources and company's capability. Good and recognisable image does not happen by chance, instead it demands creativity and determination of the company management.

The transition from identity to image is a result of public relations, marketing and other organizational processes that try to generate the impression which the subjects of business relations have within a company.

Some requests concerning corporate reputation are to make a company and its internal relations consistent, transparent, authentic and, as a result, distinctive. Successful corporate reputation may attract the owners of resources. A company may build its good rep-

utation by revealing relevant information to certain stakeholders. Therefore the intention of reputation management strategy is to give more information consistent to corporate activities within reasonable time. Good reputation is the result of consistent informative signal within a certain period of time.

Some management tasks linked to reputation are: transparency, solutions for the problems of signal misperception, and the emission of consistent information, and prevention of moral hazards that might undermine building and maintaining good reputation. In addition, some other tasks include the solutions for wrong interpretation of the problems, stakeholder information detecting and minimizing uncertainty for a stakeholder by providing information (Dentchev and Hene 2003).

Improvements of information transparency may be a good way of raising reputation and regaining trust. New corporations try to build up their reputation with the intention to avoid being labelled as untrustworthy by shareholders and stakeholders. Reputation, dialogue and experience are the basis for trust (Swift 2001).

Hilman and Keim (2001) have pointed out that a corporation is obliged to establish and maintain relations with primary shareholders, not only to increase its wealth, but also to make intangible and valuable ownership into a competitive advantage. A company therefore pays a lot of attention to stakeholders' needs and to the fulfilment of these needs.

Corporations may actively achieve intangible but valuable property by using company's resources and by participation in social problems solutions, with the intention to preserve competitive advantage. Social responsibility and relations with employees are two components of reputation.

The ownership structure and board of directors affect the transparency. Transparency is a necessary requirement for successful corporate governance and it leads to good reputation. The board structure influences the transparency. Practice in the countries with developed model of corporate governance undoubtedly shows that smaller boards are more efficient in comparison to boards with more members. With smaller boards it is easier to reach agreements on strategic policies of a company.

Internal directors in board and family controlled companies have low level of transparency. On the contrary, external non-executive boards, bring resources to a company (e.g. reputation); they are responsible for reducing informational asymmetry, and due to better information access, they are able to qualify information for stake-

holders; they have intermediate role in finding significant entities for a company. External directors are more successful in following the management towards establishing good reputation for a company.

Independent non-executive directors may play an active role for the stakeholders – company monitoring and fraud prevention. Dignified independent directors represent a significant factor for attracting the stakeholders, since they are the ones who take decisions, and their decisions depend on the company's reputation.

When speaking about ownership structure, we may conclude that important shareholders have positive influence on the reputation since they strive, without changing the strategy, to maximize corporate value, and they also put pressure on the management. Institutional shareholders provide credible mechanism for information transmission in financial markets, and start initiatives to protect their investments from frauds.

Financial institutional shareholders may engage experts to analyse company performance and monitor executive directors. In situations when ownership is more concentrated with financial institutional investors, the market valuation of a company and also its reputation are greater. Having in mind the fact that leading banks have superior information in comparison to the other shareowners Gillan and Starks (2003) point out that financial institutional investors like investment companies may play active role whereas banks and insurance companies, as traditional institutional investors may play a passive role in monitoring.

State shareholders have a primary goal announced in state participation in company operations, based on strategic significance. By state participation and state ownership we get greater openness, which is positive for transparency. Since managers may also be the owners of the shares in companies in which they work as managers, greater participation of managerial ownership may lead to defeating the monitoring mechanism.

There are several aspects that are linked to company reputation, and that should be managed by the management. These are, according to Persey, the ability to make dialogue that helps a manager to make cooperative relations with a great range of external participants which are based on trust. Secondly, there is the capability of avoiding critical reputation dangers like corporate silence. Thirdly, there is the capability that allows managers to influence external officials (advocacy). Last but not least let us mention the capability of crisis communication that enables managers to interact with in-

fluent participants in unpleasant conditions a company may find itself in (Pursey et al. 2004).

Corporate reputation may be strengthened by a program of relations with consumers – a research with the aim to know key stakeholders, to measure their strengths and weaknesses, and fill in the gap between internal reality and stakeholders' perception. Furthermore, based on the research of the main factors that include reputation of a company, it is possible to change behaviour in order to reach a certain state of harmony with the policies in all functional areas. It is expediently to make plans to exceed stakeholders' expectations, and to include CEO as a greater protector of reputation program. Logically, the measurement of results and result improvements shall become regular (Harrison 2007).

Good corporate governance is recognised as essential for maintaining attractive investment climate that is characteristic of highly competitive companies and efficient financial markets. The SE countries have made a significant progress in corporate governance during the past few years. Recent and current reforms have improved legal and regulatory framework offering protection against corruption.

When speaking about priorities for creating a framework of good corporate governance in former Yugoslav republics, we should consider:

- regulative authorities encouragement for enhancement of implementation and management;
- increasing the private sector adherence to corporate governance reforms and enabling the development of corporate governance culture;
- development of the training for all participants and professions that are crucial for good corporate governance practices;
- the protection of minor shareholders from insiders and controlling shareholders;
- strengthening the board of directors;
- the evolution towards complete convergence with international standards and practices for accounting, revision and non-financial disclosures.

Corporate reputation influences business results. In literature there the necessity for observing corporate reputation with due attention is pointed out. The multi-stakeholder measurement approach is considered to be necessary for keeping executive directors

informed and for making decisions in accordance with corporate reputation development.

The CRW results (Corporate Reputation Watch, see Resnick and Wendler 2003) say that the most of CEOs in leading corporations think that corporate reputation is more important today than ever before.

The CRW research points out three most important business goals that may be achieved by corporate reputation. These are:

- recruitment and retention of employees (73%);
- improvement of transaction and strategic partnerships (61%);
- sales improvement (56%).

This research concluded that a company in search of positive reputation depends on its consumers more than on any other external factor. It is assumed that consumers should make positive influence on reputation if internal problems of communication, transparency, values and employee treatments are also harmonised. Support and significance of employees are strongly related to reputation. That is in financial sector, with a great number of service encounters, highly expected. A high degree of satisfaction and employee loyalty is a good prerequisite for the satisfaction of external consumers and other stakeholders, and also for good overall business success.

### **Methodology**

This study uses consumer survey and company questionnaire to achieve relevant results.

*Consumer survey.* The survey was conducted by the help of 100 consumers of both genders which are employed in different sectors. The questionnaire was very short, it was composed of five questions.

*Questions* asked about the reasons that influence consumers' decisions about the purchase of products and services, about company liability to public disclose of their internal corporate information, about company duty to participate in activities that are beneficial for the community. At the end, the questions for consumers should tell us about the level of understanding the notion of corporate governance.

*Company Questionnaire* consisted of fifteen questions for managers of five financial sector companies in three former Yugoslavian countries. The questionnaire was made to explore a company perception of corporate governance and its role in building and maintaining corporate reputation as a source of company competitive advantage. The questionnaire covered the following parts:



- the recognition of corporate governance and its role in modern business;
- competition in financial sector;
- consumer requirements in choosing financial products and services;
- the significance and role of corporate reputation and factors that influence the development of corporate reputation.

## **Findings and Observations**

### CONSUMER SURVEY

Out of 100 participants included in the survey 86 responded to our questionnaire. In the survey 71,40% men and 28,60% women participated. The questions were answered by 85,70% employed and 14,30% unemployed workforce.

The participants were asked to rank the factors that influence their purchase decisions when speaking about financial products and services. They were offered six options to rank them from the most important to the least important. The service quality was put in the first place by 57,14% participants, attractive price was the most important for 30,60% of participants, whereas 12,20% think that brand recognition is the critical factor for their decision. Among the least important factors in the process of decision making about services, are extensive advertising and promotion, and social responsibility of the service provider (respect for the human rights of employees, health protection, the security of employees, etc).

Considering the openness and transparency of the company – its obligation and liability to publicly disclose information, 57,14% of consumers think that companies are liable to publicly disclose their internal corporate information, whereas 42,86% participants are of the opposite opinion.

The majority of participants (85,70%) agree that companies should participate in activities that are useful for community benefits. On the other hand 14,30% of consumers does not think that companies are liable for the development of a community and its well-being.

When speaking about the request that consumers show their knowledge and understanding of corporate governance, consumers have unfortunately not achieved the satisfying level. 42,90% of consumers has not even tried to answer the question what a corporate governance is, and 57,10% participants offered the answers containing detached elements and showed only vague knowledge of this complex notion. The greatest stress is put on the board of direc-

tors' policies that contribute to better position of a company on the market.

#### COMPANY QUESTIONNAIRE ANALYSIS

Company questionnaires were distributed within the financial sector. Five companies from three countries in the region participated in the survey. Four of them have more than 101 employees, and one has between 51 and 100 employees. The questionnaires were filled out by people who have different positions in the company – ranging from general manager, executive director to PR manager.

- Three companies show the understanding of corporate governance notion. However, their definitions lack transparency, responsibility and openness. Three companies point out that corporate governance represents a system for managing a company. Three of them show that they use the best practices of corporate governance.
- The key benefit from good corporate governance is, according to three companies, increased profitability. Two of them think that competitive advantage is the most important. It is interesting that improved stakeholder relations or attracting direct foreign investments are poorly ranked.
- Four companies think that their company is liable to publicly disclose corporate information to all stakeholders.
- Four companies see financial sector companies as their main competitors.
- The companies that participated in the survey are successful market competitors, and two of them think that the quality of products and services is essential for success. The others think that attractive price, brand management and good management practices are critical for competitiveness.
- All five companies are aware of the fact that good corporate governance is a must for successful competition on today's market.
- Three companies think that attractive price is the most important factor for consumers when deciding about services, whereas two companies think the crucial factor is quality.
- Four companies think that consumers may be interested in their corporate information, however, one does not share this opinion.
- The question about the benefits of good reputation offered eleven possible answers. Three companies chose the increase of sale, and two chose financial performance (competitiveness,

profitability, investment risks and growth perspectives) as key benefits.

- Four companies think that support from the public institutions is the least important benefit resulting from good reputation. Competitive barrier creation was considered the least important by one company.
- Two companies think that the financial strength of a company is the most important factor for corporate reputation development, whereas the others think that the most important factors are consumer satisfaction, manager-employee relations and strong leadership by CEO and his or her team, respectively.

#### COMPARATIVE ANALYSIS

Three out of five companies think that consumers are led by attractive price in deciding what financial product and service to purchase. 14.20% consumers think the same. The quality of financial products and services is the most important for the consumers, and two out of five companies think that this is the most important factor for the consumers.

The companies still do not understand that social and ethical liability contribute to their competitiveness, therefore they continue to put them in the last place. In addition to this they also poorly perceive good managerial practice. On the other hand, the consumers consider social liability of a service provider to be an important factor in the process of decision making about the services they want to use. However, they mostly agree that companies should participate in the activities that are beneficial for the community. Companies feel that positive media coverage is the least important factor of corporate reputation development. It is interesting that, for consumers, advertising and promotion came last when deciding about the services consumers want to use.

All companies and the majority of consumers (85,7%) agree that good corporate governance is a necessary condition for achieving sustainable competitive advantage.

Consumers think that companies should publicly disclose their internal corporate information and 4 out of 5 companies agree with the statement as well.

#### THE STUDY LIMITATIONS AND FUTURE RESEARCH

Limitations in resources and time are the reasons for a limited number of consumers and companies included in the research sample.

In future researches it is necessary to make a detailed study using more scientific and effective means, such as focus group discussions and more sophisticated questionnaires.

## Conclusions

The companies and consumers included in the research show high level of awareness and responsibility in recognising the role of corporate governance and the significance of integration of corporate governance into corporate strategy.

Companies do not fully understand that better corporate governance is a condition for corporate reputation development (poor understanding of management board role, and strong leadership of the CEO and his team). What is more, companies do not completely understand the nature and significance of corporate reputation and its key role in the achieving sustainable competitive advantage. When speaking about former Yugoslav countries, the role of corporate reputation should be of the utmost importance in increasing the numbers of foreign investors.

Though the majority of companies and consumers share the opinion that companies are liable to disclose their internal corporate information to public, the transparency and strong governance control are not recognised as significant factors in corporate reputation building.

## References

- Argenti, P. A., and B. Druckenmiller. 2004. Reputation and the control brand. *Corporate Reputation Review* 6 (4): 368–374.
- Barnett, L. M., M. J. Jermier, and A. B. Lafferty. 2006. Corporate reputation: The definitional landscape. *Corporate Reputation Review* 9 (1): 26–38.
- Berstein, D. 1992. *Company image and reality: A critique of corporate communication*. London: Cassell.
- Cornelissen J., and P. Harris. 2001. The corporate identity metaphor: Perspectives, problems and prospects. *Journal of Marketing Management* 17 (1): 49–41.
- Dentchev, N. A., and A. Hene. 2003. Managing the reputation of restructuring corporations: Send the right signal to the right stakeholder. *Journal of Public Affairs* 4 (1): 56–72.
- Fombrun, C. J. 1996. *Reputation, realizing value from corporate image*. Boston, MA: Harvard Business School Press.
- Gillan, S. L., and L. T. Starks. 2003. Corporate governance, corporate ownership, and the role of institutional investors. *Journal of Applied Finance* 13 (2): 4–22.

- Harrison, K. 2007. Why a good corporate reputation is important to your organization. <http://jobfunctions.bnet.com/abstract.aspx?scname=Interpersonal+Communication&docid=263774>.
- Hillman, A. J., and D. G. Keim. 2001. Shareholder value, stakeholder management, and social issues: What's the bottom line? *Strategic Management Journal* 22 (2): 125-139.
- Kay, J. 1993. *Foundations of corporate success: How business strategies add value*. Oxford: Oxford University Press.
- Kitchen, P. J., and A. Laurence. 2003. Corporate reputation: An eight-country analysis. *Corporate Reputation Review* 2 (4): 363-381.
- Purse, P. M., A. R. Heugens, B. M. van Riel, and F. A. J. van den Bosch. 2004. Reputation management capabilities as decision rules. *Journal of Management Studies* 41 (8): 1349-1377.
- Resnick, T. J., in R. E. Wandler. 2003. Corporate reputation: Raising assessment to the next level. *All Things Corporate Governance*, December: 24-32.
- Swift, T. 2001. Trust, reputation and corporate accountability to stakeholders. *Journal of Business Ethics* 10 (1): 16-26.
- Wiederman, K. P., and H. Buxel. 2005. Corporate reputation management in Germany: Results of an empirical study. *Corporate Reputation Review* 8 (2): 145-163.