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Jooh Lee
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Earnest Hall, Jr.

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Jooh Lee, *Rowan University*
Dr. Earnest Hall, Jr.

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AN EMPIRICAL INVESTIGATION OF THE 'HALO' EFFECT OF FINANCIAL PERFORMANCE ON THE RELATIONSHIP BETWEEN CORPORATE REPUTATION AND CEO COMPENSATION

Jooh Lee

Rowan University

Glassboro, NJ 08028

Ernest H. Hall, Jr.

University of Southern Indiana

Evansville, Indiana 47712

ABSTRACT

The popularity of the *Fortune* Reputation Index (FRI) can be easily discerned by a quick perusal of the management literature investigating corporate reputation, social responsibility, and stakeholder orientation. (Chakravarthy, 1986; Fombrun, 1996; Preston & Sapienza, 1990). The main focus of this paper is to empirically demonstrate the impact of firm profitability on corporate reputation and further investigate the impact of the 'halo' effect of financial performance on the general relationship between corporate reputation and CEO compensation. The results show that the FRI as a proxy measure of corporate reputation plays a significant role in determining how much a CEO receives in compensation within the context of executive compensation and performance linkages. Results suggest that FRI is a robust measure of corporate reputation that can be used with confidence, even when strict controls are not in place.

Keywords: Halo Effect of Financial Profitability; Corporate Reputation; CEO Compensation

Introduction

Fortune has been publishing annually a list of what they call the "Most Admired Companies" since 1982. Since its inception, the *Fortune* Reputation Index (FRI), as it is frequently referred to in the management literature, has come to be one of the most utilized proxies for a firm's reputation (Fombrun, 1996; Fombrun & Shanley, 1990). In addition, the FRI has also been called into service as a reflection of a firm's level of corporate social responsibility (Conine & Madden,

1986; McGuire, Sundgren & Schneeweis, 1988), and stakeholder orientation (Chakravarthy, 1986; Preston & Sapienza, 1990).

However, the FRI has suffered from some criticism that has severely curtailed the popularity of the index (Fryxell & Wang, 1994). The criticism has primarily focused on the close relationship between the financial performance of the firm and its' corresponding FRI. This close correlation between financial performance and FRI has been referred to as the "financial performance halo effect" and the overall suggestion is that it is really the financial performance of a firm that determines the majority of the variance observed in the FRI rankings (Frombrun & Shanely, 1990; McGuire, Schneeweis, & Branch, 1990) and not firm reputation. The "financial performance halo effect" (hereafter referred to as the "halo" effect) has damaged the "reputation" of the FRI. Another study by Brown & Perry (1994) developed a statistical procedure for removing the financial biases from the FRI. It is the objective of this research to empirically test the overall impact of the FRI and the halo effect on corporate executive compensation and to assess the usefulness of the FRI for future research studies.

Corporate Reputation and Financial Halo Effect

Corporate Reputation

Due to the difficulty of measuring and operationalizing a subjective concept such as reputation, it is important to establish some parameters before beginning our investigation of the FRI, which is believed to measure reputation. Simply stated, the reputation of a firm may be defined as the long-term evaluation of a firm's social and economic potential by external constituents (e.g. customers, suppliers, society, etc.). Or to utilize a more commonly accepted definition supplied by Fombrun (1996) corporate reputation is the "perceptual representation of a company's past actions and future prospects that describe the firm's overall appeal to all its key constituents when compared to other leading rivals" (p.72).

First, it should be noted that corporate reputation is perceptually based and therefore, a subjective measure of a firm's actions. Second, this subjective assessment is subject to the interpretative and evaluative paradigms of the individual who is drawing the conclusion and making the assessment. Third, the assessment of reputation can vary widely across individuals. However, the underlying foundation of all definitions of reputation is that a firm's corporate reputation is a valuable commodity, or dare we say a strategically valuable resource (Barney,

1991). Such a valuable resource must be managed and exploited by the firm's management and be capitalized by the financial community and ultimately reflected in the stock market.

In order to maximize firm's performance, it is imperative that a firm manage its strategic resources to ensure the best possible outcome. Recognizing that reputation is a hard to measure construct can be turned into a valuable commodity if managed properly. According to Roberts & Dowling (2002) "Intangible assets - such as good reputations - are critical because of their potential for value creation, but also because their intangible character makes replication by competing firms considerably more difficult" (p.1077). The real benefit of reputation may lie in the fact that it is inherently non-quantifiable or what may be called causally ambiguous. Since a firm's reputation can be rare, valuable, and imperfectly imitable, it can be a source of long-term sustainable competitive advantage (Barney, 1991). Causal ambiguity has been cited in other research as a potentially valuable factor that protects a firm's source of competitive advantage (Lippman & Rumelt, 1982).

Crisis management can have a large impact on the perceived image or reputation of a firm. Firms are constantly under review by a host of internal and external stakeholders that will largely determine how a firm is viewed from a financial perspective. For example, it is generally accepted that Johnson & Johnson's handling of the Tylenol scare was a large boost to the overall reputation of the firm. On the other hand, the reputation of Exxon has suffered from the unfavorable and ineffective response that was exhibited in response to the Valdez disaster. One thing is clear: a poor or weak reputation can have a devastating effect on the future profitability and survival of a firm (Fombrun & Shanley, 1990; Petrick et al., 1999).

Reputation management has come to play an increasingly important role in determining a firm's future organizational performance. Research suggests that developing and maintaining a favorable corporate reputation will pay dividends. Most notably, the firm will recognize larger sales and profits by: 1) influencing customer product choices (Dowling, 1986; London & Smith, 1997), 2) inhibiting rival firms' actions (Caves & Porter, 1977; Wilson, 1985), and 3) developing social status among rivals within industries (Shrum & Wuthnow, 1988). Any of these benefits possess the power to increase a firm's profitability, market share, and competitive advantage.

Based on a variety of research studies, it has been concluded that corporate reputation is positively correlated with organization performance and financial potential (Caves & Porter,

1977; Fombrun & Shanley, 1990; McGuire et al., 1988). The general conclusion that is continuously drawn from the research is that organizations that enjoy favorable reputations tend to out-perform firms which have less favorable reputations. For the purposes of the present study, previous research suggests that corporate reputation and firm performance/potential are positively correlated.

Financial Halo Effect

The *Fortune* reputation index has been the most widely used proxy for corporate reputation throughout the professional literature. Due to the ease with which the data can be gathered and statistically analyzed the FRI is very popular among researchers. However, there have been some notable critics of the FRI (Brown & Perry, 1994; Fombrun & Shanely, 1990; Hammond & Slocum, 1996; Fryxell & Wang, 1994). Criticism ranges from the FRI being one-dimensional (Fryxell & Wang, 1994) to accounting measures of risk and return as antecedents to the ratings (Brown & Perry, 1994; Fombrun & Shanley, 1990; Hammond & Slocum, 1996). The FRI has also been attacked from a design and accuracy standpoint (Fryxell & Wang, 1994). Taking a look at the *Fortune* reputation index will quickly reveal some of the evidence supporting the questions, concerns, and criticisms that have been leveled against the FRI. The FRI is calculated based on a total of eight dimensions, which include quality of management, quality of product, innovativeness, effective use of assets, financial soundness, employee talent, social responsibility, and long-term investment value.

As can been seen, the majority of these dimensions can be tied directly to firm performance. In fact, research studies have found that firm performance can explain anywhere from 42 percent (McGuire et al., 1990) to 53 percent (Fombrun & Shanely, 1990) of all the variance observed in the FRI. Such high explanatory powers by a single dimension (financial performance) raises questions of the usefulness of the FRI in measuring reputation, ethics, and social responsibility. This has lead to the argument that the FRI is a one-dimensional construct (Fryxell & Wang, 1994). Given the composition of the initial sample of firms, all very large and very profitable companies, it could be argued that the sample is unduly biased in favor of performance measures over less readily measurable variables like reputation, social responsibility, and ethics. In addition, the survey was sent to a select group that is largely interested and influenced by financial performance (securities analysts, directors, and executives).

In further support of the single-dimension theory, the eight dimensions upon which the FRI is based have been shown to be highly correlated. Instead of eight separate and distinct variables, Fombrun and Shanley (1990) have reported that the results of a factor analysis revealed that one factor explained a total of 84% of the variance reported. Based on these results it can be concluded that a "halo" effect is present. According to Dillion, Mulani, & Frederick (1984) a "halo" is confirmed whenever "a common general factor showing high loadings on nearly all attributes which accounts for appreciable variance" (p.194) is present for a principal components analysis. Given the results reported by Brown & Perry (1994) there is strong evidence to support the conclusion that the FRI suffers from a financial "halo" effect.

Based on the work of previous management scholars (Brown & Perry, 1994; Fombrun & Shanely, 1990; Fryxell & Wang, 1994; McGuire et al., 1990) it would be unwise to ignore the potential "halo" effect of the FRI. Therefore, to make sure that any "halo" effect is accounted for the present study will employ a "financial halo removal" method to account for the weaknesses highlighted by Fombrun & Shanley (1990). However, the question of how important the "halo" effect has been in biasing previous studies on corporate reputation, ethics, and social responsibility studies that relied on the FRI has not be investigated empirically. Do the findings by Fombrun & Shanely (1990), Brown & Perry (1994), and Fryxell & Wang (1994) invalidate all of the previous studies on reputation? Does the "halo" effect, although important and significant, invalidate the corporate reputation literature that has relied on the FRI? Is the FRI, even after the "halo" effect is removed or accounted for, still useful to researchers investigating corporate reputation? Or is the FRI now totally useless? These are the questions that the present study seeks to clarify.

Past studies have merely found that there is a high correlation between the eight dimensions of the FRI and firm performance and then extrapolated this to the results of all research studies that have relied on the FRI. In order to more completely investigate the "true" impact of the "halo" effect on the usefulness of the FRI in future studies, the present study will make use of three different measures of the FRI. First, the original FRIs reported by *Fortune* were used in the study to obtain results under circumstances similar to previous studies that have employed the FRI. Using the original FRI served as a control test for the present research study.

Second, in an effort to eliminate the financial "halo" bias of the FRI, a technique outlined by Brown & Perry (1994) will be employed. This corrected FRI represents a proposed FRI that has

been disinfected of any financial taint that might blur and bias the results. The technique eliminates the influence of firm performance by regressing five-year averages of five variables (return on assets, sales growth, relative market to book value, firm size, risk) on the average FRI values for each firm. Adjusted FRIs are then calculated utilizing the regression results from the previous step. The predicted FRIs are then computed by subtracting the original FRIs (as reported by *Fortune*) from the predicted FRIs to obtain the adjusted or "halo" free FRIs.

Third, the predicted FRIs were used to test the explanatory powers of the predictive model that represent the five performance variables that have been shown to heavily influence the FRI values (Brown & Perry, 1994). This model reflects the accuracy of the regression modeling technique in predicting CEO compensation. The assumption is that CEO compensation is highly related to firm performance (Combs, 2003; Gomez-Mejia et al., 1987; Prasad, 1974) and therefore, the predicted FRIs should likewise be closely correlated with compensation.

Using this methodology CEO compensation will be investigated under three different scenarios: 1) the original FRI, 2) the adjusted FRI ("halo" removed), and 3) the predicted FRI. After controlling for the effects of the "financial halo" results suggest that contrary to the conclusions of Fryxell & Wang (1994), the FRI is still useful as a valid measure of corporate reputation.

Proposed Hypotheses

The preceding discussion leads to several hypotheses with regard to the usefulness of the FRI in management studies. The hypotheses were derived from the extant literature as previously discussed. A detailed explanation of the theoretical development of the hypotheses that guided the present study will not be repeated here to conserve space. Each of the major hypotheses relating to the primary variables of the study is summarized below:

H1: CEO compensation will be positively associated with corporate reputation when measured by the original FRI.

H2: CEO compensation will be positively associated with corporate reputation when measured by the adjusted FRI.

H3: CEO compensation will not be positively associated with corporate reputation when measured by the predicted FRI.

H4: CEO compensation will be positively associated with CEO age, CEO tenure with the company and CEO tenure as CEO.

Methodology

Sample

The sample used in the study included a total of 286 firms from the *Fortune* "Most Admired Companies" list for the years 2000-2004. The initial sample was comprised of 500 firms from the list for 2000 (*Fortune*). Firms were then cross-referenced with Forbes' "Top 800 Executives Compensation" (2000). The final sample was the result of all firms that were listed in both Forbes and *Fortune* over the five-year period under study, resulting is a final sample of 286 firms/CEOs. As can be seen there was a large loss of firms/CEOs from the initial sample due to missing data. To insure comparability across the different models being used in the present study, only firms with complete data were included in the study. All of the variables used were calculated as a simple average for the five-year period of 2000-2004.

Opting to use a five-year period was a deliberate attempt to eliminate any random and idiosyncratic fluctuations that might bias the results. The application of such an approach has been commonly accepted as a valid long-term measure in the strategy literature (Bettis, 1981; Bettis & Hall, 1982; Bettis & Mahajan, 1985). Using two-digit SIC codes each firm's primary industry was identified and the firms were clustered by industry. A review of the sampling of the industries represented by the sample reflected a wide range of industries. Although the distribution of firms from each industry varied, the sample was representative of all industries and was not significantly biased in favor of any one industry or group of industries. Based on an analysis of the industries represented in the sample it was considered to be broad enough to be generalizable across all industries.

Statistical Analysis

In searching for the above mentioned relationships, several statistical procedures were utilized; namely, correlation analysis and hierarchical regression analyses. First, a Pearson correlation analysis was performed to uncover general relationships among the continuous variables of the study and to uncover any multicollinearity. Second, a series of three hierarchical regressions were run to test the relationships outlined in the hypotheses. Since industry effects have been found to be potentially damaging extraneous variables (Christensen & Montgomery, 1981), we conducted statistical tests to determine whether any industry differences were present among CEO compensation and corporate reputation. Results failed to confirm any systematic industry

biases with regard to corporate reputation and CEO compensation across industries. Corporate reputation did not vary significantly across industries, lending support to the conclusion that reputations are not industry specific. Such a conclusion would seem to be intuitive given the construction of the questionnaire utilized by *Fortune* in calculating the FRI. Given that the respondents from which the FRI is calculated are industry participants it would not be surprising that the FRI would not be consistently biased across industries.

Measures

CEO Compensation. CEO compensation was measured in three different ways: 1) salary and bonuses, 2) long-term compensation, and 3) total compensation (a composite of the other two measures of compensation). CEO compensation data were obtained from Forbes (2000-2004) "Top 800 Executives Compensation." The measures of CEO compensation that were employed in the study were chosen for two primary reasons: 1) consistency with previously used measures in the literature (Rajagopalan & Prescott, 1990) and 2) availability of reliable data. By using these measures of compensation the generalizability of the study was maximized.

Corporate Reputation

Despite the results of Fryxell & Wang (1994) that questions the validity of the FRI it remains the most widely used measure of firm reputation and therefore, will be utilized for the purposes of the present study. As was previously outlined, corporate reputation was measured using *Fortune*'s (2000-2004) "America's Most Admired Companies." *Fortune*, using a total of eight criteria (i.e., Quality of management, Quality of products or services, Value as a long-term investment, Innovativeness, Soundness of financial position, Wise use of corporate assets, Responsibility to the community and environment, and Ability to attract, develop, and keep talented people), solicited the opinions of experts, executives, members of boards of directors, and corporate analysts in assessing corporate reputation. Using a Likert scale, from 0 (poor) to 10 (excellent), firms were assessed across eight criteria (see *Fortune*, March 8, 2006 for details). The scores across these eight criteria were then averaged to arrive at a composite or overall reputation index for each firm, which then served as a proxy for overall corporate reputation. In response to earlier studies questioning the validity of the FRI (Brown & Perry, 1994; Fombrun & Shanely, 1990; Fryxell & Wang, 1994; McGuire et al., 1990) corporate reputation was then

operationalized as three distinct measures of a firm's reputation: 1) original FRI, 2) adjusted FRI (with the "halo" effect removed), and 3) predicted FRI.

Unadjusted (Original) FRI = Average of combined reputation indices (8 attributes)

Adjusted (Halo effect) FRI = Residuals of Unadjusted FRI (ROA, RMTBK, FSIZE, SALE, GROWTH, RISK (see Brown & Perrry, 1994; Fryxell & Wang, 1994)

RMTBK(Relative market to book value) = (Market value / Book value$_{firm}$) / Market value / Book value $_{industry}$);

GROWTH (Growth in Sales) = % change in sales$_t$+..+ % change in sales$_{t-5}$) /5

RISK(Debt leverage) = debt$_{it}$/equity$_{it}$

FSIZE (Firm size) = Natural logarithm value of Sales

Predicted FRI = Original (Unadjusted) FRI – New (Adjusted) FRI

Covariates

Based on a review of earlier studies on CEO compensation it was deemed appropriate to include a number of variables that have been found to be critical in explaining executive remuneration. In a similar fashion, these variables were included as control variables in the present study to maintain the study's comparability with previous research. Only a few of the most widely studied variables were included in the investigation. (1) CEO age. The age of the CEO was calculated in years. Executive age is one of the oldest and most commonly studied variables in compensation research (Andrews & Henry, 1963; Deckop, 1988). (2) Tenure as CEO. Tenure as CEO was measured as the number of years that the position of CEO was held with the current company (Deckop, 1988; Mangel & Singh, 1993). Such a measure of CEO tenure was chosen because of its more conservative nature. The measure adopted in the present study provides a more conservative assessment of the degree to which a CEO is rewarded for improvements made within the same company. (3) Tenure with the company. Tenure with the company was represented by the number of years the CEO has been with the company, regardless of the positions previously held within the same company (Mangel & Singh, 1993). The primary reason for the inclusion of such a variable is to distinguish between rewards given for performance improvements made while CEO (tenure as CEO), from rewards for company loyalty. Since there

is only one CEO per company many executives find themselves in a situation where they must be willing to "abandon ship" if they are to reach the position of Chief Executive Officer and maximize their new worth. This necessitates the shopping of their wares on the open market to the highest bidder. Since turnover among executive-level managers tends to be quite high, it is expected that the benefits that are accrued by company loyalty are relatively low.

Results and Discussion

Descriptive statistics and intercorrelations for all the variables used in the present study can be found in Table 1. Intercorrelations among the various measures of corporate reputation and CEO compensation reveal strong and consistent relationships, suggesting that all measure of reputation were helpful in explaining variations in executive remuneration. In fact, all three measures of the FRI were positively and significantly correlated with all three measure of compensation. There seems to be a direct relationship between a firm's reputation and the extent to which its' CEO is compensated.

Firm profitability was also uniformly and positively associated with CEO compensation, suggesting that compensation is closely connected with the ability to pay. Therefore, firms that are highly profitable are more likely to reward their leaders on two accounts: 1) the firm has the ability to pay higher salaries and other forms of compensation, and 2) the leaders are seen as being largely responsible for the profits generated by the firm. However, it should be noted that the relationships were not consistently strong across all measures of performance. ROS was the most consistent across all measures of compensation, while ROA was more closely correlated with long-term components of compensation, and ROE reflecting a more short-term focus.

Table 1

Mean, Standard Deviation, and Correlation[a]

Variable	Mean	Std.Dev	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1. CEO Salary & Bonus [b]	7.47	0.63															
2. CEO Long-term Compensation [b]	7.53	1.77	.52***														
3. CEO Total Compensation [b]	8.41	1.05	.72***	.87***													
4. Average ROA	5.72	5.70	.15**	.20***	.20***												
5. Average ROS	9.20	11.34	.17**	.23***	.24***	.39***											
6. Average ROE	16.00	36.03	.12*	.09+	.10*	.38***	.16**										
7. Relative Book to Market Value	0.90	2.31	.06	.04	.08	.17**	.12*	.34***									
8. Firm Size (Ln Sales) [b]	8.97	0.97	.44***	.20***	.28***	.10*	-.03	.05	-.03								
9. Growth Rate in Sales	0.15	0.16	.00	.07	.11*	.08+	.26***	.00	.14**	-.06							
10. Risk: Debt Leverage	2.19	10.01	.19***	.02	.03	-.02	.24***	.64***	.27**	.12*	.15**						
11. CEO Age	56.71	5.88	.15**	-.01	.01	-.05	.08	-.02	-.09+	.06	-.11*	.01					
12. CEO Tenure in Company	23.13	11.31	.05	.01	-.01	.04	.14**	.01	.00	.12*	-.05	.07	.47***				
13. CEO Tenure in CEO	8.46	7.93	.03	.10*	.13*	.08+	.07	-.04	.01	-.07	.15**	-.05	.36**	.39***			
14. Unadjusted FRI	6.32	0.90	.29***	.33***	35***	.40***	.27**	.27***	.19***	.33***	.20***	.14*	.07	.19***	.10*		
15. Adjusted FRI	6.10	0.53	.32***	.30***	.37***	.67***	.36**	.40***	.31***	.57***	.34***	.24***	.05	.09+	.05	.59***	
16. Predicted FRI	0.01	0.72	.12*	.19***	.17**	.16**	.12*	.15**	.20***	.15**	.18**	.09+	.12*	.17**	.09+	.81***	.00

a. N = 286
b. Natural Log value
+P <0.10, *P<0.05, ** P< 0.01, ***P<0.001

Firm performance was positively correlated with the original FRI measure of reputation ($p < .001$), supporting the thesis that a firm's image or reputation is closely related to a firm's profitability. But it should be noted that firm performance was also positively correlated with the adjusted FRI. Firms cited as having better reputations tended to be more profitable than other firms, which is consistent with the findings of Fryxell & Wang (1994).

Tables 2, 3, and 4 show the results of the OLS (Hierarchical) regression analyses. Table 2 reports the results when the original FRI was used as a proxy for corporate reputation. Table 3 used the adjusted FRI as a proxy for corporate reputation. Table 4 reports the results when the predicted FRI was employed. It should be noted that the models use in Table 4 are not identical to the models represented in Tables 2 and 3. Since Table 4 used the predicted FRI as the variable of study it was necessary to eliminate the variables that were used in removing the financial "halo"

as reported by Brown & Perry (1994). In other words, including the financial variables that were used to remove the financial halo in the models using the adjusted FRI would amount to removing the financial halo from a variable where the halo has already been removed. This would have the resulting effect of literally neutering the adjusted FRI and robbing it of any possible probability to reach significance. Since the adjusted FRI had already removed the financial effects of the supposed halo effect (Brown & Perry, 1994), it would not seem prudent to include the very variables that were used to remove the halo in the model. Doing so would result in a misspecified model. Therefore, the variables used in removing the financial halo were excluded from the models that used the predicted FRI.

Results suggest that most of the models were effective in explaining CEO compensation (most models were significant at the $p < .001$ level). Overall, the results clearly show a dramatic and strong relationship between CEO compensation and corporate reputation. With only slight variation, the original, adjusted, and predicted FRI were significantly important in explaining CEO remuneration. Corporate reputation and compensation were significantly correlated across all models, clearly indicating a strong tie between the two variables. The interesting point is that regardless of the type of measure used as a proxy for corporate reputation or CEO compensation, the tie between reputation and compensation is robust. Firms that are cited as having excellent corporate reputations pay their CEOs more than firms without such reputations. Such consistency across the models tested reveals and solidifies the close tie between the two variables under investigation. Even after controlling for the various effects of financial performance and personal characteristics, the results were unchanged: corporate reputation plays a major factor in determining CEO compensation packages.

Using hierarchical regression analysis, where the FRI, in its various forms, is entered after factoring out the effects of all other variables, results reveal a strong and consistent relationship between CEO compensation and corporate reputation. After removing any "halo" effect that has been incorporated into the FRI, the results suggest that the FRI (the original, predicted, and adjusted) are good proxies for corporate reputation. The removal of the "financial halo" from the FRI had very little effect on the overall impact of corporate reputation on CEO remuneration. Surprisingly, all three variations of the FRI were equally good at predicting and explaining the

Table 2

Results of the Hierarchical Regression Analysis Estimating CEO Compensation[a]: Unadjusted Reputation Index

	Bonus		Long-term Compensation		Total Compensation	
	Step 1	Step 2	Step 1	Step 2	Step 1	Step 2
(Constant)	4.033 (.46) ***	3.820 (.47) ***	3.704 (1.40) **	2.661 (1.41) +	4.963 (.80) ***	4.421 (.81) ***
Average ROA	.001 (.01)	-.004 (.01)	.038 (.02) +	.013 (.02)	.027 (.01) *	.015 (.01) *
Average ROS	.009 (.00) **	.009 (.00) **	.031 (.01) **	.029 (.01) **	.019 (.01) **	.017 (.01) **
Average ROE	.000 (.00)	.000 (.00)	.001 (.00)	.000 (.00)	.001 (.00)	.001 (.00)
Relative Market to Book Value	.012 (.02)	.009 (.02)	.005 (.05)	-.011 (.05)	.023 (.03)	.014 (.03)
Firm Size (Ln Sales)	.288 (.03) ***	.255 (.04) ***	.457 (.10) ***	.296 (.11) **	.370 (.06) ***	.286 (.06) ***
Growth in Sales	-.153 (.22)	-.248 (.22)	.053 (.66)	-.413 (.66)	.172 (.38)	.070 (.38)
Risk-Lverage Ratio	.006 (.00)	.006 (.00)	-.011 (.02)	-.009 (.01)	-.005 (.01)	-.004 (.01)
CEO Age (year)	.016 (.01) *	.015 (.01) *	-.013 (.02)	-.015 (.02)	-.002 (.01)	-.003 (.01)
CEO Tenure in Company	-.007 (.00) *	-.008 (.00) *	-.013 (.01)	-.017 (.01) +	-.013 (.01) *	-.016 (.01) **
CEO Tenure as CEO	.004 (.00)	.004 (.00)	.030 (.01) *	.029 (.01) *	.023 (.01) **	.023 (.01) **
Unadjusted Corporate Reputation		.096 (.05) *		.472 (.14) ***		.245 (.08) **
Model R^2	.2631	.2748	.1345	.1703	.2019	.2291
Adjusted R^2	.2363	.2457	.1083	.1419	.1729	.1982
Change in R^2		.0117		.0358		.0272
F-value	9.818 ***	9.439 ***	4.273 ***	5.112 ***	6.956 ***	7.404 ***
F-value for Change in R^2		4.430 *		11.59 ***		9.684 **

Table 3

Results of the Hierarchical Regression Analysis Estimating CEO Compensation[a]: Adjusted Reputation Index

	Bonus		Long-term Compensation		Total Compensation	
	Step 1	Step 2	Step 1	Step 2	Step 1	Step 2
(Constant)	4.033 (.46) ***	5.366 (2.69) *	3.704 (1.41) **	3.903 (1.38) **	4.963 (.80) ***	5.066 (.79) ***
Average ROA	.001 (.01)	.033 (.07)	.038 (.02) +	.040 (.20)	.027 (.01) *	.028 (.01) *
Average ROS	.009 (.00) **	.009 (.00) **	.031 (.01) **	.031 (.01) **	.019 (.01) **	.017 (.01) **
Average ROE	.000 (.00)	.000 (.00)	.001 (.00)	.001 (.00)	.001 (.00)	.001 (.00)
Relative Market to Book Value	.012 (.02)	.029 (.04)	.005 (.05)	.006 (.11)	.023 (.03)	.048 (.06)
Firm Size (Ln Sales)	.288 (.03) ***	.289 (.04) ***	.457 (.10) ***	.466 (.12) ***	.370 (.06) ***	.373 (.06) ***
Growth in Sales	-.153 (.22)	.324 (.98)	.053 (.66)	.077 (.96)	.172 (.38)	.160 (.38)
Risk-Lverage Ratio	.006 (.00)	.009 (.01)	-.011 (.02)	-.011 (.02)	-.005 (.01)	-.001 (.01)
CEO Age (year)	.016 (.01) **	.015 (.01) *	-.013 (.02)	-.013 (.02)	-.002 (.01)	-.002 (.01)
CEO Tenure in Company	-.007 (.00) *	-.007 (.00) *	-.013 (.01)	-.017 (.01) +	-.013 (.01) *	-.015 (.01) **
CEO Tenure as CEO	.004 (.00)	.004 (.00)	.030 (.01) **	.029 (.01) **	.023 (.01) **	.024 (.01) **
Adjusted Corporate Reputation		.099 (.05) *		.303 (.15) **		.247 (.08) **
Model R^2	.2631	.2751	.1345	.1704	.2019	.2296
Adjusted R^2	.2363	.2460	.1030	.1301	.1729	.1986
Change in R^2		.0120		.0359		.0277
F-value	9.818 ***	9.453 ***	4.273 ***	5.115 ***	6.956 ***	7.422 ***
F-value for Change in R^2		4.540 *		11.856 ***		9.839 **

Table 4

Results of the Hierarchical Regression Analysis Estimating CEO Compensation[a]: Predicted Reputation Index

	Bonus		Long-term Compensation		Total Compensation	
	Step 1	Step 2	Step 1	Step 2	Step 1	Step 2
(Constant)	6.530 (.38) ***	3.787 (.58) ***	8.187 (1.41) ***	4.986 (1.38) **	8.604 (.64) ***	3.618 (.95) ***
CEO Age (year)	.019 (.01) **	.022 (.01) **	-.013 (.02)	-.015 (.02)	-.002 (.01)	-.004 (.01)
CEO Tenure in Company	-.001 (.00)	-.003 (.00)	-.002 (.01)	-.009 (.01)	-.005 (.01)	-.010 (.01) +
CEO Tenure as CEO	.002 (.00)	.003 (.00)	.027 (.01) **	.024 (.01) **	.013 (.01) *	.015 (.01) *
Predicted Corporate Reputation		.404 (.07) ***		.398 (.19) **		.452 (.13) ***
Model R^2	.0220	.1355	.0120	.0981	.0206	.1550
Adjusted R^2	.0118	.1232	.0015	.0853	.0102	.1429
Change in R^2		.1132		.0861		.1344
F-value	4.138 ***	11.009 ***	3.845 ***	7.642 ***	4.978 ***	12.884 ***
F-value for Change in R^2		36.809 ***		26.821 ***		44.681 ***

[a] n = 286 Unstandardized regression coefficients are shown and Standard errors are in parentheses

Significance level: + P<0.10; * P<0.05; ** P<0.01; *** P<0.001

observed variance in CEO compensation. Therefore, the FRI index has shown itself to be a robust and valuable measure of corporate reputation based on the findings of the present research.

Taking all of the results into account would indicate that although financial performance, especially when operationalized as ROS, may be a significant factor in explaining the *Fortune* reputation index (Fryxell & Wang, 1994), it cannot be considered the sole source of explanatory power behind the index. However, based on the results of the present study, the FRI is more than just a reflection of firm performance. Even though the overall impact of performance on the FRI is significant, it does not account for all of the power of the FRI to explain executive compensation. After the effects of firm performance were extracted from the model (Brown & Perry, 1994), the reputation index still was found to be a significantly important variable in explaining CEO compensation. It may be argued that this remaining explanatory power is attributable to the "reputation/social responsibility" criteria of the *Fortune* index and therefore, can be used as a valid proxy of reputation, social responsibility, and ethics. Significance levels for reputation were universally significant at the $p < .05$ level or above, suggesting that corporate reputation is more than a reflection of firm performance.

Conclusion

The major purpose of this study was to investigate the impact of firm profitability on the FRI. Is the FRI nothing more than a reflection of a firm's financial potential or past successes? Although some studies suggest that the FRI is too reliant on performance measures (Brown & Perry, 1994; Fombrun & Shanely, 1990; Fryxell & Wang, 1994) to be of any value to researchers interested in reputation or social responsibility or ethics, such a conclusion seems to be premature at best. What might be worse is that such a conclusion is just misleading and incorrect based on the findings of this research study.

The results suggest several things: 1) The FRI still has a future, 2) The FRI is a robust and useful proxy of corporate reputation, 3) The FRI is more than a reflection of prior firm performance, 4) The FRI can be adjusted and the effects of firm performance removed without damaging the validity of the measure. In fact, within the context of executive compensation, it was found that corporate reputation plays a significant role in determining how much a CEO receives in compensation.

Researchers can take comfort in knowing that the FRI, regardless of the form it takes, can be used with confidence in representing corporate reputation. The results confirm and validate the extant research that has employed the FRI as a proxy of reputation and other subjective measures related to social responsibility and ethics. The results and conclusions of past studies which employed the FRI can be used with confidence since the alterations and corrections to the FRI produce marginal differences. The use of the original FRI as it is currently reported by *Fortune* should remain a useful and now validated measure of corporate reputation.

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