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A CEO's Most Important Strategic Asset: Assessing Corporate Reputation

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Abstract

Past research has used the Fortune Most Admired Companies index as a proxy for such difficult-to-measure variables as corporate reputation, corporate social responsibility, and stakeholder orientation. Utilizing the Fortune reputation index, the present study investigates the relationship between corporate reputation and the remuneration tendered to the leaders of these most admired companies. Given that the CEO wields the greatest power and potential to influence a firm's reputation it is suggested that the most widely respected firms would compensate their CEOs with higher levels of remuneration. The present study provides an empirical test of the reputation-remuneration linkage. Using the Fortune index as a measure of corporate reputation, the results of the present study reveal a significant and positive relationship between CEO compensation and corporate reputation.

Keywords: Corporate reputation, compensation, strategic assets

1. Introduction

Who has the greatest influence in determining a firm's reputation? Do CEO's of firm's with better reputations earn substantially more than CEOs of firms with lower reputations? These leading questions serve as the foundation of the present study. Since CEOs are considered the face of the firm and play the role of figurehead in the public, it is argued that the CEO will be compensated in direct comparison with the firm's reputation. The result would be that CEOs of firms that are widely recognized for their social responsibility, ethics, performance, and growth would garner higher salaries than CEOs of firms with less spectacular reputations. It can also be argued that firms tend to take on the personality of their leader and chief officer. Since this person has the most control and responsibility for directing and managing the organization, he/she is able to exert the most influence in molding a firm's personality/identity.

Corporate reputation has long been regarded as an elusive, but potentially very useful variable in understanding financial performance. In support of this assertion, a variety of research studies have confirmed that good reputations can be financially rewarding for the firms who are viewed as having good or excellent corporate reputations (Fombrun & Shanley, 1990; Herremans, Akathaporn, & McInnes, 1993; Landon & Smith, 1997; McGuire, Schneeweis, & Branch, 1987). However, the specifics of what corporate reputation is, how it should be measured and how it translates into increased profitability are questions that have not been adequately answered. Although not a focus of the present study, the confusion over how corporate reputation should be measured is readily acknowledged. (The reader is referred to Brown & Perry (1994) for a thorough review of the measurement issues associated with the *Fortune* Reputation Index (FRI).)

Studies during the '80s and '90s have sought to resolve this difficult and confusing issue of measurement by adopting or adapting the FRI as a proxy for a variety of different constructs, including corporate reputation (Fombrun & Shanley, 1990), management quality (Mcguire, Schneeweis & Branch, 1987), and social responsibility (Conine & Madden, 1986; McGuire et al., 1988). Due to its ease of use and availability the FRI has become the most widely used and accepted method for operationalizing corporate reputation in the management literature. Despite the results of a study by 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.

It should be noted that the FRI incorporates a total of eight different 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. Since a variety of these variables are specifically related to the management of a firm, and more pointedly are associated with the roles, duties, and responsibilities of the CEO, the relationship between corporate reputation and CEO compensation was deemed to be appropriate. At the very least, it can be argued that CEOs are ambassadors for the firm and as such, are the guardians of the company's reputation and financial performance in the future.

If a CEO makes a mistake or in some other way, either intentionally or unintentionally, damages a firm's reputation that firm will be penalized by the financial community (*Investor Relations Business*, 2000). Up to the present time there has been no previous research of the relationship between CEO compensation and corporate reputation. Specifically, a total of six of the eight criteria used in calculating the FRI (quality of management, effective use of assets, financial soundness, employee talent, social responsibility, and long-term investment value) are directly related to the functions of the CEO. Such a interrelationship between the CEO of a company and the company's reputation has been supported by a survey conducted in 2000 by *Investor Relations Business* (2000), although it has not been empirically supported. In further support of this relationship a study by Petrick, Scherer, Brodzinski, Quinn, & Ainina (1999) makes the assertion that:

> Successful corporate executives, when applying their global leadership style and substantive skills, enhance the intangible asset of corporate reputation and leverage the firm's global sustainable competitive advantage. These intangible global leadership skills heighten intangible reputational capital assets at both the firm and industry levels. (p. 58)

Human capital theory also supports the contention that compensation is dependent on the skills and experiences that an incumbent brings to the job (Combs & Skill, 2003). Such experience and skill will be manifested in the reputation that the CEO brings to a firm, which will have an effect on the firm's overall reputation (*Investor Relations Business*, 2000). The intermingling of the CEO and firm's reputation is supported by human capital theory in explaining executive premiums in the labor market (Combs & Skill, 2003). Executives or in this case CEOs that have more experience and skills will command a higher compensation package when the labor market is allowed to operate efficiently; a truly free market economy for labor. Other research has found that compensation is related to the skills and experiences that incumbents bring to their work (Agarwal, 1981). Therefore, the relationships among CEO compensation, corporate reputation, and financial performance become important to understanding the reputation/compensation/ performance linkage.

In a recent *Investor Relations Business* (2000) survey it was found that a total of 45% of a firm's reputation was attributable to the CEO's personality. This finding was supported by a survey conducted by the management consulting firm of Burson-Marsteller (*Investor Relations Business*, 2000) of financial analysts that indicated that 95% of them would buy stock in a company based on the CEO's reputation and that 94% of them would recommend that their clients buy stock in these companies. The conclusion that can be drawn from the results of these surveys is that the reputation of the CEO and the reputation of the company that he/she leads are inextricably intertwined. At the very least, as was reported in the third annual *Chief Executive/*Hill & Knowlton "Corporate reputation Watch Survey" (2001: 46) "Clearly reputation is seen as the CEO's job. Three-fourths (77 percent) say the CEO is primarily responsible for this." Therefore, corporate reputation and the CEO's reputation are closely tied together.

Within the context of the corporate reputation and executive compensation literatures the present study will employ a "financial halo removal" method to account for the weaknesses highlight by Fombrun & Shanley (1990). In an effort to eliminate the financial biases of the FRI a technique outlined by Brown & Perry (1994) will be employed. After controlling for the effects of the "financial halo" results suggest that, contrary to the conclusions of Fryxell & Wang (1994), the FRI can still be used as a valid measure of corporate reputation.

2. Corporate Reputation

Corporate reputation 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 according to Fombrun (1996: 72), corporate reputation can be defined as "a perceptual representation of a company's past actions and future prospects that describe the firm's overall appeal to all its key constituents when compared to other leading rivals." The focus of such definitions is that a firm's corporate reputation is a valuable commodity that will be capitalized by the financial community and ultimately reflected in the stock market.

Given that a firm's reputation can be considered a strategic resource, it is important that a firm take a proactive stance with regard to such a vital resource and take action to manage and exploit it to the fullest for the benefit of a firm's many constituencies (Barney, 1991). Recognizing that reputation is a hard to measure construct, "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." (Roberts & Dowling, 2002: 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 is not "perfectly imitable" it can be a source of long-term sustainable competitive advantage (Barney, 1991).

Such 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). The critical element in determining whether a strategy will be sustainable is the degree to which the firm's strategy is imitable (Barney, 1991). The lack of clearly articulated causal relationships between reputation and firm performance may be beneficial to the future success of a firm's strategy. From a competitive advantage point of view causal ambiguity can be a valuable source of competitive advantage, since by definition it is not possible to clearly understand what actions lead to the positive firm performance. Indeed, Lippman & Rumelt (1982) suggest "ambiguity as to what factors are responsible for superior...performance acts as a powerful block on...imitation." (p. 420)

In addition, a firm's response to a crisis or stand on an ethical issue will invariably have an impact on perceived image or reputation. How a firm responds to crises and how it conducts business is under constant scrutiny by a plethora of constituencies (both internal and external). Examples of effective (e.g. Johnson & Johnson's Tylenol scare) and ineffective (e.g. Exxon's response to the Valdez disaster) crisis management may either positively or negatively impact a firm's image and, therefore, its reputation. Ultimately, the person accountable for managing such crises is the CEO. One thing seems certain, a poor or weak reputation can have a devastating effect on the future profitability and survival of a firm.

As argued by Fombrun & Shanley (1990) reputation management may play an important role in determining future organizational performance. Developing a good corporate reputation may pay dividends through increased sales and profits by: 1) influencing customer product choices (Dowling, 1986), 2) inhibiting rival firms' actions (Caves & Porter, 1977; Wilson, 1985), and 3) developing social status among rivals within industries (Shrum & Wuthnow, 1988). Each of these benefits is likely to increase a firm's profitability, market share, and competitive advantage. As can be seen, the benefits of developing and maintaining a good corporate reputation are critical to the long term success of the organization.

When corporate reputation has been included in studies within the management discipline the primary emphasis has been on its effect on financial potential (Fombrun & Shanley, 1990; McGuire et al., 1988). As a result of these 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), although the issue of causality has not been investigated. Nevertheless, 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. Exactly why this occurs has been the subject of much controversy.

Although the issue is widely debated, the causal relationship of whether a good reputation leads to higher performance or high performance leads to a better reputation has not been empirically studied. One argument suggests that a favorable corporate reputation may offer an organization the opportunity to charge higher prices (Klein & Leffler, 1981; Milgrom & Roberts, 1986), influence buyer preferences (Dowling, 1986), inhibit interindustry rivalry (Caves & Porter, 1977; Wilson, 1985), and/or increase social status (Shrum & Wuthnow, 1988). The exact reason for such a relationship is not the subject of the present paper and therefore will not be addressed. However, what is important to the present study is: 1) The consistency of the findings in uncovering a positive correlation between corporate reputation and an organization's financial potential, and 2) Combining such a finding with the positive relationship between CEO compensation and financial potential.

3. Executive Compensation

Executive compensation has been the subject of numerous studies in the past (Lawler & Porter, 1966; Prasad, 1974) and is once again becoming a topic of much debate (Combs & Skill, 2003; Deckop, 1988; Fisher & Govindarajan, 1992; Fryxell & Wang ,1994; Gerhart & Milkovich, 1990; Gomez-Mejia, 1994; Gomez-Mejia, Tosi, & Hinkin, 1987; Rajagopalan & Prescott, 1990). The initial series of studies on the subject were primarily concerned with uncovering the impact of personal characteristics of the CEO (age, education, etc.) or economic factors of the organization (profits, sales, etc.) on executive compensation.

However, the predominant thrust of the recent literature has shifted to one of integration. By integrating studies from a variety of different disciplines and evaluating their composite effects on executive remuneration it is hoped that a more thorough understanding of the compensation phenomenon will result (Rajagopalan & Prescott, 1990). As Finkelstein & Hambrick (1989) state, such interdisciplinary studies have been long over due. Additionally, according to one of the most prominent scholars in the field of CEO compensation, Gomez-Mejia

(1994: 199) "the literature on executive pay is rather extensive {yet}…it is amazing how little we know about executive pay in spite of the massive volume of work available on this topic." Likewise, Kerr & Bettis (1987: 661) argue that they could find "no rational basis for the compensation paid to top management." In light of this assessment of the current development of the field of compensation, it is believed that the study of corporate reputation can help explain and/or alleviate some the confusion that currently exists. It is in this vein of interdisciplinary research that the present study was undertaken.

More specifically, the current study seeks to enhance such interdisciplinary research efforts by introducing a new variable into the picture, one which has not been previously considered in the realm of the executive compensation literature: corporate reputation. Since corporate reputation and its effect on executive compensation has never been studied within this context the present study incorporates the new variable of reputation to help in explaining executive compensation. The reputation variable has been regularly argued to be important in determining financial potential (Fombrun & Shanley, 1990; McGuire et al., 1988).

At the heart of the present study are several key questions. Can the FRI be reliably used as a measure of corporate reputation? Do CEO's of companies with excellent reputations earn higher compensation than CEO's of companies will less than excellent reputations? Therefore, the purpose of the present study is twofold: First, to determine the effect that corporate reputation plays in determining executive compensation and second, to present a more rigorous test of corporate reputation by employing a measure that controls for the "halo effect" that has been highlighted by Fryxell & Wang (1994).

4. Hypotheses

Based upon the preceding discussion two hypotheses were developed to test the relationship between CEO compensation and corporate reputation.

H_1: CEO compensation will be positively associated with *unadjusted* corporate reputation after controlling for financial performance, personal characteristics, risk, size, and company growth.

H_2: CEO compensation will be positively associated with *adjusted* corporate reputation after controlling for financial performance, personal characteristics, risk, size, and company growth

5. Methodology

5.1. Sample

A total of 359 firms were used as the sample for the present study. The initial sample was comprised of 500 firms listed in Fortune’s "Most Admired Companies” (2004). Firms were then cross-referenced with *Forbes’* "Top 800 Executives Compensation." All firms that were listed in both *Forbes* and *Fortune* were included in the final sample, leaving a total of 359 firms/CEOs. Each of the variables used in the study were calculated as simple averages for the five-year period of 2000-2004.

A five-year period was chosen in an attempt to avoid any issues that may be associated with one-year fluctuations. The decision to utilize five-year averages was based on previous research studies in the strategy literature, which have been accepted as valid long-term measures (Bettis, 1981; Bettis & Hall, 1982; Bettis & Mahajan, 1985). Additionally, the use of five-year averages insures that only firms and CEOs that consistently are included in the top categories of the publications utilized as data sources will be included in the study. Using such stringent rules, only CEOs and companies that are consistently ranked among the best firms will be included in this study. By using averages we can minimize the effects of any outliers or idiosyncratic variations and thereby, be able to more accurately assess the effects of the variables being studied.

5.2 Statistical Analysis

A multi-staged methodology was employed in searching for the above mentioned relationships, which included correlation analysis and hierarchical regression analyses. First, we tested for differences among the industries across CEO compensation and corporate reputation. Second, a Pearson correlation analysis was performed to uncover general relationships among the continuous variables of the study. Third, a series of 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. It may be possible that certain industries enjoy better overall and industry specific reputations than others.

Results failed to confirm any systematic biases with regard to corporate reputations 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 questionnaire utilized by *Fortune* in calculating the FRI.

5.3. Measures

CEO Compensation. The dependent variable of the study, CEO compensation, was measured in a total of three different ways: 1) salary and bonuses, 2) long-term compensation, and 3) total compensation, which was a composite of all the other two measures of compensation. All CEO compensation data was obtained from *Forbes* (2000-2004) "Top 800 Executives Compensation." Such a measure of compensation was chosen for several reasons: 1) It is consistent with previously used measures in the literature (Rajagopalan & Prescott, 1990), and 2) It represents the most commonly used measures in the management literature. Therefore, the generalizability of the study was maximized utilizing such measures.

Corporate Reputation. Corporate reputation was measured using *Fortune's* (2000-2004) "America's Most Admired Companies." *Fortune*, using a total of eight criteria, solicited the opinions of experts, executives, members of boards of directors, and corporate analysts in assessing corporate reputation. A Likert scale, from 0 (poor) to 10 (excellent), was used to assess a firm across the eight criteria previously introduced (see *Fortune* (2004) for details). These measures were then averaged to arrive at a composite score for each company. This average reputation score across the eight criteria was used as a proxy for overall corporate reputation.

Fortune's listing of the most admired companies has been previously validated as a measure of corporate reputation and social responsibility (Chakravarthy, 1986; McGuire, Schneeweis, & Branch, 1990). Additionally, it can be argued that the *Fortune* list has been the most popular measure of corporate reputation in past research studies (Chakravarthy, 1986; Fombrun & Shanley, 1990; McGuire et al., 1988; Wartick, 1987). However, it should be noted, that recently the index has come under attack and questions concerning its validity and usefulness have been raised (Brown & Perry, 1994; Fryxell & Wang, 1994).

To protect the generalizability of the present study statistical techniques were employed to nullify any potential financial biases. In a study by Brown & Perry (1994) a statistical procedure was proposed for removing potentially harmful contaminating factors from the FRI. Given that the FRI has been criticized for being overly dependent on financial performance (Fombrun & Shanley, 1990; McGuire, Schneeweis, & Branch, 1990) the FRI was corrected for what is commonly called the financial "halo" effect (Brown & Perry, 1994). This "halo" effect has seriously limited the usefulness of the FRI and limited its application in the management literature. In an attempt to control and remove such harmful halo effects from the FRI, Brown & Perry (1994) developed a corrective statistical technique that may help restore the FRI to it former popularity and usefulness. Using halo corrected measures of the FRI, the present study is confident that the financial biases have been corrected in the present study (see Brown & Perry (1994) for a detailed explanation of how the halo effect was calculated).

Control variables. In order to ensure the accuracy of the results and validate previous research findings, a review of the literature uncovered a number of variables that were frequently found to be associated with executive compensation.

1) **CEO age.** The age of the CEO was calculated in years.

2) **Tenure as CEO.** Tenure as CEO was measured as the number of years that the position of CEO was held within the same company (Deckop, 1988; Mangel & Singh, 1993).

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 position held within the same company (Mangel & Singh, 1993).

4). **Career Path.** The experience associated with and derived from any background, training, or experience needs to be controlled to avoid biasing the results of the study (Agarwal, 1981; Foster, 1980). Therefore, career path/educational background was used to control for such biases.

5) **Firm Profitability.** Firm profitability was measured using three commonly accepted accounting measures: ROA, ROS, and ROE.

6. Results and Discussion

Table 1 presents general descriptive statistics and intercorrelations for all the variables used in the present study. A review of Table 1 reveals a strong and consistent relationship across the primary variables of the study; namely, CEO compensation and corporate reputation. Evidence of such strong relationships among the variables being studied suggests that corporate reputation is a good predictor of CEO compensation.

The unadjusted FRI was highly correlated with all three measures of firm performance, suggesting that reputation measures have a strong financial foundation. However, the “halo” adjusted FRI failed to show any statistically significant relationships with firm performance. Given that the adjusted FRI was utilized to remove any financial biases that might exist in the original FRI, such a lack of significance is very promising. The results indicate that the adjusted FRI was not significantly associated with any of the financial measures. Therefore, the adjusted FRI was not biased in favor of accounting measures of performance. However, since both the original FRI and the adjusted FRI were strongly correlated with all three measures of CEO remuneration and with each other, but the adjusted FRI was not correlated with firm performance, it would seem that the adjusted FRI was able to measure something other than financial performance. It is suggested that the FRI is measuring what researchers and *Fortune* have purported for quite a long time; namely, corporate reputation.

Firm profitability was also strongly 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.

Of the personal characteristics, CEO age and CEO tenure as CEO were positively correlation with compensation. CEOs with post-graduate degrees consistently reported higher remuneration, regardless of which measure of CEO compensation is used. However, there were no significant associations between compensation among other career paths. The general conclusion is that CEOs of firms with excellent reputations are paid more than their counterparts in other organizations not recognized as having excellent reputations. It should be noted, that despite the limited range of the corporate reputation indices used in this study (only companies rated high on the FRI measure were included in the sample), reputation was consistently correlated with all measures of compensation. Therefore, there seems to be a direct and positive relationship between a firm's reputation and the CEO's compensation.

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. Firms cited as having better reputations tended to be more profitable than other firms, which is consistent with the findings of Fryxell & Wang (1994). However, the adjusted FRI, which controlled for financial performance bias, did not show any significant correlations with the firm performance variables, but was significantly correlated with CEO remuneration ($p < .05$ to $p < .001$). It should be noted that this relationship was strong and consistent **only** among the sample of firms with excellent reputations, suggesting the possibility of a non-linear relationship between corporate reputation and firm profitability. The possibility of such a non-linear relationship seems greater when firms of lesser reputation are included in the sample. However, due to the unavailability of data on such firms, it was impossible to determine the exact relationship that exists.

Using hierarchical regression analysis (Tables 2A and 2B), where the FRI is entered after factoring out the effects of all other variables, reports strong and consistent relationships between CEO compensation and corporate reputation. After removing any "halo" effect that has been incorporated into the FRI, a la Brown & Perry (1994), the results suggest that the FRI (both the original and adjusted) are good proxies for corporate reputation. The removal of and "financial halo" from the FRI had very little effect on the overall impact of corporate reputation on CEO remuneration. Therefore, the FRI index has shown itself to be a robust and valuable measure of corporate reputation based on the finding of the present research.

Other variables of interest that were significant in explaining compensation were: CEO age, CEO tenure with company, and CEO tenure as CEO. Although these variables were consistent across the models, slight variations in the levels of significance were observed. Tenure with the company was negatively associated with a CEO's compensation, suggesting that executives that rise through the ranks are less likely to reap the financial benefits once they reach the top. If the goal of an executive is to maximize income/compensation, the findings suggest that the individual will have to enter the labor market and seek greener pastures within another company. Within the economic labor market for executives the price for experience will bring a premium that is only obtainable by switching companies and going to the highest bidder. CEOs with long tenure with the company have a tendency to be undervalued in comparison with CEOs entering the labor market.

However, CEO age and tenure as CEO do not suffer from the same problems that afflict long company tenures. In each of the regression models using total compensation as the measure of CEO compensation, tenure as CEO was found to have a positive impact on compensation. Given the opposite results found for company tenure, this suggests that CEOs who enter a company as the CEO (situations were company tenure and CEO tenure are equal or similar), tend to receive more in the way of total compensation than those who work their way up the organizational ladder. Such promote from within strategies do not seem to maximize a CEO's total compensation. These results may help explain the frequent shifts in CEOs that are being observed on an increasingly frequent basis in the current business community. CEOs, like the companies that they represent, are being continuously reassessed by the financial community and therefore, CEOs market themselves to the highest bidder. The frequency with which the stock price of a CEO fluctuates makes executive managers marketable commodities that can be sold to the highest bidder, much as corporate stocks are sold on the market.

CEO age was also positively associated with higher levels of salary and bonus, but not significantly correlated with other, more long-term measures of compensation. The time factor may account for such a difference, given that older CEOs are more likely interested in more immediate short-term compensation, while younger CEOs are primarily interested in shielding their income from taxes by requesting or demanding more long-term compensation schedules. It should be noted, that CEOs, due to the nature of their position at the top of the organization, wield a great deal autonomy with regards to the composition of their compensation package. For older CEOs it does not make much sense to opt for long-term compensation incentives since he/she will be retired before they can be obtained. During negotiations over compensation for high ranking managers it is not uncommon to build in bonuses or incentives that suit the financial objectives, goals, and timeframe for the individual candidate.

Taking all of the results into account would indicate that although financial performance (ROA, ROE, 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, the FRI is more than just a reflection of firm performance. Even 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. Significance levels for reputation were universally significant at the $p < .05$ level or above, suggesting that corporate reputation may play a more important role in determining CEO compensation than other widely accepted variables.

From a review of Tables 2A and 2B it can be seen that in every case CEOs of firms recognized as having excellent reputations received significantly higher levels of compensation than their counterparts in firms that were not recognized as having excellent reputations. One conclusion to be drawn from the findings of the present study is that reputation/image is an important variable that should be included in future compensation studies. It is argued that this variable is a "manageable" variable, one which can be groomed and conditioned to serve the purposes of both the firm, by way of higher profitability, and the CEO, by way of increases in overall compensation.

The idea of devising and constructing a well-thought-out image is strikingly similar to the work being done in the area of organizational culture, although one is primarily concerned with the internal operations and workings of the firm (organizational culture), while the other is focused on the evaluation of the operations of the firm by important external constituencies (image or reputation). The first step is identifying weaknesses with the current culture or image/reputation. The second step is to develop a plan for changing these weaknesses into a more efficient culture or favorable image. The point of the matter is that, although organizational culture has proven to be difficult to change, it is widely accepted that the effort may be well worth it. The same thing may be said of corporate reputation, it may be difficult to change, but it may prove to be beneficial to the long-term survival of the firm and the remuneration of the CEO.

7. Conclusion

The major purpose of this study was to investigate the impact of firm reputation on CEO compensation. The results suggest that the FRI still has a future and that abandonment of the measure is premature at the present time. In fact, it was found that corporate reputation has a significant impact on CEO compensation, even after removing any biases that might be attributable to the financial performance of the firm.

The major conclusion of the present study is that corporate reputation does indeed play a major role in determining CEO compensation. CEOs of firms with excellent reputations earn more compensation than CEOs of firms that are not recognized as having excellent reputations. Therefore, CEOs of firms that have been cited as having excellent reputations by experts in their respective industries tend to benefit, by way of increased compensation, from this positive corporate image. In all of the models studied, corporate reputation was statistically significant in explaining CEO compensation.

Results of the present study are strong evidence to support the notion that corporate reputation is an important strategic resource, for both the firm and its CEO. In addition, CEOs may view corporate reputation as an indirect measure of their success. At the very least, it can be concluded that firm reputation is an invaluable variable for understanding executive compensation issues. The strength of this evidence is attested to by the extensive methodology employed in the present study. In particular, it should be noted that this conclusion is based on the results of the statistical tests performed in this study, after controlling for financial performance and other commonly studied variables within the area of executive compensation.

The present study highlights the importance of controlling for the moderating effects of important variables that have been previously identified as critical explanatory variables in executive compensation research. Without anticipating and controlling for such important variables on an a priori basis it is impossible to arrive at a clear picture of the compensation issue being investigated. In particular, the issue of the validity of the *Fortune* reputation index may have been premature given the results of the present study.

For example, Fryxell & Wang (1994) concluded that the effects of financial performance on the ratings of a firm's reputation will exert an undue influence on the ultimate ratings of a firm's reputation by industry experts (See Fryxell & Wang (1994) for a complete discussion of this relationship). Such a conclusion is logical, intuitive, and supported by empirical research. However, the question remains, "Is the *Fortune* index a valid measure of corporate reputation." In the present study, after controlling for some of the most commonly used measures of performance, the present study found that the FRI **still** wielded a positive and significant influence in explaining a CEO's level of compensation. It should also be noted that the significance of reputation in explaining compensation was highly consistent across the models tested. Given these findings it must be concluded that, although a sizable portion of the *Fortune* index can be attributable to a firms past financial success, the index can still be used as a measure of reputation. The elimination of the financial "halo" effects are critical and must be employed to guard against any financial biases that could jeopardize the results of any study.

It has been shown that the contaminating effects of firm performance on the FRI, although large, do not explain all of the variance in CEO compensation. Additionally, it can be concluded that the FRI can be used effectively in future studies of corporate reputation when prudent precautions are taken to protect the data from the influence of prior firm performance. Therefore, it can be concluded that corporate reputation plays a significant role in determining CEO remuneration.

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Table 1

Mean, Standard Deviation, and Correlation [a]

Correlations	Mean	St.Dev.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
1. Salary &	7.47	0.63																			
2. Long-terı	7.53	1.77	0.52***																		
3. Total Coı	8.41	1.05	0.72***	0.9***																	
4. Average I	5.72	5.7	0.02	0.2***	0.2***																
5. Average I	9.2	11.34	0.17**	0.23***	0.24***	0.39***															
6. Average I	16	36.03	0.12*	0.07	0.07	0.38***	0.16**														
7. Rel. Marl	0.9	2.31	0.06	0.04	0.08	0.17**	0.12*	0.34***													
8. Firm Size	8.97	0.97	0.44***	0.2***	0.28***	-0.1*	-0.03	0.05	-0.03												
9. Growth iı	0.15	0.16	0	0.07	0.11*	0.08	0.26***	0	0.14**	-0.06											
10. Risk-Lev	2.19	10.04	0.19***	0.02	0.03	-0.02	0.24***	0.64***	0.27***	0.12*	0.15**										
11. CEO Age	56.71	5.88	0.15**	-0.01	0.01	-0.05	0.08	-0.02	-0.09	0.06	-0.11*	0.01									
12. CEO Ten	23.13	11.31	0.05	0.01	-0.01	0.04	0.14**	0.01	0	0.12*	-0.05	0.07	0.47***								
13. CEO Ten	8.46	7.93	0.03	0.1*	0.13*	0.08	0.07	-0.04	0.01	-0.07	0.15**	-0.05	0.36***	0.39***							
14. Unadjust	6.32	0.9	0.29***	0.33***	0.35***	0.4***	0.27***	0.27***	0.19***	0.33***	0.2***	0.14**	0.07	0.19***	0.1*						
15. Adjusted	0	0.72	0.12*	0.19***	0.17**	0	0.07	0.03	0.01	0	0	0	0.12*	0.17**	0.09	0.81***					
16. Dummy i	0.29	0.45	-0.04	-0.05	-0.07	0.02	-0.05	-0.03	-0.01	-0.11*	-0.07	-0.1*	0.08	0.16**	0.02	-0.06	0				
17. Dummy i	0.14	0.35	-0.06	-0.07	-0.08	-0.08	-0.04	-0.03	0.06	-0.02	0.06	-0.01	-0.08	-0.11*	-0.07	-0.01	0.01	-0.26***			
18. Dummy i	0.42	0.49	-0.03	0.04	0.04	0.07	0.09	0.09	0.07	0.03	0.07	0.05	-0.11*	-0.07	0.04	0	-0.08	-0.54***	-0.34***		
19. Dummy i	0.08	0.27	0.06	-0.04	-0.01	-0.04	-0.06	-0.06	-0.01	0.03	-0.07	0.04	0.11*	0	-0.04	0.05	0.08	-0.19***	-0.12*	-0.25***	
20. Dummy i	0.08	0.27	0.13*	0.15**	0.15**	-0.01	0.02	-0.02	-0.18***	0.12*	-0.02	0.06	0.05	0	0.04	0.07	0.05	-0.18***	-0.12*	-0.24***	-0.09

[a], n = 286

[b.] Natural Log Value

* P<0.05, **

*** P<0.001

Table 2 A

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

Variables	Salary & Bonus		Long-term Compensation		Total Compensation	
	Step 1	Step 2	Step 1	Step 2	Step 1	Step 2
Constant	4.083 ***	3.872 ***	3.956 **	2.866 *	5.152 ***	4.599 ***
Dummy in Edu.: Undergraduate	0.084	0.082	-0.017	-0.028	0.007	0.001
Dummy in Edu.: Graduate	-0.026	-0.037	-0.24	-0.297	-0.145	-0.174
Dummy in Edu.: Law	0.129	0.101	-0.106	-0.251	0.079	0.006
Dummy in Edu.: Post-Graduate	0.196	0.176	0.805 *	0.702 +	0.481 *	0.428 *
CEO Age	0.014 *	0.014 *	-0.014	-0.015	-0.004	-0.004
CEO Tenure with Company	-0.007 *	-0.008 *	-0.012	-0.017	-0.013 *	-0.015 *
CEO Tenure with CEO	0.004	0.004	0.027 +	0.026 +	0.022 **	0.022 **
Average Return on Assets	-0.001	-0.005	0.035	0.011	0.025 +	0.012
Average Return on Sales	0.01 **	0.009 **	0.031 **	0.028 **	0.019 **	0.017 **
Average Return on Equity	0	0	0.002	0	0	-0.001
Rel. Market to Book Value	0.016	0.013	0.027	0.01	0.035	0.027
Firm Size (Ln Sales)	0.287 ***	0.256 ***	0.431 ***	0.274 *	0.355 ***	0.275 ***
Growth in Sales	-0.126	-0.218	0.1	-0.375	0.216	-0.025
Risk-Leverage Ratio	0.005	0.005	-0.015	-0.012	-0.008	-0.006
Unadjusted Corporate Reputation		0.091 *		0.47 ***		0.239 **
Model R^2	.2732	.2836	.1521	.1870	.2192	.2446
Adjusted R^2	.2357	.2438	.1083	.1419	.1789	.2026
Change in R^2		.0103		.0349		.0254
F-Value	7.277 ***	7.124 ***	3.473 ***	4.141 ***	5.435 ***	5.828 ***
F-Value for Change in R^2		3.895 *		11.59 ***		9.062 **

[a,] n = 286 Unstandardized regression coefficients are shown and Standard er

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

Table 2 B

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

Variables	Salary & Bonus		Long-term Compensation		Total Compensation	
	Step 1	Step 2	Step 1	Step 2	Step 1	Step 2
Constant	4.083 ***	4.111 ***	3.956 **	4.1 **	5.152 ***	5.225 ***
Dummy in Edu.: Undergraduate	0.084	0.082	-0.017	-0.027	0.007	0.001
Dummy in Edu.: Graduate	-0.026	-0.036	-0.24	-0.291	-0.145	-0.171
Dummy in Edu.: Law	0.129	0.101	-0.106	-0.25	0.079	0.005
Dummy in Edu.: Post-Graduate	0.196	0.176	0.805 *	0.702 +	0.481 *	0.428 *
CEO Age	0.014 *	0.014 *	-0.014	-0.015	-0.004	-0.004
CEO Tenure with Company	-0.007 *	-0.008 *	-0.012	-0.017	-0.013 *	-0.015 *
CEO Tenure with CEO	0.004	0.004	0.027 +	0.027 +	0.022 **	0.022 **
Average Return on Assets	-0.001	0.001	0.035	0.041 +	0.025 +	0.028
Average Return on Sales	0.01 **	0.009 **	0.031 **	0.028 **	0.019 **	0.017 **
Average Return on Equity	0	0	0.002	0	0	-0.001
Rel. Market to Book Value	0.016	0.016	0.027	0.026	0.035	0.035
Firm Size (Ln Sales)	0.287 ***	0.288 ***	0.431 ***	0.441 ***	0.355 ***	0.36 ***
Growth in Sales	-0.126	-0.132	0.1	0.067	0.216	-0.25
Risk-Leverage Ratio	0.005	0.006	-0.015	-0.01	-0.008	-0.006
Adjusted Corporate Reputation		0.092 *		0.471 ***		0.239 **
Model R^2	.2732	.2838	.1521	.1870	.2192	.2446
Adjusted R^2	.2357	.2440	.1083	.1418	.1789	.2026
Change in R^2		.0106		.0349		.0254
F-Value	7.277 ***	7.132 ***	3.473 ***	4.140 ***	5.435 ***	5.828 ***
F-Value for Change in R^2		3.980 *		11.579 ***		9.062 **

[a,] n = 286 Unstandardized regression coefficients are shown and Standard
Significance level: + P<0.10; * P<0.05; ** P<0.01; *** P<0.001