

Exploring the Drivers of Corporate Reputation: A Study of Italian Securities Analysts

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ABSTRACT

Corporate reputation can be broadly defined as a set of collectively held beliefs about a company's ability to satisfy the interests of its various stakeholders. In this paper, we report findings from an empirical study of drivers affecting the judgment of a specific group of stakeholders, that is, securities analysts. Results from a survey of 75 analysts operating on the Milan Stock Exchange indicate that securities analysts tend to judge companies mainly on their financial performance, the configuration of their governance structures, the quality of their financial disclosure and the quality of their leadership and of their prospects for the future.

Corporate Reputation Review (2007) **10**, 99–123.
doi:10.1057/palgrave.crr.1550048

KEYWORDS: *corporate reputation; securities analysts; corporate governance; financial disclosure*

INTRODUCTION

Recent studies on corporate reputations have emphasized the plurality of perceptions and representations around a company, referring to 'corporate reputations' as a multifaceted rather than as a monolithic concept (Dowling, 2001). Recent theoretical work

(Sjovall and Talk, 2004) argues that stakeholders tend to pay attention to actions that are perceived as salient to their specific interests and values, and make inferences about corporate dispositions (their trustworthiness, reliability, social responsibility, etc) based on observed actions that are interpreted as reflections of the former. Empirical research exploring the drivers of reputation among specific categories of stakeholders, however, is still scarce.

In this paper, we report results from a study of the dimensions that affect the judgment of securities analysts, key influencers whose evaluations and behavior affect collective perceptions of critical resource-holders such as institutional as well as retail investors (Fombrun, 2002; Rindova and Fombrun, 1999; Zuckerman, 1999). While past research has investigated extensively reputational issues affecting the reaction of financial markets to extraordinary events such as IPOs (eg Beatty and Ritter, 1986; Carter and Manaster, 1990; Welbourne and Cyr, 1999; Chemmanur and Paeglis, 2005) or corporate crises (eg D'Aveni, 1990; Hambrick and D'Aveni, 1992; Schnietz and Epstein, 2005), less is known about the various cues that securities analysts draw



upon to form their evaluations under normal circumstances.

Our results indicate that four dimensions of corporate reputation – namely Financial Performance, Vision & Leadership, Financial Disclosure and Corporate Governance – display a high correlation with the overall disposition of securities analysts towards a company. These four dimensions of corporate reputation, however, do not seem to have a direct effect on analysts' behavior – that is, on the content of the recommendations they issue. Instead, their influence appears to be mediated by what we termed a company's 'Emotional Appeal' – or, in other words, the extent to which a company is trusted, liked, admired and respected by the respondent.

Two of the four dimensions, the financial performance of the company and the quality of its leadership, have been identified in earlier studies carried out on the general population (Fombrun *et al.*, 2000; Fombrun and van Riel, 2004). Unlike what was observed for the general population, however, these dimensions seem central in affecting the overall disposition of our respondents. The other two, the configuration of the governance structures of a company and the quality of its financial disclosure, have never been observed before and seem to be specific to this type of stakeholder. Collectively, these results suggest that, while some dimensions of corporate reputation tend to overlap across different groups of stakeholders, different stakeholders may focus their evaluation on different sets of attributes.

We believe that the relevance of our findings is both theoretical and practical. Theoretically, our study increases our understanding of the formation of judgment among securities analysts, and provides further empirical support to the idea that different types of stakeholders base their evaluations on different subsets of dimensions of a company's reputation – or, in other words, on different subsets of perceived

corporate actions and features. Practically, our findings provide communication managers and investor relation officers with general indications about the drivers of analysts' judgment and stock recommendation, and with a practical tool for assessing the reputation of their companies among securities analysts.

The paper is organized as follows. In the first section, we review the managerial and financial literatures on reputation in financial markets, we illustrate the role of securities analysts as relevant influencers of financial markets' perceptions, and we develop some hypotheses regarding the key drivers of reputation among analysts. In the following sections, after having explained and discussed our methodology, we illustrate our results and discuss their implications for theory and practice.

THEORETICAL BACKGROUND

Over the past 20 years, a growing body of studies has addressed the topic of corporate reputation. Most of these studies have investigated the benefits that well-reputed companies enjoy among different groups of stakeholders. Past research indicates how good reputation draws customers to the company's products and enhances repeated purchases, improves a company's ability to recruit top people to its jobs, and makes it a better candidate for favorable treatment by the media (Fombrun, 1996; Fombrun and van Riel, 2004). Reputation serves as signal of the underlying quality of a firm's offer (products and services, but also employment conditions or investment opportunities), in contexts characterized by high levels of uncertainty. A company with a good reputation, then, may enjoy a price premium, as the perceived trustworthiness of the company and the credibility of its claims will induce consumers to pay a higher price for its products or services (Shapiro, 1983). At the same time, because suppliers of labor, goods or credit are less concerned about contractual

hazards when transacting with a highly reputed company, good reputation is also likely to lower contracting and monitoring costs, hence reducing the overall cost of the resources collected (Dollinger *et al.*, 1997; Stiglitz and Weiss, 1981).

While the consequences of good reputation have been broadly investigated, research on the formation of judgment among different stakeholders is less abundant. In a seminal paper, Fombrun and Shanley (1990) observed how company stakeholders evaluate firms based on a number of marketing and accounting signals indicating performance, institutional signals indicating conformity to social norms and strategy signals indicating strategic postures. Later replication of this research on a different national sample essentially confirmed Fombrun and Shanley's results (Brammer and Pavelin, 2006).

Later contributions investigated the social processes that influence the formation of individual judgment. Studies in a sociological tradition highlighted the influence of certification contests (Rao, 1994), activists and nongovernmental organizations (Bonardi and Keim, 2005) and media (Deephouse, 2000) in affecting collective perceptions and evaluations. Based on the notion of reputation as a social construct (Fombrun and Rindova, 1994), Rindova (1997) suggests that corporate reputation emerges from the accumulation of multiple images over multiple time periods: in this respect, reputation summarizes and simplifies the variety of sense-making cues offered by images and, at the same time, it provides an interpretation context and a perceptual filter for the reception of images. Later, Bonardi and Keim (2005) observed how the so-called 'reputation cascades' may facilitate the propagation of corporate evaluations across stakeholder groups and increase the salience of corporate actions for society.

More recently, building on Fombrun and Rindova's (1994) work, Sjovald and Talk

(2004) draw on cognitive attribution theory in order to develop an interpretation of the formation of observers' impressions about companies. According to the authors, stakeholders tend to pay attention to actions that are perceived as salient to their interests and values. Stakeholders, then, tend to make inferences about corporate dispositions (their trustworthiness, reliability, social responsibility, etc) based on observed actions that are interpreted as reflections of the former and/or of situational constraints. While Sjovald and Talk's framework increases our understanding of the mechanisms that underlie the formation of individual evaluation, little is still known about the relative salience of different types of action for different categories of stakeholders.

This paper aims at extending our knowledge of these processes, by investigating the drivers of corporate reputation among a specific group of stakeholders, that is, securities analysts.

Securities Analysts and the Formation of Corporate Reputation

Securities analysts play a critical role in mediating investors' perceptions and evaluations of corporate actions (Fombrun, 2002). In past research, analysts' evaluations have been used as a reliable proxy of widely spread perceptions in financial markets (among retail and institutional shareholders), as their recommendations affect investors' perceptions and representations (Lang and Lundholm, 1993; Verrecchia, 1981; Leuz and Verrecchia, 2000).

Securities analysts play two important roles in the functioning of financial markets (Kuperman *et al.*, 2003). On the one hand, analyst monitoring positively impacts the efficiency of the market by reducing the agency costs associated with separation between ownership and management. On the other hand, as conduits between public corporations and investors, analysts provide investors with the information necessary to make

informed decisions. In their role as information intermediaries, analysts increase investor cognisance of corporate performance and events that affect stock prices. In doing so, analysts are believed to contribute significantly to the functioning of the markets, and to be rewarded for their important function (Loh and Mian, 2006).

In this respect, financial analysts can indeed be seen as 'surrogate investors' (Kuperman, 2003), whose recommendations and forecasts significantly affect investors' behavior towards a company's shares (Zuckerman, 1999). Even if analysts disagree among themselves on a firm's prospects (Kandel and Pearson, 1995; Mikhail *et al.*, 2004), converging evaluations and the voice of prominent analysts tend to significantly influence prices (Cooper *et al.*, 2001; Stickel, 1992; Womack, 1996). While analysts are by no means the only sources of influence on share prices, their pronouncements on the value of firms distinguish analysts as critics of corporate equity in a manner akin to critics in other industries (Hirsch, 1972; Zuckerman, 1999). Furthermore, analysts are particularly important stakeholders in the firm's external environment, as they provide investors with information through their comments and recommendations and their interpretations of corporate plans and forecasts tend to affect financial market valuations (Asquith *et al.*, 2005; Kuperman, 2003).

Sell-side analysts – also known as stock analysts, equity analysts or equity researchers – work for investment houses and research firms (Burk, 1988; Zuckerman, 1997). Although certain sell-side analysts follow general trends in financial market and the economy, most of them track the performance of specific sets of firms. Based on their analyses, they produce equity reports containing periodic forecasts of these firms' future earnings and they advise clients to buy, sell or hold their shares in the stocks of these firms (Balog, 1991; Kleinfeld, 1985; Loh and Mian, 2006). Sell-side analysts tend to

specialize by industry and the analysts who cover a particular industry represent the principal critics for the stock issued by companies in that industry (Zuckerman, 1999).

Along with analysts working for institutional investors – also known as buy-side analysts – sell-side analysts represent the principal target for investor relations campaigns, whereby firms attempt actively to shape investor opinion (Useem, 1996). Companies that succeed in attracting recognition from the analysts who specialize in their industries enjoy greater financial market success; firms that fail to reduce their level of coverage mismatch trade at a discount (Zuckerman, 1999).

Empirical research on the formation and diffusion of judgment among financial analysts has extensively investigated extraordinary events such as initial public offerings (eg Beatty and Ritter, 1986; Carter and Manaster, 1990; Welbourne and Cyr, 1999; Chemmanur and Paeglis, 2005), takeovers (eg D'Aveni and Kesner, 1993) or bankruptcies (eg D'Aveni, 1990; Hambrick and D'Aveni, 1992). Collectively, these studies suggest that analysts' evaluations rely on various pieces of information, which analysts interpret as signals of the underlying quality of a company's assets, its competitive posture and its financial prospects.

Research on initial public offerings, for instance, suggests that when analysts are asked to evaluate companies with little track record, and whose capabilities and future prospects are surrounded by uncertainty, they rely on a range of cues such as the quality of the backers (Balvers *et al.*, 1988; Beatty and Ritter, 1986) and underwriters (Carter *et al.*, 1998; Carter and Manaster, 1990; Mavrinac, 1999), the structure of the top management team (Welbourne and Cyr, 1999), the prestige of industrial and research partners (Stuart *et al.*, 1999), or the scientific achievements (Deeds *et al.*, 1997) in order to develop an estimate of the potential flow of future earnings embodied in the stock price.

Little is known, however, about the cues that analysts draw upon as they develop a judgment about companies under normal circumstances.

The Drivers of Reputation among Financial Analysts

Past research on corporate reputations has underlined how collective perceptions tend to organize around broad dimensions (Fombrun *et al.*, 2000; Fombrun and van Riel, 2004). In other words, organizations tend to be evaluated by their audiences on a broad range of features such as their financial and competitive performances, the extent of their engagement in socially responsible behavior, and the quality and innovativeness of their product and services. While the idea that some features may be more or less salient for different categories of stakeholders does not seem unreasonable, the issue has never been explored systematically.

In the remainder of this section, building on past literature in management, accounting and finance, we advance a number of hypotheses regarding the relative salience of different organizational features for the disposition of securities analysts towards a company, under the assumption that a favorable (or unfavorable) disposition will positively (or negatively) influence analysts' recommendations about the company itself.

Financial performance

Securities analysts are particularly attuned to company performance and routinely incorporate such information in their trading decisions (Fama, 1970). Indeed, the reports they periodically issue include at least three key measures of company performance, that is, an earning forecast, a stock recommendation and a price target (Asquith *et al.*, 2005). More specifically, two are the aspects of performance that financial stakeholders seem to attend to: on the one hand, analysts and investors evaluate market performance; on the other hand, accounting information

provide an equally important source of information as to accounting profitability and risk (Fombrun and Shanley, 1990). Securities analysts view companies with good accounting and financial performance as healthy and well managed and, therefore, able to deliver positive results also in the future (Barker, 1998). Furthermore, statements of good performing companies are generally regarded by securities analysts as more credible than statements made by poor performing companies (Frost, 1997; Koch, 1999). Accordingly, we posit that:

H₁: *The higher the perceived financial performance of a company, the more favorable the disposition of securities analysts towards the latter.*

Financial disclosure

A good track record might well be a necessary but not sufficient condition for a company to be fully appreciated by the market. Despite good fundamentals, some companies experience hard times in stock markets because of their poor communication strategy (Healy and Palepu, 1993). Although listed companies must meet minimum disclosure requirements, they vary substantially in the amount of additional information they provide to financial markets. But even for mandatory disclosures, companies have substantial discretion in the informational content of the disclosures and the amount of details provided (Lang and Lundholm, 1996). Analysts are primarily information intermediaries who process information and transmit it to financial markets. Therefore, the quality and value of their report depends directly on the quality and timeliness of the information they gather from companies. In fact, several studies actually indicate that analysts appreciate increases in financial disclosure (Knutson, 1992). A communication strategy that recognizes the importance of open and honest communications to

securities analysts, therefore, seems to contribute to the fair valuation of a company's stock (Epstein and Palepu, 1999). Accordingly, we posit:

H₂: *The higher the perceived quality of financial disclosure, the more favorable the disposition of securities analysts towards the company.*

Corporate governance

Accounting research has acknowledged that the credibility of a company's financial reporting is positively associated with the quality of its governance structures and mechanisms (Farber, 2005; Lang *et al.*, 2004; Rosenstein and Wyatt, 1990). Since the credibility of corporate disclosure is one of the aspects securities analysts value the most when assessing a company (Mercer, 2004), it could very well be the case that analysts' judgments and representations about a company are influenced by its governance structures and mechanisms. Rosenstein and Wyatt (1990) provide direct evidence on the market's response to changes in the board of directors, in that they find a positive mean abnormal return over a two-day window centered on the announcement dates of outside director appointments. Lang *et al.* (2004) find that corporate governance plays an important role in analysts' willingness to follow companies, this in turn being associated with higher valuations. And Farber (2005) posits that governance changes might have a second-order effect on the restoration of corporate reputation, whereas improving the underlying economics of the company might have a first-order effect. Accordingly, we posit:

H₃: *The higher the perceived quality of the governance structures of a company, the more favorable the disposition of securities analysts towards the latter.*

Vision and leadership

Accounting research also indicates that management quality and personal factors are of high interest for analysts and investors (Higgins and Bannister, 1992; Mercer, 2004), and that interpersonal interactions with top managers are central to understanding how these factors contribute to stock market performance (Holland, 1998). Extant research shows that the reputation and prestige of a company's CEO and its top management team positively affect the behavior of financial markets in extraordinary occasions such as IPOs (Certo *et al.*, 2001; Chemmanur and Paeglis, 2005; Finkle, 1998; Welbourne and Cyr, 1999) or bankruptcies (D'Aveni, 1990; Hambrick and D'Aveni, 1992). Even under normal circumstances, the reputation of a company may benefit from association with prestigious top managers, as the reputation of corporate leaders tends to affect the perceived credibility of corporate communication (Mercer, 2004), and their personal aura and charisma may help the company garner the internal and external consensus required to implement its strategies (Hayward *et al.*, 2004; Higgins and Bannister, 1992). Accordingly, we posit:

H₄: *The higher the perceived quality of the leadership of a company, the more favorable the disposition of securities analysts towards the latter.*

RESEARCH METHOD

Research Setting and Sampling

In order to explore the factors that affect reputation among securities analysts, we decided to carry out a survey of the reputation of companies listed on the Milan Stock Exchange. Our study, therefore, required a double-preliminary sampling procedure. On the one hand, we had to select a suitable number of companies who would later be assessed by our respondents. On the other

hand, we had to select a number of analysts to be involved in the survey.

Following a criterion used in earlier research on corporate reputations (van Riel and Fombrun, 2002), we relied on an initial 'nomination' phase to select the 'most visible' companies, for good or for bad. This preliminary procedure helped us select companies that ensured a high visibility of our research topic (reputation among securities analysts) and a broad coverage. In order to do so, we administered a short questionnaire to a sample of securities analysts covering Italian companies, asking them to indicate three companies that enjoyed a good reputation in the financial community and three companies that enjoyed a bad reputation.

According to the official site of the Stock Exchange, in the three years preceding our research, 193 analysts belonging to locally headquartered investment banks and equity analysis firms had issued reports on Italian listed companies. After having eliminated those who had changed jobs, moved abroad or else, we reduced the sample to 150 analysts (90 sell-side and 60 buy-side). According to unofficial estimates, they represent about one half of the total number of national and international analysts actually covering Italian companies. Overall, in this preliminary phase, we received 21 responses – 15 from sell-side and 6 from buy-side analysts. Nominated companies were ranked by the total number of nominations they had received. Fourteen companies that had received at least three nominations were initially included in the sample for further investigation. Two of them (Finmatica and Parmalat), however, were eliminated right away because they had recently been involved in financial scandals due to accounting irregularities – hence we were afraid that the judgment of analysts would be heavily influenced by the magnitude of the event. Two more (Coin and Lazio) were removed from the sample given their relatively low

coverage, hence the difficulty of gathering a significant number of responses.

Eventually, the final sample included 10 companies (Table 1): Unicredito (banking), Capitalia (banking), Eni (oil & gas), Ras (insurance), Merloni (home appliances), RCS Mediagroup (publishing), Class Editore (publishing), Mediaset (broadcasting), Banca Popolare di Verona e Novara (banking) and Tim (mobile telephony). The relatively high number of banks in our sample seems to reflect the traditional overrepresentation of the banking industry in the Italian stock market. In 2003, the banking industry accounted for more than 25 per cent of the total market capitalisation, accounting for 33 out of a total of 262 listed companies.

Scale Design

Our research followed an established methodology in the development of measurement tools for reputational constructs (Fombrun *et al.*, 2000). The dimensions of corporate reputation among securities analysts (as independent variables), as well as their overall disposition towards the companies (as dependent variable), were investigated through a questionnaire, asking respondents to express their agreement on a seven-point Likert scale with a number of statements about a selected company. Respondents were free to select the company they felt willing to rate, and they could rate up to two companies in our sample.

The selection of the items that would eventually be used to build the measurement tools for both dependent and independent variables followed a multi-step process. An initial tentative list included items used in previous research on dimensions of corporate reputation (Fombrun *et al.*, 2000). Following indications from a preliminary review of the literature on reputational issues in financial markets however, we decided to carry out a number of interviews with financial analysts, in order to: (a) explore whether analysts really paid attention to

**Table 1: The Research Sample**

No.	Company	Industry	Number of employees (2003)	Total assets (€)	% change in total assets (2002–2003)	Revenues (€)	% change in revenues (2002–2003)	ROI (%)
1	Banco Popolare Verona e Novara	Banking	12,781	48,606,095	0.7	2,233,200	0.9	1.85
2	Capitalia	Banking	28,229	128,382,868	-8.9	4,801,240	7.8	-0.07
3	Class Editori ¹	Publishing	412	86,894	-5.4	98,200	-5.1	-0.14
4	ENI	Oil and gas	76,521	41,861,000	6.0	51,487,000	7.4	14.14
5	Indesit Company	Home appliances	19,343	709,000	0.9	3,008,000	21.3	17.07
6	Mediaset	Broadcasting	5,600	3,031,800	14.9	3,070,000	32.6	29.46
7	Ras	Insurance	12,351	61,304,725	9.9	27,407,000	11.6	0.99
8	RCS Mediagroup	Publishing	5,580	1,357,500	11.3	2,236,900	1.0	7.06
9	TIM	Mobile telephony	18,888	14,773,000	3.9	11,782,000	8.4	26.64
10	Unicredito	Banking	69,062	238,256,000	11.6	10,465,000	3.6	2.00

All data were collected on the AIDA database and cross-checked on the Annual Reports 2003 of the companies in the sample.

¹Class Editori was substantially smaller than the rest of the companies in our sample. The reasons why it was mentioned by many of our respondents are probably to be ascribed to the fact that it was reputedly one of the poorest communicators with financial audiences, which is odd, considering that Class Editori publishes one of the leading financial newspapers in Italy.

dimensions of general interest, such as those identified by Fombrun and colleagues (Fombrun *et al.*, 2000) and, if so, whether they framed them in the same way, and (b) whether they paid attention to additional issues, such as those highlighted in the literature discussed in the previous section.

In order to do so, we conducted a preliminary round of interviews with randomly selected analysts operating on the Milan Stock Exchange. Forty-nine analysts (35 buy-side and 14 sell-side) were contacted and interviewed before we agreed on having reached theoretical saturation (Glaser and Strauss, 1967). Thirty-seven of them agreed to be interviewed (27 buy-side and 10 sell-side), whereas 12 of them refused – there is no evidence that they differ substantially from those who accepted. During interviews, analysts were asked to illustrate their daily work, how they carried out their anal-

yses and how they evaluated companies. We did not explicitly mention reputation or related constructs. Later, transcriptions from the interviews were searched for potential items indicating variables affecting the judgment of securities analysts. In addition, we examined indications gathered in the nomination phase: the rationale provided by the respondents was searched for potential items indicating variables affecting the judgment of securities analysts.

For this purpose, we used a three-phase content analysis procedure (Glaser and Strauss, 1967). First, in the unitizing phase, one of us broke the transcripts down into 'thought units' (Gioia and Sims, 1986), ranging from a phrase to several sentences. The idea was to capture a complete idea or thought. Virtually, everything that had to do with analysts' judgment was used as the basis for this step. Secondly, in the categoriz-

ing phase, two of us organized all the units into categories. Then we assigned labels to each category in an attempt to capture the shared message of the units within it. Disagreements among us regarding the categories and their labels were resolved through mutual agreement and, occasionally, reformulation. Thirdly, in the classifying phase, two of us tentatively grouped the categories into eight second-order categories reflecting different dimensions of reputation. We tried as much as possible to preserve coherence with the terminology used in existing categorizations of reputational dimensions (Table 3). Our preliminary textual analysis, however, indicated the potential existence

of two specific antecedents of judgment that past studies carried out on the general population seemed to have neglected, but that were coherent with the hypotheses we built based on our literature review, namely corporate governance and financial disclosure.

Based on these preliminary phases, we prepared a draft of the questionnaire based on 28 items – 20 items coming from previous research and eight items deriving from interviews and questionnaires (Figure 1). One focus group with three sell-side and one buy-side analysts helped us refine the content and wording of the questionnaire. At this stage, we decided to exclude from the final list items

Emotional Appeal

- I trust this company
- I like this company
- I admire and respect this company

Vision & Leadership

- The company has high growth prospects.
- The company has an excellent leadership.
- The company has a clear vision for the future.
- (The company recognizes and takes advantage of market opportunities).

Corporate Governance

- *The company has effective corporate governance structures.*
- *The company has board members that are independent and vigilant.*
- *The company has structures that ensure the safeguarding of minority interests.*
- *(The company has a simple and clear group structure).*
- *(The company strictly applies the code of conduct).*

Human Assets

- (The company is a good place to work for).
- (The company has good employees).
- (The company has an open and interactive leadership).

Financial Performance

- The company outperforms competitors.
- The company has a record of profitability.
- The company is a low risk investment.

Financial Disclosure

- *The company conveys information frequently and timely.*
- *The company conveys complete and detailed information.*
- *The company lives up to its commitments.*

Products & Services

- The company provides high quality products and services.
- The company sells products and services that are good value for the money.
- (The company sells products and services that are innovative).
- (The company stands behind its products and services).

Social and Environmental Responsibility

- (The company supports good causes).
- (The company takes environmental responsibility).
- (The company takes community responsibility).

Figure 1: Dimensions and attributes of reputation in financial markets: A preliminary draft. Items in italics were derived from preliminary interviews. Items in parentheses were not included in the final questionnaire

Table 2: From Preliminary Interviews to Tentative Dimensions

<i>Second-order categories</i>	<i>First-order categories</i>	<i>Row data (Instances)</i>	
1. Emotional appeal	1. Trust	1.1 Sometimes [analysts] can't – and don't find it convenient to – verify every single information provided by companies. [...] they accept the information to be true, especially if they trust the company and its management.	
		1.2 When you speak to them, they give you the impression of being in bad faith.	
		1.3 [...] and it seems to me that they want to hide something.	
	2. Good feeling	2.1 It's a fascinating company.	
		2.2 I like covering companies listed on the STAR (high-standard mid cap segment).	
		3. Admire and respect	3.1 I was really impressed by the way Mr [...] was able to restore stakeholders' trust after he was appointed CEO.
	3.2 I think the company embodies the best part of Italy.		
	3.3 [Company A] is a company I'm proud of.		
	2. Vision and leadership	1. Clear vision for the future	1.1 [Company A] doesn't seem to have a clear vision for its future.
			1.2 They bought everything that was on the market and now they are selling everything they have bought so far. Which kind of strategy do they have?
1.3 They have ambitious plans for the future.			
2. Market opportunities		2.1 [...] some companies turned to the stock market only to collect money through the IPO. Afterwards, they did nothing to promote their stocks on the market [...]. Obviously, our opinion about these companies can't be positive.	
		2.2 Many small and mid caps stay on the market like 'mummies in a museum'.	
		3. Excellent leadership	3.1 The reason why we accepted their statements to be true was that we trusted [the CEO], who had previously done well elsewhere.
3.2 I like meeting CEOs who know what their business is like.			
3.3 [Company A's] top managers have been able to successfully address the fundamental problems of the industry.			
4. Growth prospects		4.1 The problem with Internet companies is that they promised wonderful results for the future, everybody was happy, and nobody asked where these results would come from.	3.4 Top managers [of the bank] don't seem to be up to their task: they keep giving credit to 'zombies'.
			4.1 The problem with Internet companies is that they promised wonderful results for the future, everybody was happy, and nobody asked where these results would come from.
			4.1 The problem with Internet companies is that they promised wonderful results for the future, everybody was happy, and nobody asked where these results would come from.
3. Financial performance		1. Good past performance	1.1 When you receive an earnings statement announcing an earnings growth of 20% and the company record of profitability is a complete disaster, you wonder how the company can obtain such results.

Table 2: Continued

<i>Second-order categories</i>	<i>First-order categories</i>	<i>Row data (Instances)</i>
		1.2 In my opinion, what makes companies interesting are financial figures.
		1.3 Institutional investors are mainly interested in high dividends.
	2. Outperform competitors	2.1 [Company A] stands up from all other banks.
		2.2 [...] the company is the industry best performer.
	3. Risk profile	3.1 Investors who give us their money don't like risk. If they wanted to bear more risk, they would probably turn directly to the market.
		3.2 We are expected to create portfolios with no surprises. That's why we don't like risky companies.
4. Corporate governance	1. Effective governance structures	1.1 The problem with [Company A] was that the governance structures who should have controlled the Board in fact subdued to the Board's will.
		1.2 Sometimes audit committees result in purely formal bodies with no actual authority. And that's not good.
	2. Group structures (parent–subsidiary and intra–group relationships)	2.1 Some groups are so complex that you can't understand who owns what and which kind of relationships the parent companies have.
		2.2 Sometimes we receive only aggregated data. I wonder if this isn't a device to hide the bad results of some business units.
		2.3 Many advocate the need for more transparency regarding intra–group transactions. But sometimes it's very hard to distinguish group boundaries.
	3. Board of directors	3.1 [...] The way analysts regarded the company changed substantially when [the Chairman] understood that in order to gain credibility within the financial community it was necessary to enrich the Board with independent directors.
		3.2 In principle, the market appreciates independent board members [...] but also in the Boards of Enron and Parmalat some directors were said to be 'independent'.
	4. Corporate Governance Code	4.1 The adoption of a Code of Conduct doesn't prevent per se companies from adopting an opportunistic behaviour. Nevertheless, it may indicate that companies have taken up the culture of transparency.
	5. Safeguard of minority interests	5.1 It is far too clear to me that the majority shareholder of [company A] will always have an axe to grind.
		5.2 In fact, family members can do whatever they want with their company.

Table 2: Continued

<i>Second-order categories</i>	<i>First-order categories</i>	<i>Row data (Instances)</i>
5. Financial disclosure	1. Disclosure frequency and timeliness	1.1 I don't like companies that provide analysts with information only when they release annual reports or quarterly reports. I think that companies should divulge information more frequently.
		1.2 I like companies that regularly organize meetings.
		1.3 Companies should provide analysts with precise and on time communication of targets and performance.
	2. Complete and detailed information	2.1 [Company A] has always done things 'in the right way'. It has never tried to hide bad news or to 'cheat' the market. Why shouldn't I trust it?
		2.2 Corporate communication has to be clear, detailed and punctual both in good and in bad times.
		2.3 When companies disclose forward looking information about their future performance, they have to provide analysts with information about their strategic goals, their action plans, the assets they will rely on, etc.
	3. Lives up to its commitments	3.1 Some companies communicate random targets, and they often revised downwards.
		3.2 One of the most important assets companies have is their credibility among the members of the financial community. Say, a company with a good track record won't meet the forecasts. It would be better for them to come out with a profit warning as soon as managers realize the company won't meet the expectations, rather than wait until analysts realize it by themselves.
6. Products & Services	1. High quality products and services	1.1 Sooner or later, good-quality products will turn into money.
		1.2 I'm not a fashion addict but I bought three pairs of their shoes because they are undoubtedly high-quality products.
	2. Innovative products and services	2.1 If you follow fashion companies, you should at least have an idea of the fashion trends for the season. In such an industry, producing and selling old-fashioned products means to be out of the market.
		2.2 [Company A] was the first company in Italy to offer an integrated broadband service and has benefited for a long time from being the first mover.
	3. Good value for the money	3.1 Take for instance the banking industry: nobody will ever convince me that their service is worth all the money banks ask their clients for every month!!
7. Human Assets	1. Good place to work for	1.1 In a couple of years, I would like to quit working as analyst and apply for a job as IR officer in a company such as [company A].

Table 2: Continued

<i>Second-order categories</i>	<i>First-order categories</i>	<i>Row data (Instances)</i>
		1.2 I have a close friend who works for [company A] and he always tells me how exciting it is to work for them.
	2. Good employees	2.1 The appointment of Mr [...] as CEO was a fundamental step in trying to regain credibility, but all the first-line managers had played their role in it. 2.2 [...] and their CFO is probably the best CFO of all Italian listed companies so far.
	3. Open and interactive leadership	3.1 You can easily reach the CEO and the CFO by phone. 3.2 The fact that some managers seem to sit in ivory towers irritates me.

related to corporate social and environmental responsibility. In fact, unlike other dimensions of reputations, they were never brought up spontaneously in the preliminary interviews. Further-more, participants to the focus groups had expressed scepticism about the real influence of these aspects of a firm's conduct on analysts' evaluation.

Finally, in order to explore consequences of reputation and judgment, we introduced a section to gather data about analysts' coverage and recommendations.

Data Collection and Analysis

The final version of the questionnaire was administered to 150 analysts operating on the Milan Stock Exchange. After two rounds of recall, 75 of them (43 sell-side and 32 buy-side analysts) responded, for a response rate of 50 per cent. As each respondent could rate up to two companies, eventually we gathered a total of 117 evaluations. The elimination of some severely incomplete questionnaires brought us to 114 valid observations (Table 3).

Dependent variable: The disposition of analysts towards a company

The purpose of our research was to identify perceptual variables that influence the

Table 3: Companies and Number of Respondents

<i>Company</i>	<i>Sector</i>	<i>Respondents</i>
Unicredito	Banking	17
Capitalia	Banking	14
Eni	Oil & gas	14
Ras	Insurance	12
Merloni	Home appliances	8
RCS Mediagroup	Publishing	6
Class Editore	Publishing	7
Mediaset	Broadcasting	15
Banco Popolare di Verona e Novara	Banking	9
Tim	Mobile telephony	12
Total		114

overall disposition of an analyst towards a company. In order to measure the overall evaluation and disposition of our respondents, we used a scale combining three items capturing how much a respondent likes, trusts, admires and respects a firm (Cronbach's $\alpha = 0.922$). Consistent with previous research on corporate reputation (Fombrun and van Riel, 2004), we termed this measure Emotional Appeal (EA).

A fundamental requirement for EA to be considered a good measure of the overall evaluation and disposition of analysts was its correlation with tangible behavior expressing positive or negative evaluations, as it is not unreasonable to expect analysts' behavior towards a company to be at least partly influenced by their attitude towards it (criterion validity). Furthermore, it is the analyst's behavior – and not just attitude – which influences the reputation of a company on financial markets and its capacity to gather financial resources. If EA would not have proved to be correlated with analysts' behavior, not only its construct validity would have been questionable, but also the practical significance of our study would have been lost, as there may be little purpose in examining antecedents of an attitudinal variable, which has no influence on behavior.

In order to measure the relative favorability of analysts' behavior, we observed the latest recommendation issued by the respondent about the focal company, measured on a 1–5 scale. Reassuringly, regression of analysts' recommendation on EA indicated the latter as a reasonably good predictor of analysts' recommendation (adjusted $R^2=0.335$, $\beta=0.586$, sig.<0.000), satisfying our requirement for criterion-related validity. Hence we retained EA as a valid measure for the overall disposition of a securities analyst towards a company.

Independent variables: Dimensions of reputation among securities analysts

Data-reduction techniques helped us further investigate underlying dimensions of reputation in financial markets, and build scales to be used to test our tentative hypotheses. Following common heuristics (Conway and Huffcutt, 2003; Ford *et al.*, 1986), we used exploratory factor analysis to investigate the existence of latent variables and to identify groupings of attributes that could be crystallized as dimensions of reputation in the financial markets, and grouped accordingly. Given our purpose, we used a maximum-

likelihood common factor model, with a varimax orthogonal rotation (Conway and Huffcutt, 2003). The application of the Kaiser method (Kim and Mueller, 1978) suggested the retention of three factors, collectively explaining 63.8 per cent of the variance (Table 4). As it often happens in research on corporate reputation, each factor included items related to two or more dimensions (eg Fombrun and Shanley, 1990; Fombrun *et al.*, 2000).

Factor 1 (explaining 27 per cent of the variance) gathered all items related to corporate governance and three items related to financial performance. We interpreted this factor as expressing analysts' general appreciation of the *accountability* of a firm, based on the configuration of its governance structures and on the composition of its board, as well as on its past record of profitability. Relatively high second loadings of financial disclosure items on Factor 1 seem to provide further support to our interpretation.

All items related to financial disclosure and two items related to vision and leadership, however, loaded primarily on Factor 2 (explaining 22 per cent of the variance). We interpreted this factor as reflecting analysts' evaluation of the *credibility of growth prospects* of the company, as reflected in the quality of its leadership and in the effectiveness of its communication process. A fourth item initially assigned to the Financial Performance dimension ('High growth prospects') loaded strongly on Factor 2, providing further support to our interpretation and suggesting a revision of the Vision & Leadership dimension in light of specific expectations of securities analysts, as discussed later.

Finally, Factor 3 (14 per cent of the variance) included three items related to the *quality and reliability* of a firm's product and services. Three items that we had tentatively assigned to the Human Asset dimension in a preliminary phase displayed almost equal loadings on Factors 1 and 2, which, for sake of construct validity, suggested a removal of the items as

Table 4: Rotated Component Matrix with Extraction of Three Factors

	<i>Components</i>		
	<i>1</i>	<i>2</i>	<i>3</i>
Record of profitability (FP)	0.779		
Effective governance structures (CG)	0.715		
Safeguard minority interests (CG)	0.660		
Simple and clear structure (CG)	0.646		
Outperform competitors (FP)	0.634		
Low-risk investment (FP)	0.628		
Innovative goods (PS)	0.596		0.440
Independent board members (CG)	0.578		
Applies a strict code of conduct (CG)	0.576		0.417
Open and interactive leadership (HA)	0.562	0.502	
Good employees (HA)	0.552	0.510	0.433
Good company to work for (HA)	0.503	0.492	
Takes advantage of market opportunities (FP)			
Complete and detailed information (FD)	0.401	0.799	
Frequent and on-time communication (FD)	0.432	0.773	
High growth prospects (VL)		0.739	0.431
Excellent leadership (VL)		0.661	0.409
Lives up to its commitments (FD)	0.526	0.600	
Clear vision for the future (VL)		0.529	
Good value for the money (PS)		0.421	0.711
High-quality goods (PS)	0.459		0.686
Stands behind its products and services (PS)	0.415	0.464	0.483

Only factor loadings >0.40 are displayed. Items in bold were used to build scales.

well as the dimension they were expected to measure from subsequent analyses.¹

Reliability tests guided the tentative construction of factor-based scales (Kim and Mueller, 1978) to be used to test our hypotheses relating various dimensions of reputation with the overall appeal of the company on the respondent. As a general rule, we tried to select three items for each dimension. For the sake of parsimony, items were deleted if their elimination did not reduce the reliability of the scale, measured by Cronbach's alpha, in a substantial way. Eventually, the elimination of redundant items produced a final list of 14 items, tentatively grouped into five dimensions: Corporate Governance (CG, $\alpha=0.869$),

Financial Disclosure (FD, $\alpha=0.911$), Financial Performance (FP, $\alpha=0.840$), Product & Services (PS, $\alpha=0.834$), and Vision & Leadership (VL, $\alpha=0.853$). All our scales featured reassuring α values between 0.83 and 0.92 (Nunnally, 1978). Furthermore, analysis of variance showed that each dimension displayed significantly different results across companies (Table 5).

In conclusion, our analysis brought to the identification of five key dimensions of reputation among securities analysts and of one measure of the overall disposition of a respondent towards a company. Three of these constructs (Financial Performance, Emotional Appeal, and Products & Services) reflect dimensions identified in previous

Table 5: ANOVA Table

			Sum of Squares	d.f.	Mean Square	F	Sig.
Emotional Appeal×company	Between groups (Combined)		118.226	9	13.136	12.989	0.000
	Within groups		101.137	100	1.011		
	Total		219.363	100			
Financial Performance×company	Between groups (Combined)		162.587	9	18.065	16.764	0.000
	Within groups		110.997	103	1.011		
	Total		273.583	112			
Vision & Leadership×company	Between groups (Combined)		75.652	9	8.406	7.963	0.000
	Within groups		107.672	102	1.056		
	Total		183.324	111			
Corporate Governance×company	Between Groups (Combined)		67.247	9	7.472	5.839	0.000
	Within groups		130.526		1.280		
	Total		197.774	102	111		
Financial Disclosure×company	Between groups (Combined)		97.265	9	10.807	8.775	0.000
	Within groups		125.620	102	1.232		
	Total		222.885	111			
Products & Services×company	Between groups (Combined)		60.134	9	6.682	5.707	0.000
	Within groups		120.596	103	1.171		
	Total		180.730	112			

studies of reputation among the general public (Fombrun and van Riel, 2004); two (Corporate Governance and Financial Disclosure) are specific to the special group of stakeholders we observed; a sixth one, finally (Vision & Leadership), partly differs from what was observed before (see Fombrun *et al.*, 2000), as our respondents seemed to strongly associate excellent leaders with the capacity to envision and develop a promising strategy for future growth. This last result, however, is not surprising and is consistent with the emphasis that analysts tend to place on the capacity to continuously innovate and increase the turnover and market capitalization of a company.

RESULTS

Our review of the literature had brought us to hypothesize significant relationships between the overall disposition of an analyst towards a company and her/his evaluation of the financial performance, corporate governance structures, financial disclosure practices and quality of leadership of the latter. Our preliminary research suggested the inclusion in our questionnaire of items reflecting analysts' evaluation of the quality of products and services, and the human capital of the firm. As explained in the previous section, exploratory factor analysis brought us to eliminate human assets, but suggested the inclusion in further analysis of a measure

of the perceived quality of products and services.

In order to test our hypotheses regarding the relative influence of various dimensions of reputation on the overall disposition towards a company, we regressed EA on the remaining five measures (Table 6). The model accounted for more than 70 per cent of the total variance of the dependent variable (adjusted $R^2=0.737$, $F=58.690$, $\text{Sig.}<0.001$) and displayed a significant impact of Financial Performance (std. $\beta=0.376$, $\text{Sig.}<0.001$), Vision & Leadership (std. $\beta=0.341$, $\text{Sig.}<0.001$), Corporate Governance (std. $\beta=0.173$, $\text{Sig.}<0.05$) and Financial Disclosure (std. $\beta=0.196$, $\text{Sig.}<0.05$), thus providing empirical support to **H1**, **H2**, **H3** and **H4**. Products and Services, instead, had no significant impact on the dependent variable.

In addition, in order to explore potential direct effects of our independent variables on analysts' behavior – that is, on their recommendations – we regressed the latter over both dependent and independent variables. In a preliminary analysis, described

earlier in the Research Method section, we had observed a significant correlation between EA and the favorability of the analysts' latest recommendation (adjusted $R^2=0.335$). In fact, the addition of the other dimensions did not increase the explanatory power of the model in a substantial way (adjusted $R^2=0.352$). Furthermore, only EA had a statistically significant relationship with the favorability of analysts' recommendations ruling out the possibility of direct effects of the five dimensions of reputation on analysts' behavior (Table 7).

These results suggest that analytical dimensions of reputations seemed to affect the overall judgment only through the mediated effect of the emotional appeal they generate for the company. In other words, EA seemed to mediate completely the effect of reputational dimensions on analysts' behavior. We considered this an interesting result in itself, and we will discuss it in more detail in the discussion section.

Table 6: Regression Analysis of Emotional Appeal over the Five Dimensions of Reputation among Securities Analysts

	<i>Standardized beta coefficients</i>	<i>T</i>
Vision & Leadership	0.341	3.824***
Financial Disclosure	0.196	2.045*
Corporate Governance	0.173	2.257*
Products & Services	-0.113	-1.477
Financial Performance	0.376	4.514***
R^2	0.750	
Adj. R^2	0.737	
F-ratio	58.690***	

* $p\leq 0.050$; ** $p\leq 0.005$; *** $p\leq 0.001$.

Table 7: Regression Analysis of the Analysts' Recommendation over Five Dimensions of Reputation among Securities Analysts, and on the Overall Disposition of Analysts Towards the Company

	<i>Standardized beta coefficients</i>	<i>T</i>
Emotional appeal	0.723	4.038***
Vision & leadership	-0.179	-1.090
Financial disclosure	-0.070	-0.391
Corporate governance	-0.212	-1.423
Products & services	0.183	1.430
Financial performance	0.126	0.743
R^2	0.393	
Adj. R^2	0.341	
F-ratio	7.555***	

*** $p\leq 0.001$.

DISCUSSION

Our results indicate that the overall disposition of securities analysts towards a company – or, in other words, the extent to which a company is trusted, liked, admired and respected by the analyst – has a significant direct impact on their recommendations. Coherently with what is hypothesized on the basis of a review of past studies, four dimensions of reputation – namely Financial Performance, Vision & Leadership, Financial Disclosure, and Corporate Governance – display a high correlation with the overall disposition of securities analysts towards a company. Three other dimensions, drawn from previous studies on the general population – namely Products & Services, Social Responsibility and Human Assets – were eliminated at different stages of our study, because of lack of support from empirical data. The resulting framework is illustrated in Figure 2.

These results suggest that, while some dimensions of corporate reputation tend to overlap across different groups of stakeholders, different stakeholders may focus their evaluation on different sets of attributes.

Indeed, two of the dimensions presented in this paper – corporate governance, and financial disclosure – appear to be stakeholder-specific.

The Emotional Side of Analysts' Work

Field research on corporate reputation indicates that the collective judgment of a company is strongly influenced by its general appeal on its corporate audiences, or in other words by the degree to which stakeholders instinctively like, respect and trust the company (Fombrun and van Riel, 2004). Contrary to the widespread assumption that securities analysts act as rational decision makers, elaborating available information about prospective risk and return (eg Ross *et al.*, 2005), we found evidence of the direct influence of emotional factors on analysts' evaluation and on the formation of corporate reputation in financial markets.

The essence of a sell-side securities analyst's job is to carefully examine the financial figures of a company and its managers' forecasts for the future, in order to estimate the future flow of the company's earnings. In

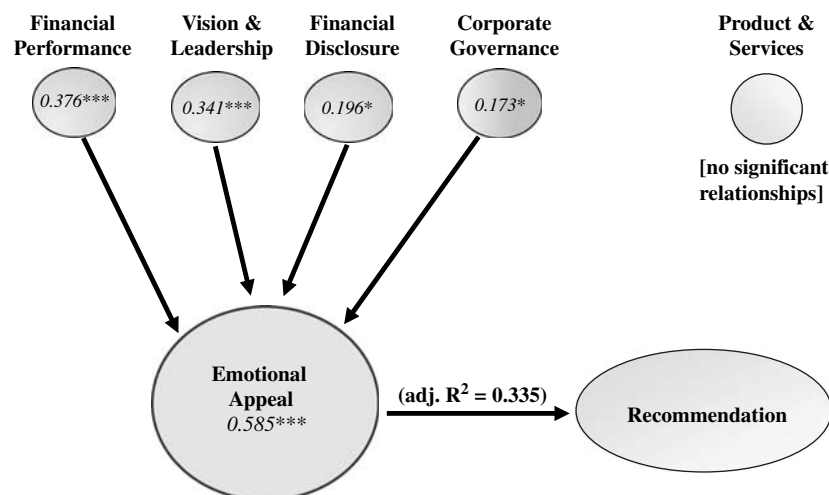


Figure 2: The drivers of corporate reputation in financial markets in Italy. The figures in italics are standardized betas. *** $p \leq 0.001$; ** $p \leq 0.005$; * $p \leq 0.050$

order to do that, they are expected to apply rational tools and procedures that guide the elaboration of corporate data and their comparison with appropriate benchmarks. In addition, they may rely on a broad set of cues that help them assess the relative credibility of corporate figures and forecasts (Kuperman, 2003; Mazzola *et al.*, 2006) and apply a prudential discount rate to corporate claims. The results of sell-side analysts' work is released in periodic reports including recommendations about the company's stock – whether it should be bought, held, sold, etc and at what target price – and it is expected to reflect a cool, professional and rational assessment of a company's financial conditions. Just like sell-side, buy-side analysts are expected to be 'driven by numbers' and to buy and sell stocks based on a rational assessment of their expected risk and return.

The combined results of our analyses seem to draw a partly different picture, whereby analysts' decision is driven more by their overall disposition towards a company rather than by the piecemeal evaluation of its characteristics: the quality of its leadership, the accountability of its governance structures, etc. Even the perceived financial performance of the company does not seem to influence directly their recommendations: its effect, along with those of other perceptual variables reflecting a more analytical assessment of a company's features, seems to be completely mediated by the overall emotional disposition of the analyst.

While consistent with previous research on corporate reputation among the general public (Fombrun *et al.*, 2000), our findings extend the idea that emotional factors affect collective evaluation also in the supposedly more 'rational' domain of securities analysts. Recent corporate scandals, such as the cases of Enron, Parmalat and others – darlings of the markets, before revelation of accounting frauds and other misdemeanours raised serious concerns also with their corporate strategies – seem to indicate how financial

analysts may be temporarily dazzled by the aura of these 'corporate superstars,' and how the development of an elaborate corporate mythology celebrating alleged corporate achievements may induce less sharp and less scrupulous analysts to complacently trust celebrated companies. In this respect, high emotional appeal and feelings of trust and respect may induce securities analysts to 'economize' on their bounded rationality and to award a high credibility to corporate claims, at the risk of forgoing careful scrutiny of their statements and claims

Then again, securities analysts are, at the same time, consumers of companies goods, employees of a company, readers of the newspapers, members of the community in which they live and work and all that they experience or get to know while playing these roles that may influence their judgments and evaluations. Recent research on securities analysts has just begun to uncover the cognitive (eg Kuperman, 2003) as well as political (eg Dugar and Nathan, 1995; Hayward and Boeker, 1998; Michaely and Womack, 1999) aspects of their activity. We suspect that a fruitful research avenue may lie also in the in-depth exploration of the emotional side of their work and how emotional factors end up affecting their judgment and recommendations.

The Drivers of Reputation among Securities Analysts

The relationship between reputation and *financial performance* has been widely investigated in previous studies on corporate reputation, which have highlighted the impact of past performance on broader collective judgment of analysts, managers and directors (Brown and Perry, 1994; McGuire *et al.*, 1990). In this respect, we were not surprised to discover that the judgment and the disposition of securities analysts are primarily affected by company performance. Indeed, when compared to other categories of stake-

holders, securities analysts seem better skilled to appreciate the financial side of a company's operations: they have privileged access to investor relations managers and company management, and their job requires them to develop a good understanding of the financial implications of a company's choices and assets. Moreover, well-performing companies bring tangible and intangible benefits to financial analysts. On the one hand, as analysts and/or their employers receive fees on traded stocks, they appreciate companies with good performance and high trade volumes (Hayes, 1998). On the other hand, research has documented the reluctance of sell-side analysts to issue negative recommendations about a company (Francis and Philbrick, 1993; Barber *et al.*, 2001). In this respect, well-performing companies do not place sell-side analysts in the uncomfortable position of trading off professional integrity and reputation with the preservation of short-term trade-commissions and good relationships with the companies they follow (Jackson, 2005).

Our analysis, however, revealed how other factors had an almost equally strong influence on analysts' disposition – hence on their recommendations – namely, the configuration of *governance structures*, the quality of their *financial disclosure* and the quality of their *leadership*.

Governance structures and reputation

Not surprisingly, previous research on corporate reputation has not indicated corporate governance as one of the drivers of reputation among the general public, who is rarely informed about it or concerned with it. Our results suggest, however, that securities analysts pay attention to governance issues when evaluating companies. In particular, analysts' judgments seem to rest on the effectiveness of the company's governance structures, the presence of independent and vigilant board members, and the safeguarding of minority shareholders'

interests. It is likely that the specific concerns of our respondents may be influenced by contextual features (La Porta *et al.*, 1999). Most Italian firms, for instance, are characterized by a great concentration of shares in the hands of the main shareholder, which in the majority of the cases, is a coalition of people belonging to the same family (Zattoni, 1999). In these companies, boards may result in purely formal bodies, subjected to the will of the majority shareholder. While the importance of independent board members has been formally acknowledged by many Italian companies, the number and standing of independent directors are not always sufficient to allow them to influence board decisions significantly. While these concerns may be common to most economic systems, some items seemed to reflect specific traits of the research setting, that is the long-standing tradition of adopting complex and obscure group structures to preserve the control of large groups with limited shareholdings (Zattoni, 1999), and the slow adoption of a voluntary governance code. Eventually, we did not use these items to build our scales.

Research in financial economics indicates different legal arrangements, governance systems and corporate forms may influence the way financial markets function (La Porta *et al.*, 1999). If this is true, future research may investigate whether securities analysts around the world share similar concerns for governance issues or whether the latter are interpreted in different ways in light of the specific context, thus requiring the adaptation of research tools.

Financial disclosure and reputation

Our findings suggest that the quality of investor relations and the degree of disclosure of financial and corporate information play a critical role in the formation and diffusion of judgments among securities analysts. More precisely, analysts' evaluations seem to be positively affected by frequent, prompt, com-

plete and detailed disclosure, and by consistency between intents, actions and results over time.

Previous research in financial accounting has highlighted the link between novelty and value of information and stock performance (eg Diamond and Verrecchia, 1991; Healy and Palepu, 1993; Lev and Penman, 1990). Our results seem to indicate that analysts appreciate not only what is communicated but also how it is communicated and that high-quality disclosure helps companies develop long-term, stable relationships with the financial community and be perceived as trustworthy and accountable. In turn, a reputation for accountability might help companies aggregate the consensus of financial analysts around corporate strategies and gather the financial resources needed to carry them out (Mazzola *et al.*, 2006).

Vision, leadership and reputation

Strategic vision and corporate leadership have been indicated as reputational dimensions by previous studies on corporate reputation. Fombrun *et al.* (2000) suggest that reputation building is affected by the degree to which corporate audiences perceive the company as having excellent leadership and a clear vision for its future, and being able to recognise and take advantage of market opportunities.

Our results seem to support this idea: companies with a clear vision for the future, with a good market positioning and ambitious strategic plans are more likely to attract positive judgments than static or reactive companies. While clear vision and challenging long-term plans seem to earn companies a positive reputation, the credibility of those plans seems to be inextricably tied to the perceived quality of the top managerial team. Securities analysts seem to trust people more than past performance, as they tend to associate future prospects with the quality of the top management team and the effectiveness of its communication.

Limitations

We are aware of the fact that our study suffers from some limitations, mainly due to the characteristics of our sample.

First of all, our results reflect the judgment of Italian analysts, hence their generalizability to other countries may be questioned. While we have no reason to believe that Italian financial analysts – who are often employed by international houses and frequently interacting with the international financial community – have developed a peculiar attitude towards companies, we cannot exclude it either. Further research spanning across different financial communities is probably needed to test the robustness of our results across different countries. In this sense, our study may act as a pilot study to be replicated across different settings, with the aim of developing a more robust tool for research and practice.

Secondly, it could be argued that our results may be affected by the composition of our sample, in that one third of the companies under observation were banks. Indeed, while recent research shows that companies belonging to different sectors may be evaluated by their corporate peers according to different criteria (Brammer and Pavelin, 2006), we found no evidence – in our preliminary interviews and focus group – that the same is true for security analysts. Furthermore, the composition of our sample roughly reflected the relatively high weight of financial institutions on the Italian Stock Exchange. We believe, however, that the issue is worth further exploration. Our data, unfortunately, did not shed significant light on the issue.

Finally, it could be argued that the small sample size for some companies may question the reliability of the measurement of reputation for those specific companies. From an academic point of view however, we were not interested in the actual scores of each company, but in the overall structure and variance of responses. The relevant sample size, in this respect, is the total



number of replies, which is 114 – large enough to consent the exploration of latent variables on a group of 14 items (Fabrigar *et al.*, 1999).

CONCLUSIONS

Our study, albeit preliminary and exploratory in nature, provides initial evidence of specificity in the formation of corporate reputation among a specific group of stakeholders, namely securities analysts. Our results indicate that the recommendations of securities analysts are significantly correlated with their overall disposition towards a company – that is, the extent to which they like, admire and trust a company – which appears to mediate completely the influence of other dimensions of reputation such as, first and foremost, its perceived financial performance and the perceived quality of its leadership.

In addition, our results suggest that securities analysts are likely to be more sensitive to governance issues than other stakeholders are, partly because their work is meant to reach retail and institutional investors, who are the primary subjects that corporate governance structures and practices are meant to protect. Moreover, securities analysts routinely provide public and private assessments with the profile of risk and return of publicly traded shares. In doing so, they directly and indirectly affect the decisions of potential investors, who tend to consider them as more knowledgeable and informed evaluators. Consequently, the job of securities analysts – and the commission they obtain by trading shares – relies deeply on the quantity and quality of information they receive from companies. It is not surprising, then, that their disposition towards a company is significantly affected by the perceived quality of the interaction with its top managers and investor relation officers.

Recognition of the specificity of reputation drivers among financial analysts brought us to develop a specific tool to measure reputation among securities analysts, with

possible applications in empirical research aimed at further investigating reputational dynamics in financial markets, as well as in practical research aimed at benchmarking the reputation of a company against other comparable organizations as well as track its evolution over time.

A good reputation in financial markets helps attract capital and generate a price premium for the company's shares, through a reduction of the perceived risk associated to the company and the ability to face market volatility better than companies with a poor reputation. As a consequence, well-regarded companies can earn abnormal returns in comparison to poorly perceived companies. Identifying and leveraging on the drivers of corporate reputation in financial markets could therefore be very useful for companies to reduce their cost of capital and to outperform the market. Practical research on building reputation in financial markets is still in an early stage. We believe that our results provide preliminary advice to managers on how to measure and track the reputation their companies enjoy in financial markets, in order to support initiatives aimed at building, preserving or regaining consensus among its financial audiences.

Acknowledgments

We thank Charles Fombrun for his insightful advice in the early phases of this research project.

NOTE

- 1 In an initial stage of analysis, we tentatively retained a Human Asset measure, together with the other dimensions of reputation. Regression analysis, however, showed how the former was not even significantly correlated with our dependent variable (the Emotional Appeal of the firm on its audience), which reassured us about our decision to remove it.

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