

Measuring Your Return on Reputation

-As appears in PR News' Guide to Best Practices in PR Measurement (2009)

Over the past 30 years, public trust in business has steadily declined. In the wake of corporate scandals and the recent financial crisis, public confidence hit an all-time low. With this decline in confidence comes challenges that directly impact the ability of companies to succeed.

Companies are beginning to understand the importance of building and protecting their reputation; In fact, surveys show that a majority of CEOs acknowledge that corporate reputation is their company's most important intangible asset. But why does reputation *really* matter? Companies invest significant resources to understand how stakeholders feel, but very few measure the impact reputation has in shaping tangible business outcomes. By measuring return on reputation (ROR), companies can convert reputation from being an *intangible* asset to an asset with *tangible value* to the company.

Reputation, and the efforts undertaken to protect and enhance it, have a measurable impact on several key factors that allow companies to succeed in the marketplace:

- Creating a more favorable regulatory environment
- Managing risk, particularly in litigation and other crises
- Enhancing employee recruitment and retention
- Strengthening and differentiating the brand
- Improving company valuation

Your License to Operate: The Policy and Regulatory Environment

Corporate reputation plays a significant role in shaping the policy and regulatory environment. APCO's research over the past 10 years has demonstrated the impact reputation has in gaining the support of policy-makers and regulators on issues that can mean the difference between success or failure for the company.

Our research for the chemical industry among federal and state legislators and regulators shows that reputation of the industry is a stronger predictor of policy-maker support for key public policy proposals and regulations than other more obvious factors such as political party or ideology. Also, reputation is a strong predictor of whether or not a policy-maker is willing to meet with representatives of the industry: A good reputation gives your company a seat at the table.

APCO's research in the pharmaceutical sector isolated the discrete reputation drivers of companies and how these reputation drivers impact public policy attitudes and decisions. Our models show that views on a company's reputation have a significant impact on how the public views various public policy and regulatory proposals. More importantly, the research isolates the specific expectations and attributes of reputation that can be most effectively leveraged to improve the policy environment for the company and the industry as a whole.

Corporate reputation also impacts the interaction companies have with local communities. For instance, community opposition fueled by concerns over big-box retailers' labor standards, land use practices and other key reputation issues can have a negative impact on the company's ability to grow. Research that links key reputation drivers to community leaders' willingness to welcome new stores into their communities have helped to inform actionable engagement and communication strategies.



MEASURING ROR: POLICY & REGULATORY ENVIRONMENT

Audiences: Policy-makers, regulators and community activists

ROR Metrics: Support for relevant policy and regulatory proposals that impact the business; willingness to support construction of facilities (stores, factories, distribution centers, etc.) in communities

ROR Analysis: Regression analysis correlating key reputation drivers with ROR metrics

Managing Risk: Litigation and Crisis Communication

Building reputation capital is like putting a deposit in the bank. In good times, interest grows, and in times of crisis it gives the ability to draw down the deposit without draining the account. Research conducted by APCO to help companies communicate on litigation shows a direct relationship between a company's reputation and how potential jurors evaluate lawsuits. In fact, a company's reputation is often a stronger predictor of the potential jurors' verdict than any arguments or merits of the case. A good reputation gives the company the benefit of the doubt; which is an invaluable asset when facing litigation or other crises. Indeed, the reputation capital a company has built can be one of the most effective tools for a company trying to communicate its case to the public.

Reputation research should seek to not only isolate the unique issues impacting your company's reputation, but also identify the discrete reputation assets and vulnerabilities that help to convince key audiences to give you the benefit of the doubt when a crisis hits.

MEASURING ROR: CRISIS MANAGEMENT

Audiences: Potential jurors (e.g. registered voters), general public

ROR Metrics: Stated position on high-profile litigation facing the company; willingness to give the company the benefit of the doubt in litigation or crisis scenarios

ROR Analysis: Regression analysis correlating key reputation drivers with ROR metrics

Becoming an Employer of Choice: Employee Recruitment and Retention

It probably comes as no surprise that job applicants are more attracted to companies that have better reputations. Indeed, two academic studies published in the *Journal of Organizational Behavior* concluded that firms with better reputations attract more – and higher-quality – applicants.¹ A study by Cherenson Group also shows that fully 77 percent of potential employees are willing to accept lower wages to work for companies that have strong reputations.² On the other hand, companies with tarnished reputations commonly experience recruitment challenges. When a large oil company was faced with a significant decline in its reputation, the CEO said that the most negative consequence was the fact that it was becoming more difficult to recruit qualified candidates.

But what aspects of your reputation can give you an edge in attracting and retaining the best employees? By including current and prospective employees in corporate reputation studies, companies are able to determine how reputation attributes (including issues related to corporate responsibility, environment, labor and other key attributes) can make your company and employer of choice.

MEASURING ROR: EMPLOYEE RECRUITMENT & RETENTION

Audiences: Current and prospective employees

ROR Metrics: Willingness to consider employment with your company over other companies, refer your company to others as a place to work; likelihood of remaining at the company for the foreseeable future

ROR Analysis: Regression analysis correlating key reputation drivers with ROR metrics



Strengthening and Differentiating the Brand: The Consumer Relationship

Traditional drivers of brand equity can no longer tell the whole story of how consumers make decisions about products and services. Employment practices, business ethics, corporate philanthropy and environmental impact are all factors that influence consumers purchase decisions.

An APCO survey shows that 72 percent of opinion leaders (the most active and informed segment of the population) say they have purchased products or services after hearing positive news about a company's reputation. The survey also shows that positive news has a greater impact than negative news on purchase behavior – suggesting that companies can improve their bottom-line by shaping their own reputation. Other research shows that while consumers may continue to purchase goods and services from companies they perceive to have a weaker reputation, they do so only if they can pay lower prices. Conversely, consumers reward firms with better reputations by paying higher prices for their brands.

Meeting the broader range of societal expectations beyond providing a good product at a good price can also help to enhance the brand. Our research for a big-box retailer indicates that everything from how the company treats its employees to how it uses space when building new stores positively differentiate its brand from other large retailers and drives greater consumer loyalty.

MEASURING ROR: CONSUMER BEHAVIOR

Audiences: Current and prospective customers

ROR Metrics: Consideration (likelihood of purchasing company products over competitors); brand loyalty (self-reported share of wallet); sales; price premium (willingness to pay a higher price for company products over competitors)

ROR Analysis: Regression analysis correlating key reputation drivers with ROR metrics; regression analysis of longitudinal reputation tracking data with sales data

Adding Value: Impact on Valuation

Corporate reputation plays a prominent role in improving the overall environment in which companies do business, including reducing litigation and regulatory risk, attracting and retaining high-quality employees and building stronger brands and relationships with consumers. Therefore, it should come as no surprise that there is a significant relationship between corporate reputation and the financial value of a company.

Thousands of articles in the academic and trade literature have evaluated the relationship between corporate reputation and financial outcomes, such as profitability and valuation. The vast majority of peer-reviewed studies conclude that there is a statistically significant positive relationship between corporate reputation and financial performance.

An analysis of *Fortune's* Most Admired Corporations ratings and data on financial performance, including firm profitability (return on total assets), market-to-book value and firm size (total sales) has shown that “firms with better corporate reputations are better able to sustain superior financial performance over time...[and] good reputations help poor performing firms in their efforts to return to profitability.”³

Many studies, including APCO's reputation research, have also demonstrated the relationship between reputation and stock market performance. One study evaluated the relationship between *Fortune's* Most Admired Companies rankings and security prices in the year following the publication of the rankings. Over a 13-year period, the 10 corporations at the top of the rankings showed an average increase of 20.1 percent in stock price over the year following the publication of the rankings, while the average increase in the S&P 500 was only 13.1 percent. On the other hand, the 10 firms at the bottom of the rankings showed an average *decline* in stock price of 1.9 percent.⁴



APCO's reputation research for dozens of *Fortune* 500 companies over the past 10 years has demonstrated a significant "reputation premium" in market capitalization. When applying a Market Value of Equity econometric model that includes APCO's Reputation Index as an independent variable, we can predict up to 92 percent of the variance in valuation. Our research consistently demonstrates a statistically significant relationship between key reputation factors and market capitalization. Across dozens of leading companies, our research shows that for every single point increase in our Reputation Index (on a 100-point scale), there is an average \$1.3 billion increase in market capitalization.

Furthermore, reputation research can isolate the specific reputation drivers that reliably predict investor behavior. While perceived financial stability and good governance practices are the most obvious drivers of investor decisions, we often find that other reputation drivers (including a company's perceived environmental responsibility, supply chain practices and other discrete drivers) play a role in whether or not investors purchase company stock. Understanding how your key reputation drivers impact the bottom-line converts reputation from a company's most valuable intangible asset to a very tangible asset.

MEASURING ROR: VALUATION

Audiences: Current and prospective investors

ROR Metrics: Likelihood of purchasing company stock; number of shares owned

ROR Analysis: Regression analysis correlating key reputation drivers with ROR metrics; regression analysis of longitudinal reputation tracking data with market capitalization and share price

¹ Turban and Cable (2003). Firm Reputation and Applicant Pool Characteristics. *Journal of Organizational Behavior*, September 2003. Vol. 24, No. 6.

² Cherenson (2002). Cash Doesn't Carry Corporate Reputation for Potential Employees. *Public Relations Strategist*, Spring 2002. Vol. 8, Iss. 2.

³ Roberts and Dowling (2002). Corporate Reputation and Sustained Superior Financial Performance. *Strategic Management Journal*, Vol. 23; 1077-1093.

⁴ Vergin and Qoronfleh (1998). Corporate Reputation and the Stock Market. *Business Horizons*, January-February 1998; 19-26.



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