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MEASURING CORPORATE REPUTATION: A FRAMEWORK FOR ITALIAN BANKS

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─Abstract ─

This paper proposes a reputational framework suitable for assessing the reputation of Italian banks. To achieve such purpose, the research follows two steps: 1) to explore the most prominent reputational models; 2) to discuss the main findings and identify which are the key-dimensions and features of a reputation measurement system for banks. The value added of this work can be identified in the effort to suggest a framework from which to begin an investigation into measurement of Italian banks reputation.

Key Words: *Corporate Reputation, Banks, Reputation Models*
JEL Classification: G20, G21, L14.

1. INTRODUCTION

Corporate Reputation (CR) is a concept of extraordinary multidisciplinary richness and it is complex to define and quantify (Fombrun and Van Riel,1997:5). Several researches look into the meaning of such critical intangible asset and among the interpretations given, the Bennett and Kottasz (2000:234) definition, seems to better incorporate the various considerations emerged in the academia. The authors describe CR as: *an amalgamation of all expectations, perceptions and opinions of an organization developed over time by customers, employees, suppliers, investors and the public at large in relation to the organization's* *qualities, characteristics and behavior, based on personal experience, hearsay or organization's observes past actions*. Such definition highlights that: a) CR is a multidimensional concept and it differs according to the stakeholder group investigated; b) CR is built over time; c) CR depends on company behavior and activities fulfilled; d) the stakeholders' experience influences CR.

As regards to the banking sector, scholars and practitioners recognize that reputation is particularly important because the services provided are largely intangible and financial operations are mainly based on trust. Trust is identified as a prerequisite and a consequence of relationship between bank and customers and, at the same time, as an important mechanism for the functioning of banking system (Stansfield,2006:475). Furthermore, the literature highlighted several reasons related to the need to increase and manage bank reputation, although, up to now, a few studies examined the events that triggered reputational risk, identified reputational drivers and proposed a model to measure bank reputation.

However, owing to the reputational crisis that involved several banks during the recent financial meltdown, the issues of how banks have to manage and measure reputation and reputational risk are receiving increasing attention not only in academia but also from Regulators. As a matter of fact, the Basel Committee, recently, settled the concept of reputational risk receiving the prior indications from scholars of management studies: *reputational risk is multidimensional and reflects the perception of other market participants* (BCBS,2009:19) and clarifying that it depends on bank internal factors but also on important external factors: *reputational risk can be defined as the risk arising from negative perception on the part of customers, counterparties, shareholders, investors or regulators that can adversely affect a bank's ability to maintain existing, or establish new, business relationships and continued access to sources of funding (eg through the interbank or securitisation markets)* (BCBS,2009:19).

Starting from these remarks, the aim of this research is to propose a reputational framework suitable for assessing the reputation of (Italian) banks. Regarding the methodology adopted, after conducting a review of the most prominent reputational models using the literature, the study proceed to critically compare the measurement tools, in order to understand which are the dimensions utilized, the stakeholders involved and the strengths and weaknesses of each methods. The paper is organized as follows. The next section (section 2) examines the measurement tools utilized to assess corporate reputation. Afterwards, section 3 proposes a critical analysis of reputational models, making remarks on a possible framework to measure the bank's reputation. Finally, the last paragraph presents the model and points out the added value, limits and future research lines.

2. CORPORATE REPUTATION MEASUREMENT SYSTEMS

CR measurement systems can be classified in two groups: 1) *qualitative models*, mainly focused on assessing corporate reputation, they are used as preventive measurement tools to support the minimization of the causes of reputational risk; 2) *quantitative models* utilized, especially in the case of bank, to measure the risk and effects of reputation losses.

2.1 The qualitative models

Until 1997 the *Fortune's Most Admired Companies*, released for the first time in 1984 and mainly focused on US firms, was the only reputation ranking available on a global level. At the end of '90s, the sampling frame has been widened in terms of countries and industries (24 industries and 13 countries) and the magazine published the results of Global Most Admired Companies index. To date, Fortune proposes the World's Most Admired Companies indicator (WMAC) that, for 2012, assigns a ranking to 698 companies from 32 countries sorted by 58 industries among which Megabanks and Superregional banks. Using a questionnaire, participants – senior executives, outside directors and financial analysts - assess the reputation of global firms in their industry on nine criteria: *innovation, quality of management, long-term investment value, social responsibility, people management* (ability to attract, develop and keep talented people), *quality of products, financial soundness, use of corporate assets and global competitiveness*. The Overall Reputation Scores (ORS) is the arithmetic mean of the attributes assigned from respondents on nine 11-point scales. Although it is wide use in several researches, the literature (Fombrun et al.,2000:245-246) identified for Fortune's indexes and other "reputation rankings" published from business media (Financial Times, Asian Business, Management Today) the following key biases: 1) a limited respondents pool that not incorporate the perceptions of all key stakeholders; 2) a small sample size, restricted to largest firms; 3) a type of respondents culturally inclined to give a great importance especially to financial performance.

Hence, with the aim to compensate such limitations the Harris Interactive, Charles Fombrun and Cee Van Riel have developed the Reputation Quotient (RQ): a model which permits obtaining data on CR from the general public, customers, employees, suppliers and investors (Schwaiger,2004:55). It relies on a questionnaire consisting of twenty items folded into six dimensions: *emotional appeal, products and services, financial performance, vision and leadership, workplace environment and social responsibility*. Data sampling is done in two stages: an initial phase dedicated to identify companies with the best or worst reputation by interviewing a wide range of stakeholders and a second stage in which the firms are evaluated by an online survey; participants assign a score on 7-point scale to the twenty items. The 2012 annual RQ survey provides a reputation score of the 60 most visible companies in the US, among which several banks (such as Bank of America, Goldman Sachs and JP Morgan Chase) that, because of financial crisis, have registered a significant declines.

A further methodology that turns qualitative variables affecting corporate reputation into a ranking is the RepTrak system developed from the Reputation Institute since 2006. It measures the degree of admiration, trust, good feeling and overall esteem that respondents express about companies of different industries. Twenty-three are the key performance indicators (valued through an online questionnaire) grouped around seven key dimensions: *products/services, innovation, workplace, governance, citizenship, leadership and performance.* Annually, the Reputation Institute publishes the results of extensive researches carried out in over 30 countries. In particular, given the recent financial crisis, in 2011, the Reputation Institute conducted an in-depth study on reputation of banking industry. The survey involves universal, commercial and investment banking firms around the world picking out that banks' reputation scores are much more favorable in emerging markets than banking industry in most developed countries. Such report's results, in addition, confirm what the Global RepTrak 2010 had highlighted: the bank industry ranks poorly compared to other industries.

2.2 The quantitative models

As stated previously, the reputation of bank among its stakeholders has a considerable importance for the development of banking activities, therefore, reputation losses represent a significant threat to financial intermediaries. Starting from this consideration, the method most used in the literature to measure reputational losses in banking sector is the *event study analysis*. Such model allows to estimate the decrease in market value of listed banks involved in events with high reputation impact (eg scandals/frauds; losses derived from employees practices; negative media coverage etc.). Empirical studies conducted in financial sector show that a reduction in bank market value greater than the operating loss announced, highlights the existence of a reputational damage (Perry and De Fontnouvelle,2005:2)

Other quantitative methods suggested from the literature to measure CR are: *intellectual capital approach*, *accounting approach* and *marketing models* (Gabbi and Patarnello,2010:343). The first two approaches rely on the consideration that there is a gap between the market price of listed company and its book value and the difference between the two values relates in part to the value of the company's intangible assets, among which reputation. The *intellectual capital approach* estimates the value of the trademarks, service marks, copyrights, rights and permissions. The costs associated with these variables are collected from financial statements and through those the reputation value is built. The *accounting method,* instead, developed with the statement of the international standard principles IAS/IFRS (see IAS 38), is focused on the assessment of corporate intangible assets. Such approach requires an analysis of reputation associated to assets and liabilities and their valuation at fair value. The difference among those generates net reputation. Finally, the *marketing models* measure CR using the brand equity concept. Among the possible approaches to evaluate the company's brand, the most visible is the royalty rates. Following such criterion, the value of the brand is determined by the amount of royalties that the market would pay to gain the grant of a trademark.

3. A COMPARISION OF REPUTATIONAL MODELS: TOWARDS A FRAMEWORK

The literature highlights the existence of different approaches (qualitative versus quantitative) attempting to quantify reputation. Each approach, outlined in the previous section, has some limitation pointed out by scholars. In particular, the limits of quantitative models are due, above all, to the partiality (*marketing approach*) and the lack of shared criteria for the determination of the reputational value that is "immaterial" for its nature (*intellectual capital* and *accounting approach*). Furthermore, the reputational results achieved are limited to be representative only of the historical moment in which they are processed. With regard to the *event study* methods, first they can only be used in case of listed companies, then a significant problem concerns the clear identification of damaging events, linked to reputation, that impact on market value (Gabbi and Patarnello,2010:346). Moreover, the existing work related to the event studies analysis show, also, as the results may change according to the type of damaging event.

Qualitative models are also subject to several criticism, concerning: sample size, dimensions, methodologies, variables and stakeholders involved. In particular, the concentration on some groups of stakeholders (see Fortune index), or even the use of a methodology based on questionnaires administered by internet, make the investigations questionable. In any case, the analysis seems to highlight that the multidimensional nature of reputation finds a better representation in the qualitative models because they are more focused on the relationships between the company and the key internal and external stakeholders. As showed in Table 1, the qualitative models have expanded and adapted over time dimensions, items and stakeholders groups investigated to better assess stakeholders' perceptions and expectations.

Table 1: Summary of prior qualitative reputation models

Measures of reputation	*Who is surveyed*	*Dimensions*	*Items for Dimensions*
Fortune's (WMAC)	Senior executives, directors and financial analysts (about 4,000)	Innovation, Quality of management, Long-term investment value, Social responsibility, People management, Quality of products, Financial soundness, Use of corporate assets and Global competitiveness.	-
Reputation Quotient (RQ)	Several stakeholders: general public, customers, employees, suppliers and investors etc (over 30,000 in 1° stage)	Emotional appeal, Products and services, Financial performance, Vision and leadership, Workplace environment and Social responsibility.	**Emotional appeal (**Feeling good about, Trust, Admire and Respect); **Products and services** (High Quality, Innovative, Value for Money, Stands Behind); **Workplace Environment** (Rewards Employees Fairly, Good Place to Work, Good Employees); **Financial Performance** (Outperforms Competitors, Record of Profitability, Low Risk Investment, Growth Prospects); **Vision and Leadership** (Market Opportunities, Excellent Leadership, Clear Vision for the Future); **Social Responsibility** (Supports Good Causes, Environmental Responsibility, Community Responsibility)
RepTrak system	Key stakeholders: advocacy groups/NGOs, regulators, governament officials, media, business leaders, community leaders, opinion elites, analysts, customers, employees, business partners and investors etc (over 60,000 for Global RepTrak Pulse)	Products/Services, Innovation, Workplace, Governance, Citizenship, Leadership and Performance.	**Products/Services** (High quality, Value for Money, Stands Behind, Meet Customers Needs); **Innovation** (Innovative, First to Market, Adapts Quickly to Change), **Workplace** (Rewards Employees Fairly, Employee well-being, Offers Equal Opportunities); **Governance** (Open and Transparent, Behavers Ethically, Fair in the way it does Business); **Citizenship** (Enviromentally Responsible, Supports Good Causes, Positive Influence on Society); **Leadership** (Well Organized, Appealing Leader, Excellent Management, Clear Vision for its Future) and **Performance** (Profitable, High Performing, Strong Growth Prospects).

Source: our elaboration on data from Fortune website, Harris Interactive website, Reputation Institute website.

However, these models do not seem to consider the peculiarities of the banking sector in analyzing CR, but, as indicated by recent analysis in assessing bank reputation is essential to consider the specific features of bank industry (Trotta et al.,2011:7). The bank offers, in fact, a variety of financial products and services to a wide range of customers and serves different markets (local/national/international). Therefore, it is possible distinguish among different types of banking: retail banking, wholesale banking, corporate and investment banking, community banking, international banking. These aspects have different consequences with regard to reputation: 1) in carrying out its activities, bank relates to different customers and, therefore, the stakeholders are numerous and various, 2) when a bank offers a multiplicity of products in different markets (global banking/ universal banking/international banking) several production, distribution and geographic issues that may affect the reputation have to be considered; 3) the regulation of banking industry is not a superstructure negligible in the system.

In the case of banks, the observance of rules is a decisive factor in the formation of reputation; the regulatory framework, together with information asymmetries problems, trust and systemic risks, are factors of specificity in the banking industry (Gabbi and Patarnello,2010:341). Considering the standards and controls which the banking system is subject (Antitrust Authority, EBA Authority, Basel regulatory) it is easy to understand that non-compliance to rules may have significant effect both on individual bank and banking system. Thus, in banking industry, reputation can be seen as *legitimacy* indicator because it aggregates assessments of company performance relative to *expectations* and *norms* in an institutional field (Fombrun and Van Riel,1997:9).

In addition, variables such as: *firm size* (Systemically Important Financial Institutions - SIFIs, international banks, community banks), *specialization* (private banking, investment banking, commercial banking, etc.), *regulation* (supervision, payment systems, antitrust, money laundering, etc.) and *listing* (listed versus not listed banks), are critical for the identification of stakeholders groups and can influence, also, the key dimensions of reputation.

4. A FRAMEWORK PROPOSAL FOR ITALIAN BANKS: DISCUSSION AND LIMITS

Taking into account the bank sector features identified in the previous section, the definition of reputational risk given by regulation (BCBS, 2009:19) and the comparison made between the main social ranking (Table 1), we propose a model focused on banking system (Five “R’s” Model) identifying the following key dimensions: *Relationship* (with internal and external stakeholders, among which other banks and supervisors); *Results; Responsibility*; *Role; Regulatory* *compliance.* The linked items for dimensions are proposed in Table 2. As explained before, the identification of the key stakeholder groups (see Table 2) is essential for a correct determination of dimensions of bank's reputation.

Table 2: A proposal to assess bank's reputation: Five "R's" Model

Key Dimensions	*Role*	*Responsibility*	*Relationship* (with internal & external stakeholders)	*Results*	*Regulatory Compliance*
Items for Dimensions	**Mission & Vision** (eg. Strategic priorities); **Leadership** (eg. CEO' reputation, Excellent management); **Governance** (eg. Remuneration/incentives policy; Presence of indipendent Directors; Implementing of gender diversity)	**CSR policy**; **Ethical Behaviour**; **Workplace Environment** (eg. employee satisfaction, employees' expertise)	**Informative transparency with stakeholders**; **Disclosure**; **Trust & Confidence** (eg. future safety of deposits and investments)	**Product & Services** (eg. quality of deposits, investments; loans); **Financial Performance** (eg. profitability, growth perspective)	**Risk Management**; **Antitrust** ; **Compliants' Management**; **Anti Money Laundering Policy**
Who/What is surveyed	Senior executives; Directors and financial Analysts; Regulators & Supervisors, Media, Customers, Employees, Shareholders & Investors, Rating Agencies, other Banks and competitors				Documents' Analysis

Furthermore, among the key dimensions of bank reputation an important role is played by *responsibility* and *regulatory compliance*. Responsibility has a key role in the banking industry because it permeates all the other reputational dimensions (drivers) (Trotta et al.,2011:11), while compliance to law is determinant owing to its significant impact on stakeholders expectations and perceptions. In fact, Regulators & Supervisors have a prominent role in the banking industry: lay down the rules, monitoring compliance, apply sanctions to banks; in addition, their activities increase the level of confidence in the banking industry. For these reasons, our model include them among the stakeholders groups and provides also a specific dimension: the regulatory compliance. Basically, we propose an index that combine the methodology used for social ranking (questionnaire with a scale value to measure the qualitative items) with an analysis of the sensible documentation by assigning a negative ranking in case of sanctions, corrective measure or special administrative procedure triggered by Authority inspections and controls.

Regarding Italian banking system, it consisted of 760 banks (to December 31, 2010) of which 205 included in 76 banking groups. On the total, 233 were limited company banks, 37 cooperative banks (*banche popolari*) and 415 mutual banks (*banche di credito coperativo*), while only 75 were branches of foreign banks

(Bank of Italy,2011:134-135). The SIFIs were 5 and 6 the conglomerates. At the end of 2010, there were 24 banks or banking groups listed. Among the top 20 groups ranked by consolidated assets 8 were not listed. The listed groups and banks held the 63.9 % of system assets and 7 of them are cooperative banks (Bank of Italy,2011:134-135). At national level, the financial system's Authority are: Bank of Italy, Consob, Isvap, Covip and Antitrust. Particular attention is given to prevention and countering of money laundering and terrorist financing. Therefore, as can be inferred listed banks and large banks represent only a minor percentage of the system and, especially banks of small size faced several difficulties in applying both qualitative and quantitative models to measure CR and avoid reputational risk. Thus, until now, in order to keep stakeholders' confidence the bank activity is mainly focused on a careful management of reputational risk by actions (eg adoption of code of conduct; monitoring of customers' complaints; improvement of CSR practices) that reduce the probability of occurrence of events that could worsen the bank's reputation (Ielasi,2011:15).

Hence, a reputational index may be useful. In addition, given the attention that the Italian banking system dedicated to regulation and supervision, *regulatory compliance* dimension plays an important role. In this case, the analysis of sensible documentation could be focused on: Bank of Italy's supervisory bulletin, annual report of Antitrust, UIF's report etc.

The major limitation of this study is that the model is under development. Thus the future research lines will be focused on: 1) establish a focus group (representative of all stakeholders) in order to identify the key opinions relating Italian bank reputation, check the model dimensions and identify a set of associated items approved by focus group; 2) verify and test our Five "R" model through empirical surveys in order to evaluate CR of listed bank and not listed bank trying to highlight the possible differences and reputational components that have major impact on bank CR; 3) understand the role that a monitoring system of financial press, financial websites and social network could be play in managing CR and preventively identify the possibility of damaging events.

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