ESTABLISHING REPUTATION ON THE WARSAW STOCK EXCHANGE

by

STEPHEN SCOTT STANDIFIRD

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[redacted]

Dr. Alan D. Meyer, Chair of the Examining Committee

8/2/99

Date

Committee in charge:

Dr. Alan Meyer, Chair
Dr. Richard Mowday
Dr. Marc Weinstein
Dr. Robert O'Brien

Accepted by:

[redacted]

Dean of the Graduate School

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During 1989, East Central Europe witnessed one of the most remarkable transformations in socio-political history. The economic transformation that followed represents one the most remarkable economic transitions in modern history. In Poland, the Warsaw Stock Exchange has greatly facilitated the transition from a centrally controlled to a market-based economy. Still, the general youthfulness of the Warsaw Stock Exchange erodes the ability of individual firms traded on the exchange to establish a positive reputation with investors. This dissertation investigates how firms traded on the Warsaw Stock Exchange establish reputation with investors despite the youthfulness of the exchange.

To address this topic, a general model of organizational reputation formation is developed. The model presented suggests that the individual firm can establish itself as reputable through the mechanisms of performance, signaling and legitimation. The general model is used to develop specific hypotheses concerning how firms traded on the Warsaw Stock Exchange establish reputation with investors. Two separate analyses are conducted to test the hypotheses. The first analysis looks at all firms traded on the

Warsaw Stock Exchange as of the end of 1996 while the second analysis looks specifically at the reputation of firms immediately following the issuing of new shares.

The results provide mixed support for the hypotheses. However, the results suggest an important role for financial performance, ownership structure and the use of international brokers during the issuing of new shares, each relating to the mechanisms of performance, signaling and legitimation, respectively. Thus, each of the mechanisms identified in the general model of organizational reputation formation appears to have some influence in shaping the reputation of the firm.

CURRICULUM VITA

NAME OF AUTHOR: Stephen Scott Standifird

PLACE OF BIRTH: Baltimore, Maryland

DATE OF BIRTH: June 23, 1965

GRADUATE AND UNDERGRADUATE SCHOOLS ATTENDED:

University of Oregon
Northwestern University
Purdue University

DEGREES AWARDED:

Doctor of Philosophy in Management, 1999, University of Oregon
Masters of Management, 1994, Northwestern University
Bachelor of Science in Chemical Engineering, 1989, Purdue University

AREAS OF SPECIAL INTEREST:

Business Strategy
International Management

PROFESSIONAL EXPERIENCE:

Visiting Lecturer, Academy of Entrepreneurship and Management, Warsaw, Poland, 1999

Graduate Teaching Fellow, Department of Management, University of Oregon, Eugene, 1994-1999

Internal Management Consultant, Amoco Chemical Company, Joliet, Illinois, 1993-1994

Human Resource Representative, Amoco Chemical Company, Joliet, Illinois, 1992-1993

Responsible Care Coordinator, Amoco Chemical Company, Joliet, Illinois, 1991-1992

Environmental Specialist, Amoco Chemical Company, Joliet, Illinois, 1989-1991

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DEDICATION

To my parents, Ike and Ann Standifird, for constantly encouraging me to pursue my dreams and to my future wife Vivian Lee for helping to make my dreams a reality.

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CHAPTER I

GENERAL INTRODUCTION

Phenomenological Background

During 1989, East Central Europe (ECE) witnessed one of the most remarkable transformations in socio-political history. Entire political systems were transformed from socialism to democracy virtually overnight. The economic transformation that followed represents one the most remarkable in modern history. Fixed prices, protective trade and governmental subsidies have significantly reduced in most ECE countries. Mass privatization, individual sale or liquidation have thrust all but the largest and most strategic organizations into the ever-growing private sector. Today, individual firms throughout ECE find themselves directly exposed to international competition with little or no protection being offered by national governments.

In Poland, the Warsaw Stock Exchange (WSE) has been major facilitator in the transition from a command and control to a market-based economy. Prior to WWII, the WSE was a thriving exchange. However, in 1939, the WSE was officially closed and remained closed for over fifty years. The re-opening of the WSE began with a review of various international exchange models. After considering a variety of options, WSE founders ultimately decided to adopt a French model and began developing the appropriate mechanisms with the aid of Societe de Bourses and the French depository SICOVAM.

In March of 1991, the Polish Parliament passed the Act on Trading in Securities and Trust Fund. The act established the groundwork for core capital market components: brokerage houses, the stock exchange itself, trust funds, and the Polish Securities Commission (PSC). On April 12, 1991, the act formally establishing the WSE was signed into law. Initial trading of the first five firms listed began four days later on April 16, 1991.

The exchange has been fairly successful to date. In 1994, the WSE was the first exchange in the region to be granted membership to the International Federation of Stock Exchanges. In the first half of 1998, the average daily equity turnover was 67 million USD. Today, more than 200 firms are traded on a daily basis with a total capitalization in excess of 18 billion USD.

Despite success of the WSE itself, firms traded on the WSE face an enormous challenge when attempting to attract investment capital. The biggest challenge for the individual firm traded on the WSE is to establish itself as reputable with investors in the increasingly competitive Polish capital market. Prior to 1989, reputation and competitiveness were relatively meaningless concepts. Central planners were primarily responsible for determining a firm's economic success. Today, reputation and the corresponding competitiveness of the individual firm is a key component in determining a firm's economic prosperity.

Several factors work against WSE firms in their attempt to appear as reputable with investors. First, firms traded on the WSE are located in a market inaccessible to investors for over 50 years. The obscurity of the market itself suggests that most investors will be largely unfamiliar with the firms traded on the exchange. This lack of familiarity vastly complicates the ability of the individual firm to establish itself as reputable with investors. Second, with rare exceptions, firms traded on the WSE have limited experience operating in a market-based economy. The lack of market-based experience increases the perceived risk of investing in WSE firms, further complicating the ability of the individual firm to establish itself as reputable with investors. Finally, the Polish socio-political environment itself continues to transform as Poland continues to make the transition from a command-and-control to a market-based economy. The ongoing volatility of the socio-political environment further erodes the ability of the individual firm to establish itself as reputable. The purpose of this study is to investigate how firms establish reputation among investors in an uncertain environment such as Poland.

Importance of the Study

Organizational reputation has recently emerged as an important strategic consideration. A positive organizational reputation can influence a firm's share price performance (Vergin & Qoronfleh, 1998), opportunities to create joint ventures (Dollinger, Golden & Saxton, 1997), and even its basic survival (Rao, 1994). The issue of reputation building is particularly important in settings where information is suspect or lacking (Weigelt & Camerer, 1988). As environmental uncertainty increases, the ability to directly assess a firm's performance decreases. In such as environment, reputation serves as a surrogate for understanding a firm's value.

Despite the potential importance of reputation in an uncertain environment, scant attention has been given to how firms establish reputation in conditions of uncertainty. The ability to establish reputation in conditions of uncertainty is precisely the problem for firms in emerging economies such as Poland's.

The Research Question

The purpose of this dissertation is to investigate how firms establish reputation in an emerging economy. This question is addressed by investigating how firms traded on the WSE establish reputation with investors. I begin with a detailed overview of the literature concerning organizational reputation (Chapter Two). At the conclusion of the literature review, I present a basic model of reputation formation. This model is then use to develop specific hypotheses concerning how firms traded on the WSE establish reputation with investors (Chapter Three). Chapter Four outlines the research methodology used to investigate the hypotheses developed in Chapter Three. In Chapter Five, I discuss the results of the research. Finally, Chapter Six provides a summary discussion of the research including a discussion of implications for research and practice.

CHAPTER II

LITERATURE REVIEW

To most, reputation is a readily comprehensible concept. Each of us recognizes the value of a good reputation and reacts to situations that threaten to damage our reputation with others. Despite the intuitive nature of reputation, organizational reputation has only recently been recognized as an important strategic construct. Still, the results of research concerning the effects of reputation appear consistent. Vergin and Qoronfleh (1998) find a direct link between a positive organizational reputation and share price performance. Dollinger, Golden and Saxton (1997) focus specifically on organizational reputation and the opportunity to create joint ventures. As predicted, the authors found that firms with a strong (positive) reputation were more likely to be targeted for joint venture. Rao (1994) found that increased organizational reputation as indicated by professional certification reduces organizational mortality. In general, a positive organizational reputation is a valuable commodity resulting in increased firm performance either directly or indirectly through increased exchange opportunities (Weigelt & Camerer, 1988).

A negative organizational reputation can be damaging to the individual firm. Nichols & Fournier (1999: 299) found empirical evidence “that a poor reputation associated with US autos during the early 1980's has persisted in reducing prices of more recent models, despite quality improvements.” Baucus and Baucus (1997) found a negative long-term performance effect associated with the discovery and conviction of illegal corporate behavior. D'Aveni (1990) found a management bailout effect associated with organizational decline. In each case, the empirical evidence suggests a long-term damaging effect associated with a negative reputation resulting from poor quality, illegal corporate behavior or firm bankruptcy.

Despite empirical evidence pointing to the importance of organizational reputation, surprisingly little work has been done to provide a theoretical foundation for understanding the sources of organization reputation, especially in conditions of uncertainty. This is not to suggest that the topic of reputation in general has been ignored by organizational scholars. Quite the contrary. The general concept of reputation appears prominent in such diverse academic literatures as finance and economics, management, and marketing. Still, a theoretical model of how organizational reputation is established has yet to be developed. The purpose of this section of the dissertation is to develop such a theoretical model.

I begin with a discussion what organizational reputation is or, perhaps better stated, what organizational reputation is not. To accomplish this task, I provide a brief overview of the literature concerning organizational image, identity and reputation. I then devote my attention to developing organizational reputation as a distinct concept independent of image and identity by reviewing the relevant literature concerning organizational reputation. Building on the existing literature concerning reputation, I conclude the chapter by presenting a model for understanding the formation of organizational reputation.

Distinguishing Organizational Reputation

Individual Reputation

The first task in understanding organizational reputation is to distinguish organizational reputation from individual reputation. The management literature concerning individual reputation is fairly well developed (see for example, Kilduff & Krackhardt, 1994; Sutton & Callahan, 1987; Freidson, 1986; Useem and Karabel, 1986; Tsui, 1984). However, the focus of this discussion in not on the individual but on the organization. Clearly, the reputation of individuals within the organization and the reputation of the organization itself are linked (D'Aveni, 1990). For example, a highly reputable senior management team is likely to be reflected in the reputation of the individual firm. However, the processes by which the organization and the individual establish reputation are themselves quite distinct.

The primary distinction between individual and organization reputation is the complexity of information involved in the assessment of the entity as reputable. Individuals for the most part act as a single entity where individual actions can readily be attributed to a specific source, the individual. This is not to suggest that such attribution is done without flaw (Heneman & Greenberger, 1989; Nisbett & Ross, 1980). Still, the ability to link the individual with a specific set of actions and associations decreases the complexity in assessing an individual as reputable. Organizations, on the other hand, are far more complex (Perrow, 1986; Starbuck, 1981; Barnard, 1938). Any one organization is characterized by a multitude of actions and associations carried out by a variety of individual actors (Weick, 1979; Cyert & March, 1963; March & Simon, 1958). Therefore, a necessary first step in establishing an organization as reputable involves identifying a unique set of actions and associations that characterize the individual firm.

An organization's top managers attempt to highlight specific actions and associations by establishing unique identities and images. Thus, in order to understand organizational reputation, we must distinguish organizational reputation from organizational identity and image. This is best accomplished by first defining organizational reputation then comparing organizational reputation to organizational identity and image.

Organizational Reputation Defined

Despite the increased interest in corporate reputation, a generally accepted definition of organizational reputation has yet to emerge. Fombrun and Shanley (1990: 234-235) identify corporate reputation as "the outcome of a competitive process in which firms signal their key characteristics to constituents to maximize their social status . . . the publics' cumulative judgements of firms over time." Dollinger, Golden and Saxton (1997: 127) suggest that "a positive reputation indicates that an organization is highly esteemed, worthy or meritorious; it implies a good name and high regard." Weigelt and Camerer (1988: 443) define corporate reputation as "a set of attributes ascribed to a firm, inferred from the firm's past actions." Fombrun (1996: 37) identifies reputation as "the overall estimate in which a company is held by its constituents . . . the "net" affective or emotional reaction – good or bad, weak or strong – of customers, investors, employees, and the general public to the company's name." In much the same spirit, Herbig, Milewicz and Golden (1994: 23) define reputation as "an aggregate composite of all previous transactions over the life of the entity, a historical notion, and requires consistency of an entity's actions over a prolonged time for its formation."

Consistent in each of the definitions is a focus on external evaluation. This external focus is what distinguishes reputation from corporate identity as will be discussed below. Moreover, each definition highlights the importance of evaluating the actions and associations of the firm. Whether discussing reputation based on repeated transactions (Weigelt and Camerer, 1998; Herbig, Milewicz and Golden, 1994), the process of legitimation (Rao, 1994), affective reactions (Fombrun, 1996) or peer evaluation (Vergin and Qoronfleh, 1998; Fombrun and Shanley, 1990), there is always a sense of evaluation based on historical knowledge of the organization. The evaluating nature of reputation is what distinguishes reputation from organizational image.

Missing from each of these definitions, however, is consideration of the relative nature of reputation, i.e., a discussion of reputable to whom and under what conditions. To suggest that an organization has a strong reputation without discussing reputable to whom is much like identifying a specific architectural style as superior to another. The perception of superiority clearly depends on the subjective assessment of an outside party and the referent group to which the comparison is being made. Likewise, the reputation of a firm will vary depending on the specific party involved. Disparate external parties such as investors and environmental regulators will undoubtedly vary concerning criteria used in their assessment.

Dollinger, Golden and Saxton (1997) provide one of the few studies that specifically identifies contextual variables as important. They do so by treating reputation as a multi-dimensional construct. Dollinger, Golden and Saxton find that adjustments can be made on some dimensions of reputation without significantly damaging overall organizational reputation. Specifically, they find that product reputation (as compared to management quality and financial reputation) is most critical when attempting to attract joint venture partners. However, the authors are quick to note that the importance of product reputation is no doubt a function of the task at hand. A more financially oriented assessment would most likely lead to a greater focus on financial reputation, according to Dollinger, Golden and Saxton (1997). Still missing from Dollinger, Golden and Saxton's study is an explicit discussion of constituent and referent groups and how this may affect the assessment of reputation. For research of organizational reputation to advance further, it is imperative that we desegregate the construct of reputation by explicitly identifying what dimension of reputation is being studied and which constituent group is assessing the organization as reputable.

To this end, I define organizational reputation as an assessment of an organization's desirability in a given environment as determined by a specific individual or group of individuals external to the firm. Reputation is externally derived in that those assessing the firm as reputable are, by definition, external to the firm. Reputation is context specific in that the factors used in determining an organization as desirable depend on the particular individual or group assessing the organization and the conditions in which the assessment is made. In short, organizational reputation is an assessment of an organization's desirability in a given environment by a specific external entity based on the past actions of the focal organization. Having defined organizational reputation, I now can distinguish organizational reputation from organizational identity and image.

Organizational Identity

Organizational identity is treated slightly different by the various scholarly disciplines. In the marketing literature, organizational identity is generally defined as "the organization's presentation of itself to its various stakeholders and the means by which it distinguishes itself from all other organizations" (Markwick & Fill 1997, 397). Organizational identity is the organization's attempt to make explicit the organization's key strategic and operational characteristics (Markwick & Fill 1997, Topalian, 1984). The management literature tends to take a more internal perspective on identity. Here, identity is defined as those organizational features that members internal to the organization perceive as central to defining the organizational character (Gioia and Thomas, 1996, Elsbach & Kramer 1996, Dutton, Dukerich and Harquail 1994, Dutton and Dukerich 1991, Sutton & Callahan 1987, Albert & Whetten 1985). "At the organizational level, corporate or organizational identity concerns those features of the organization that members perceive as ostensibly central, enduring, and distinctive in character that contribute to how they define the organization and their identification with it" (Gioia and Thomas, 1996, 372).

What distinguishes organizational reputation from identity is the externally defined nature of organizational reputation. As suggested above, reputation is externally derived in that those assessing the firm as reputable are, by definition, external to the firm. Identity, in contrast, is internally derived in that internal organizational participants are responsible for crafting the corporate identity. Where as corporate identity focuses on the perceived values and principles of organizational members (Fombrun, 1996), reputation flows from the assessment and endorsement of parties external to the firm (Rao, 1994).

Organizational Image

The way in which the marketing and management literatures treat the concept of image also varies slightly. In the marketing literature, "Corporate image can be said to be the totality of a stakeholder's perceptions of the way an organization presents itself, either deliberately (for example, through planned public relations activities) or accidentally, (for example, through comments made by staff or media comments)" (Markwick and Fill, 1997, 397). Image is the impression an organization makes on the multitude of external stakeholders (Dowling, 1993) and, as such, is defined external to the organization. Again, the management literature takes a more internal perspective. Image, according to management scholars, is a discussion of how others are perceived to view the firm (Dutton, Dukerich and Harquail, 1994). "Image generally has been defined in the organizational literature as how members believe others view their organization" (Gioia and Thomas, 1996, p. 372). Thus, image is concerned with external perceptions but is defined by internal organizational participants.

Image as portrayed in the management literature is quite similar to the discussion of identity found in marketing. In both cases, the focus is on how internal members believe others view their organization. The concern is with external beliefs but the formation of image occurs internally as internal organizational members attempt to identify external perceptions. Again, this internal focus is what distinguishes image as discussed in the management literature from organizational reputation.

Image as portrayed in the marketing literature comes much closer to the general concept of organizational reputation. Both organizational reputation and marketing image are established external to the focal organization. The key distinction between image as discussed in marketing and organizational reputation is the evaluating nature of organizational reputation. Organizational reputation is an assessment of an organization's desirability established based on past organizational activities (Deephouse, Bansal & Carter, 1998). Organizational image is the mere projection of certain organizational attributes. Corporate image is the general impression an organization makes (good or bad) while organizational reputation is the external evaluation of the image presented (Dowling, 1994). The evaluation of the corporate image projected is what makes organizational reputation distinct from image.

Having distinguished organizational reputation from identity and image, I can now provide an overview of the literature discussing organizational reputation specifically. Given the diversity of literature addressing the issue of organizational reputation, it is difficult to provide a concise summary. The primary literature streams addressed here come from economics and finance, marketing, and management.

Accounting also touches on the issue of reputation when discussing goodwill. However, goodwill as used in accounting is primarily a residual measurement lacking theoretical foundation (Shenkar & Yuchtman-Yaar, 1997). Therefore, a separate discussion of goodwill is not included in this analysis. Sociologists also address the issue of reputation. However, sociologists are most concerned with the reputation of professions and organizational forms, not organizations per se (Shenkar & Yuchtman-Yaar, 1997). Moreover, the critical links between sociological theory and organizational reputation are captured in the literature in management (e.g., Rao, 1994). Therefore, a separate discussion of organizational reputation as discussed by sociologists is not included in this analysis.

Existing Research on Organizational Reputation

Finance and Economics

While finance and economics represent distinct disciples, the underlying theories of the two disciples overlap when discussing organizational reputation. Therefore, the two are discussed here together. In both economics and finance, organizational reputation has been treated predominately as an independent variable with minimal attention being paid to developing reputation as a construct. For example, Chemmanur & Fulghieri (1994) present a model where the reputation of the investment bank associated with a firm influences perceived value of the firm (consistent with empirical observations). Carter, Dark and Singh (1998) found that Initial Public Offers (IPOs) managed by more reputable underwriters experience less short-term under-pricing. The use of a more prestigious auditor also appears to decrease the level of IPO underpricing (Eichenseher & Shields, 1985; Michaely & Shaw 1995). Wolmack (1996) found that firm reputation as assessed by broker analysts correlated positively with stock price performance. Nichols & Fournier (1999) found that the American auto industry continued to suffer from the poor reputation developed in the 1980's, despite quality improvements. In each case, the primary focus is on the effect of reputation either directly, or indirectly through the association with others. Little mention is given to the source of reputation itself. No attention is directed to how reputation is transferred from one organization to the other, in cases where such transfers are assumed to take place.

The one area where economics and finance does address the source of reputation itself concerns the topic of signaling. Signaling theory suggests that firms use specific signals or behavioral cues to establish a specific reputation in the market place (Kreps & Wilson, 1982; Milgrom & Roberts, 1986, 1982; Klein & Leffer, 1981; Wilson, 1985). For example, a firm can engage in predatory pricing behavior to develop a reputation of toughness (Kreps & Wilson, 1982; Milgrom & Roberts, 1982). By developing a reputation for predatory price, the firm attempts to decrease the expected economic benefit for other firms assessing whether or not to enter the target market. By reducing the expected economic benefit to potential entrants, the firm attempts to deter new entry thereby maintaining a greater percentage of the market share for itself.

Likewise, a firm can use price and advertising expenditures as a signal of product quality (Nelson, 1974; Milgrom & Roberts, 1986). High quality firms rely on repeat customers. Thus, the extra expense of advertising for the high quality firm is recouped with repeat business. A firm producing low quality items will not benefit from repeat business and, correspondingly, can not afford to engage in extensive advertising. As a result, the consumer can use the level of advertising as a signal of product quality (Weigelt & Camerer, 1988).

A potential weakness of the models in economics and finance is that they assume that those assessing the reputation of a firm will act rationally when making the assessment. Individual assessors of reputation can be argued to be boundedly rational at best (Simon, 1957). Thus, it is unlikely that external evaluators such as consumers will make the complicated calculations needed to use the reputational models presented in economics and finance. More importantly, the primary focus of the models is on specific aspects of a firms reputation (e.g., a reputation for predatory pricing) and not on reputation as a whole. As a result, economic and finance models of reputation are helpful in specific situations but do little to develop our general understanding of organizational reputation.

Marketing

The general notion of reputation appears prominent in the marketing literature. Reputation with consumers is a key variable in marketing research. The primary way in which the marketing literature has attempted to address the issue of reputation with consumers is through the concepts of corporate or brand image and identity (see for example, Dowling, 1994; Ind, 1992). The distinction between identity, image and reputation has already been discussed. Given the primary focuses on identity and image, the research in marketing falls short of articulating a general model of organizational reputation. Still, some of the basic concepts developed in the marketing literature can be used in developed a more general understanding of organizational reputation.

One of the most important contributions from the marketing literature is the recognition of organizational image as a multifaceted construct. While image and reputation represent distinct constructs, certain underlying principles remain constant. Both image and reputation are externally defined (Markwick & Fill, 1997). Thus, both reputation and image are defined by a medley of external stakeholders. "Since organizations have many stakeholders, each with a variety of backgrounds, objectives and levels of dependency, it cannot be expected that there will be a single, uniform and consistent image" (Markwick & Fill, 1997: 396). Dowling (1993) suggests the multiplicity of images as a fundamental aspect of managing corporate image. Likewise, the multiplicity of reputation is a fundamental aspect of corporate reputation. The recognition in the marketing literature of organizational image, and correspondingly organizational reputation, as multifaceted is a critical contribution from the marketing literature concerning our understanding of organizational reputation in general.

Another significant contribution from the marketing literature concerns the recognition of image, and correspondingly reputation, as being construed in the minds of the stakeholders themselves. "Image, therefore, exists in the mind of each stakeholder and cannot be managed directly" (Markwick & Fill, 1997: 399). Thus, the organization is limited in its ability to directly influence corporate image and reputation. "Corporate images result from as interpretation of a range of perceptual stimuli, only some of which can be influenced directly by an organization" (Markwick & Fill, 1997: 401). Therefore, any model of organizational reputation formation must include as a critical component the external entity with which the organization is attempting to establish reputation.

Finally, the marketing literature provides an important contribution to the topic of corporate reputation by highlighting the importance of communication. It is not sufficient that an organization merely adopt appropriate practices. In order to garnish reputation of external stakeholders, the actions of the organization must some how be made known to the external environment (Herbig & Milewicz, 1995). The way in which specific corporate activities (identity) are turned into external perceptions (image) is through corporate communications (Ind, 1992; van Riel, 1995). The importance of communicating organizational activities to the external environment is another critical contribution from the marketing literature.

Herbig and Milewicz (1995) provide one of the few studies in marketing that looks specifically at corporate reputation (as distinct from image and identity). To build their model of reputation, they draw extensively from theories in finance. For example, the authors suggest that "Reputation occurs primarily through market signaling. A market signal is a marketing activity that provides information beyond mere form and alerts another firm to its intentions, commitments, or motives. A reputation is established by fulfilling marketing signals" (Herbig & Milewicz, 1995: 5). Consistent with theories in economics, Herbig and Milewicz suggest that in order to establish reputation, the signals sent to the market place must be credible. Thus, a history of activity becomes necessary if a firm is to establish itself as reputable.

The literature in marketing provides an important foundation for developing a general understanding of organizational reputation. However, the marketing literature on its own does little to articulate a general model of organizational reputation. The primary limitation of the marketing literature concerns the focus of the research itself. For obvious reasons, the marketing literature is predominantly focused on reputation with consumers and of specific brands. While the focus on consumers and brands is understandable, it limits our ability to develop a general model of reputation. For example, Microsoft Word may be highly reputable with consumers. However, understanding the reputation of Microsoft Word with consumers may or may not inform us concerning the overall reputation of Microsoft as a company or concerning the reputation with non-consumer stakeholders.

The literature in marketing also appears to focus principally on the actions of the individual firm. Thus, we see more focus on concepts such as image and identity and less on understanding reputation from the perspective of the external stakeholder. Again, the reason for such a focus is obvious. As pointed out by Markwick & Fill (1997), the organization is limited in its ability to control perceptual stimuli occurring from sources external to the firm. From a marketing perspective, it makes sense to focus predominantly on factors such as corporate identity that are within the influence of the individual firm. Still, the predominantly internal focus found in the marketing literature limits our ability to develop a general understanding of how organizational reputation is established.

Management

As suggested above, the management literature concerning individual reputation is fairly well developed (see for example, Kilduff & Krackhardt, 1994; Sutton & Callahan, 1987; Freidson, 1986; Useem and Karabel, 1986; Tsui, 1984). However, the literature concerning organizational reputation has only recently captured the interest of management scholars.

From an empirical perspective, reputation has received attention as both as independent and dependent variable. As an independent variable, reputation has been found to correlate with share price performance. Specifically, more reputable firms appear to experience greater increases in stock price (Vergin & Qoronfleh, 1998; Hannon & Milkovich, 1996) and return on equity (Karake, 1998). Dollinger, Golden and Saxton (1997) focus specifically on organizational reputation and the opportunity to create joint ventures. As predicted, the authors find that firms with a strong (positive) reputation were more likely to be targeted for joint venture. Rao (1994) finds that increased organizational reputation as indicated by professional certification reduces organizational mortality.

As a dependent variable, reputation also has been found to correlate with financial performance (Hammond & Slocum, 1996), though the support for such findings is arguably weak (Vergin & Qoronfleh, 1998). The most exhaustive investigation of reputation as a dependent variable comes from Fombrun and Shanley (1990). They identify a variety of characteristics that lead to increased Fortune reputational rankings. The authors find a positive influence associated with market performance, accounting profits, concentration of ownership, organizational size, a demonstration of social concern and advertising intensity.

The management literature's theoretical discussion of the organizational reputation is less developed. The bulk of the theoretical strength is based on two studies (Rao, 1994 and Vendelo, 1998) both of which focus on the process of reputation building. According to Vendelo (1998), organizations can build reputation through a narrative process where the organization attempts to establish future performance through impression management tactics. The success of the narrative approach depends on the ability of the story to conform to prior expectations of the target audience. Furthermore, Vendelo (1998) provides a framework for understanding organizational reputation by suggesting that reputation is established via individual performance and specific affiliations. In addition, reputation is established either through first-hand or second-hand knowledge. The result is a two-by-two matrix where reputation is established either through direct experience with the organization (first-hand, performance), direct experience with the organization's affiliate (first-hand, affiliate), references to the organization's performance (second-hand, performance), or knowledge of the organization's affiliations (second-hand, affiliation).

Rao (1994) provides an alternative for understanding reputational determinants by identifying reputation as the outcome of the legitimation process. According to Rao (1994: 31), 'models of legitimacy direct attention to the collective processes by which reputation is created and sustained. . . More concretely, legitimation consists of creating an account of an organization, embedding that account in a symbolic universe, and thereby endowing the account with social facticity." Therefore, legitimating activities become the determinants of organizational reputation as symbolic activities are translated into the social facts that define a firm as reputable. The advantage of Rao's approach to understanding reputation is that it allows us to identify potential reputational determinants by looking specifically at the process of legitimation.

The primary weakness of the management literature is that each study either focuses narrowly on a specific aspect of reputation (thereby inhibiting our ability to develop a general model) or attempts to develop a general understanding of reputation at the expense of conceptual development. Hammond & Slocum (1996) and Vergin & Qoronfleh (1998), for example, both focus on the link between Fortune reputational rankings and financial performance. In doing so, these authors limit their attention to the financial aspects of the company and to reputation with a specific target group. Fombrun and Shanley (1990) attempt to address various aspects of a firm's reputation. However, their efforts are hampered due to the reliance on the Fortune rankings as their measure of reputation. Both Fryxell and Wang (1994) and Brown and Perry (1994) find a 'financial halo' associated with the Fortune ratings and argue that any study using the Fortune rankings must first remove the financial halo in order for the independent effects of non-financial characteristics to be observable.

The two-by-two matrix developed by Vendelo (1998) is potentially useful. However, Vendelo does little to develop this model. Instead, Vendelo (1998) abandons the model for a more detailed discussion of the narrative approach embraced by a specific software company. Rao's (1994) analysis is also insightful in that it provides a theoretical framework for understanding reputational determinants as the outgrowth of the process of legitimation. However, Rao's (1994) analysis is limiting when it comes to identifying the actual source of firm reputation. Professional "victories," according to Rao, are credentials that allow the organization to acquire a reputation for competence. The acquired reputation further leads to increased survival. The focus of Rao's analysis is on organizational survival. The underlying reputation of the firm is never directly addressed in Rao's analysis. The lack of discussion concerning the actual reputation of the firm inhibits our ability to use Rao's analysis as a general framework for understanding organizational reputation.

Perhaps the most serious weakness of the management literature concerning organizational reputation is the failure to recognize reputation as a multi-dimensional construct. Fombrun and Shanley (1990), Hammond & Slocum (1996) and Vergin & Qoronfleh (1998) each treats reputation as a uni-dimensional perspective by relying on the Fortune rankings as their measure of organizational reputation. Both Rao (1994) and Vendelo (1998) focus exclusively on reputation with customers failing to address other potential stakeholders in the development of their respective theories. Only Dollinger, Golden and Saxton (1997) mention the possibility of organizational reputation as a multi-dimensional construct. Still missing from Dollinger, Golden and Saxton's (1997) study is an explicit discussion how the multi-dimensional nature of organizational reputation affects an organization's ability to establish itself as reputable. For research of organizational reputation to advance further, it is imperative that we recognize the multifaceted nature of organizational reputation and incorporate this understanding into any discussion of reputation formation.

Each of the literature streams outlined above contributes to our general understanding of organizational reputation. Yet, each falls short of providing a general model of organizational reputation formation. The literature in finance and economics, for examples, highlights the importance of reputation by establishing a link between reputation and firm financial performance. In addition, this literature stream begins to explore the nature of reputation formation by looking at the role of organizational 'signaling.' However, the specificity of research combined with the assumptions of rationality makes it difficult to convert the findings from finance and economics into a general model of reputation formation. The marketing literature provides several important contributions by recognizing reputation as being multifaceted, by identifying the role of communications in establishing reputation and by recognizing reputation as being externally defined. Yet, the marketing research falls short by focusing predominantly on internal issues such as image and identity and by looking restrictively at reputation of specific brands and exclusively at reputation with consumers. The management literature on reputation also demonstrates the link between reputation and important outcome variables such as financial performance and survivability. In addition, the management literature provides some framework for understanding reputation formation by suggesting reputation as a function of actions and associations and by identifying reputation as the outgrowth of the process of legitimation. The management literature suffers by relying too heavily on poorly developed constructs of reputation and by failing to treat reputation as a multifaceted phenomenon. A summary of the contributions and limitation of the literature streams outline above can be found in Table 1.

The Missing Link

What appears to be missing from any of the research discussed so far is a detailed discussion of how organizational reputation is established. While several of the studies outlined above discuss how organizational reputation is established along certain dimensions (e.g., a reputation for product quality), none present a general model of reputation formation. Rao (1994) comes closest when he suggests reputation as the outgrowth of the legitimation process. Still, the focus on Rao's analysis is organizational survival and not reputation specifically. What's lacking in Rao's analysis is a detailed discussion of <u>how</u> reputation is established via the process of legitimation. What follows is an attempt to develop a general model of organizational reputation formation drawing extensively from the work of Rao (1994). However, the model presented below expands our knowledge of reputation formation by treating the reputation of the organization as central and by providing a detailed discussion of <u>how</u> reputation is established via the process of legitimation. To understand how organizations establish reputation via the process of legitimation, we must first discuss the nature of organizational legitimacy. Thus, the next section of the dissertation focuses on understanding the nature of organizational legitimacy in general.

TABLE 1: SUMMARY LITERATURE OVERVIEW

Literature	Contributions	Limitations	Examples
Finance and Economics	- Demonstrates a positive relationship between reputation and specific financial performance variables. - Identifies signaling as a way of establishing a firm as reputable.	- Focuses on specific aspects of reputation and not the reputation of the firm as a whole. - Assumes the external evaluator is a rational assessor of a firms activities.	Carter, Dark & Singh (1998); Chemmanur & Fulghieri (1994); Milgrom & Roberts (1986); Kreps & Wilson, (1982); Klein & Leffer (1981)
Marketing	- Recognizes reputation as a multifaceted construct. - Identifies the role of communications in establishing a firm as reputable. - Recognizes reputation as externally defined.	- Interested in internal issues, such as image and identity, more than reputation - Focuses on the reputation of products and not the firm as a whole. - Interested primarily with reputation with consumer.	Markwick & Fill, (1997); van Riel, (1995); Herbig & Milewicz (1995, 1994); Dowling (1994); Ind (1992)
Management	- Demonstrates a positive relationship between reputation and financial performance, business opportunities and survivability. - Recognizes reputation as the outgrowth of the process of legitimation.	- Relies too heavily on the Fortune rankings. - Fails to develop reputation as a distinct construct. - Tends to treat reputation as a uni-dimensional construct despite evident to the contrary.	Vendelo (1998); Vergin & Qoronfleh, (1998); Dollinger, Golden & Saxton (1997); Rao (1994); Fombrun & Shanley (1990).

Organizational Legitimacy

One of the earliest statements concerning organizational legitimacy comes from Parsons (1960). According the Parsons, legitimacy stems from congruence between organization and its cultural environment. Organizations establish legitimacy by adopting goals and engaging in activities that are congruent with the norms and expectations of the cultural environment in which the firm operates. "Legitimacy is not a commodity to be possessed or exchanged but a condition reflecting cultural alignment, normative support, or consonance with relevant rules or laws" (Scott, 1995). Legitimacy is not merely a cultural account of an organization but an evaluation process concerning the degree of cultural support for a particular organization (Meyer and Scott, 1983). One of the most comprehensive discussions of legitimacy comes from Suchman (1995). According to Suchman (1995: 574), "Legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions."

Given the above definitions of legitimacy, it is difficult to establish reputation and legitimacy as distinct constructs. Deephouse et. al. (1998: 4) attempt to provide such a distinction by describing "legitimacy as the acceptability of an organization to a social system" and "reputation as the favorableness of an organization to its social system." Yet, the distinction between acceptability and favorableness is itself suspect and could easily be argued to represent degrees of the same construct instead of the definition of distinct constructs. Moreover, the distinction of legitimacy as a measure of acceptability seems to contradict the discussions of legitimacy as a measure of desirability or a degree of cultural support as suggested in the definitions of legitimacy outline above. A more productive approach is to approach legitimation as a process and reputation as the outcome of the legitimation process.

Following the work of Rao (1994), the focus of this dissertation is on the process of legitimation and its corresponding link to organizational reputation. "Legitimation consists of creating an account of an organization, embedding the account in a symbolic universe, and thereby endowing the account with social facticity . . . Models of legitimacy direct attention to the collective <u>processes</u> by which reputation is created and sustained" (Rao 1994:30-31, emphasis added). Elsbach and Sutton (1992:700) suggest "Legitimacy is conferred when stakeholders – that is, internal and external audiences affected by organizational outcomes – endorse and support an organization's goals and activities." I suggest <u>reputation</u> is conferred when stakeholders endorse and support an organization's goals and activities. The process of legitimation <u>leads</u> to the endorsement and support by specific external stakeholders. This endorsement, in turn, defines the firm as reputable in the eyes of the endorser.

Building on Suchman's (1995) definition but focusing on the process of legitimation, I define legitimation as the process of establishing an entity as desirable, proper and appropriate based on specific firm actions that are congruent with socially constructed norms, values, beliefs, and definitions. The process of legitimation involves demonstrating specific actions that are deemed as desirable, proper and appropriate, the definition of desirable, proper and appropriate being defined by the external evaluator.

The mere adoption of appropriate practices is not sufficient. The process of legitimation also involves making known the adoption of appropriate practices. As suggested by Berger and Luckmann (1966: 93), "legitimation is this process of 'explaining' and justifying . . . It always implies 'knowledge' as well." Thus, the process of legitimation involves adopting appropriate practices and making these practices known to the target audience. Reputation is conferred once the entire process of legitimation is completed. That is, reputation is conferred when the organization adopts appropriate practices and the adoption of the appropriate practices is made known to the target audience. Still, the first component of the legitimation process involves adopting appropriate practices. Thus, in order to understanding how firms establish themselves are reputable via the process of legitimation, we must first understanding the way in which appropriate practices are defined.

Defining Appropriate Practices

The definition of appropriate practices is heavily influenced by the institutional environment of those evaluating a firm as reputable. As suggested by Rao (1994: 30), "Organizations acquire standing when they use environmentally preferred symbols and their actions conform to institutionalized rules." Institutional rules function as myths that an organization incorporates to gaining legitimacy and enhanced survival prospects (Meyer & Rowan, 1977). "Institutions do not just constrain options: they establish the very criteria by which people discover their preferences" (Powell & DiMaggio, 1991: 11). By establishing specific preferences, institutional influences highlight the aspects of an organization that an evaluator uses in determining an organization as reputable. Thus, institutional influences shape the very definition of desirable, proper and appropriate.

The institutional shaping of the evaluator's definition of desirable, proper and appropriate can occur pre- or post-consciously (Tolbert and Zucker, 1996). Individual evaluators can intentionally highlight specific actions as necessary and appropriate. Likewise, institutional influences can shape the determination of appropriateness in a subconscious way. The effects for the organization being evaluated are the same. Institutional influences shape the definition of appropriate behavior.

The adoption of appropriate practices can be real or symbolic. The organization can attempt to fully integrate the adopted behaviors thereby achieving true conformity. Likewise, the organization can symbolically adopt certain behaviors while decoupling the adopted behaviors from core organizational activities (Meyer and Rowan, 1977). What is critical is that the firm be able to demonstrate conformity, real or symbolic.

The adopted behavior need not improve the technical performance of the organization in order for the adopted behavior to enhance an organization's reputation. The adoption of specific behaviors serves as a signal of institutional conformity, not organizational performance. As suggested by Davis, Diekmann & Tinsley (1994), specific actions are deemed appropriate because actors take them for granted, rather than because a rational choice process found them to be best suited for the task. This particular aspect of legitimation is what separates reputation from legitimation as distinct from reputation as discussed in signaling theory. With signaling theory, specific behaviors enhance an organization's reputation based on the rational economic calculation of the target audience. With legitimation, specific behaviors enhance an organization's reputation independent of the economic consequences for the focal organization.

Making Conformity Known

The second component of the legitimation process involves making the conformity to institutional expectations known to the target audience. The way in which institutional conformity is most effectively communicated is heavily influenced by the level of uncertainty of the environment in which the organization resides.

In an environment of low uncertainty, the actions of the organization will be easily understood and observed. With low uncertainty, the organization can engage in a particular activity and external entities evaluating the individual firm will find it easy to recognize and acknowledge the practices of the firm. In such an environment, the mere adoption of appropriate practices will be sufficient to establish a firm as reputable. Thus, in a low uncertainty environment, the organization completes the legitimation process by merely adopting appropriate practices.

As the level of uncertainty increases, the ability of the external evaluator to identity and acknowledge specific organizational activities is reduced. With increased uncertainty, the external evaluator is forced to develop additional mechanisms for dealing with the unknown. Specific routines are introduced by the external evaluator as a way of coping with increased uncertainty (Simon, 1957; March and Simon, 1958). With the introduction of specific routines, only select information emanating from the environment is acknowledged. Much of the information available concerning individual organizations is largely ignored. In such an environment, the individual organization will find it increasingly difficult to have the adoption of appropriate practices observed. The mere adoption of appropriate behavior will no longer be sufficient. Thus, in a moderately uncertain environment, the organization must employ self promotion techniques if the organization wishes for the adoption of appropriate practices to be observed.

The purpose of the self promotion techniques is the bring to the attention of the target external evaluator the firm's adoption of appropriate practices. Correspondingly, those self promotion techniques that conform to the routines established by the external evaluator for understanding the environment will be most effective is establishing the individual firm as reputable. Thus, in a moderately uncertain environment, the organization completes the legitimation process by adopting appropriate practices and engaging in self promotion techniques that conform the routines established by the external evaluator for understanding the environment in which the firm operates.

In a highly uncertainty environment, the ability of the external evaluator to identify and acknowledge specific organizational actions is further eroded. The high level of uncertainty reduces the ability of specific routines to assist the external evaluator in understanding the environment. Lacking specific routines for understanding the environment, the external evaluator will find it near impossible to distinguish the actions of one firm from the actions of other firms in the environment. Thus, at high levels of uncertainty, the external evaluator will be unable to identify and acknowledge specific firm actions even when such actions are highly promoted by the individual firm.

Accordingly, the individual firm will be unable to make the adoption of appropriate practices known no matter how much effort is exerted.

Under such conditions, an independent third party can serve as a link between the individual firm and external evaluator. The role of this third party is to assist the external evaluator in identifying specific firm actions in the highly uncertain environment. The third party serves as an informational conduit where the level of environmental uncertainty inhibits the ability of the external evaluator to identify and acknowledge specific firm actions on its own. By serving as an informational conduit between the external evaluator and individual firms, the independent third party facilitates the process of legitimation. Hence, independent third parties that fulfill the role of informational conduit are referred to as "legitimating agents."

An individual firm attempting to promote specific firm actions can not unilaterally attach itself to a legitimizing agent. Instead, the agent must take the lead in presenting the firm to the external evaluator. Only those legitimating agents that actively interact with both the individual firm and the target external evaluator provide the critical link needed to complete the legitimation process. Once employed, the legitimating agent provides a level of exposure unable to the firm alone. Thus, in a highly uncertain environment, the individual firm completes the legitimation process by adopting appropriate practices and engaging the services of a legitimating agent who's role is to serve as an informational conduit to the target external evaluator.

A summary of the legitimation process as described above can be found in figure 1. As demonstrated in the figure, the firm completes the legitimation process by first adopting appropriate behavior as a way of achieving institutional conformity. The way in which the conformity is made known to the target audience varies depending on the level of environmental uncertainty. The outcome of demonstrating institutional conformity (i.e., the outcome of the legitimating process) is increased organizational reputation.

A Model of Organizational Reputation Formation

Having identified the critical components of the legitimation process, we can now begin to develop a general model of how organizational reputation is established. Earlier, I defined organizational reputation as an assessment of an organization's desirability in a given environment as determined by a specific individual or group of individuals external to the firm. Organizations generally establish themselves as desirable by demonstrating a history of performance that meets or exceeds the external assessor's needs and interests (Herbig and Milewicz, 1995). For example, an organization can establish a positive reputation with consumers by delivering products and services that meet or exceed the consumers expectations of performance. Likewise, an organization can establish a positive reputation with environmental groups by maintaining a positive record of environmental performance. Thus, performance becomes the primary mechanism by which the organization establishes itself as reputable.

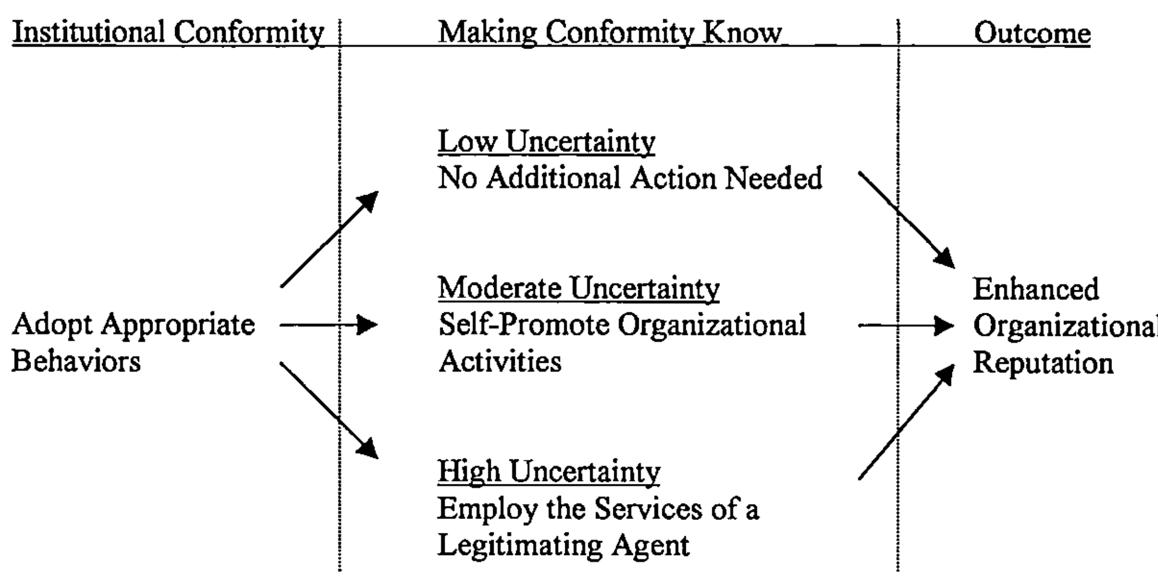

FIGURE 1: The process of legitimation

However, organizational performance is not always easily measured and understood. For example, performance may be difficult to measure as is often the case in services (Mills, Standifird and Dalton, 1996). Alternatively, a history of recognizable performance may be lacking, as is the case for recently established firms. Furthermore, the links between past and future performance may be tenuous, as is the case with many recently privatized firms in emerging economies such as Poland. In each case, the inability to measure or understand organizational performance reduces the ability of the firm to establish itself as reputation via performance alone.

In addition to building reputation via performance, the organization can attempt to establish itself as reputable through signaling techniques as discussed in Finance literature (Weigelt & Camerer, 1988). With signaling, specific firm actions or characteristics serve as an indicator of future firm performance. However, reputation building via signaling assumes that those assessing the reputation of a firm will act rationally when interpreting the signals being sent by the firm. Individual assessors of reputation can be argued to be boundedly rational at best (Simon, 1957). As a result, reputation building via signaling will most likely be ineffective in all but the most simple of situations.

In addition to performance and signaling, the organization can establish itself as reputable via the process of legitimation (Rao, 1994). This is not to suggest that legitimation replaces performance or signaling as a mechanism for establishing a firm as reputable. In fact, indicators of performance are expected to dominate the determinants of reputation when such indicators are available. The argument presented here is that organizations can use the process of legitimation as a way of enhancing reputation above and beyond the reputation gained through performance indicators alone.

To build reputation through legitimation, the organization must engage the entire legitimation process. Thus, to establish itself as reputable via legitimation, the organization must first adopt appropriate practices, the definition of appropriate being defined by the external evaluator with which the firm is hoping to establish itself as reputable. Once the appropriate practices are adopted, the organization must make the actions of the firm known to the external audience with which it is trying to establish itself as reputable.

The best way in which to draw attention to the actions of the individual firm will depend on the level of environmental uncertainty. In an environment of low uncertainty, the mere adoption of appropriate practices will be sufficient to establish a firm as reputable. In a moderately uncertain environment, the organization must employ self promotion techniques if the organization wishes to establish itself as reputable via the process of legitimation. At high levels of uncertainty, the firm is liable to engage the services of a legitimating agent in an effort to establish itself as reputable.

In summary, organizations generally establish themselves as reputable by demonstrating a history of performance that meets or exceeds the external assessors needs and interests. The demonstration of performance can be achieved either directly through past performance or indirectly through market signaling. In addition, the organization can enhance its reputation via the process of legitimation. To establish itself as reputable via the process of legitimation, the organization must adopt appropriate practices and make the activities of the firm known to the external audience with which it is trying to establish itself as reputation. The way in which the firm most effectively makes its activities known varies depending on the level of environmental uncertainty. A summary of how firms establish themselves are reputable as outlined in this section can be found in Table 2.

The model presented above is necessarily generalizable to all contexts. Not addressed here, for example, are the specific performance dimension and practices that define the organization as reputable. To provide such specificity at this point would be impossible since the specific factors used in determining an organization as reputable depend on the particular individual or group assessing the organization and the conditions in which the assessment is made. In order to provide a more specific discussion of reputation formation, we must first identify a specific external assessor and context conditions under which the organization is being assessed. Thus, the identification of a specific external assessor and context conditions is the focus of Chapter Three of the dissertation.

TABLE 2: ESTABLISHING ORGANIZATIONAL REPUTATION

Mechanism	Description	Constraints
Performance	Demonstrate a history of performance that meets or exceeds the external assessors needs and interests	1. May be difficult to measure performance 2. A performance history may be lacking 3. The link between past and future performance may be tenuous
Signaling	Engage in actions and/or adopt characteristics that serve as an indicator of future firm performance	1. Assumes that those assessing the reputation of a firm will act rationally 2. Ineffective in all but the most simple situations
Legitimation	Adopt appropriate practices and make the actions of the firm known	1. Difficult to make practices known with increased environmental uncertainty 2. Will be impossible for firm to accomplish alone at high levels of uncertainty

CHAPTER III

HYPOTHESIS DEVELOPMENT

As suggested at the end of Chapter Two, in order to develop a more precise discussion of reputation formation, we must first identify a specific external assessor and context conditions under which the organization is being assessed. As stated in Chapter One, the purpose of this dissertation is to investigate how firms establish reputation in an emerging economy such as Poland. Specifically, in this section, I present a model concerning how firms traded on the Warsaw Stock Exchange (WSE) establish reputation with investors.

Like many emerging economies, Poland has experienced a radical transformation of its economic environment. The individual firms operating in Poland find themselves directly exposed to international competition with little or no protection being offered by the Polish government. In many cases, firms require a significant influx of capital in order to compete with their newly defined international rivals. WSE's investors provide the rich source of capital many organization need merely to survive. Thus, the ability to establish reputation with WSE investors becomes a critical determinant of success for many firms operating in Poland's transformation environment.

The Polish Capital Market

To understand how firms traded on the WSE establish reputation with investors, we must first understand the particularities of the WSE. This is perhaps best accomplished by looking at the evolution of the Polish capital market in general. Like many countries in the area, Poland has experienced one of the most remarkable transformations in socio-political history. In 1989, the Polish political system underwent a radical transformation. However, from the perspective of the individual firm, the more remarkable changes came in 1990.

In July 1990, the Polish parliament passed the Law of Privatization. With this law, prices were liberalized, trade was significantly opened and government support for individual firms was all but eliminated. The law also created the Ministry of Privatization and gave the Ministry the directive of privatizing Poland's state-owned enterprises. Privatization is the process whereby previously state owned enterprises are spun off to the "private sector." The Polish Privatization Law of 1990 allowed for privatization via two distinct processes.

With process one, the state-owned enterprises were first "corporatized." "Corporatization" is the setting up of an independent legal entity for the enterprise, separate from the identity of the state as owner. In fact, the newly defined corporations were initially owned wholly by the state. However, once corporatized, the firm could be sold 1) as a publicly held firm traded on the WSE, 2) through direct sale to domestic or foreign investors, or 3) through mass privatization (which will eventually results in the selling of the firm on the WSE as will be discussed later). The approach of privatization through corporatization has been reserved primarily for larger state-owned enterprises.

In process two, state-owned enterprises were 'liquidated' usually under the guidance of employee councils and managers. The new organizations that emerged from the liquidation were almost always dominated by insiders. Privatization via liquidation was reserved predominantly for smaller state-owned enterprises and represents a small fraction of Poland's productive capacity.

A selected grouping of "corporatized" firms were eventually placed in one of 15 National Investment Funds (NIFs) as a way of mass privatizing a significant portion of Poland's economy (about 10 percent of total output). Each of the 15 NIFs created in March 1995 was given primary ownership (33 percent) in approximately 35 state-owned enterprises and about 2 percent ownership in the remaining state-owned enterprises included in the program. Workers received 15 percent ownership in their respective state-owned enterprises while the government retained a 25 percent interest for later sale. NIF vouchers were sold to Polish citizens for 40 zlotys (about 16.6 USD or approximately one week's pay). After the NIFs had operated for one year, voucher holders were able to convert their vouchers into NIF shares. Once NIF shares were distributed, NIFs were to be traded on the WSE. The initial plan was to have the NIFs up and running as early as mid-1996. However, it was not until June 12, 1997 that the NIFs were listed on the WSE. The current plan is to have many of the NIFs held firms eventually traded on the WSE as independent companies.

The Warsaw Stock Exchange

Despite the late arrive of the NIFs, the WSE itself has been a critical component of Poland's privatization process. Many of the larger business privatized via "corporatization" have found their way onto the WSE independent of the NIF program. By mid-1997, over 100 firms privatized via "corporatization" were traded on the WSE, not including the 15 NIFs. In fact, the WSE has played a critical role in the development of Poland's economy from very early on.

Prior to WWII, the WSE was a thriving exchange. However, in 1939, the WSE was officially closed and remained closed for over fifty years. The re-opening of the WSE began with a review of various international exchange models. After considering a variety of options, WSE founders ultimately decided to adopt a French model and began developing the appropriate mechanisms with the aid of Societe de Bourses and the French depository SICOVAM.

In March of 1991, the Polish Parliament passed the Act on Trading in Securities and Trust Fund. The act established the groundwork for core capital market components: brokerage houses, the stock exchange itself, trust funds, and the Polish Securities Commission (PSC). On April 12, 1991, the act formally establishing the WSE was signed into law. Initial trading of the first five firms listed began four days later on April 16, 1991.

The exchange has been fairly successful to date. In 1994, the WSE was the first exchange in the ECE area to be granted full membership to the International Federation of Stock Exchanges. By the first half of 1998, the average daily equity turnover was 67 million USD. Today, more than 200 firms are traded on a daily basis with a total capitalization in excess of 18 billion USD. As Liz Smith, staff writer for the Prague Business Journal, suggests, "Professional and well-regulated, the Warsaw Stock Exchange is the darling of the region, an integral part of the country's financial sector" (Smith, 1997).

Despite the apparent successes of the WSE, the WSE continues to be highly volatile. On August 28, 1998, most shares traded on the WSE dropped 9-10 percent in response to the financial crisis in Russia. The one-day downturn resulted in a drop of 17.5 percent for the week ending August 28, 1998 and a 28-month low concerning the overall valuation of the market. According to Eileen Simpson of the Warsaw Business Journal (August 31, 1998, page 1), "Russia's financial crisis dealt the Warsaw Stock Exchange (WSE) a crippling blow, capping off one of he worst months in the market's history." The August 28, 1998 market drop was not the first in the WSE's recent history, however. During the week of April 11, 1994, the market experienced a drop of 25.5 percent while in the week of October 27, 1997 saw a drop of 9.9 percent. While the weekly drops in market value are dramatic, so are the weekly gains. During the week of April 18, 1994, the market experienced a one-week gain of 31.2 percent. More recently, the market experience a gain of 10.9 percent during the week of October 4, 1997, just three weeks later prior to the 9.9 percent drop experience the week of October 27, 1997.

The volatiliy observed in the WSE is not uncharacteristic of an exchange located in an emerging market. Still, the volatility of the market has dramatically effected on the composition of WSE investors. Prior to the April 1994 market crash, the market was dominated by domestic investors. However, as a result of the 1994 market crash, many of the domestic investors have become less active or were driven out of the market completely. By 1997, roughly 30 percent of the investors on the WSE were foreigners (Ciszweski, 1997). However, this figure is far more influential than the mere percentage of participation might suggest. International investors tend to be more active traders and trade in much larger volume than their Polish counterparts. As such, international investors began to dominate the Polish capital market during the second half of 1994 and continue to do so even today (Ciszweski, 1997).

Unfortunately for the individual firm, international investors lack a detailed knowledge of the local environment. Subsequently, international investors are more likely to respond to events that do not necessarily correlate with the performance of individual firms traded on the WSE. For example, the average market value of a firm traded on the WSE's main market dropped in excess of 15 percent following the financial crisis in Russia. The drop reflected an assumption of strong ties between the Polish and Russian economies. Yet, in 1997, Poland exported less than 7 percent of its goods to Russia while Germany received in excess of 1/3 of all Polish exports. However, at the time of the crash, few investors were interested in understanding the fundamental value of individual firms. "The fundamentals don't really matter at this stage," observed Szymanski, an equity analyst with Schroders International Finance (Warsaw Business Journal, August 31, 1998, page 1). "Investors just want to get out." Failure to account for the fundamental value of individual firms further reduces the ability of the investor to understanding the local environment leading to increased market uncertain for both investors and individual firms.

In summary, the Polish capital market is a young market where most firms lack market-based experience. Even the longest standing privatized firms have less than 10 years experience operating in a market-based economy. The WSE has played a critical role in Poland's economic transformation. Yet, the WSE itself continues to be highly volatile where fluctuations in excess of 10 percent a week are not uncommon. As a result, international investors dominate the market. Moreover, international investors lack a detailed understanding of the local environment resulting in increased uncertainty for both investors and individual firms.

Establishing Reputation with Investors in Emerging Financial Markets

The Role of Organizational Performance

As suggested in Chapter Two, organizations generally establish themselves as reputable by demonstrating a history of performance that meets or exceeds the external assessors needs and interests (Herbig and Milewicz, 1995). The purpose of this study is to understand how firms traded on the WSE establish reputation with investors. Given the economic focus of most investors, nothing seems to satisfy the needs and interests of investors more than the financial performance of the firm (Milgrom and Roberts, 1992). Profitability is by far the most salient of financial performance indicators for WSE firms since all firms traded on the WSE are required to submit profitability statements to the

WSE on a quarterly basis. Correspondingly, firm profitability is expected to highly influence the determination of reputation with investors for firms traded on the WSE.

A series of interviews were conducted at various brokerage houses in Warsaw, Poland during fall 1998 to better ascertain the needs and interests of WSE investors. The interviews seem to confirm the WSE investor's dominant interest in profits. When ask "what specifically are investors concerned about when trying to decide which firms are reputable and which ones are not," the following opinions were offered:

> "First of all, investors look at profits. They do not care that the company is in good position, has good market share. Most are concerned about the possibility to maintain profits."
>
> - Andrew, Equity Analyst, Bank of Commerce[1]

> "On the stock exchange, most investors are interested in net profit, not things like dividends. This is because this is still a growing market."
>
> - Krzysztof, Director of Research, International Bank

> "If it earns money, investors like it. A large group of investors are speculators. Only a few investors are in for the long-term. The dominant response is speculation only based on news reports concerning profits."
>
> - Jacek, Director Investment Advisors, Bank of Warsaw

Given the propensity of investors to anchor on profitability when determining a firm as reputable and given the availability of profitability information for all firms traded on the WSE:

Hypothesis One: WSE firms reporting higher profitability will have greater reputational value with investors than WSE firms reporting lower profitability.

In addition to performing well, the individual firm can establish itself as reputable through specific signals of future performance. With signaling as discussed in finance, the firm engages in certain behavior as a way of intentionally signaling future actions (Weigelt and Camerer, 1988). With signaling as discussed below, historical organizational characteristics serve as a signal of a firm's future performance potential. The key distinction between signaling as discussed in finance and signaling as discussed here concerns the level of intent associated with the signals being sent by the individual firm. The effect on the individual firm's reputation is the same regardless of the intent of the signals being projected. The ability of the firm to signal its future performance potential has a direct effect on the ability of the firm to establish itself as reputable with investors.

A particularly salient signal of future performance potential, according the brokers interviewed, is the ability of the firm to adapt to the new market-based economy. Prior to 1990, Polish firms operated in a predominantly command-and-control economy where the government took primary responsibility for determining both the quantity and price of goods sold. Today, Poland is a highly market-based economy where consumer interest is the predominant determinant of quantity and price of goods sold. Many of the firms established during the days of the command-and-control economy had never been forced to operate in a competitive capital market prior to 1990 and subsequently lack the management and marketing skill needed to compete in a truly market-based environment. Yet, with out such skills, it is unlike that many of the Polish firms will be able to survive as the level of international competition increases. Thus, the ability to adapt and develop new skills is critical to the future performance of individual firms and is consequently an important determinant of reputation with investors. Therefore, factors that appear to contribute (positively or negatively) to a firm's ability to adapt should influence the determination of reputation with investors.

Organization age, specifically, appears to be an important factor in determining the ability of the organization to adapt. "In Poland, the stock exchange is new. People (operating the firms in Poland) are still old fashion thinking. More experienced companies are not used to treating the market more like an adult," suggests Andrew. According to Krzysztof, "The top 5 to 10 companies (in terms of relating to investors) are fully private, were formed in the last 5 to 10 years. They have always felt the need to attract investors. With older firms, this is not so. They never had a problem of need of cash or buyers." As a result, older firms are less likely to make the necessary changes to effectively compete in a market-based economy, suggests Krzysztof.

The perceived inability of older firms to adapt to environmental changes is consistent with research on the topic. As suggested by Amburgey and Barnett (1993: 71), "Our results suggest that initial goals become institutionalized quickly. If goals are changed early, they are more likely to be changed again later; if they are not changed early, they are less likely to change again" (p. 71). Once institutionalized, organizational routines become difficult to alter (Zucker, 1991). As such, firms with a longer history of operating in a command-and-control economy will find it more difficult to adjust to a market-based way of operating. Given the decreased ability of older firms to adjust to market-based conditions and given the propensity of investors to favor firms deemed more capable of adjusting to the market-based economy:

Hypothesis Two: Younger (more recently founded) WSE firms will have greater reputational value with investors than older WSE firms.

In addition to age, ownership structure also serves as a signal to investors of the ability of the firm to adjust to new market conditions. Prior to 1990, the state was the sole owner of most business enterprises in Poland. The Law of Privatization set the stage for private ownership by "corporatizing" firms. However, the actual shift to the private sector, and hence the shift towards market-based operations, does not occur until the state sells its shares in the company. The majority of firms in Poland have been privatized. However, the state Treasury continues to hold shares of stock in many Polish firms. On average, the state holds less than 5 percent of the shares in companies traded on the WSE. However, in some instances, the state holds in excess of 40 percent of the company's shares. The state as owner is perhaps the most visible legacy of the command-and-control economy. Given the perceived alignment of heavily state-owned firms to the command-and-control economy and given the propensity of investors to favor firms deemed more in line with the market-based economy:

> Hypothesis Three: WSE firms with a lower percent of state-ownership will have greater reputational value with investors than WSE firms with higher percent of state-ownership.

While state-ownership signifies strong ties to the command-and-control economy, foreign-ownership signifies the exact opposite. Without exception, all major foreign-owners of firms traded on the WSE (foreign shareholder in excess of 5 percent) come from highly capitalistic economies (predominantly the U.S.). Many of the larger shareholders are strategic investors where the explicit intent of investing in Polish firms is to improve the operation of the firm by introducing distinctly market-based management skills. "A major foreign investor would facilitate change like a kick in the ass," states Professor Obloj, Strategy Professor at Warsaw University (personal interview, November 2, 1998). "Many foreign investors brought in a blueprint from somewhere else. A very rough approach but it worked in almost every case." The ability of a major foreign investor to affect change within the organization is a major reason why the state treasury has encouraged strategic foreign investment in Polish banks as a way of improving Poland's financial sector (Halaba, 1998). Given the ability of foreign owners to affect change within the organization and given the propensity of investors to favor firms deemed more in line with the market-based economy:

Hypothesis Four: WSE firms with a higher percent of foreign-ownership will have greater reputational value with investors than WSE firms with lower percent of foreign-ownership.

Reputation via the Process of Legitimation

In addition to the performance indicators discussed above, firms traded on the WSE can enhance their reputation via the process of legitimation. The key distinction between activities that build reputation via performance and activities that build reputation via the process of legitimation concerns the performance implications of the reputation building activities identified. In order for an activity to improve a firm's reputation via performance, the activities must be presumed to indicate the firm's present or potential performance. Thus, profitability, organizational age and the percent of state and foreign-ownership all improve the reputation of firms traded on the WSE by indicating present or future financial performance of the firm.

In order for an activity to improve a firm's reputation via the process of legitimation, the activities need not improve the technical performance of the organization in order for the adopted behavior to enhance an organization's reputation. With legitimation, specific activities enhance an organization's reputation because those evaluating the firm take them for granted, rather than because a rational choice process found them to be best suited for improving the future performance of the firm (Davis, Diekmann and Tinsley, 1994). Thus, in order to understand how firms traded on the WSE establish reputation via the process of legitimation, we must first identify those practices taken for granted as necessary and appropriate by WSE investors.

Identifying Practices Deemed Necessary and Appropriate

Identifying practices deemed necessary and appropriate by WSE investors involves first understanding the nature of WSE investors. As suggested in the opening section of this chapter, international investors began to dominate the Polish capital market during the second half of 1994 and continue to do so even today. Therefore, transnational institutional forces are particularly important in influencing the definition of necessary and appropriate for WSE investors.

Institutional theorists such as Meyer (1994a; 1994b) and Powell (1991) suggest that most institutional forces now transcend international boundaries. According to Meyer (1994a) even the more macro of institutional forces (such as countries) are increasingly subjugated to a rationality that is now worldwide. In such a dynamic and all encompassing world, the actions of intermediate institutions such as national structure are diminished in importance. Instead, organizations increase reputation by conforming to wider, transnational norms and expectations. Meyer (1994a: 53) is most explicit in this position when he suggests that "The effect (of a modern rationalized environment) is that organizational structure tends to be less predictable in sectoral and national environmental factors and more predictable in worldwide trends."

To suggest transnational institutional influences dominate the determinants of organizational structure is debatable. Doing so appears to understate the importance of local stakeholders in influencing firm activities. Likewise, to suggest that transnational institutional influences have the greatest influence on determining a firm as reputable would be inappropriate. Doing so ignores the interests of location specific stakeholders such as local community groups. However, when looking specifically at WSE investors, transnational norms do appear as highly influential given the transnational nature of WSE investors in general. As such, organizations wanting to improve their reputation with WSE investors can do so by adopting practices deemed necessary and appropriate in the transnational business environment.

One area where the transnational convergence to a particular business standard seems most articulated is in the area of accounting. As Meyer (1994b: 122) proclaims, "Environments that create organizational elements such as accounting and accountants, make it easy and necessary for organizations to use them, and treat organizations that have them as by definition more legitimate than others." Thus, the use of the internationally defined accounting standards and accountants should increase a firm's reputation independent of local institutional forces, according to Meyer.

The International Accounting Standards Committee (IASC), established in 1973, is primarily responsible for the evolution of an international accounting standard. The IASC is currently supported by 122 accounting organizations and 91 countries worldwide. The International Accounting Standards (IAS) introduced by the IASC are endorsed by the International Federation of Accountants and are increasingly seen as a world standard for accounting. Through the development of IAS, the accounting standards deemed necessary and appropriate are increasingly internationally defined.

By law, Polish firms are required to use Polish accounting standards. In addition, firms can report their financial results using IAS. Many of the firms traded on the WSE report the firm's financial results using both Polish and International accounting standards. Given the propensity of WSE investors to embrace internationally defined business practices and given the convergence on IAS as the internationally defined accounting standard:

Hypothesis Five: WSE firms reporting the use of IAS will have greater reputational value with investors than WSE firms not reporting the use of IAS.

The definition of an international accountant is less clear. Still, there exists a grouping of accounting firms that have clearly established themselves as internationally reputable (i.e., the Big Five accounting firms). Correspondingly, the use of one of the Big Five accounting firms as an auditor for a particular organization suggests a conformance to internationally defined business practices[2].

In Chapter Two, I introduced the concept of a legitimation agent whose role is to serve as a communication conduit between the firm and the target audience with which the firm is attempting to establish itself as reputable. It would be tempting to think of the firm's auditor as a legitimation agent. However, to do so would be inappropriate. The role of the auditor is to provide an unbiased assessment of a firm's financial condition. The auditor's task is to confirm financial reports prepared by the company itself. This confirmation is then shared with the client company itself. No effort is made on the part of the auditor to contact parties external to the client firm. As such, the auditor does not fulfill the role of the legitimating agent as a communication conduit. Nonetheless, the use of an internationally recognized auditor does signify a transnational convergence on how financial resources are reviewed. Given the propensity of WSE investors to embrace internationally defined business practices and given that the use of an internationally recognized accountants signifies a transnational convergence on how accounting information is reviewed:

> Hypothesis Six: WSE firms reporting the use of internationally recognized auditors will have greater reputational value with investors than WSE firms not reporting the use of internationally recognized auditors.

Making Practices Known to the Target Audience

As outlined in Chapter Two, the legitimation process consists of two components. One, the organization must adopt appropriate behavior and two, the organization must make the activities of the firm known to the target audience. Hypotheses five and six discuss the role of adopting specific transnationally defined practices as a way of increasing reputation with investors. Not discussed above is the how the actions of the firm become known to the target audience.

The ability to make the actions of the firm known to the target audience is particularly important during the issuing of new shares. Once a firm is listed on the exchange, the firm's need to attract the attention of investors is reduced. However, during the new issue, attracting the attention of potential investors is critical since it is as this stage that the firm is attempting to attract large sums of investment capital.

The difficulty in making the actions of the firm known to potential investors will vary significantly depending on the type of new issue. Firms already listed on the exchange but issuing new shares (Seasoned Equity Offerings or SEOs) in general encounter less of a challenge in making the actions of the firm known since SEO-issuing firms have already, by listing on the exchange, exposed themselves to investor scrutiny. Firms issuing shares for the first time (Initial Public Offerings or IPOs), by definition, lack prior market exposure. The lack of prior market exposure associated with IPOs and the newness of the WSE in general will cause many larger investors to ignore Polish IPOs altogether. Since knowledge is a prerequisite of reputation and since IPO issuing firms lack the prior market exposure enjoyed by SEO issuing firms:

> Hypothesis Seven: WSE firms issuing a SEO will have greater reputational value with investors than WSE firms issuing an IPO.

The ability of a firm to make its actions known to WSE investors during the new issue is complicated by the particularities of the Polish capital market. In an environment of low uncertainty, the actions of the organization are easily understood and observed. Thus, in a low uncertainty environment, the organization needs merely adopting appropriate practices to establish reputation with investors. However, most WSE investors lack detailed information concerning the local environment and, as such, the mere adoption of appropriate behavior is not sufficient if the firm wishes to make its actions known to potential WSE investors.

As the level of uncertainty increases, the organization can employ self promotion techniques in order for the actions of the firm to be observed. However, self promotion is only successful if the target audience has specific routines for integrating the information provided by the organization attempting to establish itself as reputable. As previously noted, most WSE investors do not respond to information concerning the individual firm but are more inclined to respond to events that do not necessarily correlate with individual firms actions. As such, self promotion techniques are not sufficient if the firm wishes to make its actions known to potential WSE investors. Given the high level of uncertainty in the Polish capital market, an independent third party is needed to serve as a link between the individual firm and potential WSE investors. Thus, firms wanting to become better known with WSE investors during the issuing of new shares can do so by employing the services of a legitimating agent.

A series of interviews were conducted in Warsaw, Poland during the fall of 1997 to identify potential legitimating agents for WSE firms during the issuing of new shares. Based on the interviews, Brokers were identified as important legitimating agents during the issuing of new shares. "We (brokers) are the *only* intermediary between the company and investors" (his emphasis) during the issuing of new shares, according to "Michael," head of sales for "International Brokers" of Warsaw. Interviews with investment relations officers at three of the largest construction firms in Poland confirmed that even the largest and best known WSE firms rely on the assistance of brokers when attempting to communicate with potential investors during the issuing of new shares.

When issuing new shares; the individual firm usually identifies a "lead broker." The purpose of this lead broker is to walk the firm through the new issue process, including but not restricted to, the setting of an initial price, the development of a firm prospectus, communications with regulatory authorities, and the introduction of the security to potential investors. In theory, the individual firm can hire a different broker for each stage of the new issue process. In practice, the entire process is facilitated by a single lead broker.

The first step in the new issue process is the setting of an initial offering price. This setting of price is often done via "book building." Book building is a process where the lead broker works with potential investors to establish a "reasonable" market price for the proposed security. No commitment is made to buy during the book building stage. However, more often than not, investors contacted during the book building process ultimately invest in the proposed security. Thus, book building is often the first step in introducing a new security to potential investors.

The broker also plays a critical role later in the process when the individual security is introduced to the wider investment community. This wider introduction is often facilitated via "road shows" where the lead broker travels with representative from the company to meet with potential investors. Officially, road shows are conducted independent of any recommendations concerning a specific security. Road shows are designed solely to "introduce" the security to potential investors. As such, broker analysts are specifically prohibited from making recommendations for sponsored new issues. Still, many of the investors contacted during the road shows ultimately invest in the proposed security making the road show another important mechanism for linking potential investors to a specific security.

Through "book building" and "road shows," brokers serve as an important communication conduit from firm to investor. Thus, brokers appear to fulfill the role of legitimating agents when attempting to establish reputation with investors. However, not all brokers are equally qualified to serve as legitimating agents for client firms. To be effective, legitimating agents must themselves be deemed fully reputable and have a direct line of communication with the reputation conferring participants.

As suggested above, international investors dominate the activities of the WSE. Therefore, the ability of the broker to link client firms with international investors largely determines the ability of the broker to serve as an effective legitimating agent. Moreover, not all brokers are equally effective in linking with international investors. Brokerage firms based outside of Poland appear to have a distinct advantage in this area. For instance, "Polish Brokers," one of Poland's largest domestic brokerage firms, makes no effort to contact international investors during the book building process. Their approach to book building is "rather domestic," according to "Monika," head of the brokerage firm's new issues department. Nor does the brokerage firm reach beyond the boundaries of Poland when performing road shows. Typical road show destinations include Krakow, Poznan and Gdansk, all Polish cities. This is in contrast with "International Brokers" where 70 percent of the investors consulted during book building are international.

Moreover, road shows sponsored by "International Brokers" typically involve trips to London, Paris, New York and the like.

"Polish Brokers" is not alone in its distinctly domestic focus. Most Polish brokerage houses focus solely on the Polish market, according to "Marek," Marketing Manager and co-founder of the small Polish brokerage house "Local Brokers." The risks associated with such a strategy are not lost on Marek. Smaller brokerage firms such as "Local Brokers" will be unable to compete as the Polish market expands. Only those firms that join forces with larger foreign brokerage house will survive as the market expands, according to Marek.

The ability of international brokers to serve as a conduit to important international investors is not lost on client firms. When asked concerning the worthiness of brokers, "Artur," the investment relations director for a large construction company, was quick to suggest that the brokers "are very helpful, especially during new issues." This company most recently employed the services of "International Brokers" when issuing new shares. Conversely, "Henryk," investment relations officer for an equally well know construction company, finds the broker to be of "no value. For us, the broker is like a kantor (Polish money exchanger). They are in it strictly for the money and not for us." Not surprisingly, Henryk's company employs the services of "Polish Brokers."

The ability of international brokers to serve as a communication conduit between client firms and international investors makes the international broker an important legitimating agent. Conversely, the general lack of communication between local brokers and international investors inhibits the ability of local brokers to fulfill the role of legitimating agent. Since internationally based brokers fulfill the obligations of a legitimating agent where Polish based brokers do not:

Hypothesis Eight: WSE firms employing the services of international brokers during the new issue will have greater reputational value with investors than WSE firms employing the services of domestic brokers.

Legitimating agents are useful in that they provide exposure for the individual firms. As such, all firms offering new issues are expected to benefit from the use of an international broker. Firms traded on the WSE issuing new shares (SEOs) already enjoy a certain amount of exposure merely by being currently listed on the exchange. IPOs, however, completely lack market exposure prior to the new issue.

IPOs have much more to gain by employing the services of an international broker given their lack of prior market exposure. Therefore, we would expect to see a significant difference between IPOs who employ the services of an international broker compared to SEOs employing the service of an international broker. Thus, there exists an interaction between the use of an international broker and the type of new issue with IPOs benefiting more from the use of an international broker than SEOs.

Hypothesis Nine: WSE firms issuing an IPO will benefit more from employing the services of international brokers during the issuing of new shares than will WSE firms issuing a SEO.

CHAPTER IV

RESEARCH METHODOLOGY

Specific hypotheses concerning how firms traded on the WSE establish reputation with investors were developed in Chapter Three. The purpose of this chapter is to discuss the research methodology used to investigate these hypotheses. Two separate analyses are used to test the hypotheses due to the nature of the hypotheses and data sources involved. The first analysis looks specifically at hypotheses one through six for all firms traded on the WSE as of the end of 1996. Not addressed in this analysis are the particularities involved in the issuing of new shares (hypotheses seven, eight and nine). A second analysis is used to investigate hypotheses seven, eight and nine. The second analysis looks specifically at the reputation of firms immediately following the issuing of new shares.

Analysis One: All Firms Traded on the WSE

Sample

The data set for this analysis includes all the firms traded on the WSE's main and parallel markets as of year end 1996. To be traded on the main or parallel market, the firm must have a minimum market capitalization of 3 million Polish zlotys (PLN), a minimum of 300 shareholders and a minimum company value of 12 million PLN. The majority of data for this analysis come from 1996 end of the year reports filed with the WSE. Ten firms were removed from the data set due to lack of complete information resulting in a total sample size of 73 firms.

Since the data for this analysis includes all firms traded on the main and parallel markets at a particular point in time, information particular to the issuing of new shares is not included in this data set. The purpose of this analysis is to investigate hypotheses one through six. A separate data set incorporating information specific to new issues is used to investigate hypotheses seven, eight and nine.

Measures

Dependent Variable

Reputation Among Investors. Reputational capital (Fombrun, 1996) is used as the measure of a firm's reputation with investors. The variable RepCap is included to indicate the reputational capital of a firm and is measured as the market value – book value of the firm in million PLN. The stock price of a firm represents the collective assessment of a firm's future worth according to investors (Milgrom and Roberts, 1992). Therefore, it would seem logical to use market value (the number of outstanding shares multiplied by the stock price per share) as the measure of reputation with investors. However, stock price is not an accurate reflection of reputation in that stock price also takes into account the value of a firm's assets. Reputation is better assessed, according to Fombrun (1996), as the market value of a firm minus asset value. The residual ("reputational capital" according to Fombrun) represents the collective confidence of investors in the ability of an organization to perform above and beyond the capabilities embedded in the organization's assets.

A similar measure often found in the finance literature is market value divided by book value (M/B). In essence, M/B measures percent excess value while market value minus book value (M-B) measures absolute excess value. Fama & French (1995) find that US firms with high M/B values are, on average, more profitable than low M/B valued firms four years prior to the observed M/B values. The finding that more profitable firms consistently rate higher in terms of M/B values suggests empirical support for the use of market and book values to measure reputation.

The majority of the data for this analysis comes from end of the year 1996 reports on file with the WSE and are taken directly from the annual publication Taking Stock Central Europe. The measures of reputation for this analysis are as reported to the WSE in the 1st quarter 1997 and are taken directly from the WSE's quarterly publication of market statistics. Reputation with investors is measured one quarter following the end of the year 1996 reports so as to identify the reputational impact of 1996 activities. The one quarter lag between the measure of independent and dependent variables is introduced to allow sufficient time for investors to respond to the information reported to the WSE.

Independent Variables

Profits. The variable Profit is included to indicate the profitability of the firm. Profitability is measured as a continuous variable (in million PLN). Information concerning firm profitability is as reported to the WSE end of the year 1996 and is taken directly from the annual publication Taking Stock Central Europe.

Organizational Age. The variable Age is included to indicate the organizational age of the sample firm. Age is reported as a continuous variable in years with the oldest firm being founded in 1845 and the youngest firm being founded in 1993. Organizational age is measured from the day the organization was initially founded to the year 1996. Information concerning organizational longevity (age) was collected from a variety of sources including but not limited to annual reports on file with the Polish Security Commission, the Warsaw Business Journal's annual publication The Book of Lists and direct calls to the firm in question.

State-Ownership. The variable State is included as a continuous variable to indicate the percentage of state-ownership. Firms traded on the WSE are required to disclose all shareholders that hold 5 percent or greater of the firm's total shares. Shares held by the state are held by the state treasury. Information concerning the percent of state-ownership (of 5 percent or greater) is as reported to the WSE end of the year 1996 and is taken directly from the annual publication Taking Stock Central Europe.

Foreign-Ownership. The variable Foreign is included as a continuous variable to indicate the percentage of foreign-ownership. Firms traded on the WSE are required to disclose all shareholders that hold 5 percent or greater of the firm's total shares. A foreign shareholder is defined as an individual or firm whose primary business activities are conducted outside of the Polish market (mostly from the US but also including a variety of corporations and investors from European and Asian markets). Information concerning the percent of foreign -ownership (of 5 percent or greater) is as reported to the WSE end of the year 1996 and is taken directly from the annual publication Taking Stock Central Europe.

Use of International Accounting Standards. The dummy variable of IAS is included to indicate the usage of International Accounting Standards. Firms traded on the WSE are required to use Polish accounting standards. In additions, some firms chose to adopt International Accounting Standards (IAS). Firms that report the use of IAS are coded as one. Firms that do not report the use of IAS are coded as zero.

Use of Internationally Reputable Accounting Firm. The dummy variable of Auditor is included to indicate the usage of an internationally reputable accounting firm as the company's auditor. An internationally reputable accounting firm is defined as one of the "Big Five" accounting firms including Arthur Anderson, Coopers & Lybrand, Deloitte & Touche, KPMG and Price Waterhouse, all of which were operating in Poland during the period of this study. Firms that report the use of one of the Big Five accounting firms as the company's auditor are coded as one. Firms that do not report the use of one of the Big Five accounting firms as the company's auditor are coded as zero.

Control Variables

Industry. Dummy variables are included for each of the industries represented on the WSE except "other" and coded as one if the firm was from the industry and zero otherwise. Industries vary significantly concerning the interpretation of assets. The explicit purpose of the reputation with investor measurement is to factor out asset value to determine a firm's underlying reputation. However, since assets are treated differently by different industries, the ability to consistently account for and remove the effect of assets across industries is doubtful. Industry control variables are included to remove any residual effect based on the inability to completely remove asset effects. The industry specifications used here are those used by the WSE. Industries identified by the WSE include; chemical, construction, heavy industry/electrical, financial services, food, light industry, and other (consisting mainly of conglomerate firms).

Size. Size measured as net sales (in million PLN) as reported to the WSE end of the year 1996 is included as an additional control variable. The management literature is ambiguous concerning the potential influence of size. One prediction would suggest that reputation increases with size. Increased reputation is conferred with size since larger organizations tend to be more integrated into society and are generally better known (Carroll & Delacroix, 1982; Kieser, 1989). However, larger firms are also more resistant to change (Haveman, 1993). Larger firms may be perceived as incapable of adjusting to the newer market-based economy and as such be granted lower reputation than smaller firms. Size is included as an exploratory variable with no specific predictions concerning its influence. A descriptive summary of all variables used in this analysis can be found in Table 3.

TABLE 3: DESCRIPTIVE SUMMARY OF VARIABLES INCLUDED IN ANALYSIS ONE

Variable Type	Variable Name	Brief Description	Predicted Effect on Firm Reputation	Type of Measurement
Dependent	RepCap	Reputation of the firm as perceived by investors.	N.A.	Continuous variable, measured as firm market – book value (mil PLN).
Independent	Profit	Profits of the firm as reported to the WSE.	Firms reporting higher profitability are predicted to rate as more reputable (H1).	Continuous variable, measured as profits (mil PLN).
	Age	The age of the organization (since founding).	Older firms are predicted to rate as less reputable (H2).	Continuous variable, measured as the firm age since founding (years).
	State	% of firm shares held by the state treasury (5% or more).	Firms reporting higher state-ownership are predicted to rate as less reputable (H3).	Continuous variable, measured as % ownership (5% or more).
	Foreign	% of firm shares held by a major foreign investor (5% or more).	Firms reporting higher foreign-ownership are predicted to rate as more reputable (H4).	Continuous variable, measured as % ownership (5% or more).

TABLE 3: (Continued)

Variable Type	Variable Name	Brief Description	Predicted Effect on Firm Reputation	Type of Measurement
Independent	IAS	The use of International Accounting Standards (IAS).	Firms reporting the use of IAS are predicted to rate as more reputable (H5).	Dummy variable, coded as one for firms using IAS, zero otherwise.
	Auditor	The use of a Big Five accounting firm as auditor.	Firms reporting the use of a Big Five accounting firm as auditor are predicted to rate as more reputable (H6).	Dummy variable, coded as one for firms using a Big Five firm, zero otherwise.
Control	Industry	Primary industry in which the firm operates as categorized by the WSE.	None.	Dummy variable per industry, coded as one for firms in the industry, zero otherwise.
	Sales	Sales of the firm as reported to the WSE.	None.	Continuous variable, measured as sales (PLN).

Analysis

Bivariate correlations and summary statistics (including means and standard deviations) are calculated and reported in order to develop a general understanding of the data set described above. A series of OLS regressions are used to investigate hypotheses one through six. Independent variables are introduced hierarchically into a regression model to ascertain the increase reputational gains associated with specific organizational activities. With the addition of each new set of variables, a partial F test is conducted to ascertain the increased fit of the overall model. Reputation Capital (RepCap) serves as the dependent variable throughout the analysis.

Profitability is included as the first independent variable. Next, organizational age is included in the overall model. Following age, the percent state and foreign-ownership are included. Finally, the variables IAS and Auditor are added to the model. A variance inflation factor (VIF) is calculated for each variable included in the final model to check for multicolinearity. Results of the analyses are reported in Chapter Five.

Analysis Two: Firms Issuing New Shares

Sample

The analysis discussed above concerns all firms traded on the WSE at a particular point in time (end of the year 1996). Not addressed in the above analysis are the particularities involved in the issuing of new shares (hypotheses seven, eight and nine). To investigate hypotheses seven, eight and nine, a separate data set is needed. The purpose of this second analysis is to investigate hypotheses seven, eight and nine by looking specifically at the reputation of firms immediately following the issuing of new shares.

The sample for this analysis includes new issues occurring between mid-1995 to mid-1997 for firms with a prospectus on file with the Polish Securities Commission (PSC). Data for this analysis come from prospectuses filed with the PSC, quarterly market reports issued by WSE, and daily share performance information available electronically from WSE. The data set includes information concerning firm profitability, sales, industry, and type of broker used during the new issue. The data set does not include information concerning organizational age, percent ownership (state or foreign), IAS usage or type of auditor. Therefore, this analysis is restricted to an investigation of hypotheses one, seven, eight and nine with the appropriate control variable included. The final data set includes 64 IPOs and 31 SEOs for a total sample size of 95 new issues.

Measures

Dependent Variable

Reputation Among Investors. Reputational capital (Fombrun, 1996) is used as the measure of a firm's reputation with investors. The variable RepCap is included to indicate the reputation of a firm and is measured as the market value – book value of the individual firm in million PLN. Measures of reputation for this analysis are taken the day of the new issues and then one, two, three, four, five, six and nine months following the new issue to explore the longer term effects of employing the services of an international broker (as discussed in analysis section below). Information concerning the market and book values of the individual firms was obtained directly from the WSE's office of statistics.

Independent Variables

Profits. The variable Profit is included to indicate the profitability of the firm. Profitability is measured as a continuous variable (in million PLN) as reported to the WSE during the first quarter of the new issue. Profitability data for this analysis comes from quarterly reports published by the WSE. Ideally, measures of profitability would be taken prior to the new issue. However, only information for profitability following the new issue is available. Profits are held constant throughout the nine-month analysis due to data constraints.

Type of New Issue. The dummy variable IPO is included to identify the type of new issue. Firms issuing shares for the first time (IPOs) were coded as one. Firms already listed on the exchange and offering additional shares (SEOs) were coded as zero. Information concerning the type of new issue is explicitly stated in the prospectus of the share issuing firm and is also available from the WSE.

International Broker. The dummy variable Broker is included to identify the type of lead broker employed. Firms employing the services of an international broker as lead broker were coded as one. Firms employing the services of a local broker as lead broker were coded as zero. An international broker is defined as a broker with majority ownership outside of Poland. Examples include but are not limited to Creditanstalt IB of

Austria and Pioneer of the US. Conversely, a local broker is defined as a broker with majority Polish ownership. Examples include but are not limited to PKO of Warsaw and Penetrator of Krakow. Information concerning the percent of a broker's foreign-ownership was obtained from the Warsaw Business Journal's 1997-1998 Book of Lists. Information concerning the identity of the lead broker during the new issue was collected from prospectuses on file with the Polish.Security Commission.

Interaction of Broker and New Issue Type. The dummy variable BrokIPO is included to measure the usage of an international broker during an Initial Public Offer. This variable is created by multiplying the variable Broker times the variable IPO. The resulting variable is a dummy variable where firms are coded as one if using an international broker during an IPO and zero otherwise.

Control Variables

Industry. Dummy variables are included for each of the industries represented on the WSE except "other" and coded as one if the firm was from the industry and zero otherwise. The industry specifications used here are those used by the WSE. Industries identified by the WSE include; chemical, construction, heavy industry/electrical, financial services, food, light industry, and other (consisting mainly of conglomerate firms).

Size. Size measured as net sales (in million PLN) as reported to the WSE during the first quarter of the new issue is included as an additional control variable. Sales data for this analysis comes from quarterly reports published by the WSE. Sales are held constant throughout the nine-month analysis due to data constraints. The management literature is ambiguous concerning the potential influence of size (as discussed above). Size has proven a potentially important variable when specifically looking at the returns associated with new issues. Fama and French (1992; 1995) find that smaller firms are generally perceived as higher risk and, as such, demand greater returns. Fama and French are most concerned with stock returns while our focus is on current excess value. The direct link between returns and excess value is less than clear. Therefore, size is again included as an exploratory variable with no specific predictions concerning its influence. A descriptive summary of all variables used in the second analysis can be found in Table 4.

Analysis

Bivariate correlations and summary statistics (including means and standard deviations) are calculated and reported in order to develop a general understanding of the data set described above. A series of OLS regressions are used to investigate hypotheses one, seven, eight and nine. An analysis was conducted for the first day following a new issue and then at one, two, three, four, five, six and nine month intervals to check for the longer term effect of the hypothesized reputation boost afforded firms issuing SEOs and employing the services of an international broker. Thus, an analysis was conducted using reputational measures from the first day of the new issue. A separate analysis was conducted using reputational measures one month following the new issues and so forth (holding all other measures constant). Ideally, reputational measures would have been taken one plus years following the new issue to investigate the longer-term effects more fully. Unfortunately, the recency of the data set prohibits measurement beyond 9 months. A variance inflation factor (VIF) is calculated for each variable included in the analysis to check for multicolinearity. Results of the analyses are reported in Chapter Five.

TABLE 4: DESCRIPTIVE SUMMARY OF VARIABLES INCLUDED IN ANALYSIS TWO

Variable Type	Variable Name	Brief Description	Predicted Effect on Firm Reputation	Type of Measurement
Dependent	RepCap	Reputation of the firm as perceived by investors.	N.A.	Continuous variable, measured as firm market – book value (mil PLN).
Independent	Profit	Profits of the firm as reported to the WSE	Firms reporting higher profitability are predicted to rate as more reputable (H1).	Continuous variable, measured as profits (mil PLN).
	IPO	Specific type of new issue (IPO or SEO).	Firms already listed on the exchange (SEOs) are predicted to rate as more reputable (H7).	Dummy variable, coded as one for IPOs and zero for SEOs.
	Broker	Type of broker used as lead agent during the issuing of new shares (int'l or local).	The using an int'l broker during the issuing of new shares are predicted to rate as more reputable (H8).	Dummy variable, coded as one for international brokers and zero for local brokers.

TABLE 4: (Continued)

Variable Type	Variable Name	Brief Description	Predicted Effect on Firm Reputation	Type of Measurement
Independent	BrokIPO	Interaction of broker and new issue type.	Firms issuing IPOs are predicted to benefit more from the use of int'l brokers than firms issuing SEOs (H9).	Dummy variable, coded as one for firms issuing an IPO and using an international broker, zero otherwise.
Control	Industry	Primary industry in which the firm operates as categorized by the WSE.	None.	Dummy variable per industry, coded as one for firms in the industry, zero otherwise.
	Size	Sales of the firm as reported to the WSE	None.	Continuous variable, measured as sales (PLN).

CHAPTER V

RESULTS

The purpose of this chapter is to summarize the results of the analyses outlined in Chapter Four. This chapter is presented in two sections. Section one presents the results of analysis one (all firms traded on the WSE in 1996) while section two presents the results of analysis two (firms issuing new shares). Within in each section, I begin by presenting a summary of the descriptive statistics for each analysis followed by a presentation of the results of hypothesis testing. All analyses were conducted using SPSS for Windows version 6.1. A detailed discussion of the results is presented in Chapter Six.

Analysis One: All Firms Traded on the WSE

Descriptive Statistics

A summary of the descriptive statistics for Analysis One can be found in Table 5. The correlation matrix for Analysis One is presented in Table 6. As shown in Table 5, the variance concerning reputational capital for firms traded in 1996 is fairly high with the most reputable firm receiving a reputational capital value of nearly 2 billion PLN while the least reputable firm receives a negative reputational capital value (market values less than book value) of 43.8 million PLN. Profitability also varies significantly, with the most profitable firm reporting a profit of nearly 300 million PLN and the least profitable firm reporting a loss of more than 50 million PLN. The average age of a firm traded on the WSE in 1996 was 36.3 years. The average state-ownership was slightly below 5 percent while foreign-ownership averaged slightly above 20 percent. Of the firms traded on the WSE in 1996, 13 (or approximately 18 percent) reported using International Accounting Standards while 40 (or approximately 55 percent) reported using one of the "Big Five" accounting firms as the companies auditor.

Hypotheses Testing

A series of OLS regressions were used to test hypotheses one through six, as outlined in Chapter Three. The results of the analyses are presented in Table 7. Variance Inflation Factors were calculated for each variable included in the model. A VIF in excess of 10 suggests problems of multi-colinearity (Neter, Wasserman and Kutner, 1989). As can be seen in Table 7, none of the VIFs calculated were in excess of 3. Therefore, multi-colinearity does not appear to be a problem for this particular analysis.

The regression model including only control variables (model 1) proves significant ($F=5.82$, $p=00$) with sales appearing to account for the bulk of the influence ($\beta=.55$, $p=.00$). However, the influence of sales diminishes as soon as the variable of profits is added to the model.

TABLE 5: DESCRIPTIVE STATISTICS FOR ANALYSIS ONE: ALL FIRMS TRADED ON THE WSE YEAR END 1996[A]

	Means	Std Dev	Max	Min
RepCap (million PLN)	208.3	358.0	1925.1	-43.8
Profits (million PLN)	24.4	53.5	298.4	-52.4
Organizational Age (years)	36.3	35.2	151	3
State-Ownership (%)	4.8	10.5	46.87	0
Foreign-Ownership (%)	21.4	20.2	75.0	0
Use of IAS	0.18	(13 firms)		
Use of Int'l Auditor	0.55	(40 firms)		
Sales (million PLN)	295.0	353.2	1862.1	6.7
Chemical	0.15	(11 firms)		
Construction	0.16	(12 firms)		
Financial Services	0.20	(15 firms)		
Food	0.12	(9 firms)		
Heavy Industry	0.04	(3 firms)		
Light Industry	0.18	(13 firms)		

[A] N=73

TABLE 6: CORRELATION MATRIX FOR ANALYSIS ONE:
ALL FIRMS TRADED ON THE WSE YEAR END 1996[A]

	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1. RepCap	1.00													
2. Profit	.79**	1.00												
3. Age	-.05	-.15	1.00											
4. State	.19	.34**	.08	1.00										
5. Foreign	.39**	.34**	.13	.04	1.00									
6. IAS	.32**	.39**	-.04	.17	.18	1.00								
7. Auditor	.39**	.29*	-.06	.13	.47**	.13	1.00							
8. Sales	.59**	.58**	-.02	.41**	.20+	.16	.48**	1.00						
9. Chemical	.03	-.02	.33**	.14	.25*	-.10	-.08	-.05	1.00					
10. Construction	-.15	-.18	-.08	-.20+	-.05	-.01	-.12	-.17	-.19	1.00				
11. Fin. Services	.26*	.50**	-.36**	.12	.16	.20+	.26*	.21+	-.21+	-.22+	1.00			
12. Food	-.05	-.08	.33**	-.10	.07	-.07	-.08	-.04	-.16	-.17	-.19	1.00		
13. Heavy Industry	.04	-.03	-.01	.27*	-.04	-.10	.05	.00	-.09	-.09	-.11	-.08	1.00	
14. Light Industry	-.24*	-.20+	-.07	-.19	-.18	-.03	-.15	-.24*	-.20+	-.20+	-.23*	-.17	-.10	1.00

[A] N=73
\+ $p < .10$
* $p < .05$
** $p < .01$

TABLE 7: REGRESSION RESULTS FROM ANALYSIS ONE: ALL FIRMS TRADED ON THE WSE YEAR END 1996[A]

	Model 1	Model 2	Model 3	Model 4	Model 5	VIF
Profits		.78**	.78**	.77**	.78**	2.46
Organizational Age			.00	.01	.01	1.49
% State-Ownership				-.19*	-.19*	1.52
% Foreign-Ownership				.13+	.08	1.81
Use of IAS					.04	1.27
Use of Big Five Auditor					.10	1.84
Sales	.55**	.14	.14	.18+	.14	2.39
Chemical	.10	-.05	-.06	-.09	-.05	2.61
Construction	.00	-.10	-.10	-.14	-.13	2.21
Financial Services	.17	-.24*	-.24*	-.27*	-.27*	2.73
Food	.02	-.07	-.07	-.13	-.10	2.17
Heavy Industry	.06	.01	.01	.04	.05	1.45
Light Industry	-.04	-.14	-.14	-.18+	-.17+	2.28
R^2	.38	.69	.69	.73	.74	
Adjusted R^2	.32	.65	.64	.68	.68	
F	5.82**	17.61**	15.41**	15.22**	12.90**	
Partial F Test		61.97**	.01	5.17**	.77	

[A]N=73. Standardized regression coefficients are shown (dependent variable of RepCap).

+ $p < .10$
* $p < .05$
** $p < .01$

Hypothesis One

The results strongly support hypothesis one. Hypothesis one predicts that WSE firms reporting higher profitability will have greater reputational value with investors than WSE firms reporting lower profitability. Profitability is the first independent variable hierarchically introduced into the regression model (model 2). When introduced, the effect of profitability is strong (β=.78) and statistically significant (p=.00) while the model in general is highly significant (F=17.61, p=.00). Moreover, the increase in adjusted R^2 (from .32 to .65) and the results a partial F test (F=69.17, p=.00) suggests a greatly improved model with the inclusion of profitability. Thus, firm profitability appears to be a highly influential variable in determining WSE firms as reputable with investors.

Hypothesis Two

The results do not support hypothesis two. Hypothesis two predicts that younger (more recently founded) WSE firms will have greater reputational value with investors than older WSE firms. When introduced into the regression model as the second independent variable (model 3), the effect of age is virtually non-existant (β=.00, p=.95). The model in general remains highly significant (F=15.41, p=.00, adjusted R^2=.64). However, both the changes in adjusted R^2 (from .65 to .64) and the results of the partial F test (F=.01) suggest that age has no influence in shaping the reputation of WSE firms with investors.

Hypotheses Three and Four

The results provide moderate support for hypothesis three and weak support for hypothesis four. Hypothesis three predicts that WSE firms with a lower percent of state-ownership will have greater reputational value with investors while hypothesis four suggests that WSE firms with a higher percent of foreign-ownership will have greater reputational value with investors. The percentages of state and foreign-ownership were added hierarchically as independent variables three and four, respectively (model 4). When introduced, the effect of state-ownership is negative and significant as predicted (β=-.19, p=.02). The effect of foreign-ownership is positive and significant as predicted (β=.13, p=.09) although the level of significance is less than with state-ownership. The overall model remains highly significant (F=15.22, p=.00, adjusted R^2=.68). More importantly, both the changes in adjusted R^2 (from .64 to .68) and the results of the partial F test (F=5.17, p=.05) suggest an important role for ownership structure when trying to understand reputation with investors. Thus, both state and foreign-ownership appear to be a significant influence in determining reputation with investors, though the results suggest that state-ownership exerts a stronger influence.

Hypotheses Five and Six

The results do not support hypotheses five or six. Hypothesis five predicts that WSE firms reporting the use of IAS will have greater reputational value with investors, while hypothesis six predicts that WSE firms reporting the use of internationally recognized auditors will have greater reputational value with investors. When introduced into the regression model as independent variables five and six (model 5), neither IAS (β=.04, p=.57) nor the use of an internationally reputable audit firm (β=.10, p=.28) proves significant. The model in general remains highly significant (F=12.9, p=.00, adjusted R^2=.68). However, both the changes in adjusted R^2 (no change from .68) and the results of the partial F test (F=.77) suggest that neither the use of IAS nor the use of an internationally reputable auditor has a significant influence in determining WSE firms as reputable with investors.

In summary, analysis one provides strong support for hypothesis one (the impact of profits on reputation). There is also moderate support for hypothesis three (the liability of state-ownership) and weak support for hypothesis four (the benefit of foreign-ownership). There is no support for hypotheses two, five or six (the influence of age, IAS usage and usage of an internationally reputable auditor).

Control Variable Influence

Industry

The only industry control variable to consistently achieve significance in the four models is the negative influence associated with being in the financial service industry. Financial service firms rate as less reputable when including profits as the only independent variable in the model (β=-.24, p=.04). The negative influence associated with being in the financial service industry becomes more pronounced as additional variables are added to the model. In the fully specified model, the negative effect of participating in the financial service industry becomes quite pronounced (β=-.27, p=.02).

Thus, there does appear to a significantly negative influence associated with being in the financial service industry for WSE firms attempting to establish reputation with investors.

Size

The influence on reputational capital of size, as measured by sales, is less clear. Sales is not significant (β=.14, p=.15) in the most reduced form of the model (model 1). Sales does achieve statistical significance in model 3 (β=.18, p=.06). However, the influence of sales diminished (β=.14, p=.17) in the fully specified model (model 4). Thus, sales does appear to have a minor influence in determining reputation with investors. However, the influence that exists is weak at best.

Analysis Two: Firms Issuing New Shares

Descriptive Statistics

A summary of the descriptive statistics for Analysis Two can be found in Table 8. The correlation matrix for Analysis Two is presented in Table 9. As shown in Table 8, the measures of reputation capital over the nine-month period are fairly stable. The mean value of reputational capital never varies more than about 10 million PLN from month to month (despite the general volatility of the market). Within each month, the variance of reputational capital is lower than was the case in analysis one (mainly do to the lower "maximum" observed value of reputational capital). The observed variance in profitability is also lower than was the case with analysis one with an average profitability of 4.3 million PLN compared to an average profitability of 24.4 million PLN in analysis one. Of the new offerings occurring during the time period of this study (mid-1995 to mid-1996), 64 (or approximately 67 percent) were IPOs. 19 (or approximately 20 percent) reported using an international broker as lead broker during the new issue. Of the 19 new issues using international brokers as lead brokers, 8 (or approximately 8 percent) were IPOs with the remaining 11 representing SEOs.

Hypotheses Testing

In this analysis, a series of OLS regressions was used to test hypotheses one, seven, eight and nine. Repeated measures of reputational capital were used to ascertain the longer-term effects of being an IPO and using international brokers during the issuing of new shares (hypotheses seven, eight and nine). The results of the analyses are presented in Table 10. Variance Inflation Factors were calculated for each variable included in each of the analyses. None of the VIFs calculated were in excess of 3. Therefore, multi-colinearity does not appear to be a problem for this particular analysis.

TABLE 8: DESCRIPTIVE STATISTICS FOR ANALYSIS TWO:
FIRMS ISSUING NEW SHARES MID-1995 TO MID-1997

	Means	Std Dev	Max	Min
RepCap (million PLN)[A]				
Day of new offer (n=95)	105.7	169.1	820	-110
1 month later (n=94)	94.6	153.3	868	-84
2 months later (n=89)	91.0	148.7	868	-64
3 months later (n=85)	92.0	139.3	626	-53
4 months later (n=77)	100.6	155.6	698	-45
5 months later (n=76)	96.2	158.3	780	-59
6 months later (n=71)	86.1	142.5	751	-76
9 months later (n=57)	96.8	149.5	825	-55
Profits (million PLN)	4.3	8.6	67.4	-6.31
Issuing of an IPO	0.67	(64 firms)		
Use of Int'l Broker	0.20	(19 firms)		
Use of Int'l Broker during an IPO	0.08	(8 firms)		
Sales (million PLN)	57.8	75.16	427.7	2.72
Chemical	0.11	(10 firms)		
Construction	0.22	(21 firms)		
Financial Services	0.19	(18 firms)		
Food	0.11	(10 firms)		
Heavy Industry	0.14	(13 firms)		
Light Industry	0.12	(11 firms)		

[A] Reduction in sample size over time results from the recency of data. Many firms included in the data set had nine months or less of trading history during the time period of this analysis.

TABLE 9: CORRELATION MATRIX FOR ANALYSIS TWO:
FIRMS ISSUING NEW SHARES MID-1995 TO MID-1997[A]

	9	10	11	12	13	14	15	16	17	18	19
1. RepCap Day One (n=95)	.53**	-.33**	.25*	.02	.41**	.07	-.15	.05	.01	-.02	-.07
2. RepCap Month 1 (n=94)	.45**	-.32**	.29**	.00	.32**	.10	-.12	-.05	.00	.01	-.10
3. RepCap Month 2 (n=89)	.38**	-.27*	.33**	.02	.26*	.10	-.13	-.17	.02	.04	-.04
4. RepCap Month 3 (n=85)	.42**	-.20+	.28*	.02	.33**	.14	-.13	-.22*	.01	.09	-.05
5. RepCap Month 4 (n=77)	.53**	-.29*	.19+	-.02	.31**	.08	-.12	-.06	.02	.01	-.05
6. RepCap Month 5 (n=76)	.44**	-.24*	.30*	-.02	.22**	.14	-.11	-.30**	.09	.10	-.06
7. RepCap Month 6 (n=71)	.47**	-.24*	.29*	-.03	.21+	.16	-.09	-.30*	.12	.11	-.04
8. RepCap Month 9 (n=57)	.58**	-.20	.34**	.09	.53**	.14	-.14	-.20	.21	.06	-.03
9. Profit	1.00										
10. IPO	-.07	1.00									
11. Broker	.00	-.27**	1.00								
12. BrokerIPO	-.05	.21*	.61**	1.00							
13. Sales	.66**	-.08	-.04	-.09	1.00						
14. Chemical	.00	.09	-.08	.02	-.06	1.00					
15. Construction	-.17	-.06	-.08	-.07	-.11	-.18+	1.00				
16. Fin. Services	.34**	-.18+	.09	-.05	.14	-.17	-.26*	1.00			
17. Food	-.03	.02	.00	.02	.03	-.12	-.18+	-.17	1.00		
18. Heavy Industry	-.05	.08	-.04	.10	-.02	-.14	-.21*	-.19+	-.14	1.00	
19. Light Industry	-.09	.18+	-.02	.13	-.10	-.12	-.19+	-.17+	-.12	-.14	1.00

[A]Reduction in sample size associated RepCap measures results from the recency of data. Many firms included in the data set had nine months or less of trading history during the time period of this analysis. The correlation of items 9 through 18 are constant since the values of variables 9 through 18 are held constant through the nine month period of the analysis.

+ $p < .10$
* $p < .05$
** $p < .01$

TABLE 10: REGRESSION RESULTS FROM ANALYSIS TWO:
FIRMS ISSUING NEW SHARES MID-1995 TO MID-1997[A]

	Day 1	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 9
Profit	.55**	.54**	.52**	.54**	.43**	.48**	.53**	.50**
IPO	-26**	-.23*	-.16	-.10	-.06	-.08	-.05	.00
Broker	.22+	.34**	.47**	.45**	.54**	.48**	.51**	.46**
BrokerIPO	-.04	-.14	-.23+	-.23	-.31*	-.29*	-.30*	-.15
Sales	.03	-.03	-.05	.00	.01	-.04	-.04	.18
Chemical	.02	.03	-.04	.10	.02	.03	.15	.24+
Construction	-.16	-.18	-.28**	-.24+	-.21+	-.20	-.04	.08
Fin. Services	-.28*	-.39**	-.57**	-.59**	-.57**	-.56**	-.45**	-.30*
Food	-.06	-.09	-.14	-.14	-.08	-.06	.05	.12
Heavy Ind.	-.05	-.05	-.10	-.04	-.04	.00	.10	.14
Light Ind.	-.05	-.11	-.13	-.13	-.09	-.10	.01	.10
R^2	.46	.46	.50	.53	.57	.57	.59	.64
Adjusted R^2	.39	.38	.43	.46	.50	.49	.51	.56
F	6.49**	6.28**	7.04**	7.54**	8.02**	7.59**	7.63**	7.40**

[A] Standardized regression coefficients are shown (dependent variable of RepCap). Variance Inflation Factors (VIF) were calculated for each equation. In no case did the VIF exceed 3, well below the value of 10 used to suggest problems with multicolinearity (Neter, Wasserman and Kutner, 1989). Therefore, individual VIF values are not reported here.

\+ $p < .10$
* $p < .05$
** $p < .01$

Hypothesis One

Hypothesis one is again strongly supported (as was the case in analysis one). Profitability consistently associated with a firm's stock of reputational capital, suggesting that investors confer more favorable reputation on profitable firms. The influence of profits is initially strong (β=.55, p=.00) and remains strong through the nine-month period of the study. Nine months following the new issue, profits remains one of the most significant variables in the model (β=.50, p=.00). Moveover, the overall model is statistically significant following the first day of the new issue (F=6.49, p=.00) and explains a large portion of the variance in reputational capital (adjusted R^2=.39). The model remains highly significant and explanatory throughout the time period of the study. Even nine months following the new issue, the overall model remains statistically significant (F=7.40, p=.00) and capable of explaining a large portion of the variance in reputational capital (adjusted R^2=.56). Thus, we find further support for the notion that firm profitability is a highly significant influence in determining WSE firms as reputable with investors.

Hypothesis Seven

The results provide partial support for hypothesis seven. Hypothesis seven suggests that WSE firms issuing a SEO will have greater reputational value with investors than WSE firms issuing an IPO. Stated differently, hypothesis seven predicts a reputational disadvantage associated with issuing shares for the first time. As expected, firms listing on the exchange for the first time (IPOs) tend to have smaller stocks of reputational capital. However, the reputational liability associated with an IPO appears to diminish over time. The results of the analysis for the first day of new issue (Day 1) suggest a negative effect associated with being an IPO (β=-.26, p=.01). The negative effect of being an IPO remains significant one month following the new issue (β=-.23, p=.02). However, the influence of IPO status becomes insignificant in month 3 and never regains significance during the 9-month period studied. Nine months out, the influence of being an IPO appears to disappear completely (β=.00, p=.99) despite the robustness of the overall model (F=7.40, p=.00, adjusted R^2=.56). Thus, the initial reputational liability associated with an IPO appears to exist (supporting hypothesis seven). However, this liability appears to diminish quickly with time.

Hypothesis Eight

The results provide strong support for hypothesis eight. Hypothesis eight predicts that WSE firms employing the services of international brokers during the new issue will have greater reputational value with investors than WSE firms employing the services of domestic brokers. As predicted, there appears to be a strong reputational advantage associated with employing the services of an international broker when issuing new shares. Moreover, the reputational advantage appears to be sustained over the nine-month period covered by this analysis. Following the first day of initial offer, the effect of employing the services of an international broker as lead issuing agent is only moderately strong (β=.22) and barely significant (p=.08). The reputational advantage of using an international broker appears to emerge as more significant two months following the new issue (β=.34, p=.00) and reaches a peak influence by month four (β=.54, p=.00). Nine months following the new issue, the reputational advantages of using an international broker remains quite strong (β=.46, p=.00) while the overall model remains strong throughout the nine-month period. Thus, there appears to be strong support for the notion that firms that employ the services of internationally based brokers when issuing new shares on the WSE will rate as more reputable among investors than firms that employ the services of domestic (Polish) brokers (hypothesis eight).

Hypothesis Nine

Results do not support hypothesis nine. Hypothesis nine predicts that WSE firms issuing an IPO will benefit more from employing the services of international brokers during the issuing of new share than will WSE firms issuing a SEO. Thus, hypothesis nine predicts a positive interaction between the variables Broker and IPO. The interaction variable of BrokerIPO does not appear as largely significant during the first three months of the study. BrokerIPO does prove significant in months four (β=-.31, p=.02), five (β=-.29, p=.02) and six (β=-.30, p=.02). However, the influence observed is in the opposite direction of that predicted.

Mean differences were calculated as a way of further investigating hypothesis nine. Mean differences were calculated by taking the average measures of reputational capital for IPO-issuing firms using domestic brokers and then comparing this number to the average measures of reputational capital for IPO-issuing firms using international brokers. This analysis was repeated for SEO-issuing firms. The means for IPO-issuing firms employing the services of international brokers versus IPO-issuing firms employing the services of a local broker range from 79.8 million PLN following the first day of new issue to 17.3 million PLN six months out. The means for SEO-issuing firms employing the services of international brokers versus SEO-issuing firms employing the services of a local broker range from 244.8 million PLN four months following the new issue to 145.4 million PLN nine months out. In fact, the mean differences for SEO-issuing firms throughout the nine-month period are two to nine times greater than for IPO-issuing firms. Thus, the effect of employing the services of an international broker appears more pronounced for firms already listed on the exchange (SEOs) thereby contradicting hypothesis nine.

In summary, analysis two provides further support for hypothesis one (the importance of profits). There is moderate support for hypothesis seven (the liability of issuing an IPO) and strong support for hypothesis eight (the benefit of using international brokers during the issuing of new shares). The results of analysis two fail to support hypotheses nine (the suggestion that WSE firms issuing an IPO will benefit more from employing the services of international brokers).

Control Variable Influence

Industry

The only industry control variable to consistently rate as significant is the negative influence associated with being in the financial service industry. Financial service firms rate as less reputable immediately following the new issue (β=-.28, p=.02).

The negative influence associated with being in the financial service industry is quite pronounced at month three (β=-.59, p=.00) and remains strong even nine months following the new issue (β=-.30, p=.03). Thus, there does appear to a significantly negative influence associated with being in the financial service industry for WSE firms attempting to establish reputation with investors (consistent with analysis one).

Size

Contrary to what was found in Analysis One, the results of Analysis Two show insignificant influence associated with size as measured by sales. The influence of sales is initially weak (β=.03) and insignificant (p=.75). Moreover, sales never emerges as significant despite the robustness of the models in general. Thus, sales does not appear to have an influence in determining reputation with investors.

CHAPTER VI

DISCUSSION AND CONCLUSIONS

Overview of Results

In the previous chapter, I outlined the results of the analyses discussed in Chapter Four. The purpose of this chapter is to provide a detailed discussion of the results including a discussion of limitations and implications for research and practice.

The purpose of the research was to investigate how firms establish reputation in an emerging economy. This question was addressed by first developing a general model of organizational reputation, then by deriving specific hypotheses from the model concerning firms traded on the WSE, and finally by testing the hypotheses in two multivariate analyses. The results provide mixed support for the hypotheses developed in Chapter Three and thus offer partial support for the model of organizational reputation formation discussed in Chapter Two.

The Role of Performance in Establishing a Firm as Reputable

The result of both analysis one and two provide strong support for the notion that a firm can establish itself as reputable by demonstrating a history of performance that meets or exceeds the external assessors' needs and interests. As suggested in Chapter Three (hypothesis one), firms traded on the WSE meet or exceed the needs and interests of investors by demonstrating a high level of profitability. Profitability emerges as highly significant whether one looks at all firms traded on the WSE at a particular point in time, or whether one singles out firms issuing new shares. In both analyses, profitability emerged as the most important factor in establishing a firm as reputable with investors.

One could argue that the results concerning the importance of profitability are unexpectedly strong given the general uncertainty of the Polish market. In a highly uncertain environment, investors may find it difficult to rely on the firm's internally generated accounts of profitability. Lacking reliable measures of profitability, one would expect profits to be less influential in determining a firm as reputable with investors. However, the reports of profitability for firms traded on the WSE are surprisingly reliable due to the aggressive nature of the Polish Security Commission (PSC).

In 1995, the PSC initiated 20 proceedings and levied 10 fines in cases where firms where found not to have made appropriate disclosure under the law, this in a year when less then 60 firms where listed on the exchange. According to William Philbrick, editor of "Taking Stock" and former securities lawyer for the US Securities and Exchange Commission, "A diligent enforcement system is vital to the transparency and legitimacy of any stock market . . . The successes of the Polish stock market are due to the exemplary oversight of the Polish Securities Commission and the Warsaw Stock Exchange" (Philbrick, 1996: 6). The aggressive nature of the PSC increases the ability of the investor to rely on the reported profitability of Polish firms as a valid indicator of a firm's true financial performance. Therefore, it seems reasonable that investors would anchor on profits more than one would otherwise expect in the highly uncertain environment of an emerging economy. Thus, the ability to demonstrate a history of profitability dominates the determination of reputation with investors for firms traded on the WSE.

The Role of Signaling in Establishing a Firm as Reputable

Despite the dominant influence of profitability, there does appear to be some role for signaling in establishing a firm as reputable with WSE investors. Hypotheses two, three and four suggest that the perceived ability of a WSE firm to break from the centrally planned command-economy and perform well in a market-based economy can serve as a signal of future performance potential. The results concerning the influence of age (hypothesis two) received no support. Thus, youthfulness does not appear as a signal of future financial performance capable of enhancing a firm's reputation with investors. However, ownership structure (hypotheses three and four) does appear as potentially influential when attempting to establish reputation with investors.

The results of analysis one suggest that both state and foreign-ownership influence the ability of WSE firms to establish reputation with investors. However, the negative influence associated with state-ownership appears to be more influential than the positive influence of foreign-ownership. Thus, there appears to be a greater disadvantage associated with ties to the command-and-control economy than the advantages associated with ties to a more market-based economy.

A possible explanation for this particular finding has to do with the nature of shareholder intent. It is often difficult to ascertain the exact intent of a major foreign shareholder. However, the state as shareholder is a visible signal of the state's continued influence in the affairs of the individual firm. Thus, state-ownership serves as a stronger signal to investors than does foreign-ownership. Correspondingly, state-ownership has a greater impact on reputation than foreign-ownership.

The negative influence of state-ownership exists despite the fact that firms with greater state-ownership are more profitable than the general population of WSE firms. The fact that firms with increases state-ownership are afforded lower reputation despite increased profitability further supports the assertion of state-ownership as a negative signal of future performance potential independent of actual past performance.

The results of analysis one do not support the notion of age as a signal of a firm's future performance potential with the corresponding effect on reputation. However, the results do suggest an important role for signaling through ownership structure despite the disparity of influence concerning the role of state and foreign-ownership. Thus, signaling as a way of indicating future firm performance does appear to influence the reputation of WSE firms with investors.

The Role of Legitimation in Establishing a Firm as Reputable

The results concerning the importance of legitimation in establishing a firm as reputable are less clear. The adoption of the appropriate accounting practices as operationalized in this study had no influence on firm reputation with investors. However, the ability to make known the actions of the firm (the second component of the legitimation process) proved highly significant.

The Adoption of Appropriate Practices

Neither the adoption of IAS (hypothesis five) nor the use of internationally reputable accounting firms (hypothesis six) appear to have any influence on the ability of WSE firms to bolster their reputations with investors. Thus, the contention of Meyer (1994b: 122) that "Environments create organization elements such as accounting and accountants, make it easy and necessary for organizations to use them, and treat organizations that have them as by definition more legitimate than others," is not supported by this research.

It remains to be seen if the adoption of certain non-accounting practices such as the adoption of a particular organizational structure or specific human resource practices can enhance the reputation of a WSE firm with investors. However, the adoption of appropriate practices as defined in hypotheses five and six of the dissertation does not appear to have a significant influence on investors.

Making the Actions of the Firm Known

Despite the lack of influence concerning the adoption of appropriate behavior, the ability to make the practices of the firm known to investors does appear to have a significant influence on the ability of a firm to establish its reputation. Hypothesis seven suggests that IPOs will suffer a reputational liability due to their lack of prior market exposure. As predicted, there appears to be a reputational disadvantage associated with listing on the exchange for the first time (IPOs). The reputational liability associated with an IPO does not appear to be long lived. The decline observed over time in the reputational liability associated with an IPO could result from the increased exposure afforded any firm listed on the WSE. By merely listing on the WSE, the IPO-issuing firm reduces the liability associated with its prior anonymity. Still, the initial reputational liability associated with IPOs supports the importance of making the practices of the firm known.

Despite the initial reputational liability of being an IPO-issuing firm, IPO-issuing firms do not benefit more from using international brokers than SEOs as predicted in hypothesis nine. A possible explanation comes from Greg, an equity analyst for the international brokerage firm "International Brokers." According to Greg, "Most of our investors are institutional and foreign and are only interested in the more liquid and heavily capitalized firms." IPOs generally are too small to attract the attention of international institutional investors. This phenomenon appears to be echoed in an article by Robert Frank of the Wall Street Journal (March 27, 1998: A1). "U.S. funds shy away from many of the (Polish) IPOs, since the companies are too small to absorb the multimillion-dollar investments that fund managers prefer."

International brokers increase the perceived reputation of client firms by serving as a conduit to the increasingly important international investment community. If, in fact, international investors are uninterested in IPOs, no amount of exposure will increase the reputation of the IPO issuing firms. If, on the other hand, international investors are predisposed to invest in a particular type of security (e.g., SEOs), then the international broker serves the important role of exposing specific securities that match the interests of potential investors. Thus, we would expect SEO issuing firms to benefit more from employing the services of an international broker if we first recognize the predisposition of international investors to invest in SEO issuing firms.

The most convincing evidence for the value of making the actions of the firm known comes from the results of the analysis concerning the use of international brokers in general. As predicted, employing the services of an international broker when issuing new shares appears to enhance a firm's reputation. Moreover, the reputational advantage appears to persist over the nine-month period covered by this analysis and, at times, rivals the influence of profitability. Thus, we find strong support for the notion that the use of an international broker increases the reputation of WSE firms with investors (hypothesis eight). However, the lack of support for hypotheses five and six (the importance of accounting practices) combined with the strong support for hypothesis eight (the use of international brokers) suggests several important competing hypotheses that must be explored before we can comment on the role of international brokers as legitimating agents.

Competing Hypotheses

Given the lack of support for hypotheses five and six, it might be tempting to conclude that international brokers do not serve as legitimating agents for their client firms but merely serve the role of correcting for existing market inefficiencies. That is, perhaps the international brokers seek to eliminate the search, matching and coordination problems (Milgrom & Roberts, 1992) associated with the infantile WSE. This interpretation suggests that any increased reputation observed when employing the services of an international broker results from increased market efficiency and not increased individual firm reputation.

True, the individual firm does appear to benefit from increased exposure thereby reducing the search and matching cost for the individual firm.. Increased firm exposure is the primary role of legitimating agents such as international brokers. However, for the increased market efficiency argument to be valid, increased reputation would have to be observed for all firms traded on the WSE and not just for firms employing the services of the international broker. International brokers as legitimating agents assist the individual firm by providing exposure unavailable to other market participants. The international broker as legitimating agent works to enhance their client's reputation at the expense of other firms and, if anything, contribute to the ongoing market inefficiencies.

Another potential counter argument concerning the influence of international brokers has to do with the study design. Firms were not randomly assigned to experimental groups but instead self-selected into assigned categories based on the use of a local or international broker. One could argue that international brokers screen potential clients and agree to represent only high quality clients, thereby assuring a higher measure of reputation for client firms. Similarly, one could argue that brokers that works exclusively with high quality clients use their selectivity as a signal of client firm quality. Thus, the suggestion that international brokers work only with high quality clients undermines our ability to depict international brokers as legitimating agents and, instead, suggests that the use of an international broker serves as a signal of a firm's higher quality.

However, the suggestion that international brokers work only with high quality clients is inconsistent with information collected during field interviews. According to Michael, head of sales for "International Brokers," the company has never turned down the opportunity to serve as lead broker. John, a senior analyst with one of the smaller internationally based brokers in Poland, argues that the issuing of new shares is the "bread and butter of the brokerage houses." No brokerage house, local or international, is going to turn down the opportunity for new issues business, according to John. Thus, selectivity on the part of brokers does not appear to account for the increase reputation afforded firms employing the services of an international broker.

One could also argue that a bias is introduced in that only high quality firms seek to employ the services of international brokers (a selection bias driven by the firms issuing new shares). Thus, the increased reputation associated with firms employing the services of an international broker results from the fact that only high quality firms are attracted to international brokers to begin with. However, such an argument is inconsistent with information collected during field interviews. Often, the decision as to which broker to employ during the issuing of new shares is highly personal.

When asked why the company decided to use a specific broker, the investment relations officer at a medium sized construction firm was quick to respond, "the president of (the company) knows the president of (the brokerage firm), and it was the presidents decision." In fact, many of the firms interviewed indicated personal contacts as the dominant reason for choosing a specific broker used during the issuing of new shares. The influence of personal contacts appears as prominent in firms of both high and low quality (as measured by profitability). Thus, high quality firms appear no more likely to employ the services of international brokers than do lower quality firms.

To further investigate this potential bias, a collection of broker analyst recommendations from 1997 was compared with the use of international brokers when issuing new shares. Broker analyst recommendations represent an investor independent assessment of a firm's value. If higher quality firms are inherently attracted to international brokers, then there should be a positive statistically significant correlation between positive broker analyst recommendations and firms employing the services of international brokers.

The broker analyst recommendations used in this analysis come from a broad base of locally and internationally based brokerage houses and are available online through the Polish publication Parkiet (http://www.parkiet.com.pl). The number of recommendations per firm ranged from one to sixteen. Each recommendation provided was coded according to the type of recommendation; one for buy, zero for hold and negative one for sell recommendations. A summary of all recommendations per firm was calculated providing individual firms with average 1997 recommendation scores. A total of 64 firms are included in the Parkiet data set. Of these 64 firms, 40 are also included in the new issues data set. The correlation between the use of an international broker as lead broker and the quality of the firm as assessed by broker analysts is low (.1028) and statistically insignificant (p=.528). Thus, selectivity on the part of individual firms does not appear to be a biasing issue.

The fact that individual firms, and not the entire market, benefit from employing the services of an international broker suggests that the reputational advantage of employing international brokers can not be accounted for based on increased market efficiency. The fact that no brokerage house, local or international, is likely to turn down the opportunity for new issues business suggests that the reputational advantage of employing international brokers can not be accounted for based on brokerage house selectivity. Finally, the lack of a relationship between the use of an international broker and the quality of the firm as assessed by brokerage firm analysts suggests that the reputational advantage of employing international brokers cannot be accounted for based on firm level selectivity. Therefore, it seems reasonable to suggest that the reputation boost afford the individual firm employing the services of an international broker is best attributed to the ability of international brokers to serve as effective legitimating agents for firms traded on the WSE.

The Process of Legitimation and its Link to Reputation

While the hypotheses concerning the importance of adopting appropriate practices are not supported, the results concerning the importance of making the practices of the firm known are each supportive of the model of legitimation outline in Chapter Two. The lack of support concerning the importance of accounting practices may result from the fact that these practices go largely unobserved for the firms listed on the WSE in 1996.

This would support the basic notion of the legitmation model outlined in Chapter Two since the mere adoption of appropriate practices is unlikely to result in increased reputation for firms in a highly uncertain environment such as Poland's. The mere adoption of IAS and the use of an internationally reputable auditor are insufficient to establish the WSE firm as reputable given the highly level of uncertainty associated with firms traded on the WSE. In an uncertain environment such as Poland's, a legitimating agent is needed to help make the practices of the firm better know. Thus, we find the use of international brokers as highly influential in establishing the WSE firm as reputable. Collectively, these results are supportive of the model of legitimation outline in Chapter Two. Thus, we find general support for the notion that the individual firm can attempt to establish itself as reputable via a process of legitimation.

Control Variable Influence

Only one control variable included in this study's analyses was consistently significant. The participation of a firm in the financial services industry was negative related to its stock of reputational capital in each of the models estimated. This occurs despite the above average profitability of firms participating in the financial service industry.

There are two possible explanations for the negative reputation of firms in the financial service industry. One possible explanation is that firms in the financial service industry account for assets in a way that artificially decreases their measure of reputation. It may be that firms in the financial service industry are required to account for a greater amount of firm specific assets. Hence, financial services firms are inappropriately penalized by our attempt to remove the influence of assets in determining a firm as reputable.

Alternatively, the financial service industry may genuinely be perceived as less reputable among investors. The financial service sectors of most ECE countries have been criticized for their lack of effective performance (Borish & Noel, 1996). In Poland, the financial service industry is generally profitable. However, the financial service industry remains a fairly protected industry in Poland. The result has been increased profitability for the industry as a whole. The performance of the Polish financial section will undoubtedly deteriorate as the market becomes more competitive, according to various broker analysts interviewed. Thus, the long-term prospect of firms in the financial service industry is much less encouraging than current financial performance might otherwise indicate. Accordingly, the negative reputation of financial services firms may accurately reflect the perception of investors concerning the long-term performance potential of firms in the financial service industry.

Limitations of the Study

Before considering the implications of these findings for future research and practice, several limitations should be noted. First, it is important to note that these findings are specific to firms traded on the WSE and more specifically to reputation with investors. This level of specificity is necessary given the multifaceted nature of organizational reputation (as will be discussion in the next section concerning implications for future research). It would be inappropriate to assume that the reputational determinants identified in this study are applicable to firms outside the WSE or with external audiences other than investors. For example, it is highly unlikely that the use of international brokers will have a significant influence with external audiences other than investors. Moreover, the negative influence of state-ownership may stem from factors idiosyncratic to the case of Poland. Thus, it would be inappropriate to generalize the specific findings of this research to any other context.

Secondly, the research is limited by the definition and scope of appropriate behaviors investigated. The adoption of IAS and the use of internationally reputable accounting firms clearly do not exhaust the potential mechanisms through which a firm may legitimize itself in the eyes of investors. It remains to be seen if the adoption of certain non-accounting practices such as the adoption of a particular organizational structure or specific human resource practices can enhance the reputation of a WSE firm with investors. The absence of data pertaining to the impact of a broader range of practices is a distinct limitation of the study.

Finally, the inability to comment on the precise information transmitted through the international broker limits our ability to depict international brokers as legitimating agents. Clearly, the use of an international broker during the issuing of new shares has a distinct impact of the reputation of a firm. However, it is not entirely clear the precise role played by the international broker. This study has proposed that an international broker increases the reputation of client firms by serving as an informational conduit to the international investment community, thereby fulfilling the role of a legitimating agent. It would be easier to substantiate this claim if we knew the precise information transmitted through the international broker. Having such information would also assist us in identifying practices deemed appropriate by the international investment community. Thus, the lack of such information is a clear limitation of the study.

Implications for Future Research

Despite the limitations, there are several important research implications that can be extracted from the study. The most important implication concerns the nature of organizational reputation research in general. The results reported here are strong. I was successful in identifying specific reputational determinants because I focused specifically on firms traded on the WSE and even more specifically on reputation from the perspective of investors. As suggested above, it would be inappropriate to assume that the specific reputational determinants identified in this study could apply to other contexts. The results are particular to WSE firms and even more particular to reputation with investors. Specifying the target audience and identifying the specific contextual environment is a necessary prerequisite to understanding the sources of organizational reputation. Thus, any discussion of firm reputation must begin with a discussion of reputable to whom and under what conditions. Recognizing this reality is one of the key contributions of this research.

To suggest that reputation is situationally specific does little to advance our knowledge of reputational determinants. The primary theoretical contribution of this investigation is to identify certain mechanisms through which reputation can be established. Specifically, this study identifies the importance of performance, signaling, and legitimation in establishing a firm as reputable. Identifying specific reputation determinants still requires a detailed discussion of reputable to whom and under what conditions. However, the factors identified in this analysis could provide a useful framework for understanding the source of specific organizational reputation once the appropriate contextual variables have been clearly established.

The results of this analysis provide support for the impact of financial performance, signaling and legitimation. Still, much additional research is needed to confirm or deny the potential importance of each in establishing a firm's reputation. The importance of both performance and signaling has received some attention in the literature. However, the potential impact of legitimation remains largely unexplored. Thus, research concerning the nature of legitimation and its link to organizational reputation remains a topic open for future investigation.

This study highlights the potential advantages of employing the services of an international broker as legitimating agent for firms traded on the WSE. Despite the particularities of this study, the general concept of legitimating agent can be applied in a variety of environments. For example, one can envision a situation where a starving artist engages the aid of a legitimating agent as a way of demonstrating appropriate behavior to the target audience of collectors. In fact, the whole concept of legitimating agent is one that has applicability way beyond the confines of this particular analysis. Identifying conditions where legitimating agents may or may not be useful is a possible avenue of future research.

Despite the potential of advantages of employing the services of a legitimation agent, firms many not have equal access to prospective legitimating agents. What factors may lead to the successful partnering with legitimating agents? Under what conditions might potential legitimating agents be inclined to turn away potential clients? Answers to these and related questions would undoubtedly enhance our understanding of the process and outcomes of legitimation.

I touch on the longer-term effects of employing the services of an international broker in this analysis but am limited in doing so due to data constraints. The question remains as to the longer-term benefits of reputation building activities in general. Clearly, certain activities will have more profound and lasting effects on a firm's reputation than other activities. For example, the reputational impact associated with profitability seems quite pronounced for firms traded on the WSE. Conversely, the reputational liability of listing for the first time (IPOs) is initially important but seems to decline rapidly over time. It may be that certain reputation-building activities have a long-term effect on firm reputation while other activities are important initially but quickly diminish as a reputational determinant. As suggested by Fombrun and Shanley (1990: 254), "separating the short- and long-term components of reputational signals should be the subject of much future debate in the analysis of corporate reputation building." Clearly more research is warranted in this area.

Implications for Practice

The most obvious practical implication of this research is the recognition of the importance of performance in shaping a firm's reputation. Profitability dominates the determinants of reputation with investors for firms traded on the WSE. While the results reported here are admittedly context specific, it seems reasonable to assume that performance will dominate the determination of reputation in other contexts as well. Thus, organizations wishing to establish their reputation can do so most effectively by identifying the performance requirements of the target audience and then focusing first and foremost on meeting or exceeding the target audience's expectations.

Indeed, performing well in ways that satisfy the needs and interests of the target audience is a critical determinant of organizational reputation. However, organizational performance is not always easily measured and understood. Lacking clear measures of performance, the organization can attempt to establish itself as reputable through the mechanisms signaling and legitimation. The appropriate signaling mechanisms will depend on the specific context. However, the results of this research suggest an important role for signaling. Moreover, the results point to the importance of both positive and negative signaling. Thus, firms wishing to enhance their reputation are advised to be aware of potential signals both as a way of enhancing a firm's reputation and as a way of assuring that the reputation of the firm is not inadvertently damaged.

In certain cases, the firm will find it near impossible to argue itself as reputable either due to radical differences between the firm and target audience or due to the location in a domain traditionally ignored by the target audience. In either case, the organization can still enhance its reputation through the mechanism of legitimation by employing the services of an appropriate legitimating agent. The legitimating agent assists the firm by serving as an informational conduit between the firm and target audience with which the firm is attempting to appear as reputable. Thus, those firms wishing to establish themselves as reputable but lacking the requisite contacts are encourage to seek out specific agents that can serve as a bridge between the firm and target audience.

Conclusion

The purpose of this dissertation was to investigate how firms establish reputations in an emerging economy such as Poland's. This question was addressed by first developing a general model of organizational reputation, then by applying the model to form specific hypotheses concerning firms traded on the WSE, and finally by conducting two different analyses designed to test the hypotheses. The results provide mixed support for the hypotheses and subsequently provide mixed support for the model of organizational reputation formation presented in Chapter Two. Nonetheless, each of the mechanisms examined - performance, signaling and legitimation - appear to have some influence in shaping the reputation of the firm. My sincere hope is that the results reported here will not only serve as an initial indication of the importance of performance, signaling and legitimation but also serve as a catalyst for future research into the topic of organizational reputation formation in general.

ENDNOTES

1. All pseudonyms presented concerning interviews conducted in Warsaw both in 1997 and 1998 correspond to specific individuals and organizations but are presented fictitiously to protect the interviewee's identity.

2. The Big Five accounting firms include Arthur Anderson, Coopers & Lybrand, Deloitte & Touche, KPMG and Price Waterhouse, all of which were operating in Poland as independent firms during the period of this study. The merger of Coopers & Lybrand and Price Waterhouse did not occur in Poland until after the time period of this study.

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