The Effect of Reputation on Firm Valuation *

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Abstract

We consider the role that firm reputation plays in the pricing decision of investors. Using a measure of reputation based on an index that captures and quantifies a company's reputation exposure to ESG and business conduct risk, we predict that there will be a valuation discount impounded on earnings of firm's with poorer reputation. Our results indicate that reputation plays a non-linear role in valuation. Consistent with the idea that if firm's do not push the boundaries they do not add value to shareholders, we find that there is a valuation premium on earnings initially, until a point where earnings are then discounted for firms with poorer reputation. We augment this analysis to show that poorer reputation is associated with muted returns at the time of the annual earnings announcement, and with worse future accounting outcomes and a higher implied cost of equity capital.

Keywords: announcement returns; book value; earnings; future outcomes; reputation; value relevance.

JEL Classification: G12; G14; G32; L14; M40; M41.

1 Introduction

Corporate reputation is defined as "a perceptual representation of a company's past actions and future prospects that describes the firm's overall appeal to its key constituents when compared to other leading rivals" (Fombrun 1996, p. 72). It has received considerable attention from accounting scholars and practitioners since the 1980s and became increasingly important following Enron and other financial scandals that resulted in investor losses in the early 2000s. Companies strive to build and maintain positive corporate reputation as a way for self-promotion and differentiation from rivals to generate tangible excess economic and other benefits (Clarkson *et al.* 2019). The question we explore in this paper is whether, and how, investors consider reputation into their decision-making processes, specifically in terms of firm valuation. In doing so, we extend prior literature on the effect of corporate reputation by investigating whether the valuation of accounting variables are associated with corporate reputation.

A positive corporate reputation can boost stakeholders' general impression on firms, affecting investors' decision making, building customers' loyalty and employee's satisfaction (Filbeck and Preece 2003; Henard and Dacin 2010; Smith *et al.* 2010; Walsh *et al.* 2009). The corporate scandals that occurred in Enron and other firms indicated that negative corporate reputation can result in a loss of trust, which is fundamental not only to investors, but also to customers, suppliers, regulators and employees. As demonstrated by Chaney and Philipich (2002) a loss in reputation for the audit firm Arthur Anderson was associated with significant loss in value for their clients.[1]

There are also real economic effects from corporate scandals resulting in a loss of reputation. Graham *et al.* (2002) estimate that the joint effect of the WorldCom and Enron bankruptcies cost the U.S. $35 billion in a reduction in GDP in the first year following their collapses. Similarly, it was reported by Steven Greenhouse in the *New York Times* that pension funds lost more than $1.5 billion due to a sharp decline in their Enron holdings.[2] Therefore, given that there are also broader economic effects, a greater understanding of how corporate reputation affects

[1] It is worth noting that Nelson *et al.* (2008) demonstrate that this result is much reduced after controlling for macroeconomic factors, notably concurrent negative news in the energy sector.

[2] https://www.investmentexecutive.com/news/industry-news/pension-funds-say-enron-losses-top-us1-5-billion/

the valuation of firms is important.

Corporate reputation not only indicates firms' reputational status in institutional fields, but also signals firms' salient advantages to stakeholders (Fombrun and Shanley 1990). Corporate stakeholders rely on corporate reputation to interpret and gauge the ambiguous financial and non-financial information of firms. Also, a high corporate reputation accumulates social capital for companies by fostering emotional appeal and trust among stakeholders. Companies put effort into managing their reputation to build and maintain their competitive advantages. Arguably, corporate reputation plays an important role in shaping general impressions of all stakeholders, including investors, customers, employees, and regulators.

Existing studies address the economic consequences of corporate reputation, including increased profitability and a lower cost of capital (Smith *et al.* 2010; Tischer and Hildebrandt 2014). Other studies demonstrate a link between firms' initiatives and management strategies that enhance corporate reputation for different aspects and firm valuation from a shareholder perspective (Anderson and Smith 2006; Filbeck and Preece 2003). Corporate reputation is also able to contribute to firms' competitive advantages independently of financial performance. Nonetheless, empirical evidence on the consequences of corporate reputation is limited.

In this study, we explore whether and how corporate reputation impacts the value relevance of book value of equity and earnings under a residual income model, and the underlying mechanism for the implicit pricing decisions of investors. Two sets of theoretical arguments provide the foundation for our research objectives. First, research on corporate reputation assessment has demonstrated that it is a signal of a firm's quality and trustworthiness, impacting multiple audiences' general impression and interpretation of firms (Frooman 1999). Second, behavioral finance and psychology related research theorize how corporate reputation is incorporated into stakeholders' decision-making directly, and indirectly by affecting firms' financial performance.

We use the market value of equity in this study as a proxy for the decision-making of stakeholders. The Collins *et al.* (1997) variant of the Ohlson (1995) valuation model is applied to test both the proposed premium effect and moderating effect of corporate reputation on stakeholders' decision making. Market valuation reflects a broader capital market participant,

not just shareholders (Clarkson *et al.* 2019). Market value of equity is shown as a cumulative reflection on all stakeholders' overall reaction and assessment on corporate reputation (Fombrun and Shanley 1990; Huang 2021; Tischer and Hildebrandt 2014; Weigelt and Camerer 1988), and provides a significant input for stakeholders' decision-making (Elliott *et al.* 2014).

To address our research questions, we employ a standard value-relevance approach, where we interact corporate reputation with the book value of equity and net income to determine whether there is a valuation premium or discount. Using a sample of U.S. firms over the period 2007 to 2023 and using the RepRisk Index as a proxy for corporate reputation, we first observe, in a linear model, a discount on the valuation of book value for firms with poorer corporate reputation but a premium on net income. When we further explore this result and apply a quadratic functional form, we find a modest valuation discount on book value of equity of small economic magnitude. However, for the valuation of net income, we find that initially as reputation worsens from its minimum value there is an additional premium on net income, however, there reaches a turning point whereby poorer reputation reduces the valuation coefficient on earnings. This result is consistent with the notion that investors see value in firm's pushing the boundaries to generate earnings, but not so far as to have too low of a corporate reputation.

To further complement the implicit pricing decisions of investors from a value relevance approach, we then examine investor reactions surrounding the release of the annual earnings announcement. Here we find that the impact of reputation has a mediating affect on investors' average reaction to the earnings surprise. In the three-day announcement return surrounding the earnings release, we find that for a one standard deviation increase in the reputation score (*i.e.*, poorer reputation), the market reaction would be 21.8% lower. Similarly, in the post-earnings announcement period we find that poorer corporate reputation reduces the reversion in returns, with a one standard deviation increase in the reputation score reducing the reversion by over 50%. This result is consistent with corporate reputation being a construct that reflects the credibility of a firm's information.

Finally, we consider to what extent the reputation of the company is associated with both future accounting outcomes and perceived financial risks. Focusing on year-ahead sales growth and profitability as proxies for firm's future outcomes, and cost of capital as a proxy for

firm's perceived financial risks, we demonstrate that for firms with poorer corporate reputation, this is reflected in poorer future accounting outcomes and higher financial risks. In terms of economic magnitude, we demonstrate that for a one standard deviation increase in the reputation score, future sales growth and profitability are 25.6% and 31.6% less than the sample mean, respectively. We also demonstrate that, to the extent that the cost of equity is used as a discount rate in the valuation of expected future earnings streams, that for firms with poorer corporate reputation there is a higher implied cost of capital. To the extent that poorer corporate reputation is associated with worse future earnings outcomes and higher financial risks, it would be a rational pricing decision to discount firms with poorer corporate reputation.

Our study makes a number of contributions to the literature and practice. First, using the RepRisk index, we are able to demonstrate that poorer corporate reputation has negative pricing implications for firm earnings. However, it is important to note that this relation is not a simple linear one. The evidence we present implies that investors are prepared to pay a premium for firms with worse reputation to the extent that they are seen to push the boundaries in the interests of progressing shareholder objectives, but not so much that the overall reputation is severely tarnished.

We are also able to contribute to the literature by demonstrating that firms are penalized in the future for worse reputation in lower growth and profitability, demonstrating that corporate reputation has real economic effects beyond investors' valuation decisions. This result, however, also implies that investors are rational in their pricing decisions by recognizing the impact of worse future outcomes in their pricing decisions.

Finally, we are able to contribute to a wider discussion around the impact of corporate reputation. Where reputational loss is considered in securities class action litigation. Donelson *et al.* (2024) consider the impact on corporate reputation from meritorious and non-meritorious securities class actions. Their results imply that reputational damage is primarily due to fraud which securities litigation helps to reveal, rather than the litigation itself. However, we are able to contribute to the discussion to show that investor reactions to earnings announcements are muted for firms with a poorer reputation. Essentially, we consider the *ex ante* role of reputation, as opposed to *ex post* changes in reputation.

The remainder of the paper is structured as follows. In Section 2 we summarize prior literature on corporate reputation and its association with firm valuation, proposing hypotheses in Section 3. Section 4 outlines our research design and sample selection. We present the discussion of our results in Section 5. Finally, we conclude our study in Section 6.

2 Literature Review

Corporate reputation has been widely discussed across multiple disciplines, however there exist different perceptions and concepts for it. To date, the most widely used definition for corporate reputation is: "a perceptual representation of the company's past actions and future prospects that describes the firm's overall appeal to all of its constituents when compared to leading rivals" (Fombrun 1996, p. 72). There exists an agreement that corporate reputation is a reflection of the general impression of all stakeholders on firms. In an incomplete information setting, stakeholders actively seek information to make decisions, which adds value to their evaluation of firms as a competitive advantage and can later adjust their interpretation and assessment of traditional financial information (Clarkson *et al.* 2019; Smith *et al.* 2010).

There is a general consensus that corporate reputation is of considerable strategic value because it reflects companies' attractive features and enable managers to charge a premium on products and services, or to implement innovative programs (Fombrun 1996). Positive corporate reputation is an indicator for superior financial performance, customer loyalty, employee satisfaction, higher firm profitability and lower financial risks (Puncheva 2007). On the other hand, negative views of a company that negatively impact on reputation can result in lawsuits, loss of revenue, high financial risks and increased debt costs. Companies strive to build, sustain, and defend that positive corporate reputation as a way for self-promotion and differentiation from rivals to generate tangible excess economic return and other benefits (Clarkson *et al.* 2019).

Prior literature related to corporate reputation crosses disciplines and concerns the relationship between corporate reputation and shareholders' perception. Prior research links corporate reputation to valuations from a shareholders' perspective (Anderson and Smith 2006; Filbeck and Preece 2003; Fombrun 1996). It is posited that a good corporate reputation adds

value to stock price by reducing investors skepticism, which lowers firms' cost of capital (Smith *et al.* 2010; Tischer and Hildebrandt 2014). Additionally, prior literature relates the effect of corporate reputation to firms unexpected financial outcomes (Cao *et al.* 2012), shareholders' reactions (Chaney and Philipich 2002; Nelson *et al.* 2008; Pfarrer *et al.* 2010), and the market value premium for corporate reputation (Smith *et al.* 2010). Across these studies, firms with higher perceptions of corporate reputation are more likely to disclose higher quality accounting information, it constructs a better connection and exchange relationship with stakeholders, especially investors, resulting in a premium of firm stock price, which is attributed to providing greater information about a firm's financial performance.

Corporate reputation effect on firms' quality and trustworthiness plays an important role on firms' fundamental business activities involving stakeholders such as customers, employees and regulators (Fombrun and Shanley 1990; Smith *et al.* 2010). Prior literature uses stakeholder theory, which emphasis on mutual value creation and sheds light on indirect benefits, to reveal the correlation between corporate reputation and stakeholders' skepticism, interpretation, and evaluation regarding companies (Huang 2021; Mukherjee and He 2008). In a corporate context, impression management theory suggests that firms manage corporate reputation to shape stakeholders' perception on firms' competitive advantages compared to rivals and get stable economic and other benefits (Agnihotri 2014).

Traditional financial theories about the efficient market suggest that corporate reputation have no premium effect on firms' future market valuation, because companies' well-known virtues are presumably already taken into account by the market (Anderson and Smith 2006; Huang 2021). However, contrary to this view, behavior finance theories suggest the estimated market valuation can deviate from fundamental value. Together with social capital theory, Smith *et al.* (2010) emphasize the value relevance of corporate reputation, which they consider as an intangible asset independent of financial information. Firms manage reputation status to self-promote and differentiate themselves from leading rivals, attempting to impact stakeholders' decisions on valuation by credibly signalling firms' competitive advantages (Fombrun and Shanley 1990). In the context of information asymmetry, corporate stakeholders make decisions relying on not only judgments of firm's economic performance, but also the general impression

on firm, which does not refer to specific attributes (Jang *et al.* 2016).

It has been claimed that the summary accounting information, such as equity book value and earnings, reflect firm-related information that used by investors for decision-making (Barth *et al.* 2001). Traditional accounting items are exposed to timeliness, inaccuracy, limited reflection on firm's performance and risks for investors, which motivate the awareness of the importance of involving information that is not included in financial statements into firm valuation (García-Meca and Martínez 2007). The change of value relevance of information disclosed on financial statements generated from intangible assets, growth opportunities and alternative performance and the requirement for assessing the unobservable qualities of firms create a context for corporate reputation to serve as an indicator of the accuracy and reliability of traditional financial information.

In addition to the above, existing research addresses the effect of corporate reputation on economic performance, including superior financial performance and lower cost of capital (Smith *et al.* 2010; Tischer and Hildebrandt 2014). Signalling theory and agency theory are applied to model how corporate reputation affects stakeholders' interpreting and gauging financial information. Positive reputation signals stakeholders' credibility of financial information displayed by companies and lower risk for companies' future prospects. Companies strive to build and maintain a positive corporate reputation for competing for firms' reputational status to influence stakeholders' assessments (Tischer and Hildebrandt 2014; Weigelt and Camerer 1988).

Prior literature on the consequences of corporate reputation finds that companies with higher reputation are less likely engage in financial statement misstatement and earnings management, and earnings quality is higher for firms with better reputation (Cao *et al.* 2012). The sources of corporate reputation, such as investment on R&D and advertising contribute to decreasing uncertainty surrounding the valuation of intangible assets. Lev and Sougiannis (1996) and Core *et al.* (2003) illustrate the positive association between investment in intangible assets, R&D and advertising expenses, are positively correlated to firm's future operating earnings.

On the basis of signalling theory, corporate reputation plays an important role in providing forward-looking information for investors' evaluation. Signalling theory and agency theory

are applied to model how corporate reputation affects stakeholders' interpreting and gauging financial information. Thus, this study attempts to test whether and how corporate reputation impacts investors' evaluation of firms' share price by adjusting the credibility of traditional financial information. Also, signalling theory supports that corporate reputation would signal firm's stability and the extent of information asymmetry between investors and managers. Thus, we expect that the association between corporate reputation and investors' decision-making is rationalized by firm's future outcomes and financial risks.

Investors incorporate corporate reputation as an indicator for both relevance and reliability of financial information to reduce information asymmetry. The prior literature supports the view that firms with a higher corporate reputation provide higher quality financial reports and higher earnings quality (Cao *et al.* 2012), which is associated with a lower capital cost by reducing information asymmetry (Barth *et al.* 2013). The corporate scandals that occurred in Enron and other firms indicates that negative corporate reputation could result in lawsuits, loss of revenue, high financial risks and increased costs of financing. Firms with poorer corporate reputation tend to have less stable and more volatile earnings, which is indicative to investors of higher financial risks.

Thus, although a large body of literature address the effect of corporate reputation on shareholders perceptions and link those perceptions to valuation, there is a gap in the literature examining the association between corporate reputation and the explicit valuation of accounting variables conditional on corporate reputation. In this study, we extend prior literature by examining how corporate reputation impacts on the valuation of accounting earnings and book values.

3 Hypothesis Development

While a large literature examines the value relevance of corporate reputation and its economic consequences (see, for example, Barth *et al.* 1998; Cao *et al.* 2012; Clarkson *et al.* 2019; Fombrun 1996; Lourenço *et al.* 2014; Nelson *et al.* 2008; Pfarrer *et al.* 2010; Puncheva 2007; Schnietz and Epstein 2005), research has been scare on the impact of corporate reputation on the value relevance of traditional accounting amounts, especially the impact of decreased corporate

reputation. According to Fombrun (1996), corporate reputation reflects the general impression of stakeholders on firm's competitive advantages over rivals, which represents firm's past actions and future prospects. Corporate reputation as a substantial fraction of intangible brand assets plays an important role that contributes to differentiate the brand in the marketplace, foster emotional connection with key constituents and develop competitive advantages compared to other leading rivals (Keller 1993).

Our overarching research question is to understand the degree to which corporate reputation affects the investment decisions of users of financial reports. Prior studies have examined the positive effect of corporate reputation focusing on the market reaction to the inclusion in the *Fortune* 'Best 100 Companies to Work for in America' (Filbeck and Preece 2003), and the reputation ranking by the German *Manager Magazin* (Tischer and Hildebrandt 2014). Positive corporate reputation also acts as a signal of competitive advantages on firms' quality and trustworthiness, which affects the business activity involvement of stakeholders (Cao *et al.* 2012; Fombrun and Shanley 1990; Frooman 1999).

To address our primary research question, we examine the value relevance of accounting numbers, and the market reaction to the release of a firm's earnings. Value relevance tests are generally joint tests of the relevance and reliability of accounting numbers (Holthausen and Watts 2001). Value relevance is an empirical operationalization of these criteria because an accounting amount will by value relevant if the amount reflects information relevant to investors in valuing the firm, and is measured reliably enough to be reflected in share prices (Holthausen and Watts 2001).

Our initial expectation is that the value relevance of the book value of equity will be close to 1, as the Ohlson (1995) residual income framework model which states that fundamental value will be equal to the opening book value plus the present value of residual earnings. As contemporaneous corporate reputation is unlikely to affect the recognition of past transactions leading to current book values, we would expect that there should be no association between reputation and the pricing of the book value of equity.

From one perspective, we expect that corporate reputation provides investors signals about the quality of financial statement and earnings. Firms with higher levels of corporate reputation

provide more credible and reliable information for investors decision making on firm valuation. Conversely, poorer corporate reputation is associated with a decreased trustworthy of firm's disclosures. On the other hand, the value relevance of equity book value, which is a reflection of tangible assets disclosed within the balance sheet, is more stable than the value relevance of earnings (Barth *et al.* 2023; Collins *et al.* 1997). Corporate reputation is arguably a component of either recognized intangible asset as goodwill, or unrecognized intangible assets, reflecting attributes of firms such as customer loyalty, employee satisfaction, intellectual capital, and trustworthiness. Therefore, we expect that the variation in corporate reputation does not significantly affect the value relevance of book value of equity.

It is foreseeable, however, that if poorer corporate reputation causes investors to reassess their assessment of prior accounting recognition, then they may discount current book values of equity to adjust their expectations of the recognition of prior years' transactions such that for firm's with poorer corporate reputation, the value relevance of the book value of equity will be reduced. In this case, we would expect that there is a negative association between corporate reputation and the valuation coefficient on the book value of equity.

Notwithstanding this alternate explanation, we provide our hypothesis in the null, consistent with the theoretical formation of the residual income model:

Hypothesis 1 (*H1*): *Corporate reputation does not affect the market pricing of the book value of equity.*

To the extent that corporate reputation as a construct reflects the credibility of a firm's information, then investors, on average, will be expected to impound this into the way they interpret a firm's earnings. To the extent that a firm has a poorer reputation, this would be expected to be reflected in less credence placed on the earnings signal from that firm. This line of reasoning is consistent with a stream of literature that predicts, and finds, that when earnings signals are less biased they should be more informative to market participants as the information is more reliable (see, for example, Jackson *et al.* 2017, 2020).

As a dominant signal about future firm performance, earnings are an important information source from managers to outside stakeholders (Ball and Brown 1968; Beaver 1968; Easton and Zmijewski 1989). Where poorer corporate reputation then reduces the credibility with which

the market can place on the reported firm earnings, we would expect to observe a discount on the valuation coefficient of earnings. This argument is also consistent with a reduced reliability in the earnings number, such that the information is not able to be reflected in share prices (Holthausen and Watts 2001) As such, we frame our expectation in the alternate form:

Hypothesis 2 (*H2*): *Firms with a poorer corporate reputation are associated with a valuation discount on earnings.*

Following the prior argument, we would also expect that investors would place less weight on the earnings news at the time of the annual earnings announcement date. This would result in a muted reaction to the earnings surprise for firms with poorer corporate reputation. To the extent that in the post-earnings announcement period we observe a general reversal to any overreaction to earnings information immediately following the earnings announcement, we would likewise expect to observe a muted reversal during this later period. Formally stated, we present our expectations:

Hypothesis 3 (*H3*): *Firms with a poorer corporate reputation are associated with lower returns around the earnings announcement date.*

Finally, we consider the extent to which poorer corporate reputation has real economic effects in future accounting outcomes. Based on prior literature and theories, investors consider corporate reputation as a reflection of firm's past action and their future prospect on firm's financial performance (Fombrun 1996). The general consensus is reputation loss is associated with misconduct of both customer and investors and has long-term consequences for firms (Armour *et al.* 2017). Following this, we would expect that firms with poorer corporate reputation would face multiple changes and is associated with worse future outcomes

If corporate reputation is associated with poorer future outcomes, then any valuation discount on earnings, or muted price reaction to the earnings announcement, would be a rational pricing decision based on future expectations. Theories in prior research has assumed and empirically documented that there is a positive association between good corporate reputation and better future firm performance (Eberl and Schwaiger 2005) and greater loyalty towards the firm from customers (Henard and Dacin 2010; Walsh *et al.* 2009).

Following this, from a financial statement analysis perspective, if better (poorer) corporate reputation has a positive (negative) impact on customer loyalty, then we would expect that this would result in greater (lesser) increases in future sales revenues. Holding all else constant, increased sales growth would lead to increases in future firm profitability. Under both scenarios, the earlier hypothesized expectations around investor pricing decisions surrounding the earnings announcement date would be justified by expectations of superior future outcomes. Similarly, if a poorer corporate reptuation is taken to indicate that there is greater risk associated with the firm, then we would expect to observe that the cost of equity would also be greater, resulting in an increase in the discount rate used in present value calculations leading to a reduction in firm value.

In the context of information asymmetry, corporate reputation provides investors with information about firms' quality for interpreting and gauging the disclosed financial information. Cao *et al.* (2014) provide evidence that firms with higher corporate reputation enjoy the lower cost of equity financing, and Maaloul *et al.* (2021) illustrates that positive corporate reputation reduces the cost of debt financing. Conversely, negative corporate reputation indicates to investors the decreased reliability and credibility of the disclosed information, which increases the information asymmetry. Firms with poorer corporate reputation is considered less stable and investors would require higher returns for firm's exposed to higher proposed financial risks. Following this, we would expect that firms with poorer corporate reputation would associate with the increased cost of capital, which is the denominator effect that rationales the muted returns around the earnings announcement date.

Using a sample of firms charged by the Securities and Exchange Commission (SEC), Karpoff *et al.* (2008) find that firms lose a total of 38 per cent of their market values, as measured by price reactions on dates related to the enforcement action. Importantly, they suggest that two-thirds of the price decline represents lost reputation, defined as "the expected loss in the present value of future cash flows due to lower sales and higher contracting and financing costs" (Karpoff *et al.* 2008, p. 581).

We formally state our hypothesis in the alternate form as:

Hypothesis 4 (*H4*): *Firms with a poorer corporate reputation are associated with worse future*

outcomes.

4 Research Design

For testing *H1* and *H2*, we apply the Collins *et al.* (1997) variant of the Ohlson (1995) valuation model to test both the effect of corporate reputation on firm valuation:

$$\begin{aligned} Price &= \beta_0 + \beta_1 BVE + \beta_2 NI + \beta_3 Reputation + \\ &\quad \beta_4 BVE * Reputation + \beta_5 NI * Reputation + \epsilon, \end{aligned} \tag{1}$$

where $Price$ is the stock price (CRSP absolute PRC) adjusted for stock splits (CRSP $CFACPR$) three months after fiscal year end; BVE is the book value of equity per share defined as total assets (Compustat AT) minus total liabilities (Compustat LT) divided by total shares outstanding (Compustat $CSHO$), NI is earnings per share, defined as net income (Compustat NI) divided by total shares outstanding (Compustat $CSHO$); and $Reputation$ is our measure of corporate reputation obtained from the RepRisk metrics file. The RepRisk metrics file is measured on a daily basis, and we match on the same basis as the price data, i.e., three months after fiscal year end. We include year and industry (2-digit SIC) fixed effects and cluster standard errors by firm. All variables are as defined in Table 1.

- - - INSERT TABLE 1 ABOUT HERE - - -

The RepRisk Index (RRI) is a propriety algorithm that dynamically captures and quantifies a company's reputation exposure to ESG and business conduct risk, which ranges from zero (lowest) to 100 (highest). An RRI of 0 denotes that it was wither once above 0 but has since decayed to 0 over a maximum period of two years; or that RepRisk has captured no ESG-related risk incidents for the company. From the RepRisk database we obtain four measures of reputation: $CurrentRRI$, $PeakRRI$, $TrendRRI$, and $Rating$. $PeakRRI$ denotes the highest level of ESG risk exposure over the prior 24 months, and is considered a proxy for overall ESG and business conduct risk exposure. $Rating$ combines the company-specific ESG risk exposure

(based on $PeakRRI$) and the Country-Sector Average value for a company to provide a rating ranging from AAA (low risk exposure) to D (very high risk exposure) which we convert to an ordinal scale from 1 to 10.[3]

To test our third hypothesis (*H3*), we consider the stock returns around the earnings announcement date. If poorer reputation causes investors to discount a firm and their earnings, then we would expect returns around the announcement date to be lower in general, and that there is a muted reaction to the unexpected component of earnings. To test this prediction we estimate a standard earnings response model:

$$\begin{aligned} Return &= \gamma_0 + \gamma_1 ESurp + \gamma_2 Reputation + \gamma_3 ESurp * Reputation + \gamma_4 lnMVE + \\ &\quad \gamma_5 MTB + \gamma_6 Spread + \gamma_7 RetVat + \epsilon, \end{aligned} \tag{2}$$

where $Return$ is the estimate of returns, where we use the raw ($RawRet3$) and value-weighted market adjusted returns ($AbRet3$) in the three-days [-1,+1] surrounding the annual earnings announcement date, and the raw ($RatRet30$) and value-weighted market adjusted returns ($AbRet30$) in the period [+2,+30] following the earnings announcement date, where the announcement date is determined as the announcement date (Compustat Quarterly RDQ) for the fourth quarter; $lnMVE$ is the log of the market value of equity, estimated as the stock price (CRSP absolute PRC) adjusted for stock splits (CRSP $CFACPR$); MTB is the ratio of the market value of equity to the book value of equity; $Spread$ is the average of the daily bid-ask spread over the prior 12 months; and $RetVar$ is the variance of daily raw stock returns over the prior 12 months. We include year and industry (2-digit SIC) fixed effects and cluster standard errors by firm. All variables are as defined in Table 1.

Finally, to test our predictions of the impact corporate reputation has on future outcomes

[3]We denote AAA as 1, AA as 2, A as 3, BBB as 4, BB as 5, B as 6, CCC as 7, CC as 8, C as 9, and D as 10. A ratings denote low ESG risk exposure, B ratings denote moderate ESG risk exposure, C ratings denote high ESG risk exposure, and D denotes very high ESG risk exposure. In our sample, we do not observe any observations with a D rating, which means that we only observe a *Rating* that ranges from 1 to 9.

($H4$), we estimate the following model:

$$\begin{aligned} Outcome_{t+1} &= \lambda_0 + \lambda_1 Reputation + \lambda_2 lnMVE + \lambda_3 SalesGrowth + \lambda_4 IntangInt + \\ &\quad \lambda_5 ESurp + \lambda_5 Accruals + \lambda_6 CashFlow + \lambda_7 Spread + \lambda_8 RetVar + \epsilon, \quad (3) \end{aligned}$$

where $Outcome_{t+1}$ is the future outcomes, specifically year-ahead sales growth ($\Delta Sales_{t+1}$), year-ahead profitability (ROA_{t+1}), and the implied cost of equity capital based on the Easton (2004) price-earnings growth ratio (PEG); $SalesGrowth$ is the growth in sales from year $t-1$ to t; $IntangInt$ is intangible intensity estimated as the proportion of total assets (Compustat AT) made up of intangible assets (Compustat $INTAN$); and all other variables as previously defined. We include year and industry (2-digit SIC) fixed effects and cluster standard errors by firm. All variables are as defined in Table 1.

4.1 Sample

We utilize three samples for our study. First, for the tests of value relevance, we obtain our sample from the intersection of Compustat, CRSP and the RepRisk database. We are limited to begin our sample in 2007 when the RepRisk database starts reporting measures of RRI. We match Compustat with RepRisk by matching the 9-character CUSIP from Compustat to the security identification from the primary ISIN in RepRisk.[4] After deleting observations with missing values of reputation, price, book value of equity and net income, we are left with a sample of 24,427 firm-year observations. To minimize the impact of influential outliers, we winsorize varibles, with the exclusion of the reputation measures, at the 1^{st} and 99^{th} percentiles.

For the announcement return sample, we augment our sample by including daily returns and bid-ask spreads from CRSP. After deleting observations with missing variables, we are left with 19,538 firm-year observations. For the final sample of future outcomes, we require firms to have year ahead returns and accounting data which further limits our sample to 18,261 observations.

[4]The primary ISIN is made up of the first two characters indicating the country code, the next nine characters representing the security identification, and the twelfth character being a check digit to prevent counterfeit numbers.

5 Results

5.1 Descriptive Statistics

We first present the descriptive statistics for the sample to test our hypotheses regarding value relevance in Panel A of Table 2. Our measures of corporate reputation demonstrate, on average, firms are characterized as having low risk, with the mean (median) *PeakRRI* of 15.057 (6.000). At the 3^{rd} quartile, *PeakRRI* is characterized as medium risk exposure with a score of 29, and at the 99^{th} percentile of high risk exposure with a score of 57. Given that *PeakRRI* is measure is taken as the highest level of ESG risk exposure over the prior 24 months, it is unsurprising that *CurrentRRI* have lower values. When considered using *Rating*, the general interpretation is consistent, that at the mean and median, firms are considered to have low risk exposure, and only at the 99^{th} percentile is the risk exposure considered high.

- - - INSERT TABLE 2 ABOUT HERE - - -

In the samples used to test the hypotheses for announcement returns (Panel B of Table 2) and future outcomes (Panel C of Table 2), the values of *PeakRRI* are slightly higher with a mean (median) of 16.033 (16.000) and 16.408 (18.000), respectively, but the interpretations remain the same.

Compared to prior literature (see, for example, Collins *et al.* 1997), the value of *Price* is larger, with a mean (median) value of 47.256 (26.551), as is the book value of equity per share (BVE) with a mean (median) of 27.064 (12.340). The value of earnings per share (NI), however, is closer to that reported by Collins *et al.* (1997) with a mean (median) of 1.717 (1.145). A significant difference is that the sample in Collins *et al.* (1997) covers the period 1953-1993, while our sample is limited to the period 2007- 2024. It is reasonable to expect over the different time periods that while firm earnings have not altered significantly, firms have grown larger. It is also plausible that our sample may be biased towards larger firms given the media coverage required for inclusion in the RepRisk database.

In Panel B, we present the descriptive statistics for the announcement returns sample. Three-day returns surrounding the earnings announcement date are positive and close to 0, with mean (median) raw returns of 0.3% (0.2%) and value-weighted abnormal returns of 0.3%

(0.1%). The longer returns from day +2 to day +30 following the earnings announcement demonstrate mean (median) raw returns of 0.9% (1.2%) and value-weighted abnormal returns of 0.3% (-0.1%).

Finally, we consider future accounting outcomes in Panel C of Table 2. One-year ahead sales growth ($\Delta Sales_{t+1}$) are positive with mean (median) of 10.2% (6.0%), year ahead profitability (ROA_{t+1}) has mean (median) of 2.6% (3.6%), and the cost of capital (PEG) has a mean (median) of 12.6% (9.3%).

We next present correlation matrices in Table 3, with Panels A through C representing the value relevance, announcement returns, and future outcome samples, respectively. From Panel A, it is notable that the correlation between the peak ($PeakRRI$) and current ($CurrentRRI$) values are very highly correlated ($\rho = 0.827$), and the correlations with $Rating$ is likewise high ($PeakRRI\rho = 0.728$, $CurrentRRI\rho = 0.672$). We also demonstrate that $Price$ is positively correlated with $PeakRRI$ ($\rho = 0.140$), $CurrentRRI$ ($\rho = 0.137$) and $Rating$ ($\rho = 0.114$) at less than a 1% level of significance. Likewise, $PeakRRI$, $CurrentRRI$ and $Rating$ are all positively correlated with BVE and NI at less than a 1% level of significance.

- - - INSERT TABLE 3 ABOUT HERE - - -

From Panel B, we document that firm reputation ($PeakRRI$) is negatively correlated with both raw ($\rho = -0.0240$ and market-adjusted returns ($\rho = -0.025$) for the three days [-1,+1] surrounding the earnings announcement, significant at less than a 1% level of significance. For the period [+2, +30] following the earnings announcement, reputation is negatively correlated with raw returns ($\rho = -0.031$) at less than a 1% level of significance, and market-adjusted returns ($\rho = -0.011$) at a 10% level of significance. From Panel C, we also likewise show at a univariate level, reputation ($PeakRRI$) is negatively associated with future sales growth ($\Delta Sales_{t+1},\ \rho = -0.060$) and the implied cost of capital ($PEG,\ \rho = -0.065$), but positively correlated with future profitability ($ROA_{t+1},\ \rho = 0.079$).

5.2 Value Relevance

We next consider the multivariate analysis in our tests of *H1* and *H2* with results presented in Table 4. In column (1) we present the baseline value relevance model without the inclusion

of *Reputation* or its interactions with the book value of equity or earnings. Our baseline model is consistent with prior literautre, documenting that the valuation coefficient on book value is close to 1 (1.120, t-stat 11.80) with a larger coefficient in earnings (5.134, t-stat 13.81). In columns (2) through (4) we include *Reputation*, proxied by $PeakRRI$, $CurrentRRI$ and *Rating* respectively. Across all columns, the main results on BVE and NI remain consistent with the tenor of the baseline results.

- - - INSERT TABLE 4 ABOUT HERE - - -

Turning to the impact of reputation on firm pricing, we find that for $PeakRRI$, $CurrentRRI$ and *Rating*, there appears to be a premium on firms with a worse reputation ($PeakRRI$ 0.232, t-stat 3.18; $CurrentRRI$ 0.409, t-stat 3.72; *Rating* 2.758, t-stat 2.83). However, this may well capture a function of firm size, given the correlations between reputation and firm size ($\rho(PeakRRI, lnMVE) = 0.504$ in Panel B of Table 3). Indeed, in untabulated analysis, when we control for $lnMVE$ in Table 4 we do not observe any significant association between *Price* and *Reputation*.

Our main test of *H1* is based on the interaction term $BVE * Reputation$ in Panels (2) through (4). Here, we find that there appears to be a valuation discount on the pricing of the book value of equity. In economic terms, this corresponds to a one standard deviation increase in $PeakRRI$, i.e. poorer reputation, is associated with a decrease in price of -13.8% relative to the valution coefficient on BVE.[5] The equivalent economic magnitude on $CurrentRRI$ and *Rating* are -14.9% and -10.8%, respectively.

As for our test of *H2*, we consider the coefficient on $NI * Reputation$. With the exception of $TrendRRI$, counter to our predictions in *H2*, we find a positive coefficient indicating that investors place a premium on the earnings of firms with poorer reputation. The economic magnitude for a one standard deviation increase in *Reputation* relative to the valuation coefficient on earnings is 22.7% for $PeakRRI$, 16.0% for $CurrentRRI$, and 15.0% for *Rating*.

Given the results contrary to expectations, we consider an alternate functional form. There is an opinion that if firms are not pushing the boundaries of what is acceptable, then they are

[5] Coefficient estimate on $BVE * Reputation$ (-0.011) multiplied by the standard deviation of $PeakRRI$ (16.64) divided by coefficient on BVE (1.328) which equals -0.138.

not generating maximum value for shareholders. The outworking of this, is that firms that are pushing the boundary may be reflected as having a poorer reputation. Under this view, we would expect that as the RRI increases from the minimum of 0 there would be a premium on the valuation of earnings for firms with poorer reputation, however, at a certain point as reputation continues to worsen, this premium on the valuation of earnings would decrease. Accordingly, we estimate a variant of equation (1) including a squared term on *Reputation*. If this alternate view holds, we would expect to observe a positive coefficient on β_7 and a negative coefficient on β_8 in equation (4):

$$\begin{aligned} Price &= \beta_0 + \beta_1 BVE + \beta_2 NI + \beta_3 Reputation + \beta_4 Reputation^2 \\ &\quad \beta_5 BVE * Reputation + \beta_6 BVE * Reputation^2 + \\ &\quad \beta_7 NI * Reputation + \beta_8 NI * Reputation^2 + \epsilon. \end{aligned} \tag{4}$$

Our results, presented in Table 5 demonstrate that the role corporate reputation plays in the pricing of firms is indeed non-linear in nature. First, however, we largely continue to document consistent results on the main effects on BVE and NI, with the expection that where using *Rating* as our measure of reputation, there is no significant valuation coefficient on NI. Next, we find that while initially as the main effect of reputation reduces firm valuation, this increases from a turning point where $PeakRRI$ is equal to 14.92.[6] Given the non-significant coefficient on *Reputation* for $CurrentRRI$ we are unable to conclude there is a non-linear functional form using these proxies. Similarly, while there are significant coefficients on the reputation terms using *Rating*, the minimum point of 0.05[7] is less than the minimum value of *Rating* of 1 assigned to firms with a AAA rating. As with the analysis in Table 4, when we include a control for $lnMVE$ the significance on *Reputation* and its squared term lose their significance, indicating that this may be capturing firm size.

- - - INSERT TABLE 5 ABOUT HERE - - -

Turning to the non-function association of reputation on the valuation of the book value

[6] $-1*$ coefficient on *Reputation* (-0.567) divided by $2*$ the coefficient on $Reputation^2$ (0.019)

[7] $(-1 * -0.182)/(2 * 1.899)$

of equity (*H2*), we find a significant negative coefficient on $BVE * Reputation^2$ (-0.001, t-stat -3.25), but no significant coefficient on $BVE * Reputation$ when using $PeakRRI$, indicating that where corporate reputation is poorer, there is a valuation discount on the book value of equity, albeit of a small magnitude. When using *Rating*, however, we find the opposite result, that initially a discount is provided on the valuation coefficient of the book value of equity, until a turning point of an AA rating at which point there is a valuation premium on the book value of equity for firms with poorer reputation.

As for the impact of reputation on the valuation of earnings under a quadratic model, we find using $PeakRRI$ a positive coefficient on $NI * Reputation$ (0.136, t-stat 3.69) and a negative coefficient on $NI * Reputation^2$ (-0.002, t-stat -2.36) indicating that as corporate reputation begins to decrease from its highest level (i.e., $PeakRRI$ equals 0) there is a premium on earnings. However, once the value of $PeakRRI$ reaches 34,[8] the valuation coefficient on earnings decreases. This result is consistent with the notion that investors see value in firm's pushing the boundaries to generate earnings, but not so far as to have too low of a corporate reputation. Where, in untabulated analysis, we find that the main effect on *Reputation* dissipates when including a control for $lnMVE$, the results on the interactions with NI and BVE remain.

As for the other proxies of *Reputation*, we do not find any significant coefficient on $NI * Reputation$ when using $CurrentRRI$, and while the coefficient on $NI * Reputation^2$ is statistically significant, at a value of -0.000 (t-stat -1.83) it is not economically meaningful. When we use *Rating* we find an economically and statistically significant coefficient on $NI*Reputation^2$ (-0.036, t-stat -1.81), but not on $NI * Reputation$, indicating that poorer reputation leads to a valuation discount on earnings. Given the results consistent with expectations under the quadratic functional form using $PeakRRI$, and the recommendation from RepRisk that $PeakRRI$ be used as the primary measure of reputation, we continue our subsequent analysis focussing on using this as our proxy for corporate reputation.

We next consider whether components of book values and earnings are more or less likely to be impacted by corporate reputation. In column (1) of Table 6, we first separate out intangible assets from the book value of equity and estimate equation (4). The rationale behind separating

[8] $(-1 * 0.136)/(2 * -0.002)$.

intangible assets is that these are the most likely to be influenced by reptuation, especially goodwill.[9] First, we document that intangible assets, on average, have a larger valuation coefficient (1.570, t-stat 9.66) than the remainder of the book value of equity (1.185, t-stat 8.86), and that this difference is statistically significant (F-value 9.34). We then document reputation does not have any moderating affect on the valuation of non-intangible book value of equity, but has a quadtratic association with the valuation coefficient on intangible assets, whereby it is increasing in reputation until a maximum value where $PeakRRI$ is equal to 9.5[10] from where the valuation of intangible assets is decreasing.

- - - INSERT TABLE 6 ABOUT HERE - - -

In columns (2) and (3) of Table 6 we then subsequently separate the earnings into accruals ($Accruals$) and cash flows ($CashFlows$), and expected earnings ($FEPS$) and earnings surprise ($ESurp$), respectively. First, we consider that if corporate reputation would have differing imnpacts on the degree to which earnings are deemed to be more or less difficult to verify, then we would expect there to potentially be differences in valuation coefficients on these. To the extent that cash flows are determined to be easy-to-verify and accruals difficult-to-very (Ball *et al.* 2013; Jackson *et al.* 2024), we would expect to observe that reputation would have a different moderating affect on accruals than cash flows. Our results demonstrate that while there is no significant difference in the main effects on $Accruals$ and $CashFlow$ (F-value 2.50), there are statistically significant differences between $Accruals * PeakRRI$ (0.108, t-stat 2.80) and $CashFlow * PeakRRI$ (0.140, t-stat 4.06) at less than a 10% level of significance (F-value 3.28), and $Accruals * PeakRRI^2$ (-0.001, t-stat -1.65) and $CashFlow * PeakRRI^2$ (-0.002, t-stat -2.83) at less than a 5% level of significance (F-value 4.88).

We then consider whether reputation has a different moderating affect on the expected and unexpected components of earnings, using the latest median consensus analyst forecast prior to the earnings announcement date as our proxy for expectations. This requirement of matching

[9] We do not further separate goodwill due to the proportion of observations with missing values, which we are not able to determine whether this means that goodwill is zero or not. Similarly, while we would expect that the impairment of intangible assets would be related to corporate reputation, due to the large proportion of missing values we are not able to test this.

[10] $(-1 * 0.019)/(2 * -0.001)$.

our data with I/B/E/S results in a reduced sample of 19,719 observations. Our results, presented in column (3) of Table 6 indicate that it is the expected component of earnings that is valued by investors, and not the earnings surprise. This result holds both in the terms of the main effect, and the interaction terms with $PeakRRI$ and its squared term.

Overall, our results indicate that investors do consider corporate reputation in their pricing decisions. Using a simple value relevance model, we document that reputation plays a non-linear role in valuation. Consistent with the idea that if firm's do not push the boundaries they do not add value to shareholders, we find that there is a valuation premium on earnings initially, until a point where earnings are then discounted for firms with poorer reputation.

5.3 Announcement Returns

In our first set of tests we consider the implicit pricing decisions of investors by utilizing a value relevance approach. However, this is only one way of assessing the pricing decisions of users. An alternate approach is to consider investor reactions surrounding the release of the annual earnings information. To consider this, and test our *H3*, we estimate equation (2) using the 3-day announcement returns over days [-1,+1], and the subsequent post-earnings announcement returns over days [+2,+30] with results presented in columns (1)-(2) and (3)-(4) of Table 7, respectively.

- - - INSERT TABLE 7 ABOUT HERE - - -

From our results, our inferences are consistent using either the raw ($RawRet$) or value-weighted market adjusted ($AbRet$) returns for both sets of return windows and as such limit our discussion to the raw returns. Focusing first on the $ESurp$, we find that in the three-day announcement return, the market reacts to the earnings surprise with a return on 31 basis points (0.0031, t-stat 4.88), with a reversion over the period [+2,+30] of 23 basis points (-0.0023, t-stat -1.92). This result is consistent with investors, on average, overreacting to the earnings news at the date of the announcement with the post-earnings announcement period providing a correction. Second, our results indicate the across both returns windows, firms with poorer reputation ($PeakRRI$) experience lower returns in general of around 2 basis points.

Finally, our test of our *H3* demonstrates that the impact of reputation has a mediating affect on investors' average reaction to the earnings surprise information. Specifically, during the 3-day earnings announcement period [-1,+1] the coefficient on $ESurp * PeakRRI$ is statistically significant (-0.0000, t-stat -2.03). While the coefficient is very small (0.000043 without rounding), there is a meaningful economic interpretation. Specifically, for a one standard deviation increase in $PeakRRI$ (16.779), this would result in the market reaction to the earnings surprise would be 21.8% lower.[11] Similarly, in the post-earnings announcement period we find that poorer corporate reputation has a mediating affect on the reversion in returns ($ESurp * PeakRRI$ 0.0001, t-stat 1.83). This corresponds to a one standard deviation increase in $PeakRRI$ reducing the reversion by 52.3%.[12]

We interpret this finding in the following way. To the extent that corporate reputation as a construct reflects the credibility of a firm's information, then investors, on average, will be expected to impound this into the way they interpret a firm's earnings. To the extent that a firm has a poorer reputation, this would be expected to be reflected in less credence placed on the earnings signal from that firm. This is reflected in our findings that investors have a weaker reaction to the earnings surprise for firms with a poorer corporate reputation, *i.e.* a higher $PeakRRI$ measure.

As with the value relevance tests, we also estimate equation (2) using a quadratic functional form. Untabulated results indicate that the association of reputation with returns around the announcement date do not exhibit non-linearities.

5.4 Future Outcomes

Finally, we consider whether corporate reputation is able to predict future accounting outcomes. Specifically, we consider whether corporate reputation will affect future sales growth ($\Delta Sales_{t+1}$) and profitability (ROA_{t+1}). We present the results of estimating equation (3) in Table 8.[13]

[11] $(-0.000043 * 16.779)/0.0031 = 0.2180$.
[12] $(0.000073 * 16.779)/ - 0.0023 = 0.5326$.
[13] As with the value relevance tests, we also estimate equation (2) using a quadratic functional form. Untabulated results indicate that the association of reputation with future outcomes do not exhibit non-linearities.

- - - INSERT TABLE 8 ABOUT HERE - - -

In testing our *H4* we focus on the coefficient of $PeakRRI$. Our results indicate that for firms with a poorer corporate reputation, this is reflected in poorer future accounting outcomes for both $\Delta Sales_{t+1}$ (-0.0016, t-stat -8.78) and ROA_{t+1} (-0.0005, t-stat -5.87) at less than a 1% level of significance. In terms of the economic magnitude of these effects, given a one standard deviation increase in $PeakRRI$ (16.408), this will result in the future growth in sales being 25.6% less than the mean,[14] and future profitability being 31.6% less than the sample mean.[15]

Valuation can be impacted by the numerator effect, i.e., expectations of future earnings, or the demoninator, i.e., discount rate. In columns (1) and (2) of Table 8 we consider the numerator effects. In column (3) we now turn to investigate whether the discount rate, proxied by the implied cost of capital using the Easton (2004) price earning growth ratio, is associated with corporate reputation. Consistent with prior literature (Smith *et al.* 2010; Tischer and Hildebrandt 2014), we find that there as corporate reputation is poorer, the cost of capital increases. Given our inverse measure of reputation, this is evidenced by a positive coefficient on $PeakRRI$ (0.0007, t-stat 10.58). This result is also economically significant, with a one standard deviation increase in $PeakRRI$, being associated with an implied cost of capital 9.4% higher than the sample mean.[16]

To the extent that poorer corporate reputation is associated with worse future accounting outcomes, it would be a rational pricing decision to discount firm's with poorer corporate reputations. We demonstrate this through both a decrease in expected earnings (i.e., lower future sales growth and profitability) and a higher discount rate. This result is consistent with the announcement return results presented in Table 7, and the eventual discounting of earnings in the non-linear functional form specifications of our value relevance tests in Table 5.

[14] $(-0.0016 * 16.408)/0.102 = 0.2574$.
[15] $(-0.0005 * 16.408)/0.026 = -0.3155$.
[16] $(0.0007 * 16.408)/0.126 = 0.0936$

6 Conclusions

In this study, we consider the effect of corporate reputation by investigating whether the valuation of accounting variables are associated with corporate reputation. To address our research questions, we employ a standard value-relevance approach, where we interact corporate reputation with the book value of equity and net income to determine whether there is a valuation premium or discount. We first find, applying a quadratic functional form, a modest valuation discount on book value of equity of small economic magnitude. However, for the valuation of net income, we find that initially as reputation worsens from its minimum value there is an additional premium on net income, however, there reaches a turning point whereby poorer reputation reduces the valuation coefficient on earnings. This result is consistent with the notion that investors see value in firm's pushing the boundaries to generate earnings, but not so far as to have too low of a corporate reputation.

To further complement the implicit pricing decisions of investors from a value relevance approach, we then examine investor reactions surrounding the release of the annual earnings announcement. Here we find that the impact of reputation has a mediating affect on investors' average reaction to the earnings surprise. Similarly, in the post-earnings announcement period we find that poorer corporate reputation reduces the reversion in returns. This result is consistent with corporate reputation being a construct that reflects the credibility of a firm's information.

Finally, we consider to what extent the reputation of the company is associated with future accounting outcomes. Focusing on year-ahead sales growth and profitability, we demonstrate that for firms with poorer corporate reputation, this is reflected in poorer future accounting outcomes. In terms of economic magnitude, we demonstrate that for a one standard deviation increase in the reputation score, future sales growth and profitability are 25.6% and 31.6% less than the sample mean, respectively. To the extent that poorer corporate reputation is association with worse future earnings outcomes, it would be a rationale pricing decision to discount firm's with poorer corporate reputation.

As previously mentioned, Donelson *et al.* (2024) consider the impact on corporate reputation from meritourius and non-meritorious securities class actions with their results implying that

reputational damage is primarily due to fraud which securities litigation helps to reveal, rather than the litigation itself. Karpoff *et al.* (2008) also demonstrate that firms charged by the SEC with financial misrepresentation lose a total of 38 per cent of their market values on dates related to the enforcement action. The results we present in this paper show that investor reactions to earnings announcements are muted for firms which poorer reputation. Taken together, this would appear to suggest that for firms with poorer corporate reputation, investors would already take into account the risk of financial misrepresentation in their pricing decisions, meaning that the market reaction to this revelation would be lower. We, however, do not address this issue in the current study and leave this for future research.

Similarly, while we consider the impact of broad corporate reputation based on the RepRisk Index to valuation, we do not consider either shocks to a firm's reputation, or specific business risk. The RepRisk Index we are able to use as our proxy for corporate reputation captures and quantifies a firm's reputation exposure to ESG and business conduct risk. The limitation this has to our study is that not all exposure to ESG risks are expected to be relevant to a firm's valuation. We leave to further studies a more specific consideration of how investors interpret shocks to specific types of business risk that impacts on corporate reputation.

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Table 1: Variable Definition

Reputation	
RRI	A propriety algorithm that dynamically captures and quantifies a company's reputation exposure to ESG and business conduct risk, which ranges from zero (lowest) to 100 (highest).
$PeakRRI$	The highest level of ESG risk exposure over the prior 24 months, and is considered a proxy for overall ESG and business conduct risk exposure.
$CurrentRRI$	The RRI measured at the current date.
$Rating$	combines the company-specific ESG risk exposure (based on $PeakRRI$) and the Country-Sector Average value for a company to provide a rating ranging from AAA (low risk exposure) to D (very high risk exposure) which we convert to an ordinal scale from 1 to 10.

Financial Variables	
$Price$	Stock price (CRSP absolute value of PRC) three months after fiscal year end, adjusted for stock splits (CRSP $CFACPR$).
BVE	Book value of equity per share defined as total assets (Compustat AT) minus total liabilities (Compustat LT) divided by total shares outstanding (Compustat $CSHO$)
NI	Earnings per share, defined as net income (Compustat NI) divided by total shares outstanding (Compustat $CSHO$).
$Intangibles$	Intangibles per share, defined as reported intangibles (Compustat $INTAN$) divided by total shares outstanding (Compustat $CSHO$).
$Accruals$	Total accruals per share, estimated as $(\Delta ACT - \Delta CHE) - (\Delta LCT - \Delta DLC - \Delta TXP) - DP$, dived by total shares outstanding.
$CashFlow$	Cash flows per share, estimated as net income less accruals, divided by total shares outstanding.
$FEPS$	Latest analyst median forecast of earnings per share before the earnings announcement date from I/B/E/S.
$ESurp$	Earnings surprise, estimated as realized net income per share less the latest analyst median forecast of earnings.

Announcement Returns	
$RawRet3$	The sum of the daily log raw returns for the days -1 to +1 surrounding the annual earnings announcement date (4^{th} quarter Compustat RDQ).
$AbRet3$	The sum of the daily log raw returns less the sum of the daily value weighted log returns for the days -1 to +1 surrounding the annual earnings announcement date (4^{th} quarter Compustat RDQ).
$RawRet30$	The sum of the daily log raw returns for the days +2 to +30 following the annual earnings announcement date (4^{th} quarter Compustat RDQ).
$AbRet30$	The sum of the daily log raw returns less the sum of the daily value weighted log returns for the days +2 to +30 following the annual earnings announcement date (4^{th} quarter Compustat RDQ).

Future Outcome Variables	
$\Delta Sales_{t+1}$	Future change in sales, defined as the change in sales (Compustat $SALE$) from year t to year $t+1$, scaled by sales in year t.
ROA_{t+1}	Future return on assets, defined as net income (Compustat NI) in year t divided by total assets (Compustat AT) in year t.

PEG	The implied cost of equity capital based on the Easton (2004) price-earnings growth ratio, defined as $\sqrt{\frac{FEPS_{i,t+2}-FEPS_{i,t+1}}{P_{i,t}}}$, where $FEPS$ is the analyst median consensus forecast for two- and one-years in the future, and P is stock price.

Control Variables

$lnMVE$	Log value of the market value of equity, defined as stock price (CRSP absolute value of *PRC*) three months after fiscal year end, adjusted for stock splits (CRSP *CFACPR*) multiplied by total shares outstanding (Compustat *CSHO*).
MTB	Market to book ratio, divided as the market value of equity divided by book value of equity as defined above.
Spread	Average of the daily bid-ask spread (CRSP) over the 12 months ending three months after fiscal year end.
$RetVar$	Return variance, defined as the variance of daily returns of the 12 months ending three months after fiscal year end.
SalesGrowth	Sales growth, defined as the change in sales (Compustat *SALE*) from year *t-1* to year *t*, scaled by sales in year *t-1*.
$IntangInt$	Intangible intensity, defined as the proportion of intangible assets (Compustat *INTAN*) relative to total assets (Compustat AT).

Table 2: Descriptive Statistics

	Mean	Std. Dev	p1	Q1	Median	Q3	p99
Panel A: Value Relevance Sample							
$PeakRRI$	15.057	16.640	0.000	0.000	6.000	29.000	57.000
$CurrentRRI$	7.529	11.264	0.000	0.000	0.000	16.000	48.000
$Rating$	2.619	1.204	1.000	2.000	2.000	3.000	7.000
$Price$	47.256	69.283	1.050	12.408	26.551	52.290	481.375
BVE	18.064	19.237	0.248	5.722	12.340	23.213	115.693
NI	1.717	3.865	-8.936	-0.055	1.145	2.815	21.719
$Intagibles$	8.537	14.706	0.000	0.201	2.633	10.118	86.466
$Accruals$	-1.591	4.674	-27.684	-2.372	-0.841	-0.060	15.196
$CashFlow$	3.311	6.783	-14.292	0.219	2.038	4.763	41.175
$FEPS$	2.183	3.264	-4.910	0.470	1.500	3.060	18.600
$ESurp$	-0.229	1.995	-9.469	-0.524	-0.027	0.229	7.552
Panel B: Announcement Returns Sample							
$PeakRRI$	16.033	16.779	0.000	0.000	16.000	30.000	58.000
$RawRet3$	0.003	0.087	-0.251	-0.043	0.002	0.047	0.271
$AbnRet3$	0.003	0.083	-0.240	-0.041	0.001	0.044	0.260
$RawRet30$	0.009	0.163	-0.490	-0.065	0.012	0.083	0.578
$AbnRet30$	0.003	0.131	-0.359	-0.063	-0.001	0.059	0.484
$lnMVE$	7.711	1.775	3.759	6.497	7.661	8.880	12.060
MTB	1.417	1.604	0.044	0.453	0.911	1.722	9.297
$Spread$	0.043	0.073	0.010	0.013	0.022	0.043	0.423
$RetVar$	0.029	0.015	0.010	0.018	0.025	0.036	70.083
Panel C: Future Outcomes Sample							
$PeakRRI$	16.408	16.851	0.000	0.000	18.000	31.000	59.000
$\Delta Sales_{t+1}$	0.102	0.319	-0.558	-0.029	0.060	0.169	1.497
ROA_{t+1}	0.026	0.118	-0.491	0.005	0.036	0.079	0.279
PEG	0.126	0.106	0.000	0.067	0.093	0.141	0.662
$lnMVE$	7.715	1.778	3.787	6.501	7.665	8.877	12.065
$SalesGrowth$	0.117	0.348	-0.566	-0.023	0.063	0.176	1.813
$IntangInt$	0.192	0.210	0.000	0.016	0.112	0.318	0.772
$ESurp$	-0.269	2.011	-9.469	-0.561	-0.037	0.210	7.152
$Accruals$	-1.703	4.814	-27.684	-2.573	-0.965	-0.108	15.196
$CashFlow$	3.712	6.925	-14.292	0.555	2.425	5.242	41.175
$Spread$	0.043	0.073	0.010	0.013	0.022	0.043	0.430
$RetVar$	0.029	0.015	0.010	0.018	0.025	0.035	0.081

Notes: This table presents the descriptive statistics for the full sample (N = 24,427 in Panel A; 19,538 in Panel B, and 18,261 in Panel C). All variables are as defined as in Table 1.

Table 3: Correlation Matrix

Panel A: Value Relevance Sample

	PeakRRI	*CurrentRRI*	*Rating*	*Price*	*BVE*	*NI*	*Intangibles*	*Accruals*	*CashFlow*	*FEPS*
CurrentRRI	**0.827**									
Rating	**0.728**	**0.672**								
Price	**0.140**	**0.137**	**0.114**							
BVE	**0.181**	**0.178**	**0.121**	**0.442**						
NI	**0.166**	**0.172**	**0.133**	**0.463**	**0.598**					
Intangibles	**0.180**	**0.166**	**0.107**	**0.344**	**0.481**	**0.325**				
Accruals	**-0.105**	**-0.115**	**-0.060**	**-0.156**	**-0.283**	**-0.136**	**-0.180**			
CashFlow	**0.167**	**0.177**	**0.118**	**0.385**	**0.545**	**0.681**	**0.315**	**-0.782**		
FEPS	**0.211**	**0.209**	**0.180**	**0.664**	**0.626**	**0.813**	**0.443**	**-0.155**	**0.575**	
ESurp	**-0.029**	**-0.020**	**-0.032**	**0.055**	**0.097**	**0.507**	**-0.118**	**0.027**	**0.288**	**-0.036**

Panel B: Announcement Returns Sample

	PeakRRI	*RawRet*3	*AbnRet*3	*RawRet*30	*AbnRet*30	*lnMVE*	*MTB*	*Spread*
*RawRet*3	**-0.024**							
*AbnRet*3	**-0.025**	**0.969**						
*RawRet*30	**-0.031**	-0.006	-0.003					
*AbnRet*30	*-0.011*	0.003	-0.004	**0.894**				
lnMVE	**0.504**	**0.026**	**0.021**	**-0.023**	**0.025**			
MTB	**-0.032**	**0.066**	**0.065**	**0.034**	**0.031**	**0.200**		
Spread	**-0.083**	-0.002	0.002	**-0.020**	***-0.016***	**-0.059**	**0.147**	
RetVar	**-0.146**	**-0.028**	***-0.015***	**0.038**	**0.027**	**-0.436**	***-0.014***	**0.031**

Panel C: Future Outcomes Sample

	PeakRRI	$\Delta Sales_{t+1}$	ROA_{t+1}	*PEG*	*lnMVE*	*SalesGrowth*	*IntangInt*	*ESurp*	*Accruals*	*CashFlow*	*Spread*
$\Delta Sales_{t+1}$	**-0.060**										
ROA_{t+1}	**0.079**	**0.047**									
PEG	**-0.065**	**0.073**	**-0.279**								
lnMVE	**0.516**	**0.030**	**0.280**	**-0.375**							
SalesGrowth	**-0.064**	**0.191**	**-0.057**	-0.006	0.007						
IntangInt	**0.037**	**-0.034**	**0.050**	**-0.144**	**0.168**	0.001					
ESurp	**-0.024**	**0.023**	**0.113**	**-0.090**	***0.018***	**0.084**	**-0.123**				
Accruals	**-0.110**	**0.054**	-0.007	**-0.030**	**-0.123**	**0.065**	***0.016***	**0.028**			
CashFlow	**0.171**	**-0.099**	**0.192**	**-0.181**	**0.308**	-0.011	-0.004	**0.288**	**-0.795**		
Spread	**-0.085**	**0.038**	**0.057**	**-0.042**	**-0.054**	**0.064**	**-0.048**	**0.122**	**-0.115**	**0.269**	
RetVar	**-0.155**	**0.055**	**-0.319**	**0.514**	**-0.439**	**0.055**	**-0.152**	**-0.168**	**-0.028**	**-0.179**	**0.023**

Notes: This table presents the Pearson correlations for the sample. All variables are defined in Table 1. Significance indicated by boldface <0.01, bold italics p<.005, italics p<0.1.

Table 4: Impact of Firm Reputation on Pricing

	(1)	(2)	(3)	(4)
	Baseline	*PeakRRI*	*CurrentRRI*	*Rating*
BVE	1.120***	1.328***	1.284***	1.508***
	(11.80)	(10.52)	(11.59)	(8.86)
NI	5.134***	3.973***	4.423***	3.748***
	(13.81)	(7.55)	(9.57)	(4.88)
Reputation		0.232***	0.409***	2.758***
		(3.18)	(3.72)	(2.83)
$BVE * Reputation$		-0.011***	-0.017***	-0.135***
		(-2.90)	(-3.39)	(-2.90)
$NI * Reputation$		0.054***	0.063***	0.467**
		(3.15)	(2.60)	(2.09)
Constant	18.207***	14.577***	15.057***	10.707***
	(11.36)	(7.76)	(8.81)	(3.63)
Fixed Effects	Year, Industry	Year, Industry	Year, Industry	Year, Industry
Cluster	Firm	Firm	Firm	Firm
N	24,427	24,427	24,427	24,427
Adjusted R^2	0.345	0.348	0.348	0.347

Notes: This table reports the results from estimating equation (1). All variables are as defined in Table 1. Standard errors are clustered by firm, with t-statistics in parentheses and significance indicated by *** p<0.01, ** p<0.05, * p<0.1.

Table 5: Impact of Firm Reputation on Pricing: Quadratic Functional Form

	(1)	(2)	(3)
	PeakRRI	*CurrentRRI*	*Rating*
BVE	1.236***	1.234***	1.090***
	(9.51)	(10.54)	(3.92)
NI	3.534***	4.190***	1.438
	(6.42)	(8.48)	(0.96)
Reputation	-0.567***	-0.002	-0.182*
	(-3.56)	(-1.46)	(-1.90)
$Reputation^2$	0.019***	0.130***	1.899**
	(4.85)	(2.79)	(2.36)
$BVE * Reputation$	0.012	-0.163	-5.098*
	(1.60)	(-0.93)	(-1.76)
$BVE * Reputation^2$	-0.001***	0.016***	1.094***
	(-3.25)	(3.14)	(2.62)
$NI * Reputation$	0.136***	-0.001	0.137
	(3.69)	(-0.09)	(0.90)
$NI * Reputation^2$	-0.002**	-0.000*	-0.036*
	(-2.36)	(-1.83)	(-1.81)
Constant	16.665***	16.213***	22.192***
	(8.65)	(9.15)	(4.51)
Fixed Effects	Year, Industry	Year, Industry	Year, Industry
Cluster	Firm	Firm	Firm
N	24,427	24,427	24,427
Adjusted R^2	0.353	0.350	0.349

Notes: This table reports the results from estimating equation (4). All variables are as defined in Table 1. Standard errors are clustered by firm, with t-statistics in parentheses and significance indicated by *** p<0.01, ** p<0.05, * p<0.1.

Table 6: Impact of Firm Reputation on Pricing: Components

	(1) Intangibles		(2) Accruals	(3) Earnings Surprise
BVE	1.185***	BVE	1.276***	1.000***
	(8.86)		(9.57)	(8.20)
$Intangibles$	1.570***	$Accruals$	2.323***	
	(9.66)		(4.68)	
NI	3.387***	$CashFlow$	2.658***	
	(6.21)		(5.49)	
$PeakRRI$	-0.570***	$FEPS$		7.916***
	(-3.47)			(8.93)
$PeakRRI^2$	0.020***	$ESurp$		0.823
	(4.60)			(1.59)
$BVE * PeakRRI$	-0.003	$PeakRRI$	-0.559***	-0.370***
	(-0.43)		(-3.22)	(-2.86)
$BVE * PeakRRI^2$	-0.000	$PeakRRI^2$	0.019***	0.013***
	(-1.57)		(4.33)	(4.18)
$Intangibles * PeakRRI$	0.019*	$BVE * PeakRRI$	0.010	0.000
	(1.92)		(1.23)	(0.00)
$Intangibles * PeakRRI^2$	-0.001***	$BVE * PeakRRI^2$	-0.000**	-0.000
	(-3.17)		(-2.28)	(-1.17)
$NI * PeakRRI$	0.142***	$Accruals * PeakRRI$	0.108***	
	(3.82)		(2.80)	
$NI * PeakRRI^2$	-0.002**	$Accruals * PeakRRI^2$	-0.001*	
	(-2.44)		(-1.65)	
Constant	15.356***	$CashFlow * PeakRRI$	0.140***	
	(7.85)		(4.06)	
		$CashFlow * PeakRRI^2$	-0.002***	
			(-2.83)	
		$FEPS * PeakRRI$		0.120**
				(2.34)
		$FEPS * PeakRRI^2$		-0.002**
				(-2.12)
		$ESurp * PeakRRI$		0.060
				(1.34)
		$ESurp * PeakRRI^2$		-0.001
				(-0.82)
		Constant	16.604***	8.440***
			(7.93)	(4.82)
Fixed Effects	Year, Industry	Fixed Effects	Year, Industry	Year, Industry
Cluster	Firm	Cluster	Firm	Firm
N	24,427	N	22,909	19,719
Adjusted R^2	0.366	Adjusted R^2	0.350	0.585

Notes: This table reports the results from estimating equation (4). All variables are as defined in Table 1, with the exception that BVE in Column (1) excludes the value of intangible assets per share. Standard errors are clustered by firm, with t-statistics in parentheses and significance indicated by *** p<0.01, ** p<0.05, * p<0.1.

Table 7: Impact of Firm Reputation on Announcement Returns

	(1)	(2)	(3)	(4)
	$RawRet3$	$AbRet3$	$RawRet30$	$AbRet30$
$ESurp$	0.0031***	0.0033***	-0.0023*	-0.0020*
	(4.88)	(5.49)	(-1.92)	(-1.92)
$PeakRRI$	-0.0002***	-0.0002***	-0.0002**	-0.0003***
	(-3.91)	(-4.00)	(-2.42)	(-3.82)
$ESurp * PeakRRI$	-0.0000**	-0.0000**	0.0001*	0.0001*
	(-2.03)	(-2.09)	(1.83)	(1.81)
$lnMVE$	0.0027***	0.0024***	0.0034***	0.0067***
	(4.70)	(4.41)	(3.39)	(7.48)
MTB	0.0041***	0.0040***	0.0034***	0.0023***
	(7.26)	(7.37)	(3.48)	(2.67)
$Spread$	-0.0205**	-0.0195**	-0.0311**	-0.0237*
	(-2.31)	(-2.46)	(-2.15)	(-1.80)
$RetVar$	0.2215**	0.2168**	0.7727***	0.5773***
	(2.52)	(2.55)	(4.83)	(4.08)
Constant	-0.0259***	-0.0230***	-0.0402***	-0.0640***
	(-4.51)	(-4.19)	(-3.94)	(-7.09)
Fixed Effects	Year, Industry	Year, Industry	Year, Industry	Year, Industry
Cluster	Firm	Firm	Firm	Firm
N	19,538	19,538	19,540	19,540
Adjusted R^2	0.023	0.019	0.185	0.051

Notes: This table reports the results from estimating equation (2). All variables are as defined in Table 1. Standard errors are clustered by firm, with t-statistics in parentheses and significance indicated by *** p<0.01, ** p<0.05, * p<0.1.

Table 8: Impact of Firm Reputation on Future Outcomes

	(1)	(2)	(3)
	$\Delta Sales_{t+1}$	ROA_{t+1}	PEG
$PeakRRI$	-0.0016***	-0.0005***	0.0007***
	(-8.78)	(-5.87)	(10.58)
$lnMVE$	0.0250***	0.0134***	-0.0133***
	(10.38)	(12.40)	(-13.06)
$SalesGrowth$	0.1388***	0.0018	-0.0120***
	(7.10)	(0.39)	(-3.38)
$IntangInt$	-0.0691***	-0.0329***	0.0173***
	(-4.82)	(-4.10)	(2.78)
$ESurp$	0.0143***	-0.0022***	0.0039***
	(7.92)	(-3.36)	(3.79)
$Accruals$	-0.0111***	0.0062***	-0.0068***
	(-8.04)	(10.89)	(-8.84)
$CashFlow$	-0.0140***	0.0052***	-0.0055***
	(-12.06)	(10.65)	(-8.70)
$Spread$	0.3177***	0.0186	-0.0096
	(7.34)	(1.04)	(-0.50)
$RetVar$	0.9165**	-2.1334***	3.0802***
	(2.51)	(-14.82)	(22.70)
Constant	-0.0707***	-0.0122	0.1391***
	(-3.03)	(-1.23)	(14.81)
Fixed Effects	Year, Industry	Year, Industry	Year, Industry
Cluster	Firm	Firm	Firm
N	18,244	18,261	15,101
Adjusted R^2	0.142	0.311	0.418

Notes: This table reports the results from estimating equation (3). All variables are as defined in Table 1. Standard errors are clustered by firm, with t-statistics in parentheses and significance indicated by *** p<0.01, ** p<0.05, * p<0.1.