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RESEARCH ARTICLE

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Does reputation matter for firm risk in developing country?

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Abstract

This research examines the effect of corporate reputation for firm risk in a developing country for a sample of 256 Indonesia firms for the period 2011–2015. Using two-step generalized method of moments approach, this research documents five important findings: (a) firm with higher reputation exhibits lower total risk (stock return volatility) and lower tail risk, yet, no significant effect on default risk; (b) Firms with high leverage use reputation effect for less total risk, tail risk, and default risk; (c) Firms with low leverage only enjoy the reputation effect on less total risk, but no reputation effect on tail risk and default risk; (d) Firms with high profitability utilize reputation to reduce the tail risk and default risk; and (f) firm with low profitability has less tail risk when their reputation is high. This evidence contributes to the literature by uncovering important and previously unidentified determinants of risk, namely, reputation. It offers an insight to stakeholders that reputation does matter.

KEYWORDS

corporate reputation, corporate strategy, extreme risk, financial risk, total risk

1 | INTRODUCTION

The reputation of a firm is a strategic intangible asset that may help inducing firm's value (Gonzalez Sanchez & Morales de Vega, 2018; Roberts & Dowling, 2002), and it is also a signal about how manager run the organization (Herbig & Milewicz, 1995; Silver & Shaw, 2018). In the perspective of resource-based view theory, manager characterized corporate reputation as the most important assets (Lee & Jungbae Roh, 2012; Rindova, Williamson, & Petkova, 2010; Veh, Göbel, & Vogel, 2019; Walker, 2010), accordingly, researchers extensively investigate that proposition by testing the association between corporate reputation and firm performance. The consensus is that higher reputation leads to better performance (e.g., Inglis, Morley, and Sammut (2006)—Australia; Rose and Thomsen (2004)—Denmark; Dunbar and Schwalbach (2000)—Germany; Gillet, Hübner, and Plunus (2010)—the United States and Europe).

Meanwhile, the literature of signalling theory and brand-image theory find empirical support for the relationship between corporate reputation and perception towards the organization (Connelly, Certo, Ireland, & Reutzel, 2011; Heinberg, Ozkaya, & Taube, 2018; Weigelt & Camerer, 1988). For instance, Connelly et al. (2011) review the use of signalling theory in management studies and address that reputation as a critical factor in a signal of quality. They describe that firms gain credibility for their organizational performance by renting the reputation of auditors, or owners, or even lenders. As a consequence, banks or other stakeholders make a business decision based on that perception. It

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