Do Credible Firms Perform Better in Emerging Markets? Evidence from China

Ran Zhang
Zabihollah Rezaee

ABSTRACT. Prior research suggests that corporate credibility is associated with firm financial performance in developed countries. This article examines whether corporate credibility is related to firm performance using *Economic Observer*'s rating of corporate credibility in China, the largest emerging market in the world. Based on a four-stage valuation model, we find that more reputable and credible firms outperform those with low ratings by almost 20% in 3-year stock returns and have better 3-year net profit margins, return on equity, and sales growth. This study is the first to directly examine the relationship between corporate credibility and firm performance in emerging markets such as China, and our results confirm that firms with high credibility exhibit better financial and market performance at least in the following 3 years.

KEY WORDS: corporate credibility, corporate reputation, emerging markets, financial performance, market value

Introduction

This article investigates whether corporate credibility is associated with firm performance in emerging markets such as China. Corporate credibility is the backbone of corporate governance and an integral component of corporate strategy for achieving sustainable performance. The ever-increasing attention to corporate credibility is evidenced in recent years (Goldsmith et al., 2000; Lafferty, 2007; Maathuis et al., 2004; Newell and Goldsmith, 2001), primarily because of the existence and persistence of financial scandals, loss of investor confidence, and reputation damage to financial institutions and banks caused by recent subprime loan crises and resulting economic meltdown. Prior research suggests that as companies develop their identity and image, reputation and credibility become the key components of their strategic managerial strategy (Schultz et al., 2000) and that corporate credibility is positively correlated to financial results (Roberts and Dowling, 2002).

Corporate credibility is also becoming more critical in emerging markets with the development of their corporation systems and financial markets. Taking China as an example, over the last two decades, it has experienced astounding levels of growth and structural change. In this evolving competitive arena, corporate credibility and corporate reputation have become major concerns for most firms operating in the Chinese market. Major foreign multinationals have shown through their behavior that they believe corporate reputation to be a significant asset in China (Zyglidopoulos and Reid, 2006).[1] At the same time, some local Chinese companies seem to understand the need to build solid reputations nationally and abroad.[2] However, not all firms as yet realize the importance of corporate credibility and corporate reputation in China. A recent survey, by the Guangdong Provincial Situation Study and Investigation Center, reveals that about 90% of the companies surveyed had made significant contributions to China's economic development, but only about 22% had fulfilled their social responsibilities commensurately with profits they had made in China. Moreover, people all over the world have been shocked by the melamine scandal ignited by Sanlu milk powder, a product of the Sanlu group, in September 2008. In this case, the firm pursued financial interests at the expense of human health (and of course their own reputation).[3] All these cases make corporate credibility a more national focus than ever before.

Does favorable corporate credibility or corporate reputation increase firm performance in emerging markets, such as China? The answer to this question

will guide the behavior not only of local Chinese firms, but also of multinationals operating in the Chinese market. As corporate credibility becomes more crucial than ever in emerging markets, research in this area is an urgent need. Especially, given the difference in people's ethical reasoning and decisions between developed and emerging countries (Ge and Thomas, 2007; Lam and Shi, 2008; Whitcomb et al., 1998), research results from developed markets may not be generalizable to developing countries. Thus, an advocacy of a research program in corporate reputation to understand the role that corporate reputation plays in competition in the emerging market context has been proposed (Zyglidopoulos and Reid, 2006). However, the literature on credibility-related issues in the developing-country context is still quite limited. Our research tries to fill this gap by investigating (1) the effect of credibility on a firm's long-term accounting performance and (2) whether credible firms have better long-term stock returns in China, the world's largest emerging market.

We use the corporate credibility index (CCI), released by the Economic Observer Research Institute (EORI) as published by *Economic Observer* magazine, as a proxy for firm credibility.[4] According to EORI, credibility is the basis for transactions and resource allocation. More and more economists realize that the success of economic events and transactions is influenced by credibility, and some of them consider credibility the most important issue in the development of transitional economies.[5] The corporate credibility index reflects the reliability of firm financial reporting and the effectiveness of corporate governance and, consequently, the extent to which investors trust financial reports and other disclosures. Our overall sample of 101 firms is stratified into two subsamples: the 50 firms with the highest CCI scores in China's stock market and the 51 firms with the lowest CCI scores.

Based on a four-stage valuation model, we find that the accounting performance of a high CCI score firm, as measured by net profit margin, return on equity (*ROE*), and sales growth, is consistently better than that of a low CCI score firm in both univariate and multivariate analyses. After controlling for other factors that influence firm performance, we find that long-term stock returns are also significantly worse when a firm's credibility rating is low. This difference in stock return performance persists for 3 years after

the CCI release. Taken together, our findings suggest that Chinese firms' credibility is positively associated with both future firm accounting and market-based performance. Chinese firms that are searching for competitive advantages may wish to consider strengthening their credibility and reputation to ensure sustainable performance.

This article is related to several strands of literature. First, it provides additional evidence on the effects of credibility, an aspect of firm reputation, on firm performance in an emerging market (Klapper and Love, 2004). Second, it extends the literature on firm credibility as one dimension of corporate reputation and performance consequences. Our evidence that credibility is positively related to firm performance complements several recent studies that focus on the relationship between corporate reputation and firm performance (Clayman, 1987; Landon and Smith, 1997; Neville et al., 2005).

The remainder of the article proceeds as follows: the next section reviews the literature, and then we present theoretical background, including research hypotheses, concerning the relationship between firm credibility and performance. This is followed by a description of our sample, descriptive analysis, and methodology and by the study's results. Concluding comments complete the article.

Literature review

According to Barnett et al. (2006), "corporate reputation" is defined as observers' collective judgments of a corporation based on assessments of the financial, social, and environmental impacts attributed to the corporation over time. "Corporate credibility" reflects the extent to which investors trust financial reports and other disclosures of a firm. In this article, corporate credibility includes firm financial reporting reliability and corporate governance effectiveness. From those definitions, we can see that corporate credibility is one of the main dimensions of corporate reputation.

The effect of corporate credibility or corporate reputation on firm performance in the developed-country context has been documented extensively in the literature (Neville et al., 2005; Roberts and Dowling, 2002; Rose and Thomsen, 2004; Sabate and Puente, 2003; Sanchez and Sotorrio, 2007). Roberts

and Dowling (2002), Sabate and Puente (2003), and Sanchez and Sotorrio (2007) provide comprehensive outlines of the many empirical research studies, critiques, and reviews that have examined this relationship in developed countries with confirmed results of positive links among corporate credibility, corporate reputation, and firm performance. As noted by Sabate and Puente (2003), for developed countries, the positive influence of corporate reputation on financial performance has always been validated, despite studies' using various methodologies and using data of heterogeneous nature, both for measures of corporate reputation, of financial performance, and of using several different lags (Dierickx and Cool, 1989; Rumelt, 1987; Weigelt and Camerer, 1988).[6]

According to a resource-based view, firms with assets that are valuable and rare possess a competitive advantage and can expect to earn superior returns (Grant, 1991). Those whose assets are also difficult to imitate may achieve sustained superior financial performance (Barney, 1991; Grant, 1991). Within this line of reasoning, intangible assets – such as credibility and good reputation – are critical because of their potential for value creation, but also because their intangible character makes replication by competing firms considerably more difficult. Thus, numerous studies confirm the expected benefits associated with good reputations (Fombrun and Shanley, 1990; Herremans et al., 1993; Landon and Smith, 1997; McGuire et al., 1990; Podolny, 1993; Sanchez and Sotorrio, 2007). They find that favorable reputations drive firm-specific financial benefits to corporations by reducing the mobility of industry rivals (Caves and Porter, 1977; Mahon and Wartick, 2003; Wilson, 1985), by attracting well-educated employees with higher productivity (Devine and Halpern, 2001; Gray and Balmer, 1998; Stuart, 2002), by getting access to more capital resources at lower cost (Beatty and Ritter, 1986), and by enhancing customer loyalty or allowing firms to charge higher prices for their products and services (Fombrun, 1996; Fombrun and Van Riel, 2004; Groenland, 2002; Milgrom and Roberts, 1982).

Although the relationship between firm credibility, reputation, and performance has been documented extensively in developed countries, research on this area is still quite limited in developing countries. However, there is an urgent need for this kind of research in emerging markets, in particular. In November 2004, nongovernmental organizations (NGOs) and trade unions, primarily in Europe, joined together to call for the European Union to propose a new corporate social responsibility (CSR) agenda. At the top of that agenda was the demand that CSR ''demonstrate its credibility globally, particularly in the developing country context'' (Blowfield, 2005). The statement also underscores the need for corporate credibility research in developing countries.

Despite the needs for corporate credibility and reputation research in developing countries, to date, only a few recent articles have addressed this area and none of them examines the firm credibility–performance relationship directly in developing countries. Klapper and Love (2004) have focused attention on the effect of corporate governance on firm performance. An examination of 14 emerging markets shows that better corporate governance is highly correlated with better operating performance and market valuation. Through a survey of 122 Chinese business leaders, Sudhaman (2004) find that Chinese CEOs now regard CSR and corporate reputation as key factors in building successful brands and customers are seen as the most influential force affecting corporate reputation. Wang et al. (2006) explore the role of brand equity and corporate reputation in customer-relationship management (CRM) within the Chinese market. In testing their conceptual framework through an empirical study of customers of financial institutions in China, they find that brand equity is a positive driver of CRM performance and that corporate reputation plays both a mediating and a moderating role in the relationship between brand equity and CRM performance. Although related studies investigate the determinants, influencing factors, and current situation of corporate reputation in emerging markets, none of them examine the relationship between corporate reputation and future firm performance, especially as related to credibility. We extend the existing research by empirically examining the relationship between corporate credibility, an important dimension of corporate reputation, and future firm performance in China, the largest developing country in the world.

Model and hypotheses to test

In this section, we propose a four-stage valuation model based on Copeland et al. (2000) and Dowling

(2006) to illustrate how corporate credibility and reputation affect firm financial performance and market price (see Figure 1). This model is one of the most commonly used general frameworks for corporate valuation, and is also widely used in economics and management research (Dowling, 2006); by breaking down the process into stages, it helps pinpoint exactly where corporate reputation influences value creation.

We then propose two hypotheses that accord with this model.

Stage 1: corporate value drivers

At a strategic level, corporate value is created by addressing three basic imperatives: investing to achieve a return in excess of the cost of capital (Return), growing the business (Growth), and managing risk (Risk) (Black et al., 1998; Dowling, 2006). A good corporate reputation can enhance company value drivers by (1) increasing sales from current markets (Kreps and Wilson, 1982; Milgrom and Roberts, 1982; Shapiro, 1983), (2) fueling future growth by helping the company expand into new markets (Bromley, 2002; Williamson, 1985), and (3) lowering the risk of doing business with the company (Orlitzky and Benjamin, 2001).

Stage 2: financial indicators (H1)

In this section, we discuss the question of how a good corporate reputation affects the three principal

Figure 1. A four-stage model of corporate valuation and share market valuation (based on Copeland et al. 2000).

value drivers – return, growth, and risk – and manifests itself in future financial indicators, such as net profit margin, *ROE*, and sales growth. This discussion leads to our hypothesis 1 and it is based on a growing body of research that focuses on product and service brands (e.g., Srivastava et al., 1998), corporate brands (e.g., Schultz and de Chernatony, 2002) and summaries of corporate reputation research (e.g., Fombrun and Van Riel, 2004).

Effect of reputation on sales

A good corporate reputation affects sales in several ways. First, reputation increases sales revenue. Since consumers in many situations are not able to tell the quality of the goods offered for sale before purchasing, a strong reputation can signal the underlying quality of the corporation's products (Kreps and Wilson, 1982; Milgrom and Roberts, 1982; Rose and Thomsen, 2004; Shapiro, 1983). Thus, a favorable reputation helps increase sales revenue through any one or more of the following mechanisms: increasing the number and loyalty of customers, improving the volume purchased by each customer, increasing the price premium obtained relative to competitive products and services, reinforcing customer satisfaction and countering any isolated episode of customer dissatisfaction, decreasing the sensitivity to price rises, and decreasing the effects of price discounts by competitors, especially with loyal customers.

Second, positive corporate credibility and corporate reputation also help enhance sales growth. When a company uses its name as an umbrella brand for its products and services, its corporate reputation is also signaled and signified by the corporate name. Thus, companies with good reputations can leverage this intangible asset by launching new products and services and entering new markets under the umbrella of the corporate brand. For example, a good corporate brand can help gain access to markets through established distributors, set a higher price, as well as speed up the adoption and diffusion of a new product or service (Keller, 1998; Sabate and Puente, 2003).

Finally, favorable corporate reputation also helps lower sales variance. A good corporate brand and reputation are often responsible for more customer loyalty; this can help produce a more stable sales base and thus reduce the variance in sales when economic conditions or competitive actions act against the company.
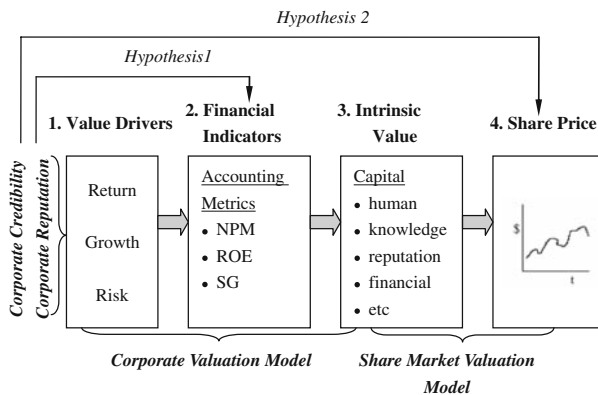
Thus, we posit that corporate credibility increases sales, enhances sales growth, and decreases sales variance. All three of these mechanisms further help increase profit.

Effect of reputation on costs

A favorable corporate reputation helps reduce costs through (1) decreasing contracting costs by allowing a firm to negotiate better terms of trade than a less well-respected competitor (Milgrom and Roberts, 1982; Sabate and Puente, 2003); (2) spending less on marketing and on launching new products and services by enabling the establishment of relationships with distributional channel members or brand name recognition among target consumers (Keller, 1998; Rossiter and Percy, 1997); and (3) getting access to more capital resources at a lower cost as firms with good reputation are always considered to be less risky entities for investment and enjoy high credit rating. This can further decrease firms' cost of capital as banks and other lenders are more willing to lend money and to charge lower rate for firms with higher credit ratings (Beatty and Ritter, 1986; Orlitzky and Benjamin, 2001).

Based on the above discussion on how good reputations enhance sales revenue and lower cost, we can see that firms with favorable credibility and reputation should be more profitable and report better accounting-based performance measures than other firms. Thus, we propose our first hypothesis:

H1: Firms with high CCI attain relatively better accounting-based performance than firms with low CCI in China.

Stage 3: intrinsic value

Figure 1 suggests that the various accounting metrics reported in traditional financial statements provide only a partial indication of the intrinsic or fundamental value of a company. From the perspective of an investor, there are many other types of capital that combine to form the total intrinsic value of a company. These are typically referred to as intangible assets.

This part of the corporate valuation model in Figure 1 indicates that the intrinsic value of a company is composed of various types of capital that it acquires, develops, and uses. In the current competitive market, companies seek to build up their stocks of other types of capital such as human capital (employees), organizational capital (databases, trademarks, intellectual property), customer capital (brands, customer base), and stakeholder capital (corporate credibility and corporate reputation) to distinguish themselves from others.[7] In the strategic management literature, the resource-based theory of the firm indicates that these very important resources can be the primary source of competitive advantage for many companies (Barney, 2001).

Stage 4: from corporate value to share price (H2)

In the accounting and finance literature (Fama and French, 1992, 1995), two different views are presented on how a firm's share price is determined. One view regards the stock market to be efficient and new information is instantaneously reflected in a company's share price. This new information can originate outside the company (e.g., a report about the company's industry or a competitor) or inside the company (e.g., a statement about its future prospects). The capital markets will factor any investment that increases reputation capital into the price of the company's shares.

The other view holds that share markets are not perfect and stock price is determined by both financial (such as the firm's annual income) and nonfinancial (such as analyst forecasts and investor sentiments) imperfections. Under this view, share prices move predominantly because of supply and demand pressures for particular shares, and this is driven by the expectations and emotions of investors. A good reputation can play a role here, by fostering positive emotions. A good corporate reputation is a part of the company's intrinsic value that is then factored into its share price.

Thus, both views of share price valuation can accommodate the effects of a good corporate reputation. Those two views should also apply in China as the Chinese market is semi-strong efficient (Zhang and Li, 2003).[8] Accordingly, we propose our second hypothesis:

H2: Firms with high CCI attain relatively better market-based performance than firms with low CCI in China.

Method

Sample

In 2004, EORI rated all firms listed in the Chinese capital market and published a credibility index for the 50 highest and the 51 lowest firms.[9] EORI's Chinese corporate credibility index is a tool that is already used as a reference for companies in assessing and managing their public credibility image, as it is the only Chinese index to annually evaluate (since 2004) the credibility of the companies that operate in China – as do those published by *Fortune* or the *Financial Times* – although EORI's scope is not as broad as the latter two. These two groups with total 101 firms constitute our research sample and are identified in two investment groups, called the high CCI group and the low CCI group, respectively.

The CCI is formulated by a survey of EORI's trained, independent analysts. In this survey, analysts are asked to evaluate different companies in response to 54 questions regarding firms' financial information quality and corporate governance. The questionnaire is based on generally accepted accounting principles and corporate law in China. It also follows the OECD's principles of corporate governance, specifically for developing countries, and a firm credibility questionnaire released by Columbia University. The companies evaluated are given a score ranging from 0 to 100 points. The financial data and market price data are from the *SinoFin* database.[10]

Table I compares the descriptive statistics of capital structure, financial performance, and market value for the high and low CCI groups. The mean of total assets for the high CCI group was significantly larger than that for the low CCI group (*p*-value = 0.069). The high CCI group's debt-to-asset ratio (38.6%) was significantly lower than that of the low CCI group (63.9%), suggesting that the low CCI group may have higher capital risk. We can also see that the high CCI group performed better than the low CCI group on earnings per share (*EPS*), return on assets (*ROA*), and cash flows from operations per share (*CPS*). The low CCI group had higher price-to-earnings (*PE*) and price-to-book (*PB*) ratios than the high CCI group.

TABLE I

Sample description and comparison between high and low CCI firms

	Low CCI average [SD] (median)	High CCI average [SD] (median)	Rank-sum *Z* for the difference (two-tailed *p*-value)
CCI			
CCI score	18.792 [2.446] (19.045)	48.663 [1.409] (48.305)	−29.870 (<0.001)
Capital structure			
Total assets (in million Yuan)	218.345 [203.172] (144.090)	156.161 [120.073] (113.610)	62.200 (0.069)
Debt-to-asset ratio	0.639 [0.249] (0.615)	0.386 [0.159] (0.370)	0.253 (<0.001)
Performance			
EPS	0.115 [0.171] (0.107)	0.283 [0.147] (0.265)	−0.168 (<0.001)
ROA	0.0236 [0.022] (0.021)	0.049 [0.028] (0.044)	−0.026 (<0.001)
CFO	0.025 [0.067] (0.018)	0.063 [0.063] (0.061)	−0.039 (0.004)
Market value			
PE	144.200 [234.723] (59.813)	36.309 [16.555] (30.324)	107.890 (0.016)
PB	3.771 [2.727] (2.544)	2.603 [0.763] (2.489)	1.168 (0.007)

Variable definitions: *CCI score*: corporate credibility index score; *total assets*: total assets at the end of the year; *debt-to-asset ratio*: total debt divided by total assets at the beginning of the year; *EPS*: earnings per share *ROA* net income divided by total assets at the beginning of the year; *CFO*: operating cash flow at the end of the year; *PE*: ratio of price to earnings (net income) at the end of the year; *PB*: ratio of market value to book value of net assets at the end of the year.

This implies that the market may have overvalued the low CCI group. Taken together, the descriptive statistics indicate that high CCI firms had less debt, performed better, and had lower *PE* and *PB* ratios.

CCI and accounting performance

In developing our research, we selected a series of variables to measure a firm's performance. We used both accounting-based and stock market-based measures. Accounting-based performance measures were net profit margin, *ROE*, and sales growth. Market-based performance measures were market-adjusted return and total return. We also considered other variables, such as assets, capital, growth of profit before tax, *ROA*, and cost of capital, which are commonly used to measure performance (Cochran and Wood, 1984; La Porta et al., 1999; McGuire et al., 1988; Simpson and Kohers, 2002).[11]

To compare accounting performance difference for high and low CCI firms, we used two different statistical tools. First, we examined the performance difference between high and low CCI firms for Year 1 (the year of CCI release), Year 2 (the year after CCI release), and Year 3 (the second year after CCI release), testing to determine whether the difference was significant using two-sample Wilcoxon rank-sum tests across the two groups. Second, we investigated the possible link between CCI scores, or CCI group dummy, and corporate performance, which was measured by performance indicators using regression analysis.

We further analyzed whether there was a direct link between performance and CCI scores. The models proposed included net profit margin, *ROE*, or sales growth as dependent variables, and CCI score, or a group dummy (which took the value of 1 if the firm was in the high CCI group and 0 otherwise), as independent variable. Size, growth, lagged performance, industry, and year were also included as control variables to keep these firm-related factors constant. The log form of total market value is recorded as a measure of size (*Size*), *PB* ratio as the measure of growth, last year's net profit margin, *ROE*, sales growth as measures of lagged performance, and sectors of activity of the firm as a measure of industry (*industry dummy*). The specific regression model tested was

Accounting performance

$$\text{(net profit margin, } ROE, \text{ or sales growth)}_i$$
$$= \beta_0 + \beta_1 Score_i \text{ (or } Group_i) + \beta_2 Controls_i + \varepsilon_i$$

The results are expected to show a significantly positive link between firms' CCI scores (or the group dummy, *Group*$_i$) and firms' accounting performance, as we expect a positive relationship between accounting performance and credibility. As to size, we took the log form of total market value (*Size*) as the control variable with no expected sign for size since the relationship between firm size and performance is still under debate.[12] We also controlled for lagged accounting performance, as accounting variables are normally sequentially correlated (Foster, 1977). Prior research shows that the ratio of market value to book value is both positively related to future book *ROE* (Penman, 1992, 1996) and negatively related to future stock returns (Fama and French, 1992, 1995). Accordingly, we predicted a positive relation between *PB* and future *ROE*. The industry variable may exercise some influence on firm performance (Schmalensee, 1985). We controlled for industry dummies to capture the industry effect. As the Chinese economy grows year-to-year, we also controlled for year dummies to capture the macroeconomic factors that may affect firm performance.

CCI and market performance

We employed two stock-based measures to evaluate performance of the Chinese firms in our sample. These measures are the 1-, 2-, and 3-year monthly average returns (*MRs*) and cumulative abnormal market-adjusted stock returns (*CARs*). *CARs* are calculated on the basis of monthly stock returns, starting from the first month after the 2004 annual report release date.

We next performed regression analyses to examine the effects of firms' credibility on their stock-based performance. Ordinary least squares (OLS) regressions were introduced using the 1-, 2-, and 3-year *MRs* as dependent variables. On the right side of the regressions, we included a dummy variable that equaled 1 for firms belonging to the high CCI group and 0 otherwise (*Group*$_i$) or firms' CCI scores

($Score_i$) to examine the relationship between ethical performance and market performance. We also included several control variables: the market return in month t ($MarketMR_t$), the market-to-book equity ratio (PB_i), the debt-to-asset ratio (Lev_i), the log of total market value ($Size_i$), and the industry dummy variable. According to our hypothesis 2, MRs and $Score_i$ or $Group_i$ should be positively associated, so we expected the coefficient on $Score_i$ or $Group_i$ to be significantly positive.

Empirical results

Table II reports variable means, mean differences, and Z-statistics from Wilcoxon rank-sum tests for high and low CCI firms during Years 1–3. Panels A and B show that both net profit margin and ROE were significantly higher for high CCI firms than low CCI firms for all 3 years and the difference decreased with time. Panel C of Table II shows that sales growth was higher for high CCI firms than for low CCI firms in Years 1 and 2. Sales growth for high CCI firms was still higher than for their low counterparts, but the difference was not significant in Year 3. The results are consistent with our hypothesis 1 – high CCI firms had better accounting-measured performance, and this advan-

tage persisted until 3 years after the release of the CCI scores.

The regression results of the relationship between firm performance and firms' CCI scores, or group dummies, are shown in Table III.[13] In accord with our hypothesis 1, Panel A shows that the coefficients for $Group_i$ or $Score_i$ were both positive and significant when net profit margin was the dependent variable. This suggests that high CCI firms had higher net profit margins for the next 3 years. $Size$ was positively related to future net profit margins, and the relations between the other variables considered and net profit margin were not significant. Panel B of Table III, indicates that there was a positive and statistically significant relation between $Group_i$ or $Score_i$ and future ROE. $Size$ was positively related to future ROE, and PB is also positively related to future ROE, as previously predicted. Lagged ROE was negatively related to the current year's ROE. Panel C of Table III shows that high CCI firms had higher future sales growth as the relation between $Group_i$ or $Score_i$ and future sales growth was significantly positive. $Size$ was also positively related to future sales growth, and all other control variables considered were not significant.

Tables II and III show that the accounting performance of a high CCI score firm, as measured by net profit margin, ROE, and sales growth, was

TABLE II

Univariate analysis of accounting performance difference between high and low CCI firms

	Year 1	Year 2	Year 3
Panel A: net profit margin			
High CCI	0.070	0.052	0.043
Low CCI	−0.081	−0.089	0.040
Difference	0.151	0.141	0.003
Rank-sum Z for the difference (two-tailed p-value)	4.156 (0.001)	4.193 (0.001)	2.553 (0.01)
Panel B: return on equity (ROE)			
High CCI	0.086	0.060	0.072
Low CCI	−0.306	−0.148	−0.006
Difference	0.392	0.208	0.078
Rank-sum Z for the difference (two-tailed p-value)	4.679 (0.001)	3.014 (0.01)	2.098 (0.01)
Panel C: sales growth			
High CCI	0.284	0.124	0.129
Low CCI	0.109	0.050	0.034
Difference	0.175	0.074	0.095
Rank-sum Z for the difference (two-tailed p-value)	2.239 (0.05)	2.239 (0.05)	0.762 (0.50)

TABLE III

Multivariate analysis of accounting performance difference between high and low CCI firms

Variables	1	2
Panel A: regression of net profit margin on CCI and other control variables		
Intercept	−0.703 (−2.20)★	−0.798 (−2.24)★
Group$_i$	0.142 (4.48)★★	
Score$_i$		0.005 (4.30)★★
Lagged net profit margin	−0.003 (−1.24)	−0.003 (−1.37)
Size$_i$	0.032 (2.08)★	0.033 (2.10)★
PB$_i$	−0.001 (−0.14)	−0.001 (−0.19)
Industry dummy	Controlled	Controlled
Year dummy	Controlled	Controlled
R^2 (%)	17.09	16.61
Panel B: regression of ROE on CCI and other control variables		
Intercept	−5.274 (−2.80)★★	−5.565 (−2.91)★★
Group$_i$	0.485 (2.68)★★	
Score$_i$		0.015 (2.51)★★
Lagged *ROE*	−0.233 (−4.00)★★	−0.230 (−3.96)★★
Size$_i$	0.245 (2.89)★★	0.246 (2.89)★★
PB$_i$	0.013 (2.15)★	0.014 (2.28)★
Industry dummy	Controlled	Controlled
Year dummy	Controlled	Controlled
R^2 (%)	15.70	15.47
Panel C: regression of sales growth on CCI and other control variables		
Intercept	−1.279 (−2.82)★	−1.374 (−2.99)★
Group$_i$	0.106 (2.41)★	
Score$_i$		0.004 (2.55)★
Lagged sales growth	−0.001 (−0.84)	−0.001 (−0.76)
Size$_i$	0.069 (3.38)★★	0.070 (3.42)★★
PB$_i$	0.001 (0.59)	0.001 (0.56)
Industry dummy	Controlled	Controlled
Year dummy	Controlled	Controlled
R^2 (%)	14.37	14.55

Variable definitions: *Group*: 0 for low CCI group and 1 for high CCI group; *Score*: CCI score for firm *i*; *Size*: log form of total market value for firm *i* at the end of the year; *PB*: price-to-book ratio for firm *i* at the end of the year.
★,★★Significant under 5% and 1% level, respectively (two tailed).

consistently better than that of a low CCI score firm for both our univariate and multivariate analysis, verifying our hypothesis 1 that firms with higher corporate credibility attain relatively better subsequent accounting-based performance than their lower counterparts.

Figure 2 plots the mean *CARs* of our sample companies sorted by whether they belonged to the high or the low CCI groups. The mean *CAR* of the group of firms with the lowest CCI scores exhibited a steep decline of 40% over the 3 years after the 2004 annual report release, while the mean *CAR* of the high CCI group experienced a much smaller drop of 12% over the same period, as well as an increase of over 10% in Year 1. From this comparison, we can see that high CCI firms exhibited much better stock-based performance than low CCI firms.

Panel A of Table IV reports the mean values of the stock-based performance measures for subsamples sorted by firms' CCI scores. In accord with Figure 2, in the first two of the three subsequent years, the mean *MRs* of firms with high CCI scores
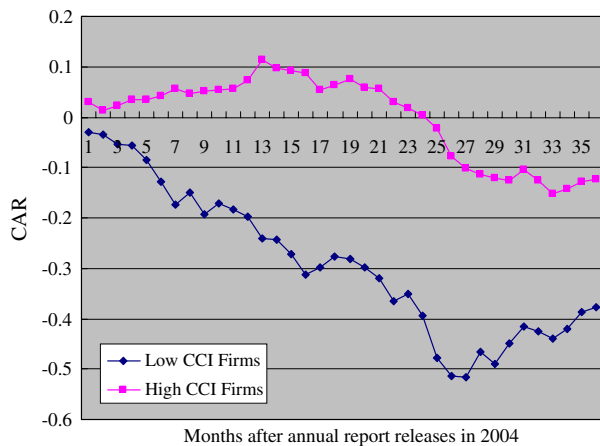
Figure 2. Mean cumulative market-adjusted compound stock returns (CARs) from 1 to 36 months after the annual report release in 2004 of 50 firms with the highest corporate credibility index (CCI) scores and 51 firms with the lowest CCI scores in the Chinese stock market.

Discussion

We find a significant positive relationship between firm credibility and performance in China. In general, the evidence is consistent with the stakeholder theory (Cornell and Shapiro, 1987; Neville et al., 2005): stakeholders, other than investors and management, play an important role in financial policy and constitute a vital link between corporate strategy and corporate finance. Firms with a reputation of high credibility may find that they have more low-cost implicit claims than other firms, thus exhibiting higher financial performance. Although this relationship has been tested in developed countries, our study is among the early studies in this area with regard to emerging markets.

Implications

Our analysis of China's listed firms reveals that the credibility issues faced by firms, namely, the low earnings quality and poor corporate governance (the highest score is only 51.85), significantly impair firm performance, as well as board effectiveness and governance. Building corporate credibility is the key to the success of future reforms aiming to improve market efficiency and investor protection in China. Our results show that even with different cultural, institutional, legal, economic, and ethical backgrounds, the emerging market that we examined still shows a positive relation between firm credibility and performance, as do their developed counterparts. These results are meaningful not only to local firms in emerging markets, but also to multinational firms in those markets, as it indicates that being credible to the public helps create long-term firm value and firms operating in China that search for competitive advantages in the global market may consider strengthen their credibility and reputation to ensure sustainable performance.

were statistically significantly higher than those with low CCI scores, indicating that the market was able to distinguish between the two groups of firms. Moreover, the magnitude of the difference in the *MRs* between the two groups became smaller each year, suggesting that over the years either the advantage of high CCI firms was decreasing or the low CCI firms improved their financial reporting quality or corporate governance subsequently.

In accord with the univariate results reported in Panel A of Table IV, the multivariate regression results presented in Panel B of Table IV show that high CCI firms' stock performance for the subsequent 3 years was statistically significantly higher than that of low CCI firms. The differences in *MRs* between these two subsamples were similar in magnitude to or even more prominent than the univariate results, even after we controlled for firm-specific factors that could affect stock return performance. The results show that firms with high CCI scores outperformed those with low CCI scores by 2.6% monthly 1 year after the 2004 annual report release, 1.3% monthly 2 years after the 2004 annual report release, and 1% monthly 3 years after the 2004 annual report release. The results in Figure 2 and Table IV are consistent with our hypothesis 2 that firms with higher corporate credibility attain relatively better subsequent market-based performance than their lower counterparts.

Limitations and directions for future research

There are at least two noteworthy limitations of this research. First, our results may not be generalizable to developing countries other than China, which may have different cultural, legal, economic, and

TABLE IV

Market performance difference between high and low CCI firms

	Year 1	Year 2	Year 3
Panel A: monthly average return (%)			
High CCI	−2.91	0.84	10.15
Low CCI	−5.59	−0.48	10.00
Hedge return	2.68	1.32	0.15
Rank-sum Z for the difference (two-tailed *p*-value)	3.576 (0.001)	1.962 (0.05)	0.457 (0.65)

Variables	Year 1		Year 2		Year 3	
Panel B: regression of stock return on CCI and other control variables						
Intercept	−0.191 (−3.23)★★	−0.214 (−3.55)★★	−0.077 (−1.15)	−0.087 (−1.29)	−0.064 (0.66)	0.074 (0.76)
$Group_i$	0.026 (4.95)★★		0.013 (2.10)★		0.010 (1.86)	
$Score_i$		0.001 (5.07)★★		0.001 (2.19)★		0.001 (1.75)
$MarketMR_{i,t}$	0.997 (29.31)★★	0.996 (29.32)★★	0.969 (22.13)★★	0.969 (22.14)★★	0.869 (20.77)★★	0.869 (20.76)★★
$Size_i$	0.008 (3.09)★★	0.009 (3.19)★★	0.002 (0.71)	0.002 (0.73)	−0.001 (−0.36)	−0.001 (−0.36)
PB_i	−0.001 (−2.35)★	−0.001 (−2.39)★	0.000 (0.87)	0.000 (0.83)	0.000 (1.59)	0.000 (1.61)
Lev_i	0.002 (1.93)	0.002 (1.92)	0.000 (0.42)	0.000 (0.41)	−0.006 (−1.10)	−0.006 (−0.99)
Industry	Controlled	Controlled	Controlled	Controlled	Controlled	Controlled
R^2 (%)	45.20	45.26	31.30	31.33	32.94	32.91

Variable definitions: *Score*: CCI score for firm *i*; *MarketMR*: market index return in month *t*; *Size*: log form of total market value for firm *i* at the end of the year; *PB*: price-to-book ratio for firm *i* at the end of the year; *Lev*: debt-to-asset ratio for firm *i* at the end of the year.

★, ★★Significant under 5% and 1% level, respectively (two tailed).

ethical backgrounds. Future research may examine whether the positive relationship between corporate credibility (corporate reputation) and firm performance relationship also holds elsewhere. For example, country size might make a difference. China is very large, so the processes of making a reputation and the correlations between reputation and return might work differently than they do in very small economies. Second, although EORI's CCI rating has provided a measure of corporate credibility new to the literature, the validity and appropriateness of this measure require further examination. As do other measures of firm reputation, such as *Fortune* magazine's rating of corporate reputation, EORI's rating may reflect the biases of the evaluators. Thus, an examination of appropriation of EORI's rating as a research tool is a promising area.

In general, this study provides a platform for future research in corporate credibility in emerging markets, examining one dimension of corporate reputation. Showing that an overall measure of corporate reputation is associated with performance in emerging markets and how and to what extent corporate reputation affects firm performance in developing countries other than China are two possible areas that should be addressed by future research.

Notes

[1] For example, Procter & Gamble Co., whose advertisements focus on specific products such as Tide laundry detergent and Pantene shampoo, is simultaneously running ads promoting its corporate image, as it views China as one of its crucial growth markets and by enhancing its corporate reputation; P&G hopes to make customers more willing to buy its products (Lee, 1998).

[2] For example, Ningbo Bird, the largest and most successful Chinese cell phone handset manufacturer, acknowledges that as it expands to international markets it needs to build a solid reputation for quality (Schuman, 2004).

[3] In September 2008, thousands of babies were diagnosed with kidney stones after having been fed Sanlu milk powder, which was subsequently detected to contain a large ratio of melamine. A wide national investigation into the milk industry indicated that dozens of large milk manufactures were involved in adding melamine to their products.

[4] On July 22, 2004, the EORI, which belongs to *Economic Observer* magazine, released its rating of firm credibility in China, the "Corporate Credibility Index".

[5] EORI argues that "in a market with severe agency problems that result from conflicts between controlling and minority ownerships, consistent and reliable information disclosure from corporations to the public, especially minority shareholders and investors, is fundamentally important for the continuing operation of companies and development of the market. Therefore, information disclosure is one of the most important issues in today's Chinese market."

[6] Dunbar and Schwalbach (1998) and Chung et al. (1999) find that reputation has a weak impact on subsequent financial performance.

[7] Stakeholder theory (Cornell and Shapiro, 1987; Neville et al., 2005) asserts that firm value depends on the cost not only of explicit claims, such as wage contracts and product warranties, but also of implicit claims, such as the promise of continuing service to customers and job security to employees. Stakeholders other than investors and management play an important role in financial policy and constitute a vital link between corporate strategy and corporate finance. Firms with good corporate reputation and credibility may find that they have more lower-cost implicit claims than other firms and thus have better financial performance.

[8] The efficient-market hypothesis (EMH) asserts that financial markets are "informationally efficient," or that prices on traded assets, e.g., stocks, bonds, or property, already reflect all information, public and private. Semi-strong-form efficiency implies that share prices adjust to all publicly, but not privately, new information very rapidly and in an unbiased fashion (Fama, 1991).

[9] Ideally, we should include the medium firms from the EORI list for China. However, EORI published the credibility index only for the 50 highest and the 51 lowest firms, which makes it impossible for us to include the middle CCI firms in our sample. Nevertheless, our sample size should not be a concern. First, most academic articles that investigate the relation between firm reputation and performance use similar or even smaller sample size (e.g., Antonovich and Laster, 1998; Chung et al., 1999; Fibeck and Preece, 2003). Second, using power and sample size calculation software (http://biostat.mc.vanderbilt.edu/twiki/bin/view/Main/PowerSampleSize), we find that both our rank-sum *Z* tests and our regressions have enough power with the current sample size.

[10] The *SinoFin* database collects financial reporting data and stock market data on Chinese listed firms from 1993 to the present. We also test our results using the

China Stock Market Accounting Research (CSMAR) database and generate similar results.

[11] For the sake of brevity, we do not report those results here.

[12] After Banz ([1981]) proposes a "size effect," i.e., smaller firms have had higher risk adjusted returns, on average, than larger firms, some scholars suggest a different size–performance relationship. For example, Ritter ([1991]) suggests that small firms' long-run stock performance is worse than that of large ones; Loughran and Ritter ([1995]) find that firm size is not a significant influence factor in long-run performance.

[13] R^2 for the six regressions in Table III are between 14% and 17%, which is consistent with previous studies (Orlitzky et al., [2003]).

Appendix A

Abbreviated CCI questionnaire

EORI considers the following factors to determine a firm's CCI:

A. Validity standards

1. Whether the board structure is appropriate and board members agree with the annual financial reports.
2. Whether the annual report is disclosed before April 30.
3. Whether the management compensation plan is fairly disclosed.
4. Whether any director or supervisor has resigned abnormally during the past fiscal year. Whether the board conferences have discussed and agreed with any such resignation.
5. Whether any independent board director has resigned abnormally during the past fiscal year.
6. Whether the firm deviates significantly from the Chinese Public Firms Corporate Governance Principles.
7. Whether the firm is separate from its controlling shareholders in business, personnel, assets, organization, and financing.
8. Whether the participants of the board conferences represent different interests.
9. Whether the "Management Discussion and Analysis" section of the financial report provides reasonable explanation on material events or policy changes.
10. Whether the directors' report completely discloses segment reports. Whether the financial report reasonably explains material change(s) of segments.
11. Whether the financial report completely discloses subsidiaries' operation and performance.
12. Whether significant extraordinary items are recognized following standard accounting principles.
13. Whether there are fair reasons for any accounting change that affects earnings significantly for this period.
14. Whether the financial reports disclose possible influence of significant changes in operating environment.
15. Whether there are explanations from certified accountants and independent board members for related party expropriation.
16. Whether the financial reports cover all significant operational changes.
17. Whether the report of the supervisory committee provides any independently substantive content.
18. Whether the firm recognizes liabilities properly when significant lawsuits or arbitration causes current obligation. Whether contingent liability is appropriately recognized.

19. Whether the significant influence of any material merger or acquisition on current-period performance is properly explained.
20. Whether sales heavily depend on internal trading. If so, whether the firm disclosed the trading fairly.
21. Whether the purchase of semi-finished goods or raw materials relates to internal trading. Whether it is fairly disclosed if there were such purchases.
22. Whether the disclosure of significant liabilities to and from related parties and their effect is prompt.
23. Whether there is significant noncash trusteeship, contract, or lease.
24. Whether insider trading involves off-balance sheet financing.
25. Whether there is illegal financial warranty. If there is, whether the firm discloses the cause and amount of the warranty fairly.
26. Whether there is sufficient disclosure of the authorization, commission amount, commission term, commission party, and profits or losses of cash asset commission management.
27. Whether the revised report discloses new information.
28. Whether the revised report involves problems with reporting validity.
29. Whether there is any issue that the firm should have disclosed promptly but did not.
30. Whether the financial report footnotes are complete.

B. Fairness standards

31. Whether the *ROA* is normal for acquired assets that are material.
32. Whether the historical performance of sold assets is consistent with the selling price.
33. Whether the price and payment method of any significant extraordinary items transaction between related parties are fair.
34. Whether the price and payment method of any significant extraordinary items transaction between unrelated parties are fair.
35. Whether there is a large difference between related parties' and unrelated parties' gross profit margin for the same type of products. If there is, whether it is disclosed fairly.
36. Whether the selling price of any insider trading is fair. Whether it is fairly disclosed.

37. Whether the purchase price for any related party commission purchase is fair. Whether it is fairly disclosed.
38. Whether the matching of revenue and expense is fair if there is substantial insider trading.
39. Whether the restructuring report involves unfair reporting problems (most Chinese firms experienced a privatization restructuring in 2002–2004).

C. Consistency standards

40. Whether earnings before extraordinary items are misstated.
41. Whether net assets per share are correctly calculated.
42. Whether the ''Management Discussion and Analysis'' section omits negative information and exaggerates positive information.
43. Whether the reported earnings are consistent with management's earnings forecast.
44. Whether the usage, amount, progress, and return of capital raised from an IPO are consistent with the projected plan on the firm's IPO prospectus.
45. Whether financial reports disclose significant changes in financial results and the explanations for those changes.
46. Whether the directors' report provides sufficient explanation for qualified or adverse auditing opinion.
47. Whether the number and topics of supervisory committee conferences are consistent with those of board of director conferences.
48. Whether the restructuring report reveals problems in consistency.

D. Symmetry standards

49. Whether operating cash flows are under significant manipulation.
50. Whether management compensation changes proportionally with net income.
51. Whether management receives compensation from controlling ownership entities or related parties.
52. Whether the firm provides reasons, responsibility analysis, and solutions for significant financial losses.
53. Whether the financial results are consistent with material changes in operating environment.

54. Whether the ratio of financing warranty amount to net assets is relatively high and increases the firm's financing risk.

References

Antonovich, P. and D. Laster: 1998, 'Do Investors Mistake a Good Company for a Good Investment?', Working Paper, Federal Reserve Board, New York.

Banz, R. W.: 1981, 'The Relationship Between Return and Market Value of Common Stocks', *Journal of Financial Economics* **9**(1), 3–18. doi:10.1016/0304-405X(81) 90018-0.

Barnett, M. L., J. M. Jemier and B. A. Lafferty: 2006, 'Corporate Reputation: The Definitional Landscape', *Corporate Reputation Review* **9**(1), 26–38. doi:10.1057/ palgrave.crr.1550012.

Barney, J. B.: 1991, 'Firm Resources and Sustained Competitive Advantage', *Journal of Management* **17**(1), 99–120. doi:10.1177/014920639101700108.

Barney, J. B.: 2001, 'Is the Resource-Based View a Useful Perspective for Strategic Management Research? Yes', *Academy of Management Review* **26**(1), 41–56. doi:10.2307/259393.

Beatty, R. P. and J. R. Ritter: 1986, 'Investment Banking, Reputation, and Underpricing of Initial Public Offerings', *Journal of Financial Economics* **15**(1–2), 213–232. doi:10.1016/0304-405X(86)90055-3.

Black, A., P. Wright, J. Bachman and J. Davies: 1998, *In Search of Shareholder Value* (FT Pitman, London).

Blowfield, M.: 2005, 'Corporate Social Responsibility: Reinventing the Meaning of Development?', *International Affairs* **81**(3), 515–524. doi:10.1111/j.1468-2346. 2005.00466.x.

Bromley, D. B.: 2002, 'An Examination of Issues That Complicate the Concept of Reputation in Business Studies', *International Studies of Management and Organization* **32**(3), 65–81.

Caves, R. E. and M. E. Porter: 1977, 'From Entry Barriers to Mobility Barriers: Conjectural Decisions and Contrived Deterrence to New Competition', *The Quarterly Journal of Economics* **91**(2), 241–262. doi:10.2307/ 1885416.

Chung, S. Y., T. Schneeweis and K. Eneroth: 1999, 'Corporate Reputation and Investment Performance: The UK and US Expertise', SSRN Electronic Paper Collection.

Clayman, M.: 1987, 'In Search of Excellence: The Investor's Viewpoint', *Financial Analysts Journal* **43**(3), 54–63. doi:10.2469/faj.v43.n3.54.

Cochran, P. L. and R. A. Wood: 1984, 'Corporate Social Responsibility and Financial Performance', *Academy of*

Management Journal* **27**(1), 42–56. doi:10.2307/ 255956.

Copeland, T., T. Koller and J. Murrin: 2000, *Valuation: Measuring and Managing the Value of Companies* (Wiley, New York).

Cornell, B. and A. C. Shapiro: 1987, 'Corporate Stakeholders and Corporate Finance', *Financial Management* **16**(1), 5–14. doi:10.2307/3665543.

Devine, I. and P. Halpern: 2001, 'Implicit Claims: The Role of Corporate Reputation in Value Creation', *Corporate Reputation Review* **4**(1), 42–49. doi:10.1057/ palgrave.crr.1540131.

Dierickx, I. and K. Cool: 1989, 'Asset Stock Accumulation and Sustainability of Competitive Advantage', *Management Science* **35**(12), 1504–1511. doi:10.1287/ mnsc.35.12.1504.

Dowling, G.: 2006, 'How Good Corporate Reputations Create Corporate Value', *Corporate Reputation Review* **9**(2), 134–143. doi:10.1057/palgrave.crr.1550017.

Dunbar, R. L. M. and J. Schwalbach: 1998. 'Corporate Reputation and Performance in Germany', Paper Presented at the 19th Annual International Conference of the Strategic Management Society.

Fama, E. F.: 1991, 'Efficient Capital Markets: II', *The Journal of Finance* **46**(5), 1575–1617. doi:10.2307/ 2328565.

Fama, E. F. and K. R. French: 1992, 'The Cross-Section of Expected Stock Returns', *The Journal of Finance* **47**(2), 427–465. doi:10.2307/2329112.

Fama, E. F. and K. R. French: 1995, 'Size and Book-To-Market Factors in Earnings and Returns', *The Journal of Finance* **50**(1), 131–155. doi:10.2307/23 29241.

Fibeck, G. and D. Preece: 2003, 'Fortune's Best 100 Companies to Work for in America: Do They Work for Shareholders?', *Journal of Business Finance & Accounting* **30**(5–6), 771–797. doi:10.1111/1468-5957. 05362.

Fombrun, C. J.: 1996, *Reputation: Realizing Value from the Corporate Image* (Harvard Business School Press, Cambridge, MA).

Fombrun, C. J. and M. Shanley: 1990, 'What's in a Name? Reputation Building and Corporate Strategy', *Academy of Management Journal* **33**(1), 233–258. doi:10.2307/ 256324.

Fombrun, C. J. and C. B. M. Van Riel: 2004, *Fame & Fortune: How Successful Companies Build Winning Reputations* (Pearson Financial Times, London, UK).

Foster, G.: 1977, 'Quarterly Accounting Data: Time-Series Properties and Predictive-Ability Results', *Accounting Review* **52**(1), 1–21.

Ge, L. and S. Thomas: 2007, 'A Cross-Cultural Comparison of the Deliberative Reasoning of Canadian and

Chinese Accounting Students', *Journal of Business Ethics* **82**(1), 189–211. doi:10.1007/s10551-007-9571-5.

Goldsmith, R. E., B. A. Lafferty and S. J. Newell: 2000, 'The Impact of Corporate Credibility and Celebrity Credibility on Consumer Reaction to Advertisements and Brands', *Journal of Advertising* **29**(3), 43–54.

Grant, R.: 1991, 'The Resource-Based Theory of Competitive Advantage: Implications for Strategy Formulation', *California Management Review* **33**(3), 114–135.

Gray, E. R. and J. M. T. Balmer: 1998, 'Managing Corporate Image and Corporate Reputation', *Long Range Planning* **31**(5), 695–702. doi:10.1016/S0024-6301(98)00074-0.

Groenland, E. A.: 2002, 'Qualitative Research to Validate RQ-Dimensions', *Corporate Reputation Review* **4**(4), 308–315. doi:10.1057/palgrave.crr.1540152.

Herremans, I. M., P. Akathaporn and M. McInnes: 1993, 'An Investigation of Corporate Social Responsibility Reputation and Economic Performance', *Accounting, Organizations and Society* **18**(7–8), 587–604. doi:10.1016/0361-3682(93)90044-7.

Keller, K. L.: 1998, *Strategic Brand Management* (Prentice Hall, Upper Saddle River, NJ).

Klapper, L. F. and I. Love: 2004, 'Corporate Governance, Investor Protection, and Performance in Emerging Markets', *Journal of Corporate Finance* **10**(5), 703–728. doi:10.1016/S0929-1199(03)00046-4.

Kreps, D. M. and R. Wilson: 1982, 'Reputation and Imperfect Information', *Journal of Economic Theory* **27**(2), 253–279. doi:10.1016/0022-0531(82)90030-8.

La Porta, R., F. Lopez-de-Silanes and A. Shleifer: 1999, 'Corporate Ownership Around the World', *The Journal of Finance* **54**(2), 471–517. doi:10.1111/0022-1082.00115.

Lafferty, B. A.: 2007, 'The Relevance of Fit in a Cause-Brand Alliance When Consumers Evaluate Corporate Credibility', *Journal of Business Research* **60**(5), 447–453. doi:10.1016/j.jbusres.2006.09.030.

Lam, K. C. and G. Shi: 2008, 'Factors Affecting Ethical Attitudes in Mainland China and Hong Kong', *Journal of Business Ethics* **77**(4), 463–479. doi:10.1007/s10551-007-9360-1.

Landon, S. and G. E. Smith: 1997, 'The Use of Quality and Reputation Indicators by Consumers: The Case of Bordeaux Wine', *Journal of Consumer Policy* **20**(3), 289–323. doi:10.1023/A:1006830218392.

Lee, L. L.: 1998, 'P&G Wants to be on Tip of Tongues in, Let's Say, Tianjin', *Wall Street Journal (Eastern Edition)* Aug 24, 1.

Loughran, T. and J. R. Ritter: 1995, 'The New Issues Puzzle', *The Journal of Finance* **50**(1), 23–51. doi:10.2307/2329238.

Maathuis, O., J. Rodenburg and D. Sikkel: 2004, 'Credibility, Emotion or Reason?', *Corporate Reputation Review* **6**(4), 333–345. doi:10.1057/palgrave.crr.1540003.

Mahon, J. F. and S. L. Wartick: 2003, 'Dealing with Stakeholders: How Reputation, Credibility and Framing Influence the Game', *Corporate Reputation Review* **6**(1), 19–35. doi:10.1057/palgrave.crr.1540187.

McGuire, J. B., S. Alison and T. Schneeweis: 1988, 'Corporate Social Responsibility and Firm Financial Performance', *Academy of Management Journal* **31**(4), 854–872. doi:10.2307/256342.

McGuire, J. B., T. Schneeweis and B. Branch: 1990, 'Perceptions of Firm Quality: A Cause or Result of Firm Performance', *Journal of Management* **16**(1), 167–180. doi:10.1177/014920639001600112.

Milgrom, P. and J. Roberts: 1982, 'Predation, Reputation and Entry Deterrence', *Journal of Economic Theory* **27**(2), 280–312. doi:10.1016/0022-0531(82)90031-X.

Neville, B. A., S. J. Bell and B. Menguc: 2005, 'Corporate Reputation, Stakeholders and the Social Performance – Financial Performance Relationship', *European Journal of Marketing* **39**(9–10), 1184–1198. doi:10.1108/03090560510610798.

Newell, S. J. and R. E. Goldsmith: 2001, 'The Development of a Scale to Measure Perceived Corporate Credibility', *Journal of Business Research* **52**(3), 235–247. doi:10.1016/S0148-2963(99)00104-6.

Orlitzky, M. and J. D. Benjamin: 2001, 'Corporate Social Performance and Firm Risk: A Meta-Analytic Review', *Business & Society* **40**(4), 369–396. doi:10.1177/000765030104000402.

Orlitzky, M., F. L. Schmidt and S. L. Rynes: 2003, 'Corporate Social and Financial Performance: A Meta-Analysis', *Organization Studies* **24**(3), 403–441. doi:10.1177/0170840603024003910.

Penman, S. H.: 1992, 'Return to Fundamentals', *Journal of Accounting, Auditing & Finance* **7**(4), 465–483.

Penman, S. H.: 1996, 'The Articulation of Price-Earnings Ratios and Market-To-Book Ratios and the Evaluation of Growth', *Journal of Accounting Research* **34**(2), 235–259. doi:10.2307/2491501.

Podolny, J. M.: 1993, 'A Status-Based Model of Market Competition', *American Journal of Sociology* **98**(4), 829–872. doi:10.1086/230091.

Ritter, J. R.: 1991, 'The Long-Run Performance of Initial Public Offerings', *The Journal of Finance* **46**(1), 3–27. doi:10.2307/2328687.

Roberts, P. and G. Dowling: 2002, 'Corporate Reputation and Sustained Superior Financial Performance', *Strategic Management Journal* **23**(12), 1077–1093. doi:10.1002/smj.274.

Rose, C. and S. Thomsen: 2004, 'The Impact of Corporate Reputation on Performance: Some Danish Evidence', *European Management Journal* **22**(2), 201–210. doi:10.1016/j.emj.2004.01.012.

Rossiter, J. and L. Percy: 1997, *Advertising Communications and Promotion Management* (McGraw Hill, New York).

Rumelt, R. P.: 1987, 'Theory, Strategy and Entrepreneurship,' in *The Competitive Challenge* (Harper & Row, New York), pp. 137–158.

Sabate, J. M. and E. Puente: 2003, 'Empirical Analysis of the Relationship Between Corporate Reputation and Financial Performance: A Survey of the Literature', *Corporate Reputation Review* **6**(2), 161–177. doi:10.1057/palgrave.crr.1540197.

Sanchez, J. L. F. and L. L. Sotorrio: 2007, 'The Creation of Value through Corporate Reputation', *Journal of Business Ethics* **76**(3), 335–346. doi:10.1007/s10551-006-9285-0.

Schmalensee, R.: 1985, 'Do Markets Differ Much?', *The American Economic Review* **75**(3), 341–351.

Schultz, M. and L. de Chernatony: 2002, 'Corporate Branding', *Corporate Reputation Review* **5**(2–3), 105–112. doi:10.1057/palgrave.crr.1540168.

Schultz, M., M. J. Hatch and M. H. Larsen: 2000, *The Expressive Organization: Linking Identity, Reputation and Corporate Brand* (Oxford University Press, Oxford), pp. 1–7.

Schuman, M.: 2004, 'China's Big, Big Bird', *Time* **163**(8), A8.

Shapiro, C.: 1983, 'Premiums for High Quality Products as Returns to Reputations', *The Quarterly Journal of Economics* **98**(4), 659–679. doi:10.2307/1881782.

Simpson, W. G. and T. Kohers: 2002, 'The Link between Corporate Social and Financial Performance: Evidence from the Banking Industry', *Journal of Business Ethics* **35**(2), 97–109. doi:10.1023/A:1013082525900.

Srivastava, R. K., T. A. Shervani and L. Fahey: 1998, 'Market-Based Assets and Shareholder Value: A Framework for Analysis', *Journal of Marketing* **62**(1), 2–18. doi:10.2307/1251799.

Stuart, H.: 2002, 'Employee Identification with the Corporate Identity', *International Studies of Management and Organization* **32**(3), 28–44.

Sudhaman, A.: 2004, 'China CEOs Awaken to Benefit of CSR', *Media*, July 2, 8-8.

Wang, Y., J. A. Kandampully, H. P. Lo and G. Shi: 2006, 'The Role of Brand Equity and Corporate Reputation in CRM: A Chinese Study', *Corporate Reputation Review* **9**(3), 179–197. doi:10.1057/palgrave.crr.1550027.

Weigelt, K. and C. Camerer: 1988, 'Reputation and Corporate Strategy: A Review of Recent Theory and Applications', *Strategic Management Journal* **9**(5), 443–454. doi:10.1002/smj.4250090505.

Whitcomb, L. L., C. B. Erdener and C. Li: 1998, 'Business Ethical Values in China and the U.S.', *Journal of Business Ethics* **17**(8), 839–852. doi:10.1023/A:1005793424492.

Williamson, O. E.: 1985, *The Economic Institutions of Capitalism and Firms, Markets and Relationship Contracting* (The Free Press, New York).

Wilson, R.: 1985, *Game-Theoretic Models of Bargaining* (Cambridge University Press, London).

Zhang, B. and X. Li: 2003, 'An Evolving Market Efficiency Test on the Chinese Stock Market', *Journal of China Economics* **38**(1), 54–61, in Chinese.

Zyglidopoulos, S. C. and D. M. Reid: 2006, 'Managing Corporate Reputation Within the Chinese Context: Future Research Directions', *Corporate Reputation Review* **9**(3), 155–161. doi:10.1057/palgrave.crr.1550028.

Ran Zhang
Guanghua School of Management,
Peking University,
Beijing, 100871, P.R. China
E-mail: rzhang@gsm.pku.edu.cn

Zabihollah Rezaee
Fogelman College of Business and Economics,
The University of Memphis,
Memphis, TN 38152, U.S.A.
E-mail: zrezaee@memphis.edu