

Corporate reputation is a double-edged sword for companies

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Abstract. Corporate reputation is a double-edged sword for companies. While a good corporate reputation has benefits, a good corporate reputation can also bring disadvantages. A good corporate reputation can lead managers to overestimate the level of corporate risk-taking and can hide internal corporate defects. In addition, corporate reputation may exacerbate the impact of negative events: a good corporate reputation buffers the impact of risky events in a conventional scenario, but in a crisis scenario, a good corporate reputation increases the impact of negative events, while an average corporate reputation reduces the impact of negative events. The purpose of this paper is to explore the negative effects of corporate reputation on firms and the means to prevent them.

Keywords: corporate reputation, agency issues, corporate risk-taking level.

1. Introduction

In today's society with highly developed digital media, the speed of information dissemination has become faster, and corporate reputation changes with the constant updating of information. Traditionally, a good corporate reputation means trustworthy, safe and reliable, but with the collapse of Silicon Valley Bank, it is easy to see that a good corporate reputation may also hide certain risks, so it has become inevitable to study the relationship between corporate reputation and business.

A good corporate reputation can directly improve risk-taking by cushioning the impact of adverse events, but a good reputation can also cause management to overestimate risk-taking and lead to poor decisions. A good corporate reputation may amplify the impact of adverse events in certain circumstances, while a poor corporate reputation may reduce the impact of adverse events.

The article concludes that corporate reputation is a double-edged sword for companies by analyzing the positive and negative effects of corporate reputation in the marketplace. The following suggestions are made in response to these conclusions: (1) For the damage caused by negative events to corporate reputation in a crisis situation, the management of a company may seek endorsement from a company or organization with a high reputation. (2) For investors, corporate reputation has a certain reference value for investment.

2. The benefit of reputation

Corporate reputation, as the perceived representative of a company, is essentially the aggregation of the perceptions and judgments of the company's stakeholders. Stakeholders are any individuals and groups, such as employees, consumers, and community members, who can influence the achievement of corporate goals or be influenced by the process of achieving corporate goals. Based on the observation of the company's historical behavior and prediction of its future activities, the aggregation of the relevant perceptions and judgments accumulated by these individuals and groups creates the corporate reputation. [1].

Corporate reputation has good aspects for companies. In March 2022, the Federal Reserve launched an unprecedented interest rate hike cycle that made deposits more expensive and low-cost savings a thing of the past; at the same time, the value of bonds went down and the large amount of securities held by Silicon Valley banks began to shrink. The interest rate hike also makes these new techies start to demand liquidity. According to the annual report, the total annual amount of Silicon Valley banks fell by \$16 billion in 2022, about 10% of total deposits, especially demand non-interest deposits plummeted from \$126 billion to \$81 billion. Silicon Valley Bank had to sell securities assets that were still losing money. In late February 2023, Moody's, an international rating agency, called

Silicon Valley Bank and warned that its bonds could be downgraded to junk status due to the bank's worrisome financial condition. (\$1.8 billion in losses), a convertible bond offering to raise \$15 billion, and an emergency offering of new shares to raise \$2.25 billion. The Silicon Valley bank's cash crisis began to be publicized. Silicon Valley tech companies were mostly panicked, and on March 9, Silicon Valley Bank's customers demanded \$42 billion in cash withdrawals, equivalent to a quarter of Silicon Valley Bank's total deposits. By the end of the day, Silicon Valley Bank's cash balance had turned into a negative \$1 billion, which simply could not meet its payables at the Federal Reserve. On March 10, the panic spread and Silicon Valley's stock price plunged 68%, to less than \$35 from a previous high of \$267. Silicon Valley Bank had to declare bankruptcy 48 hours after the announcement of the bond sale. Silicon Valley Bank has been exposed to the risk of bankruptcy for a long time, but its reputation for providing capital, credit, venture capital and other financial services to startups in Silicon Valley and its good corporate reputation in the industry led investors to ignore the huge risks, thus showing that a good corporate reputation can cushion the impact of bad events.

3. The harmful of reputation

However, corporate reputation has bad aspects for companies. A good corporate reputation may allow corporate managers to overestimate the level of corporate risk-taking and can hide internal corporate weaknesses. Research in behavioral finance suggests that human psychology influences individual behavioral decisions, and the psychology of management in high positions in the firm can have a significant impact on corporate decisions. Overconfident management tends to overestimate its own capabilities and underestimate potential risks, and has a stronger risk appetite when choosing investment projects, which makes firms less likely to abandon risky investment projects [2]. Taking Silicon Valley Bank as an example, Silicon Valley Bank, because of its own good reputation, wrongly assesses its corporate risk-taking ability and chooses to purchase a large amount of assets such as U.S. Treasuries and real estate mortgage securities to improve its own yield. In terms of asset composition, 35% of the funds owned by Silicon Valley Bank as of the end of 2022 were used to make loans and 55% were used to purchase Treasuries and MBS, a level that is the highest among the top 50 U.S. banks. Silicon Valley Bank's own liquidity was poor among banks due to the large amount of capital that was used to purchase long-term assets. This was one of the reasons that led to the bankruptcy of Silicon Valley Bank. Thus, a high corporate reputation can boost management's confidence level, which in turn increases the willingness to take risks and ultimately influences corporate risk decisions.

A good corporate reputation may amplify the impact of an adverse event, while an average corporate reputation may reduce the impact of an adverse event. Mixue Ice Cream & Tea is a very well known restaurant company in China and enjoys a good corporate reputation. Food safety is an issue that deserves attention in any restaurant business and is a common problem. After the outbreak of food safety problems in Mixue Ice Cream & Tea, consumers' trust in Mixue Ice Cream & Tea as a company was significantly reduced, while other companies that were exposed to food safety problems did not suffer too much fluctuation. This phenomenon can be attributed to the following four factors: (1) The high reputation of a company's high profile makes it more visible in individual perceptions, making it easier for the company to be seen as the source of the crisis. (2) The high visibility of high reputation will attract more rigorous and close attention from media and stakeholders, which will aggravate the negative impact of corporate crisis. (3) In a crisis scenario, a high reputation will exacerbate subsequent negative stakeholder reactions as the crisis undermines stakeholders' high expectations of the firm. (4) The interaction between high reputation and the other two dimensions in a crisis scenario. When a crisis occurs, corporate reputation is a multidimensional concept, and its dimensions interact with each other, making the role of corporate reputation in a crisis scenario more complex. [3].

4. Conclusion

The authors have the following two proposals for the above problem. (1) For the damage caused by negative events to corporate reputation in a crisis situation, the management of the company can look for a highly reputable company or organization to endorse. Rumors of the imminent collapse of Jiangsu Sheyang Rural Commercial Bank led to a rapid decline in the bank's reputation, a run on the bank, and a serious crisis. Subsequently, the governor of Sheyang County issued a televised speech stating that he would ensure that the interests of depositors would not be affected at any time; leaders of the township government also went to the scene to appeal not to believe the rumors; and the China Banking Association made a public statement that Jiangsu Sheyang Rural Commercial Bank was not at risk of collapse. The run on Jiangsu Sheyang Rural Commercial Bank was successfully resolved after several authoritative endorsements with good reputations in the community. By replacing low reputation with high reputation, the damage to corporate reputation caused by negative events in crisis situations can be solved to a certain extent. (2) For investors, corporate reputation has a certain reference value for investment. As Seth Karaman says, "In a panic market, the number of undervalued securities increases and the degree of undervaluation rises. Conversely, in a bull market, the number of undervalued securities and the extent of their undervaluation both decline. When tempting opportunities abound, value investors have plenty of time and space to pick bargains with great future potential. Market panic is the hardest and busiest time for value investors: countless good shots may be thrown at you one by one." When a company is in a crisis situation, the valuation of the company will definitely be lower than the value of the company should have, because the return of any company has the characteristics of mean reversion, undervalued companies have a great probability to return to the mean, and investment in undervalued companies have a greater margin of safety, so you can profit from it. In early 2020, RuiXing Coffee was forced to delist the company because of the financial fraud fiasco that broke out, and not only did the management quit, but the company was also forced to delist. Investors were generally pessimistic about the business. However, with the formation of a new management team at RuiXing, the emergence of a series of products and vigorous store expansion through bankruptcy restructuring, equity changes, investor compensation, and a series of products made it possible for RuiXing Coffee to turn around to a profit of 1.156 billion yuan in 2022, with an operating margin of 8.7%. A poorer corporate reputation can, to some extent, be equated with an undervalued marker, and profit by bringing undervalued companies back to the mean. Corporate reputation may also be an investment reference indicator.

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