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# LINK FROM ORGANIZATIONAL FINANCIAL PERFORMANCE TO REPUTATION: THE ROLE OF BOARD COMPOSITION

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## *ABSTRACT*

This research seeks to investigate the effects of organizational financial performance, managerial board composition on organizational reputation. Especially, it further explores the moderating influence of managerial board composition on the causal relationship between organizational financial performance and organizational reputation. A survey of 150 best publicly listed firm-year observations in Vietnam discovered that companies that achieve improved organizational financial performance could maintain and enhance their organizational reputation. It also revealed that firms where the majority of independent executives are in the managerial board often obtain better organizational reputation. The findings found out that at firms with the majority of independent executives in the board, their organizational financial performance would play a more vital role in maintaining and improving their organizational reputation. This research provides a comprehensive overview of the roles of organizational financial performance and the composition of directorial boards in building up and developing organizational reputation. This allows business managers to make better decisions on the proportion of independent executives in their managerial board, so achieve better organizational financial performance and then obtain higher organizational reputation.

**Contribution/ Originality:** This work is one of very few studies, which emphasizes the moderating effect of managerial board composition in the causal link from organizational financial performance to organizational reputation, where it is statistically evidenced to augment the influential magnitude of organizational financial performance on organizational reputation.

## 1. INTRODUCTION

The objective of this research is to evaluate how organizational reputation is built up by organizational financial performance and the role of managerial board composition in this process. Organizational reputation leads firms to enhance their value over the duplicate value of physical resources. The resource-based view regards organizational reputation an important and scarce resource that results in sustainable competitive advantages. It has been also deemed as a strategic resource, so it is very important that a company should take a proactive standpoint to maintain a critical strategic source which provides the opportunity to improve competitive advantages (Hall and Lee, 2014). The reputation of a firm functions as an intangible resource distinguishing a company from others the role of which is to draw consumers' attention to buy back and willingly disburse higher for services or goods (Roberts and Dowling, 2002; Eberl and Schwaiger, 2005). Workers really like to work in companies of great reputation and highly reputable companies are easier to recruit and maintain a skilled work force with less expense (Ansong and Agyemang, 2016).

Organizational reputation denotes the representation of the organization created in time and with considerable effort, which affects the way where people think of the organization (Sandu, 2015). Organizational reputation is a decisive driver of organizational value and a chief cause that results in good competency for an organization. Its function is considered as a mechanism to diminish vagueness for consumers and improve marketing efficiency, which offers clients with higher satisfaction (Huynh, 2018). Given that organizational reputation is a significant source of core competence of a company, studies on the drivers of the reputation of a company become essential for numerous businesses. On the one hand, a firm with a higher reputation is supposed to enjoy a better competitive advantage; on the other hand a better financial performance leads to improvements in organizational reputation (Blajer-Gołębiewska and Kozłowski, 2017). Many researchers analyze and document empirical evidence on the causal link from organizational reputation to organizational financial performance (Roberts and Dowling, 2002; Iwu-Egwuonwu, 2011; Lee and Roh, 2012; Kariuki, 2014; Gatzert, 2015; Li *et al.*, 2016). However, to the best of my knowledge, so far only a few studies have investigated the causal connection from organizational financial performance to organizational reputation, and especially these research projects have not conducted in Southeast Asia (Gabbioneta *et al.*, 2007; Hall and Lee, 2014; Blajer-Gołębiewska and Kozłowski, 2017). Furthermore, organizational reputation is claimed as a fairly new edge and still lacks intensive studies concerning its antecedents and consequences (Jinfeng *et al.*, 2014) therefore this study tries to examine the role of managerial board composition in building up organizational reputation as well as in the causal link between organizational financial performance and organizational reputation.

Business conditions are ever changing all over the world, particularly in emerging economies. Southeast Asia, a developing region, is enormously vulnerable to the business environment, but plays a very important position in linking main economies globally and one of the most active and highest-speed developing economies (Huynh, 2017). Vietnam is expected as a participant of the intercontinental economy, making a large contribution to the globally economic development. The dynamic business environments in Vietnam lead companies to be more interested in research on management (Huyng and Wang, 2014). In addition, Doan *et al.* (2011) claim that there has still been little research on managerial area and note that it is necessary to do more research on this scientific field in Vietnam to narrow the gap. In this research, the author attempts to review the previous knowledge related to the relationship between and among managerial board composition, organizational financial performance and organizational reputation, then investigate the causal link from organizational financial performance to its consequence that is organizational reputation. It especially focuses on the role of managerial board composition in that relationship and is performed in Vietnam as an emerging economy in Southeast Asia. The remains of this research are arranged in the following structure. Part 2 summarizes literature reviews on organizational financial performance and reputation and then develops the research hypothesis, followed by data selection and analyses. Part 3 provides empirical results. The last part offers some conclusions.

## 2. THEORETICAL FRAME AND METHODOLOGY

### *2.1. Theoretical Frame*

Organizational reputation is really interested by shareholders and other stakeholders such as managerial executives, creditors, recruiters and employees. A good organizational reputation transmits a good sign to those stakeholders about its services or goods over the rivals. On the other hand, organizational financial performance signals information reflecting a business's success in past objectives, efficiency in resource distribution as well as goal fulfillment (Walsh *et al.*, 2009). It is asserted that a firms' effectiveness such as product quality, service quality, input quality or asset productivity, rankings, achievements and high-status' affiliation is a key factor building up organizational reputation (Rindova *et al.*, 2005). Additionally, the positive influence of organizational financial performance on organizational reputation has been confirmed by some previous studies (Hammond and Slocum, 1996; Gabbioneta *et al.*, 2007; Jinfeng *et al.*, 2014).

A study by Hammond and Slocum (1996) tries to connect organizational reputation, evaluated according to Fortune magazine's most admired list, to organizational financial performance, which is measured with two items that are "standard deviation of the market return" and "return on sales". Their work offers some managerial implications where organizational financial performance can improve subsequent organizational reputation. The association between organizational financial performance and organizational reputation is intricate due to different reasons. Firstly, it needs to make profit for capital to spend for socially responsible behaviors. It is also suggested if a firm suffers surplus stock; it will have many chances to put more money in socially responsible activities, which so improves organizational reputation. Secondly, Cornell and Shapiro (1987) reply on stakeholder theory recommending that it is necessary to equally satisfy all stakeholders' expectations. Satisfying a specific group of stakeholders will lead to the cost of other groups. These researchers classify stakeholders into two groups. The first group has a clear agreement with the company such as shareholders. The second has intrinsic relationships with the company such as employees and customers. Thirdly, organizational reputation normally indicates the quality of organizational managerial level perceived by the company's stakeholders who regard organizational reputation to social responsibility as an indicator of the highest-level management ability to efficiently supervise the company against the uncertain business environment (Miles, 1987). If organizational reputation decreases, it can indicate that business executives are not able to predict and manage their business environment correctly and so there is a need to make changes to gain an improved fit.

As Gabbioneta *et al.* (2007) defined; organizational reputation is a set of cooperatively held viewpoints of a firm's competency to meet the benefits of different stakeholders. Those scholars provide empirical findings of antecedents influencing the evaluation of a specific group who are financial analysts, key actors whose assessments and actions affect joint perceptions of decisive resource-holders, for instance institutional or retail investors. Financial specialists are especially interested in organizational financial performance, and then regularly integrate such financial information into their business judgments. The effects of high organizational reputation have been widely analyzed, but research on the assessments among various stakeholders is still modest. In an analysis on the link between corporate strategy and organizational reputation – building, Fombrun and Shanley (1990) explore how stakeholders assess firms according to numerous accounting and marketing indications demonstrating organizational performance, strategic indications representing strategic plans and institutional indications representing compliance with social practices. In addition; Sjovall and Talk (2004) draw on cognitive attribution theory, then explain stakeholders' impressions on firms. Stakeholders have a tendency to activities, which are perceived as salient to their values and interests, and then often infer organizational dispositions according to surveyed activities as signs of the contextual constraints.

As reported by Jinfeng *et al.* (2014) different stakeholders might take hold of various viewpoints to a business. As a reply, numerous organizations have applied organizational financial performance as a managerial instrument to satisfy different stakeholders' desires to create a positive business image, which will build up an excellent organizational reputation. Moreover, McWilliams *et al.* (2006) view organizational social performance as a tool to build up and maintain organizational reputation. This social performance - related activities will develop organizational reputation and are external motives for firms. In a study on a resource-based view, Boyd *et al.* (2010) point out that organizational financial performance has a positive relationship with organizational reputation. Another side of organizational financial performance, which plays a vital role in organizational reputation, is relevant to organizational financial stability; whereas firms that have obtained sustainable financial performance are expected to be in higher regard. Stakeholders, such as employees, creditors, shareholders, suppliers, customers and others are commonly risk and so support more financially sustainable companies.

Further, Surroca *et al.* (2010) base their arguments on instrumental stakeholder theory and resource based view that, by building close links with primary stakeholders a organization could enhance some intangible resources such as organizational reputation, which allow the most effective and wise use of organizational resources to obtain competitive advantages over the competitors leading to superior organizational financial performance. Grounded on the discussions above, which are related to organizational financial performance and organizational reputation, it can hypothesize the following hypothesis "Organizational financial performance positively influence on organizational reputation".

Furthermore, Wang and Huynh (2014a) study the importance of directorial board composition to the connection from managerial accounting to organizational performance, reporting that the managerial boards, where independent executives are in a majority, will respond to agency problems, as they can manage self-interests done by management, which resulting in superior organizational financial performance. Independent executives who are normally recruited based on their exceptional experience, knowledge and education can make valuable managerial decisions, leading to competitive advantages for the organizations. Likewise, as Wang and Huynh (2014b) stated, independent executives hold an exclusive supervising role for the firm by dismissing underperforming members of the managerial board, which can reduce or limit the expenses of agency, so enhance organizational financial performance. These researchers employ Sobels' analyses to study the complicated links among firm performance, corporate governance, managerial accounting, indicating that the firms where independent executives make up the majority likely make better organizational performance.

Besides, García-Meca and Palacio (2018) examine the effect of managerial board composition on organizational reputation, revealing that independent executives are efficient in enhancing organizational reputation, but not all of them are similarly useful. Some types of independent executives such as business experts are very helpful to organizational reputation. The findings indicate a statistically significant and positive effect of managerial board composition on organizational reputation, which recommends that a high proportion of independent executives in the managerial board will act as a related and evident sign of managerial efficiency. This affects the perceptions of stakeholders on organizational reputation. Hillman *et al.* (2000) categorize the administrative board into business specialists, financial experts, and community stakeholders, and then investigate the influence of managerial composition on organizational reputation. The empirical results ascertain that, the proportion of independent executives on managerial boards is significantly as well as positively linked to organizational reputation. The proficiency and experience of independent executives help settle industrial problems as well as make better business decisions. Based on the suggestions above that, the proportion of independent executives is not only influential on organizational financial performance, but also on organizational reputation; therefore, it can be recommended, "the proportion of independent executives may moderate the causal linkage from organizational financial performance to organizational reputation".

### *2.2. Data Collection*

The research sample was based on the 50 best Vietnamese publicly listed firms elected by Forbes Vietnam during the last six years from 2012 to 2017. Forbes is a global media firm, focusing on business, investing, technology, entrepreneurship, leadership and lifestyle. According to Forbes Vietnam, the annual list bases on the ranking method of Forbes with the consideration on listed company specification in Vietnam. Information used to vote is audited financial reports of continuous three years. There are totally 300 firm-year observations to be used for analyses in this research. As Hair *et al.* (2012) recommended, a minimum sample size of 100 for multiple regressions is required, if there are fewer than five constructs in the research model. Using a simple random sampling approach, this research selected 150 firm-year observations from the 300 observations, which is enough for quantitative analyses.

### *2.3. Measurements*

The list of Vietnam's 50 best publicly listed firms is applied to compute the variable of organizational reputation (ORE). The voted firms for the list are assessed by giving a score from 1 to 50 where number 1 is the best and number 50 is the worst of the list. The variable of organizational financial performance (OFP) is evaluated according to two dimensions which are "after-tax rate of return on shareholders' equity" (ROE) and "after-tax rate of return on total assets" (ROA). Managerial board composition (MBC) is measured grounded on the proportion of independent executives in the board. These measurements are adapted from Huynh (2018).

### *2.4. Analyses*

The collected data went through some statistical techniques. Firstly, this research utilizes the reliability analysis to verify the consistency of the scales. Reliability is referred to as the degree where a construct generates consistent outcomes, if the items are repeated many times. The reliability analysis is confirmed by achieving the quantity of logical variance in a scale that could be performed by deciding the relationship between the scores attained from different administrations of the construct; so if the connection in reliability analysis is high, the construct produces consistent outcomes and is consequently reliable. Subsequently, it performed regression analyses to explore the causal link from organizational financial performance to organizational reputation. Then the moderating influence of the proportion of independent executives on the causal connection from organizational financial performance to organizational reputation is explored by applying hierarchical multiple regressions.

## 3. EMPIRICAL FINDINGS

### *3.1. Construct Reliability Test*

The consistence of measurements within the construct was assessed by using the reliability analytic method. There are three main variables in the research model, only one of which is rated on two dimensions. Organizational financial performance is formed by two items, namely "after-tax rate of return on shareholders' equity" (ROE) and "after-tax rate of return on total assets" (ROA); so they should be entered for reliability check of its own consistency. The Cronbach's Alpha approach was performed to verify the reliability and valid of "organizational financial performance".

**Table-1.** Reliability analysis results

| Measurement | Manifest items | Total-item correlations | Cronbach's Alpha |
|---|---|---|---|
| Organizational financial performance | ROA | 0.64 | 0.78 |
| | ROE | 0.64 | |

**Source:** Author's computations from gathered data

As illustrated in Table 1, the item-total correlation of "after-tax rate of return on shareholders' equity" and "after-tax rate of return on total assets" is 0.64; which is larger than 0.5, the lowest limit suggested by Hair *et al.* (2012). The Cronbach's Alpha obtains a value of 0.78, above the 0.7 level as Hair *et al.* (2012) stipulated. Those ensure that "after-tax rate of return on shareholders' equity" and "after-tax rate of return on total assets" are internally consistent with their construct "organizational financial performance".

### *3.2. Causal Hypothesis Test*

After ensuring that the variable "organizational financial performance" was adequately reliable and valid for statistical analyses, regression analyses were undertaken to test the causal hypothesis "organizational financial performance positively affect organizational reputation". "Organizational financial performance" is measured on "after-tax rate of return on shareholders' equity" and "after-tax rate of return on total assets". This research at first regresses organizational reputation on "after-tax rate of return on shareholders' equity" and "after-tax rate of return on total assets" separately; then on "organizational financial performance" that is the average of "after-tax rate of return on shareholders' equity" and "after-tax rate of return on total assets".

The results of the causal hypothesis test are shown in Table 2. "After-tax rate of return on shareholders' equity" and "after-tax rate of return on total assets" similarly impact positively on organizational reputation with the coefficients of 0.335 and 0.331 respectively at the 1% significance level. Further, the findings in Table 2 also indicate that "organizational financial performance" imposes a positive impact on organizational reputation at 1% significance level with the 0.686 coefficient. The explanatory power of "organizational financial performance" in the variation in organizational reputation achieves 30.4%. These findings statistically support the proposed hypothesis that organizational financial performance plays an important role in building up and improving organizational reputation.

**Table-2.** Causal hypothesis test with ORE as an explained variable

| Explanatory variables | Model 1 | Model 2 |
|---|---|---|
| Constant | 0.898 | 0.900 |
| ROA | 0.331** | |
| ROE | 0.355** | |
| OFP | | 0.686** |
| R-squared | 0.304 | 0.304 |
| F | 32.070 | 64.551 |
| $P_F$ | 0.000 | 0.000 |

****Significance at 1%*

**Source:** Author's computations from gathered data

### *3.3. Moderating Hypothesis Test*

The moderation of the proportion of independent directors on the causal link between organizational financial performance and organizational reputation is investigated by using the hierarchical multiple regression method, which consists of two regression models based on the procedures recommended by Baron and Kenny (1986). The main influences of the proportion of independent directors and organizational financial performance on organizational reputation are explored by regressing Model 1, and then in addition to the main influences, the interaction variable is entered into Model 2.

**Table-3.** Moderating test with ORE as an explained variable

| Explanatory variables | Model 1 | Model 2 |
|---|---|---|
| Constant | -0.278 | -0.340 |
| OFP | 0.550** | 0.604** |
| MBC | 0.374** | 0.352** |
| OFP*MBC | | 6.725* |
| F | 46.833 | 34.190 |
| $P_F$ | 0.000 | 0.000 |
| R-squared | 0.389 | 0.413 |
| Test of increases in $R^2$: | $\Delta R^2 = 0.023$; $p = 0.017 \leq 5\%$ | |

***Significance at 1%; *Significance at 5%*

**Source:** Author's computations from the gathered data

To lessen multicollinearity, before generating the interaction variable, explanatory and moderating variables need centering (Mathies and Ngo, 2014). Hence, to generate the interaction term of organizational financial performance and the proportion of independent directors, standardized indices of organizational financial performance and the proportion of independent directors are multiplied together. The results of moderating test are demonstrated in Table 3. Both organizational financial performance and the proportion of independent directors positively affect organizational reputation at the 1% significance level with the influential coefficients of 0.550 and 0.374 respectively in Model 1 and 0.604 and 0.352 respectively in Model 2. These indicate that, not only organizational financial performance, but the proportion of independent directors in the managerial board also positively influences organizational reputation. The addition of the interaction term (organizational financial performance x the proportion of independent directors in the managerial board) into Model 2 makes an increase in the explanatory power of the research model to 0.413 from 0.389 (a increase by 0.023) with the change significance level of smaller than 5%. Moreover, the interaction term of organizational financial performance and the proportion of independent directors positively impacts organizational reputation at the 5% significance level with the influential coefficient of 6.725, in support of the moderating hypothesis "the proportion of independent executives moderates the causal relationship from organizational financial performance to organizational reputation". The findings imply that, the composition of managerial boards affects the causal association between organizational financial performance and organizational reputation in the way if the proportion of independent executives in the managerial board increases, then the casual link from organizational financial performance to organizational reputation becomes stronger.

## 4. CONCLUSIONS

To sum up, this project investigated the role of organizational financial performance in building up and maintaining organizational reputation and then explored the effect of managerial boards' composition on organizational reputation as well as on the causal link between organizational financial performance and organizational reputation. This research contributes to extant management knowledge into the relationships between and among managerial boards' composition, organizational financial performance and organizational reputation in several ways.

The first objective was to examine the influence of organizational financial performance on organizational reputation. The findings revealed that firms that obtain superior organizational financial performance can enhance their organizational reputation. Secondly, this research also investigated the link between the proportion of independent executives in the managerial board and organizational reputation. The results found that companies where there are the majority of independent executives in the managerial board often maintain their organizational reputation in higher levels.

The third contribution was that this research discussed the moderating role of the proportion of independent executives in the effect of organizational financial performance on organizational reputation and discovered that at firms with the majority of independent executives in the board, their organizational financial performance will play a more essential role in building up and improving their organizational reputation. To practical aspects, this research provides a better understanding of the roles of organizational financial performance and the composition of directorial boards in building up, maintaining and improving organizational reputation; so the managers of companies can decide on a suitable proportion of independent executives in their managerial board which leads to better organizational financial performance and then obtain a higher organizational reputation.

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