THE EFFECTS AND DETERMINANTS OF EXTENSIVE DISCLOSURE: EVIDENCE FROM JAPAN

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Abstract

It is believed to be increasingly important for firms to be engaged in extensive disclosure in Japan. This paper simultaneously investigates the relationship between Corporate Social Performance (CSP) and corporate attitude toward extensive disclosure and between corporate attitude toward extensive disclosure and corporate reputation. We find that corporate attitudes toward extensive disclosure and CSP are positively correlated and that corporate attitudes toward extensive disclosure and corporate reputation are positively correlated. This evidence indicates that firms are engaged in extensive disclosure as a component of their corporate strategy in social responsibility activities and that those with more positive attitudes toward extensive disclosure appear to be able to develop and maintain better relationships with their various stakeholders.

Keywords: Corporate reputation, Corporate Social Performance (CSP), Corporate Social Responsibility (CSR), Extensive disclosure, Stakeholder theory

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1. Introduction

One purpose of our research is to investigate, from a strategic decision-making perspective, why firms voluntarily disclose extensive information about their economic, social, and environmental aspects to various stakeholders. Another aim of this paper is to identify the benefits that firms can derive from such extensive disclosure on non-financial aspects. The strategic aims of corporate disclosure activities are not simply restricted to obtaining the financial outcome. Instead, corporate disclosure strategies now encompass all aspects of a firm. Moreover, corporate disclosure activities are continually evaluated, not just by the financial market but also by all the other stakeholders of a firm.

In Japan, many practitioners support the notion of stakeholder activism, which assumes that a firm evolves within a broader societal context and that a firm’s long-term existence is dependent upon addressing the concerns of its various stakeholders. As a result, many large Japanese firms voluntarily address extensive disclosure and are broadening the scope and the scale of information being released. This is why, in our study, we focus on large firms within a Japanese context. Such an investigation is important not only to the financial analysts and managers in Japan but also to those across the world because of the global influence of Japanese firms. Therefore, it is evident that understanding the behavior of Japanese firms has significant global implications.

Stakeholder theory, as it is understood today, was popularized by Freeman (1984) and is one of the potentially powerful theories that underpin the phenomenon of voluntary disclosure activities (Gray et al. 1995). On the other hand, the concept of corporate reputation has recently been emerging as a topic of interest in the literature of both accounting and stakeholder theory (Neville et al. 2005; Riahi-Belkaoui 2001; Waddock and Graves 1997). Therefore, we focus on corporate reputation in measuring the effects of extensive disclosure in accordance with the stakeholder theory perspective.

Our analysis is related to two branches of literature. One contains the literature pertaining to the determinants of corporate disclosure. According to stakeholder theory, some firms strategically engage in corporate social responsibility activities in order to develop and maintain good relationships with their various stakeholders. Such firms are likely to voluntarily disclose extensive information as a component of their corporate strategic social responsibility activities. Roberts (1992) empirically demonstrates that firms appear to engage in corporate social disclosure in order to develop and maintain good relationships with various stakeholders. Belkaoui and Karpik (1989), Cormier and Magnan
(1999), and Gelb and Strawser (2001) empirically demonstrate that firms with a higher CSP, which is a measure of the level of corporate social responsibility activities, appear to have a better quality or quantity of disclosure. The other branch of the literature related to this paper concerns the determinants of corporate reputation. Riahi-Belkaoui (2001), Toms (2002), Landgraf and Riahi-Belkaoui (2003), and Hasseldine et al. (2005) provide evidence that firms with a better quality or quantity of disclosure appear to have a better overall or environmental corporate reputation. In contrast, in this study, we focus on corporate attitudes toward extensive disclosure rather than the quality or quantity of disclosure.

We contribute to the existing literature by simultaneously studying the relationship between CSP and corporate attitudes toward extensive disclosure, and the relationship between corporate attitudes toward extensive disclosure and corporate reputation. The demands or needs of the stakeholders can be reflected in business activities by enabling firms to communicate with them through extensive disclosure; consequently, firms can develop risk management strategies. Furthermore, they can receive a high valuation in financial markets by building good relationships with the various stakeholders. Thus, it is important to study the determinants and consequences of extensive disclosure. Another contribution of this paper is that the evidence presented here is among the first concerning the strategic background and effects of corporate disclosure within a Japanese context in accordance with the stakeholder theory perspective. Moreover, the focus of most empirical studies on the relationship between corporate disclosure and corporate reputation has been the U.S., U.K., and Australia. In contrast, very few have focused on Japan. We find evidence that corporate attitudes toward extensive disclosure and CSP are positively correlated after controlling other possible determinants. This suggests that firms with a higher CSP appear to disclose extensive information more positively than those with lower CSP. Further, we demonstrate that corporate attitudes toward extensive disclosure and corporate reputation are positively correlated after controlling other factors that could affect corporate reputation. This indicates that firms with more positive attitudes toward extensive disclosure appear to have a better corporate reputation. This evidence suggests that firms are engaged in extensive disclosure as a component of their corporate strategic social responsibility activities, and that those that hold more positive attitudes toward such disclosure appear to be able to develop and maintain better relationships with various stakeholders. The remainder of this paper is organized as follows. Section 2 reviews existing literature on the topic and presents the research hypothesis. Section 3 describes the empirical procedures employed. Section 4 reports the results and Section 5 summarizes the research and presents our conclusions.

### 2 Literature Review and the Development of Hypotheses

#### 2.1 Stakeholder theory as the theoretical framework for corporate social and environmental disclosure

Previous research has attempted to explain and understand corporate disclosure activities, which at least superficially appear to lie outside the conventional domains of financial disclosure activities. In other words, past researches have focused on corporate social and environmental disclosure activities. The stakeholder theory is one of the accepted theoretical frameworks of such disclosure. It argues that systematic attention to various stakeholder interests is critical to a firm’s success. Therefore, managers are assumed to have wider responsibilities toward various stakeholders and not only toward shareholders. While managers are responsible to shareholders, they must also consider other groups who have vested interests in the performance of the firm and are affected by its activities. A major role of a manager is to assess the importance of meeting stakeholder demands in order to achieve the strategic objectives of the firm. The more powerful the stakeholders, the more must their demands be addressed by the firms. Even though managers are not required to be legally accountable to stakeholders other than the shareholders, voluntary disclosure to the various stakeholders is posited as a way to respond to the pressures exerted by them (Evan and Freeman, 1988; Freeman, 1984).

Ullmann (1985) uses stakeholder theory to build a conceptual framework to explain corporate social responsibility activities involving disclosure, and concludes that stakeholder theory provides an appropriate justification for incorporating strategic decision-making into the studies of both corporate social responsibility activities and disclosure. Specifically, he dissects the firms’ strategy for developing and maintaining good relationships with various stakeholders into three dimensions: the stakeholders’ power, the firms’ strategic posture toward corporate social responsibility activities, and the firms’ past and current financial performances.

Roberts (1992) tested Ullmann’s framework empirically and concluded that stakeholder theory was indeed an appropriate theoretical basis for explaining corporate social activities and disclosure. That is, he examines whether the levels of corporate social disclosure are related to any of these three dimensions. He shows that firms with a higher stakeholder power, those with a more positive posture toward corporate social responsibility, and those with better financial performance appear to have a better quality of social disclosure.

Given the above argument, extensive disclosure, which is the focus of this paper, is seen as a part of the dialogue between the firm and its various stakeholders from a stakeholder theory perspective. Indeed, from
the position of the firm, there is much to recommend stakeholder theory in theorizing about the relationships between the firm and its various stakeholders. Since the purpose of this paper is to reveal the strategic background and the effects of extensive disclosure in the light of the firms’ perspective, we assume that stakeholder theory is a better explanation for such disclosure rather than other alternative theories (e.g., agency theory, legitimacy theory, and political economy theory).

2.2 The strategic background of extensive disclosure from a stakeholder theory perspective

2.2.1 Extensive disclosure as a component of corporate social responsibility activities

As mentioned above, according to stakeholder theory, it is assumed that firms strategically intend to first develop and maintain good relationships with their various stakeholders and then voluntarily disclose further information about their economic social and environmental aspects than is required as a component of corporate strategic social responsibility activities. Therefore, stakeholder theory suggests that the more positively the firms engage in corporate social responsibility activities other than disclosure, the more positively do they also engage in corporate disclosure activities. CSP can be fundamentally characterized by the relationship between the firms and their various stakeholders including shareholders, employees, customers, communities, in accordance with the stakeholder theory perspective (Waddock and Graves, 1997). In other words, it is suggested that there is a positive correlation between CSP and corporate disclosure.

Previous studies have investigated the link between the quality or quantity of the corporate disclosure and corporate social or environmental performance (Belkauoi and Karpik, 1989; Cormier and Magnan, 1999; Freedman and Jaggi, 1982; Freedman and Walesy, 1990; Gelb and Strawser, 2001; Ingram and Frazier, 1980; Rockness, 1985; Walden and Stagliano, 2004; Wiseman, 1982). However, previous research under the corporate social responsibility paradigm finds that the quality or quantity of corporate disclosure does not always reflect the actual social or environmental performance. Although Belkauoi and Karpik (1989) and Gelb and Strawser (2001) demonstrate a strong support for a positive relationship between the two, the results as a whole are weakly supportive of the relationship. This may be due to the focus on the quality or quantity of corporate disclosure not on the corporate attitude toward such disclosure. The quality or quantity of corporate disclosure only reflects on what the firms claim to be doing, which may be very different from what they are doing in fact.

Corporate attitude toward disclosure directly reflects on the firms’ actual activities with regard to such disclosure. Further, corporate social or environmental performance also reflects on what the firms are actually doing with regard to corporate social or environmental responsibility activities other than disclosure. Thus, both are directly related to corporate strategic activities. Then, it is assumed that there is a stronger positive relationship between corporate attitude toward disclosure and corporate social or environmental performance than between the quality or quantity of the disclosure and corporate social or environmental performance.

Moreover, some authors point out that there have been methodological problems pertaining to the definition and measurement of CSP (see Graves and Waddock, 1994; Waddock and Graves, 1997; Wood, 1991; Wood and Jones, 1995). The financial data are readily available. Conversely, the reasonably consistent and the relatively easily available measures of CSP have been ill-defined and measured in a wide variety of ways in each study. Each study employs a different measure as the surrogate for CSP. This may be the reason for the mixed results with regard to the relationship between the quality or quantity of corporate disclosure and corporate social or environmental performance in the previous studies.

Given this argument, in this paper, we introduce CSP as a possible determinant of corporate attitude toward extensive disclosure and investigate the following hypothesis.

H1 The corporate attitude toward extensive disclosure is positively correlated with corporate social performance (CSP).

2.2.2 Extensive disclosure as a response to stakeholder power

According to Ullmann (1984)’s framework, corporate financial performance (CFP) determines the relative weight of stakeholder demand and the attention that firms receive from them. In periods of low CFP, economic demands will have priority over social demands. Moreover, CFP directly affects the firms’ financial ability to institute social responsibility activities. In accordance with his framework, Roberts (1992) predicts that firms with higher CFP may be able to afford to be engaged in corporate social disclosure. Hence, from a stakeholder theory perspective, a positive association between CFP and corporate social and environmental disclosure is predicted.

However, corporate disclosure activities impose certain costs on the firms; therefore, engaging in such activities poses the danger of impairing the firms’ CFP. If this is the case, conversely, it is possible that there is a negative link between CFP and corporate social and environmental disclosure. Further, firms that are less profitable may be engaged in social and environmental disclosure in an attempt to improve their public image.

The bulk of empirical research on corporate social and environmental disclosure has attempted to investigate the relationship between CFP and such
disclosure. However, the results of these studies have been very equivocal, and this line of research has not been conclusive. For example, Cowen et al. (1987), Belkaoui and Karpik (1989), Patten (1991), Hackston and Milne (1996), and Bewley and Li (2000) find no relationship between CFP and disclosure, whilst Freedman and Jaggi (1982: 1988) find either no relationship or an inverse relationship between the two. Neu et al. (1998) and Alnajjiar (2000) also discover that there is a negative relationship between CFP and disclosure. On the other hand, Roberts (1992), Cormier and Magnan (1999), and Gray et al. (2001) find a strong positive relation between corporate social and environmental disclosure and CFP. In this study, we focus on profitability among CFP measures, and consider the relationship between the return of equity (ROE) and corporate attitude toward extensive disclosure; however, we do not predict the direction of this relation. Then, we investigate the following hypothesis.

**H2** The corporate attitude toward extensive disclosure is positively or negatively correlated with ROE.

The stakeholder theory also suggests that the more powerful the stakeholders, the more responsive are the firms to the intensity of their stakeholders’ demands. The stakeholders’ power to influence corporate managers is viewed as a function of the stakeholders’ degree of control over resources required by the firm (Ullmann, 1985). Therefore, the more critical are the stakeholder resources to the continued success of the firm, the greater is the expectation that stakeholder demands will be addressed. Thus, according to the stakeholder theory, firms are posited to be voluntarily engaged in corporate social responsibility activities including disclosure as a strategic response to pressures exerted by their various stakeholders. In other words, a positive correlation between stakeholder power and corporate disclosure is expected.

We assume that firm size is regarded as a surrogate for exposure to the varieties of societal pressure. Larger firms tend to receive greater attention from their various stakeholders and also tend to require more resources from them; therefore, they are under greater pressure than smaller firms to be involved in voluntary disclosure.

Although there are significant epistemological differences within the literature, researchers are rather consistent in concluding that larger firms exhibit a greater predisposition toward the voluntary use of social and environmental disclosure. Previous research has produced considerably consistent results with regard to the positive relationship between firm size and corporate social and environmental disclosure. For example, Cowen et al. (1987), Belkaoui and Karpik (1989), Patten (1991), Hackston and Milne (1996), Neu et al. (1998), Cormier and Magnan (1999), Alnajjiar (2000), Bewley and Li (2000), Gray et al. (2001), Patten and Crampton (2004), and Cormier et. al. (2005) conclude that corporate social and environmental disclosure can be explained by surrogates for firm size, although in some cases, there is limited evidence to support this view. However, not all prior studies have supported a positive relationship between firm size and corporate social and environmental disclosure. For example, Roberts (1992) found no relationship between size and corporate social and environmental disclosure. Note that in this study, a surrogate for firm size is treated as merely a control variable. Further, the other variables are treated as surrogates for stakeholder power. Given that argument, in this paper, we treat firm size as a possible determinant of corporate attitude toward extensive disclosure, and posit the following hypothesis.

**H3** The corporate attitude toward extensive disclosure is positively correlated with firm size.

### 2.3 Corporate reputation and the effects of extensive disclosure on non-financial aspects

In accordance with the strategic motives for corporate disclosure activities explained from a stakeholder theory perspective as mentioned above, firms with good corporate disclosure activities are expected to be able to develop and maintain good relationships with their various stakeholders. Therefore, the stakeholder theory suggests that the more positively the firms engage in corporate disclosure, the better will their relationships be with their various stakeholders.

Most previous studies under accounting research make an attempt to measure the effects of corporate disclosure only on financial aspects by focusing on the cost of capital. Such tendencies are especially prominent in studies on financial disclosure (Botosan, 1997; Botosan and Plumlee, 2002; Botosan et al., 2004; Sengupta, 1998). It is entirely possible to assume that the effect of the decreasing cost of capital by corporate disclosure reflects the positive relationship between the firms and participants in the financial market, such as stockholders and investors. However, corporate stakeholders are not restricted only to such participants. Other corporate stakeholders, for example, employees, customers, communities, etc., also have a relationship with firms outside the financial market. Thus, the effect of decreasing cost of capital by corporate disclosure does not always or appropriately reflect the relationship between the firms and their various stakeholders. Furthermore, the previous studies provide only limited evidence to suggest that better corporate disclosure can lead to a lower cost of capital. Thus, previous academic literature has not adequately revealed the effect of corporate disclosure even only with regard to financial aspects.

Hence, it is necessary to alternatively have a multidimensional or overall measure of the effects of
corporate disclosure, which comprehensively reflects the relationship between the firms and their various stakeholders. This is because in contrast to previous research, we focus on corporate reputation as a measure of the effects of corporate disclosure.

Corporate reputation can be defined as a global perception or net assessment of the firm’s behavior based on the expectations of stakeholders from the stakeholder theory perspective (Neville et al., 2005). Stakeholders are expected to have diverse expectations over a firm’s behavior. Thus, the assessment criteria they use to judge corporate reputation will differ depending on the particular stakeholder’s expectations of a firm’s behavior. Then, while firms will be likely to have different sub-reputations for different aspects of their behavior with different stakeholder groups, the net assessment by various stakeholders may nevertheless incorporate both instrumental and normative concerns. If we define corporate reputation as such, and then focus on corporate disclosure activities among the firm’s behavior, the firms with a more positive attitude toward corporate disclosure would also have a better corporate reputation, which ultimately reflects on the better relationship between the firms and the various stakeholders.

Some previous research has investigated the determinants of corporate reputation, focusing on the link between corporate reputation and the quality or quantity of corporate disclosure (Riahi-Belkaoui, 2001; Toms, 2002; Landgraf and Riahi-Belkaoui, 2003; Hasseldine et al., 2005). The results consistently support the view that corporate reputation is positively related to the quality or quantity of corporate disclosure. However, these studies did not necessarily depend on stakeholder theory and they lacked the perspective of focusing on corporate reputation as the measure of the effects of corporate disclosure. Instead, they regard corporate disclosure as merely one of the information signals that could affect corporate reputation, and they have a greater interest in revealing the determinants of corporate reputation. On the other hand, this paper focuses on corporate reputation as an alternative measure of the effects of corporate disclosure to replace the cost of capital. Given that argument, we predict that firms with a more positive attitude toward extensive disclosure have a better corporate reputation. Thus, we test the following hypothesis.

H4 The corporate attitude toward extensive disclosure is positively correlated with corporate reputation.

2.4 Other factors that could affect corporate reputation

We need to incorporate other possible factors that could affect corporate reputation when we investigate the determinants of corporate reputation. We depend on Fombrun and Shanley’s (1990) seminal model in selecting such factors. According to their model, corporate reputation is related to the signals that stakeholders have received, whether directly from the firm or via other information channels. In other words, the researchers show that stakeholders appear to construct corporate reputation from a mix of signals derived from market signals, accounting signals, institutional signals, and strategy signals. These signals may mediate or promote the influence of corporate disclosure activities on corporate reputation. However, we exclude strategy signals due to the lack of data. In the following, we will discuss each of these signals in turn.

Corporate reputation is formed in part by market and accounting signals concerning current CFP, which rise from accounting data or movements in stock prices (Fombrun and Shanley, 1990). A strong CFP may be interpreted by various stakeholders as a signal of effective corporate strategy, good management, and good resource allocations, and is therefore expected to help a firm establish or maintain a good corporate reputation among them. While various stakeholders view financially successful firms favorably, many of them tend to be risk-averse. Thus, firms with less risk appear to develop a better corporate reputation (Fombrun and Shanley, 1990). Such risk may be related to a firm’s leverage, because more indebted companies may face higher levels of insolvency risk. Consistent with this view, some empirical literature cited below find evidence of an association between corporate reputation and market or accounting signals.

We include the variable price-to-book ratio (PBR) as a market signal. Firms with a high PBR are considered to be a great investment opportunity. Such firms are likely to be evaluated favorably (Fombrun and Shanley, 1990). Thus, we predict that firms with a better PBR have a better corporate reputation. Then, we have the following hypothesis.

H5 PBR is positively associated with the degree of corporate reputation.

We use ROE as the accounting signal; it also acts as a proxy for a firm’s profitability. Firms with a high ROE have high profitability and therefore are likely to be evaluated favorably (Fombrun and Shanley, 1990; Landgraf and Riahi-Belkaoui, 2001; Riahi-Belkaoui, 2003). Thus, we predict that firms with a better ROE have a better corporate reputation. Then, we introduce the following hypothesis.

H7 ROE is positively associated with the degree of corporate reputation.

In addition, we use the ratio of stockholder’s equity to total assets (RSETA) as an accounting signal. The ratio is related to the possibility of a firm’s solvency. Williams and Barrett (2000) show that firms with a higher degree of leverage have worse corporate
reputation, and then conclude that a firm’s low solvency negatively affects its corporate reputation. Moreover, during the sample periods in this paper, Japan suffered from a recession. Thus, we consider that a firm’s solvency may be one of the determinants of its corporate reputation and that firms with a better RESTA have a better corporate reputation. Then, we have the following hypothesis.

H7 The ratio of stockholder’s equity to total assets (RSETA) and corporate reputation is positively correlated.

Corporate reputation is also formed in part by institutional signals (Fombrun and Shanley, 1990). We discuss the possibility that ownership structure and firm size can be surrogates for such signals.

Ownership structure would play a mediating or promoting role in the creation of corporate reputation. In the Japanese context, the main banking system is one of the featured elements of corporate governance; financial institutions, therefore, are particularly considered to be good monitors of it. If this is the case, they make their monitoring decisions after carefully reviewing the relevant information about a firm and its potential performance. Even if they are dissatisfied with a firm’s performance, they have an incentive to seek a modification of the corporate strategy, and subsequently, the managers have an incentive to pay attention to such a request. Thus, financial institutions hold a position of great monitoring influence on managers. The presence of significant financial institution’s shareholdings may therefore send a strong signal to other stakeholders that poor financial performance will not be tolerated. Finally, the financial institution’s holding of a larger percentage of a firm’s stock reflects favorably upon the firm and serves to shape a better corporate reputation.

On the other hand, managers would be more responsive where shareholdings are dispersed because of the relatively large number of small shareholder scrutiny. If this is the case, the presence of block shareholders’ large shareholdings may imply the shareholder’s low monitoring influence on managers in Japan, where the block shareholders typically represent family holdings or cross-shareholdings. Thus, the great percentage of block shareholders’ shareholdings to the total share may lead to a poor corporate reputation.

Some previous studies present evidence for a positive link between the extent of institutional ownership and corporate reputation (Brammer and Millington, 2005; Fombtun and Shanley, 1990). Moreover, Toms (2002) and Hasseldine et al. (2005) provide evidence that the firms with a greater amount of stock held by block shareholders achieve poorer corporate reputations. We include the fraction of total equity owned by financial institutions (FINOWN) and the fraction of total equity owned by the Top 10 (TOP10OWN) as some of the institutional signals. Given the above argument, we predict the following hypothesis.

H8 The greater the fraction of total equity owned by financial institutions (FINOWN), the better is the corporate reputation.

H9 The fraction of total equity owned by the Top 10 (TOP10OWN) is negatively associated with corporate reputation.

Firm size would promote the creation of corporate reputation. In general terms, larger firms are expected to have a better corporate reputation as they are usually subjected to greater public scrutiny and tend to have more numerous and significant interactions with their various stakeholders. Thus, they enjoy greater name recognition than the smaller firms. Finally, this may also lead to a bias in the assessments of corporate reputation by various stakeholders. Fombrun and Shanley (1990), Riahi-Belkaoui and Pavlik (1991), Riahi-Belkaoui (2001), Landgraf and Riahi-Belkaoui (2003), and Hasseldine et al. (2005) show that as firms grow larger, they can achieve a better corporate reputation. Consistent with these studies, we predict that larger firms have a better corporate reputation. Therefore, we predict the following hypothesis.

H10 The firm size is positively associated with the degree of corporate reputation.

3. Research Design and Data

3.1 Measurement of Extensive Disclosure and CSP

Our measures of corporate attitude toward extensive disclosure and CSP are created using a result of the “Survey of Corporate Contributions to Society” conducted by the Asahi Shimbun Cultural Foundation. This survey was representative of a survey of corporate social responsibility activities including disclosure in Japan. It had been continuously conducted every year from 1990 to 2002, and was discontinued in 2003. Hence, the 2003 edition of this survey is the last one. It is the only survey that was continuously conducted over the mid-and long-term and covered a variety of different categories of corporate social responsibility activities of large Japanese firms. Thus, we assume that it can provide a basis that is worthy of a comprehensive measure of corporate attitude toward extensive disclosure and CSP. This survey comprises 47 items that the firms responded to. The survey assigned an alphabetical ranking, which is converted into a numerical ranking (A = 5, B = 4, C = 3, D = 2, and E = 1) for each questionnaire. When no response was provided, the ranking was converted to 1.

In order to measure corporate attitude toward extensive disclosure and then prepare the variable EXDISC, which represents the degree of corporate
attitude toward extensive disclosure, we selected six items: Under the heading of Consumer Orientation, Effort for Providing Information; under Environmental Protection, Information Disclosure; and under Information Disclosure, Disclosure Policy, Independence of the Department of Public Relations, Financial Information Disclosure, and General Information Disclosure. We do not include “Cooperation in This Survey” under the heading of Information Disclosure because this item does not directly reflect the attitude toward corporate disclosure. Finally, in order to measure the score of corporate attitudes toward extensive disclosure and then prepare the variable EXDISC, we summarize the above rankings and divide them by the number of items, i.e., six. If a firm answers “No fit,” we do not count it in the summarized rankings or the number of items. The procedure for measuring CSP is similar to that for measuring corporate attitude toward extensive disclosure. We summarize all of the above rankings except the items used to measure corporate attitude toward extensive disclosure and “Cooperation in This Survey”. Finally, we divide this score by the number of items, i.e., 40, and then prepare the variable CSP. In this paper, we distinguish corporate disclosure activities from corporate social responsibility activities that are other than such disclosure. Therefore, the variable CSP represents the degree of corporate social responsibility activities other than corporate disclosure activities.

3.2 Measurement of Corporate Reputation

We obtain the measure of corporate reputation (CR) from the result of the “Corporate image ranking for 140 firms” prepared by Weekly Diamond, which is one of Japan’s leading economic magazines. Sakurai (2005) points out that this survey is one of the most suitable for the measurement of corporate reputation in Japan. It has been conducted annually since 1997. Thus, we conclude that it can provide a basis that is worthy of the appropriate measure of corporate reputation. This survey result provides both the score and ranking with regard to the general or overall corporate image, which in this paper is assumed to represent corporate reputation. In addition, it provides both the scores and rankings with regard to the seven attributes of the firm’s image, which in this paper is assumed to represent the firm’s specific reputation. The seven attributes are as follows: (1) quality of product or service, (2) contribution to society and business ethics, (3) innovation, (4) ability to develop talented people, (5) growth opportunity, (6) quality of manufacturing and R&D, and (7) financial power or soundness. We use these rankings or scores in creating the variable CR.

3.3 Empirical Specification

The first equation pertains to corporate attitude toward extensive disclosure:

$$EXDISC_i = \alpha_1 + \alpha_3 CSP_i + \alpha_4 ROE_i + \alpha_5 SIZE_i + \alpha_6 \text{Industry}_i + \epsilon_i$$

where

- $EXDISC_i$ is the score of corporate attitude toward extensive disclosure defined in 3.1,
- $CSP_i$ is the score of corporate social performance defined in 3.1,
- $ROE_i$ is the net income divided by the average of stakeholders’ equity at t and t-1,
- $SIZE_i$ is the natural logarithm of book value of total assets, and
- $\text{Industry}_i$ is the vector of a five-indicator variable assuming the value of 1 if a firm belongs to the food, cosmetic/medicine, electronics, machinery, or distribution industries, and 0, otherwise.

The second equation relates to corporate reputation:

$$CR_i = \alpha_1 + \alpha_3 EXDISC_i + \alpha_4 PBR_i + \alpha_5 ROE_i + \alpha_6 RSETA_i + \alpha_7 FINOWN_i + \alpha_8 \text{TOP10OWN}_i + \alpha_9 SIZE_i + \epsilon_i$$

where

- $CR_i$ is the score or ranking of overall corporate reputation or firm’s specific reputation defined in 3.2,
- $EXDISC_i$ is the score of corporate attitude toward extensive disclosure defined in 3.1,
- $PBR_i$ is the ratio of market value of equity to stockholder’s equity,
- $ROE_i$ is the net income divided by the average of stakeholders’ equity at t and t-1,
- $RSETA_i$ is the ratio of stockholder’s equity to total assets,
- $FINOWN_i$ is the fraction of total equity owned by financial institutions,
- $\text{TOP10OWN}_i$ is the fraction of total equity owned by the Top 10, and
- $SIZE_i$ is the natural logarithm of total assets.

EXDISC is an endogenous variable. First, we investigate the determinants of the overall CR score and ranking. Second, we investigate the determinants of the scores of the firm’s specific reputations.

3.4 Sample selection and basic statistics

Given these model specifications, our data on CSP and extensive disclosure (EXDISC) are obtained from the 2002–2003 edition of the “Survey of Corporate Contributions to Society” that was conducted by the Asahi Shimbun Cultural Foundation. We also obtained data on corporate reputation (CR) from the 2001–2002 edition of the “Corporate image ranking for 140 firms” prepared by Weekly Diamond. We used
the financial data from the Nikkei NEEDS Financial Data CD-ROM⁸ and obtained the stock price data from the Toyokeizai Stock Price CD-ROM. In order to consistently gather data on CSP, EXDISC, and CR, the sample periods are selected. Our sample periods are the fiscal years ending in November 2000–October 2001 and November 2001–October 2002.

Furthermore, we restrict ourselves to the companies whose financial data and stock price data can be obtained from these databases, whose net assets are not negative, and whose ROEs are beyond –100%. We also exclude banks and security firms because their disclosures are very different from those of firms in other industries. Finally, our sample contains 120 observations. The descriptive statistics are listed in Table 1, which shows that the average of the PBR is nearly 2. This implies that our samples consist of firms with richer growth opportunities than average Japanese firms. Industry dummy variables are omitted in Table 1.

Table 2 presents the intercorrelation among variables other than the overall CR ranking and industry dummy variables. All CR variables are positively correlated with all independent variables with the exception of TOP10OWN. The low intercorrelation among the independent variables indicates no reason to suspect multicollinearity.

4. Empirical Results

4.1 Basic Results

Our basic results are presented in Table 3. The parameter estimates for equation (1) are shown in Panel A. CSP is positively correlated with EXDISC at the 1% significance level. This evidence is consistent with H1 and suggests that firms are more positively engaged in extensive disclosure when they undertake social responsibility activities more positively, and supports the stakeholder theory perspective.

Next, we discuss the determinants of corporate reputation. The parameter estimates for equation (2) are shown in Panel B. The first line of Panel B presents the result when the overall CR score is used as the dependent variable. We test the null hypothesis that EXDISC is not an endogenous variable using the Hausman’s specification test⁹. The null hypothesis was rejected; thus, we use the two-stage least squares method (2SLS).

EXDISC is positively correlated with the overall CR score at the 1% significance level. This is consistent with H4 and suggests that firms with more positive attitudes toward extensive disclosure would achieve higher corporate reputations.

PBR is positively correlated with the overall CR score at the 1% significance level. This result is consistent with H5 and indicates that firms that have a greater investment opportunity would achieve higher corporate reputations.

ROE is positively associated with the overall CR score at the 5% significance level. This implies that firms that are more profitable would achieve higher corporate reputations. RSETA is positively associated with the overall CR scores at the 1% significance level. This implies that, in Japan, safer firms would achieve higher corporate reputations. These results are consistent with H6 and H7 and suggest that accounting signals affect corporate reputation.

The coefficients of FINOWN and SIZE are positive but not statistically significant. The coefficient of TOP10OWN is negative but not statistically significant. This implies that institutional pressure is not high in Japan.

The second line of Panel B presents the 2SLS result when the negative of the overall CR ranking is employed as the dependent variable⁹. The signs of the coefficients are the same as they are when using the overall CR score as the dependent variable. However, the coefficient of the FINOWN is positive at the 5% significance level. This evidence weakly supports the hypothesis that financial institutions may be good monitors of corporate governance. These imply that institutional signals form corporate reputation only to some extent.

4.2 Additional Results

In this subsection, we additionally study the determinants of the scores of firms’ specific reputations using 2SLS. These results are provided in Table 4. The parameter estimates for equation (1) are the same as in Table 3 and therefore they are omitted in Table 4.

[Insert Table 3]

ROE is negatively associated with EXDISC at the 10% significance level. This evidence is inconsistent with H2 and the stakeholder theory. This implies that firms with low profitability are engaged in extensive disclosure in order to improve their public image.

On the other hand, SIZE is positively correlated at the 5% significance level. This result is consistent with H3 and the stakeholder theory perspective. This suggests that larger firms appear to provide information more positively because they are more likely to be scrutinized by the general public. With regard to the industry variable, only the coefficient of the cosmetic industry is positively associated with EXDISC at the 10% level of significance. Firms that belong to this industry are very closely related with consumers. This may be the reason why such firms are engaged in extensive disclosure.

[Insert Table 4]

EXDISC is positively correlated with all the scores of the firms’ specific reputations at no less than the 5% significance level. Thus, corporate attitude toward extensive disclosure is a crucial determinant of a firm’s specific reputation.
PBR is positively correlated with all the scores of firms’ specific reputations at the 1% significance level. Therefore, the market signal of investment opportunities is also an important determinant of a firm’s specific reputation.

ROE is positively correlated with the scores of a firm’s four specific reputations at no less than the 10% significance level. This suggests that the present profitability affects some specific attributes of the firm’s reputation. The coefficients of RSETA are positive for all the scores of the firm’s specific reputation at the 1% significance level. Thus, firm solvency may also be a key determinant of the firm’s specific reputation in Japan.

The FINOWN are positively associated with the scores of the firm’s five specific reputations at no less than the 10% significance level; however, they are not associated with contribution to society and business ethics or with the financial power attributes of the firm’s specific reputation. This implies that banks carefully monitor firms from the productive or service competitiveness viewpoints, but not from the viewpoint of the stockholder or community stakeholder. The TOP10OWN is negatively correlated with contribution to society and business ethics at the 10% significance level. This implies that firms held by block shareholders are considered as unsociable. SIZE is positively correlated with the quality of manufacturing and R&D and financial power at no less than the 10% significance level. Therefore, some factors other than corporate attitude toward extensive disclosure may also be partial signals that affect the degree of the firm’s specific reputation.

5. Conclusion

This paper simultaneously investigates why firms voluntarily engage in extensive disclosure to their various stakeholders and measures the effect of this extensive disclosure from the stakeholder theory perspective. The study empirically demonstrates that firms with a higher CSP appear to be more positively engaged in extensive disclosure than firms with lower CSP. It also indicates that firms with more positive attitudes toward extensive disclosure appear to be able to create a better corporate reputation. This evidence is consistent with the stakeholder theory and suggests that firms are engaged in extensive disclosure as a component of their corporate strategic social responsibility activities and that firms with more positive attitudes toward extensive disclosure appear to be able to develop and maintain better relationships with their various stakeholders.

Additionally, our paper demonstrates that the firms with high profitability are less engaged in extensive disclosure. This evidence may be inconsistent with the stakeholder theory. On the other hand, it shows that larger firms appear to be engaged in extensive disclosure more positively. This result is consistent with the stakeholder theory.

Our paper also empirically discovers some factors besides corporate attitude toward extensive disclosure that affect corporate reputation within the Japanese context. Thus, we provide the evidence that market and accounting signals are the crucial determinants of corporate reputation or a firm’s specific reputation in Japan. On the other hand, it is empirically presented that institutional signals only partially affect corporate reputation or a firm’s specific reputation in Japan.

References

Appendix

Items used in the “Survey of Corporate Contributions to Society” conducted by the Asahi Shimbun Cultural Foundation

- Fair Working Environment
  - Balance of Work and Family
  - Effort in Consensus Building
  - Respect for Employee Individuality
  - Mental Health Care
  - Treatment of Middle-aged Employees

- Sexual Equality
  - Sexual Equality in Recruitment
  - Consideration for Employment Stability
  - Positive Action for Promotions
  - Equality in Actual Promotions
  - Policy Against Sexual Harassment

- Employment of People with Disabilities
  - Systematic Support for People with Disabilities
  - Employment Stability and Skill Enhancement
  - Consideration for Types of Disabilities

- Internationalization
  - Employment and Promotion of Foreigners
  - Localization of Personnel Acquisition
  - Prevention of Child Labor
  - Working Environment in Developing Countries
  - Anti-bribery Provisions

- Consumer Orientation
  - Effort for Systematic Response
  - Effort for Providing Information
  - Status of Consumer Troubles
  - Protection of Personal Information
  - Universal Design

- Coexistence with Society
  - Clarification of Philosophy
  - Support Activities
  - Cooperation with Volunteers
  - Social Contribution Activities

- Environmental Protection
  - Establishment of Policy
  - Implementation Structure
  - Action Plan
  - Management by Objectives
  - Information Disclosure
  - Consideration in Off-the-job Activities
  - Consideration in Backoffice
  - Consideration in Department of Core Business

- Business Ethics
  - Code of Ethics
  - Scope of Code of Ethics
  - Effort for Penetration
  - Implementation Structure
  - Management of Effectiveness
  - Effort for Improving Implementation Structure

- Information Disclosure
  - Disclosure Policy
  - Independence of the Department of Public Relations
  - Financial Information Disclosure
  - General Information Disclosure
  - Cooperation in This Survey

Notes

However, a generally accepted implication or definition of corporate reputation is absent. Many researchers or practitioners studied corporate reputation in a wide range of disciplines, and each of them defined it differently (Oriens, 2004, 17).

Fombrun and Shanley (1990) considered corporate social responsiveness as one of the institutional signals, and found a positive association between corporate reputation and the level of corporate charitable donations or the presence of separately endowed corporate charitable foundation. However, they did not permit the effect of corporate overall social responsibility activities on corporate reputation. Moreover, the assessment of corporate overall social responsibility activities cannot be made by various stakeholders unless it is signaled to them. This might be achieved through some information channels, and indeed, corporate disclosure is a chief signaling device. In other words, managers investing in corporate social responsibility activities that are likely to create corporate reputation will not be able to realize the corporate reputation outcome without engaging in associated disclosures. Therefore, we assume that corporate reputation can be created and managed only through the disclosure process, not through other corporate social responsibility activities.

Precise information is found in the Appendix.

This rule is also applied to the measurement of CSP.

This classification is followed by the “Survey of Corporate Contributions to Society.” The criterion for choosing these industries is that they should consist of more than 10 observations.

We mainly use consolidated financial data. However, since one company does not prepare consolidated financial statements, we use parent-only financial data for this purpose.

We also investigate the determinants of the rankings of a firm’s specific reputations. The result is very similar to the one when we investigated using the scores of the firm’s specific reputations. Then, we omit the result when we use the rankings of the firm’s specific reputations.

We test this null hypothesis for all regressions using any CR variable, and then reject the hypothesis for all the regressions. Thus, we estimate all the regressions using the 2SLS for equation (2).

In order to compare the results efficiently and understand them more intuitively, we use the negative of overall CR ranking.
### Table 1 Descriptive statistics (N = 120)

<table>
<thead>
<tr>
<th>Variables</th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
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<tr>
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<td>36.80</td>
<td>88.30</td>
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<td>90.00</td>
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<td>10.48</td>
<td>49.00</td>
<td>97.40</td>
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<tr>
<td>Contribution to society and business ethics</td>
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<td>8.09</td>
<td>39.60</td>
<td>91.80</td>
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<tr>
<td>Innovation</td>
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<td>10.15</td>
<td>43.10</td>
<td>96.80</td>
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<tr>
<td>Ability to develop talented people</td>
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<td>8.84</td>
<td>43.00</td>
<td>93.90</td>
</tr>
<tr>
<td>Growth opportunity</td>
<td>70.73</td>
<td>10.24</td>
<td>45.20</td>
<td>94.40</td>
</tr>
<tr>
<td>Quality of manufacturing and R&amp;D</td>
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<td>Financial power or soundness</td>
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<td>47.00</td>
<td>98.80</td>
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<td>5.00</td>
</tr>
<tr>
<td>CSP</td>
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<td>2.17</td>
<td>5.00</td>
</tr>
<tr>
<td>PBR</td>
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<td>1.05</td>
<td>0.51</td>
<td>7.02</td>
</tr>
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<td>ROE</td>
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</tr>
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<td>TOP10OWN</td>
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<tr>
<td>Total Asset (million yen)</td>
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<td>31,585</td>
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</table>

### Definitions

- **Corporate reputation**: The score of overall corporate reputation or a firm’s specific reputation, except for overall CR ranking.
- **EXDISC**: The score of corporate attitude toward extensive disclosure.
- **CSP**: The score of corporate social performance.
- **PBR**: The price-to-book ratio.
- **ROE**: The return on equity.
- **RSETA**: The ratio of stockholder’s equity to total assets.
- **FINOWN**: The fraction of total equity owned by financial institutions.
- **TOP10OWN**: The fraction of total equity owned by Top 10.
- **Total Asset**: The book value of total assets.

### Table 2 Correlation among selected variables

<table>
<thead>
<tr>
<th>Variables</th>
<th>Overall CR score</th>
<th>Quality of product or service</th>
<th>Contribution to society and business ethics</th>
<th>Innovation</th>
<th>Ability to develop talented people</th>
<th>Growth opportunity</th>
<th>Quality of manufacturing and R&amp;D</th>
<th>Financial power</th>
<th>EXDISC</th>
<th>CSP</th>
</tr>
</thead>
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<td></td>
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<td></td>
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<td>0.95</td>
<td>0.92</td>
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<td></td>
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<td>0.89</td>
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<td>1.00</td>
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<td>0.91</td>
<td>0.92</td>
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<td>Growth opportunity</td>
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<td>0.91</td>
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<td>0.95</td>
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<td>Quality of manufacturing and R&amp;D</td>
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<td>0.93</td>
<td>0.94</td>
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<td>0.87</td>
</tr>
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<td>PBR</td>
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<td>0.22</td>
<td>0.18</td>
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<td>0.20</td>
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<td>TOP10OWN</td>
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<td>0.07</td>
<td>(0.06)</td>
<td>0.08</td>
<td>0.02</td>
<td>0.01</td>
<td>(0.01)</td>
<td>0.04</td>
<td>0.21</td>
<td>(0.11)</td>
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<td>0.22</td>
<td>0.24</td>
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<td>0.30</td>
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<td>0.47</td>
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<td>PBR</td>
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<td>1.00</td>
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<td></td>
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<td></td>
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</tr>
<tr>
<td>ROE</td>
<td>(0.00)</td>
<td>0.22</td>
<td>1.00</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RSETA</td>
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<td>0.02</td>
<td>(0.06)</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FINOWN</td>
<td>(0.00)</td>
<td>0.02</td>
<td>(0.08)</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TOP10OWN</td>
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<td>0.31</td>
<td>0.28</td>
<td>0.32</td>
<td>1.00</td>
<td></td>
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</tr>
<tr>
<td>SIZE</td>
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<td>(0.07)</td>
<td>0.34</td>
<td>0.31</td>
<td>0.23</td>
<td>(0.24)</td>
<td>1.00</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**SIZE**: natural logarithm of total assets.

Other variables are defined in Table 1. Overall CR ranking and industry dummy variables are omitted.
Quality of manufacturing

Financial power

Innovation and business ethics

Contribution to society

Ability to develop talented people

Growth opportunity

Quality of manufacturing and R&D

Financial power

---

Panel A: Explaining extensive disclosure

<table>
<thead>
<tr>
<th>Independent/dependent variable</th>
<th>Intercept</th>
<th>EXDISC</th>
<th>CSP</th>
<th>ROE</th>
<th>SIZE</th>
<th>Adj. R²</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall CR score</td>
<td>16.47</td>
<td>5.43</td>
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<td>14.44</td>
<td>18.45</td>
<td>0.04</td>
</tr>
<tr>
<td>(1.73)</td>
<td>(2.24)</td>
<td>(4.06)</td>
<td>(2.44)</td>
<td>(5.19)</td>
<td>(1.29)</td>
<td>(-1.13)</td>
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</tbody>
</table>

Panel B: Explaining corporate reputation

<table>
<thead>
<tr>
<th>Independent/dependent variable</th>
<th>Intercept</th>
<th>EXDISC</th>
<th>PBR</th>
<th>ROE</th>
<th>RSETA</th>
<th>FINOWN</th>
<th>TOP10OWN</th>
<th>SIZE</th>
<th>Adj. R²</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall CR score</td>
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<tr>
<td>(5.54)</td>
<td>(4.34)</td>
<td>(3.96)</td>
<td>(2.96)</td>
<td>(5.06)</td>
<td>(2.22)</td>
<td>(0.96)</td>
<td>(0.73)</td>
<td>0.33</td>
<td></td>
</tr>
</tbody>
</table>

All variables are defined in Tables 1 and 2.

* t-ratios are within parentheses.

** Significant at the 1% level, two-tailed.

*** Significant at the 5% level, two-tailed.

Significant at the 10% level, two-tailed.

---

Table 4: Additional Results (N = 120)

<table>
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<th>Intercept</th>
<th>EXDISC</th>
<th>PBR</th>
<th>ROE</th>
<th>RSETA</th>
<th>FINOWN</th>
<th>TOP10OWN</th>
<th>SIZE</th>
<th>Adj. R²</th>
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</thead>
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<tr>
<td>(1) Quality of product or service</td>
<td>9.72</td>
<td>6.86</td>
<td>2.61</td>
<td>11.13</td>
<td>28.74</td>
<td>19.24</td>
<td>-2.67</td>
<td>1.02</td>
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<td>(2) Contribution to society and business ethics</td>
<td>31.96</td>
<td>5.84</td>
<td>2.61</td>
<td>15.34</td>
<td>17.02</td>
<td>4.74</td>
<td>-16.07</td>
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<tr>
<td>(3) Innovation</td>
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<td>1.93</td>
<td>17.48</td>
<td>22.46</td>
<td>14.42</td>
<td>2.15</td>
<td>0.95</td>
<td>0.36</td>
</tr>
<tr>
<td>(4) Ability to develop talented people</td>
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<td>2.61</td>
<td>16.01</td>
<td>19.62</td>
<td>11.32</td>
<td>-10.66</td>
<td>1.22</td>
<td>0.37</td>
</tr>
<tr>
<td>(5) Growth opportunity</td>
<td>2.86</td>
<td>7.11</td>
<td>3.10</td>
<td>11.22</td>
<td>26.35</td>
<td>22.32</td>
<td>-6.06</td>
<td>1.17</td>
<td>0.41</td>
</tr>
<tr>
<td>(6) Quality of manufacturing and R&amp;D</td>
<td>4.36</td>
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<td>2.65</td>
<td>8.43</td>
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<td>(7) Financial power</td>
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<td>1.87</td>
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<td>33.52</td>
<td>10.96</td>
<td>-6.46</td>
<td>3.11</td>
<td>0.33</td>
</tr>
</tbody>
</table>

All variables are defined in Tables 1 and 2. The parameter estimates for equation (1) are omitted.

* t-ratios are within parentheses.

** Significant at the 1% level, two-tailed.

*** Significant at the 5% level, two-tailed.

Significant at the 10% level, two-tailed.