

*Research Paper***Corporate Reputation and Stock Liquidity: the US case***Submitted in 05, January 2022**Accepted 13, September 2022**Evaluated by a double-blind review system***FABIANA DOMINGOS¹****LÍGIA FEBRA¹****MAGALI COSTA^{2*}****ABSTRACT**

Purpose: The purpose of this paper is to analyse if there is a positive relationship between corporate reputation communication through media ranking and stock liquidity.

Methodology: A model based on firms' financial market data was estimated, through a panel data analysis that included 18,444 observations, from a full sample of 348 firms listed on the New York Stock Exchange (NYSE), half of which were listed in the 2015 ranking of Fortune's World's Most Admired Companies (WMAC).

Findings: The results show that there is a positive relationship between corporate reputation communication and the stocks liquidity, since firms listed in the Fortune Ranking have higher liquidity than firms that are not listed, and firms classified with a high rank have higher liquidity than firms classified with a low rank.

Originality: Stock liquidity is important to obtain financing resources to invest in profitable projects that increase the firm value. On the other hand, it is recognized by the literature that corporate reputation has a strong influence on firm performance. To the best of our knowledge, this is the first study that addresses the analysis of the relationship between corporate reputation and stock liquidity. Therefore, this study may provide important insights into the firms' management, for the investor's decisions and the government policies. Capital markets react ever more to market stimuli, including investor and consumer perceptions, which may influence the stock trade level. The identification of additional drivers of a firm's stock liquidity improves decision-making.

Keywords: Corporate Reputation, Liquidity, Amihud Illiquidity, Market Illiquidity.

1. Introduction

Stock liquidity is a topic that has been studied over the last years since it is one of the most important characteristics that influences the stock market development. The literature highlights that stock liquidity has a negative impact on the expected return (Amihud and Mendelson, 1986).

Corporate reputation has been targeted mainly in the marketing field. However, due to its importance and influence on the firm performance, it has aroused the interest of

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stakeholders (Peterson, 2018). As noted by Fombrun and Shanley (2017), the reputation may signalize consumers about product quality, and attract talented employees and investors. Reputation may also create a halo effect that protects an organization from a crisis (Coombs and Holladay, 2006). Corporate reputation, when communicated by the media, signalizes the firm quality for investors in times of crisis (OuYang et al., 2017). In this sense, media plays an important role to reduces information asymmetries, particularly in periods of financial instability (Godfrey et al., 2009).

The relationship between corporate reputation and performance has been addressed and the literature evidences a positive relationship between financial performance and the firms' reputation (Koch and Cebula, 1994; Hammond and Slocum, 1996). This relationship may be affected by the effect of reputation on customer loyalty (Bontis et al., 2007).

Even though reputation and liquidity are largely debated individually, to the best of our knowledge there are no studies that directly addressed the relationship between these two topics. Existent literature has not explored the potential effect of corporate reputation on stock liquidity, which is a risk factor that plays an important role in influencing investment decisions (e.g., Amihud and Mendelson, 1986; Amihud and Mendelson, 1991; Baker and Stein, 2004). When analyzing the investment between two assets with similar characteristics, investors choose the most liquid, given its ease of transaction without significant price impact. The stock risk premium includes the illiquidity premium (Amihud and Mendelson, 1986), i.e., the investor requires a higher return to support a higher liquidity risk. Thus, firms have an incentive to increase stock liquidity and consequently decrease the required return (cost of equity). Therefore, the main aim of this work is to fill this gap in the literature. The purpose is to analyze whether reputation influences stock liquidity based on a sample of firms listed in the Fortune - World Most Admired Companies 2015. This study will contribute to the increase in stock market knowledge since it explores the newly uncovered relationship between corporate reputation and stock liquidity, and it will be of particular interest to organizational decision-makers (managers, regulators, and investors). Capital markets react ever more to market stimuli, including investor and consumer perceptions, which may influence the stock trade level. Particularly, and according to the availability bias (Tversky and Kahneman, 1973), investors tend to trade more stocks of firms that receive more media attention. In this sense, reputation may imply more product-market disclosure and, consequently, potentiate more stock trade. Better knowledge about stock liquidity drivers will expand the understanding of the capital market, which may impact development and the whole economy (e.g., Levine and Zervos, 1998). Finally, the findings can justify future policies in terms of firms' incentives programs, including taxes benefits.

The remainder of the paper is structured as follows: the next section, it is presented a background overview of stock liquidity and corporate reputation. In section three the research methods are described. Then, in the fourth section, the results are presented and further discussed. Finally, the conclusions, their implications, and some guidelines for future research are presented.

2. Background overview

2.1. Liquidity

Liquidity is defined as the ability to quickly transact a large volume of stocks, with reduced transaction costs, and without price impact (Amihud and Mendelson, 1986). Díaz

and Escribano (2020) and Le and Gregoriou (2020) consider that although the concept of liquidity is consensual, there is no indicator capable of capturing all its dimensions. Over the years it has been developed innumerable measures that comprise different dimensions. The dimensions of liquidity are: transaction costs; transaction volume; price impact; trading frequency (Naik, Poornima and Reddy, 2020).

Amihud and Mendelson (1986) were one the pioneers of liquidity analysis, which demonstrated the positive relationship between illiquidity and stock return. For that, a measure of illiquidity- the bid-ask spread, or absolute quoted spread, was used. This measure considers the transaction costs related to the transaction. According to the authors, the bid-ask spread is considered the natural measure of liquidity and is simple to determine. Other measures have been developed based on the natural measure of liquidity, adopted by Amihud and Mendelson (1986), such as the relative quoted spread; the effective spread, and the relative effective spread. The interpretation of these four measures is based on the value of the indicator, that is higher it is, the lower the stock liquidity. According to Le and Gregoriou (2020), these measures are simple to apply, however, it is difficult to obtain data in some capital markets, and therefore, this limitation prompted other researchers to construct other liquidity measures.

Regarding the transactions volume, the most usual measures are: transaction volume (Pagano, 1989); turnover (Brennan and Subrahmanyam, 1996, Datar et al., 1998 and Chordia and Swaminathan, 2000); quote size (Mann and Ramanlal, 1996); and market depth (Chordia et al., 2004). According to Gregoriou and Nguyen (2010), the transaction volume is defined by multiplying the total number of transactions of an asset by its price. Although being a measure easily determined for a stock listed, the transaction volume is considered an inappropriate measure of liquidity: i) due to it is in absolute values; ii) as it does not take into account the price impact; iii) and due to double counting of dealer trades in some markets. The turnover indicator is also a widely used liquidity indicator, for example it is used by Chordia and Swaminathan (2000), Datar, Naik and Radcliffe (1998), Naik et al. (2020), and Rouwenhorst (1999). This indicator, according to Naik et al. (2020), is determined by the ratio between the volume traded and the total number of outstanding shares. According to Le and Gregoriou (2020), turnover is easy to calculate and allows to capture the liquidity of numerous stocks over a long-time horizon. However, this indicator does not take into account the price impact. The conclusion to be drawn from this indicator, according to Naik et al. (2020), is the higher the turnover, the higher the stock liquidity.

Amihud (2002) developed an illiquidity measure (ILLIQ), which comprises the price impact. The measure is determined by the average ratio between the absolute return and the trading volume in monetary terms. The Amihud ratio is usually applied in several studies, such as Ben-Rephael, Kadan and Wohl (2015), Christensen et al. (2016), Dey and Wang (2012). It is a measure easy to compute for long periods and it can be applied in several markets (Le and Gregoriou, 2020). However, according to Florackis et al. (2011), the Amihud ratio has a size bias because the trading volume in monetary terms is positively correlated with market capitalization. Another limitation is the fact that the Amihud ratio does not consider the trading frequency dimension (Florackis et al., 2011). Kang and Zhang (2014) developed a liquidity measure based on the Amihud ratio (2002), called ILLIQ_ZERO, which incorporates the price impact and the number of days in which there were returns equal to zero. Florackis et al. (2011) also developed another measure inspired by the Amihud ratio (2002) defined as the return-to-turnover ratio. According to Florackis et al. (2011), this ratio has the advantage to isolate the impact of price from the size effect and it is not necessary to make adjustments to exchange rates, as it uses the turnover ratio as a denominator. In addition to the measures described above,

other studies consider the price impact in determining liquidity. Namely Hua, Peng, Schwartz and Alan (2020) propose 'resiliency' as a new measure that takes into account the impact of price and unpredictable variations on liquidity.

The transaction frequency measure is a time-based measure, and it is determined by the number of transactions in a specific period (Peng, 2001). In turn, the time on market indicator consists of the time that an asset needs for being traded on the market (Benefield and Hardin, 2015; Lin and Vandell, 2007). However, it does not take into account the transaction volume. Barardehi, Bernhardt and Davies (2019) developed a liquidity measure taking into account the time factor and the price impact. The authors argue that their measure is better at capturing transaction costs than the liquidity measures most used in the literature as it measures the price impact by taking into account periods with fixed transaction volumes rather than specific periods.

2.2. Corporate Reputation

There are several definitions of reputation in the literature (Fombrun and Van Riel, 1998; Vergin and Qoronfleh, 1998; Roberts and Dowling, 2002; Carmeli and Tishler, 2005; Chun, 2005; Barnett et al., 2006; Pfarrer et al., 2010; Cao et al., 2012).

Weigelt and Camerer (1988) defined reputation as a set of attributes resulting from past firm actions that generates future returns. In the same line, corporate reputation is a set of perspectives and beliefs that the stakeholders have about the firm results (Fombrun and Van Riel, 1998; Vergin and Qoronfleh, 1998; Roberts and Dowling, 2002; Chun, 2005; Dowling and Moran, 2012). Corporate reputation has also been characterized as an effective tool in managing the stakeholders' behavior towards an organization (Chun, 2005). The author described such behavior as employee retention, customer satisfaction and loyalty, and attraction of good/efficient staff. Furthermore, the same author refers, based on Vergin and Qoronfleh (1998), that reputation might encourage shareholders to invest in a firm since reputation is positively correlated with superior overall returns. In addition, corporate reputation can be defined as an intangible asset that constitutes a sustainable competitive advantage for the firm against its competitors (Carmeli and Tishler, 2005; Flatt and Kowalczyk, 2011; Cao et al. 2012). Although reputation is a dimension that is perceived by stakeholders, it must first be built internally.

Firms' reputations are usually measured by the media. The most used measures are highlighted in Table 1.

Table 1. Media measures

Media	Evaluation
America's Most Admired Companies by Fortune	financial strength; the value of long-term investments; use of firm assets; innovation index; quality of management board; quality of products and services; ability to attract; development of social responsibility actions
Manager Magazine	management quality; innovation; communication skills; work orientation; financial stability
Britain's Most Admired Companies by Management Today	quality of management; financial stability; quality of products and services; ability to attract, retain and develop talented workers; long term value creation; innovative capacity; marketing quality; community and environmental responsibility; effective use of

	corporate assets; creative leadership; global competitiveness; corporate governance
Asian's Most Admired Companies by Asian Business	firm admiration; management quality; products and services quality; firm contribution to the local economy; workers quality; potential for future returns; ability to adapt policies, and strategies to changes in the economic environment
<i>Asia's Leading Companies by Far Eastern Economic Review</i>	company awareness; leadership; the high quality of products and services; innovation in response to customer needs; long-term financial stability
World's Most Respected Companies by The Financial Times	firm strategy; customer satisfaction and loyalty; business leadership; products and services quality; financial performance stability; organizational culture; management and business adaptation
Global RepTrak® 100	products and services; innovation; workplace; governance; citizenship; leadership; and performance
100 Best Managed Companies by Industry Week	people; society; markets; and change
World's Most Admired Companies by Fortune	management quality; products and services quality; innovation, long-term investment; financial stability; ability to attract, retain and develop talented workers; social and environmental responsibility; assets usability

Some reputation studies use alternative measures, such as S-M Quotient (Fombrun et al., 2000) and social responsibility (Fombrun and Shanley, 1990). The S-M Quotient is based on the analysis of 20 items inserted in 6 major groups: products and services, vision and leadership, work environment, social and environmental responsibility, financial performance, and emotional appeal (Fombrun et al., 2000). Whereas this measure may be an alternative to the media measures, it is not easy to construct, and the collection of data can be a lengthy process. On the other hand, when reputation is communicated through the media (media ranking) it has an impact on the reputation itself because the media acts as an intermediary in quality signaling (OuYang, 2017). This is because communication influences the perception of firm activities (Floreddu et al., 2014), and thus communication may improve reputation (Aula, 2011). Žabkar and Arslanagić-Kalajdžić (2013) reinforce this idea by mentioning that corporate communication builds, protects, and maintains corporate reputation. The most used corporate reputation indexes are developed by the magazine ranking Fortune, namely the America's Most Admired Companies and the World's Most Admired Companies (Veh et al., 2019).

2.3. Liquidity and Corporate reputation

As previously mentioned, some studies have analyzed the relationship between liquidity and return, such as Amihud and Mendelson (1986), Datar et al. (1998), Velnampy and Niresh (2012), Koch and Cebula (1994), Hammond and Slocum (1996), and between return and reputation, for instance, Vergin and Qoronfleh (1998), Roberts and Dowling

(2002), and Carmeli and Tishler (2005). However, to the best of our knowledge, there are no studies that directly analyze the relationship between liquidity and reputation.

The closest existing study is that of Sánchez and Vega (2018). However, this study aims to analyze the reputational risk (measured by negative news) on liquidity. The authors conclude that the bad news implies an increase in illiquidity. Contrary, the present study has the purpose to analyse the importance of the corporate reputation level on stock liquidity.

The study of this relationship is relevant since it is known that a high reputation increases the firms' visibility (Vergin and Qoronfleh, 1998). Aspara (2013) argues that investors' beliefs and convictions influence investment stock decisions, and they tend to invest in firms that are coherent with their own identity and values. Concerning information availability, Barber and Odean (2008) refer to those investors who consider stocks that catch their attention (availability bias). So, based on the availability bias, more visibility may imply more stock trade.

Since investors tend to prefer known firms, and firms with a higher corporate reputation are highly visible, it is expected that investors trust more in these firms, and therefore they trade more confidently these stocks. Considering this, this study aims to test the following hypothesis:

Hypothesis: There is a positive relationship between corporate reputation and the stocks' liquidity.

3. Research methods

To analyze if there is a positive relationship between corporate reputation and stock liquidity, and in line with Hammond and Slocum (1996) and Pfarrer et al. (2010) and Veh et al. (2019), the present study uses the ranking of Fortune-World's Most Admired Companies of 2015 as a reputation measure. As referred before, namely by Dowling and Moran (2012), a firm's reputation is a set of perspectives and beliefs that stakeholders have about a firm result. Since the Fortune ranking measures the reputation of large firms, considering some qualitative attributes, and it is an effective means of transmitting information, this measure fits the reputation definition and the objectives of this study. This measure has the additional advantage of being easy to collect information. The Global RepTrack® 100, published by the Reputation Institute, also meets the objectives of this study. Compared with the World's Most Admired Companies of 2015, which considers only the views of top corporate executives, the Global RepTrack® 100 considers multiple perspectives of different stakeholders. This advantage can also be considered a negative point, as the Global RepTrack® 100 does not distinguish the opinion of different groups of stakeholders as mentioned by Eckert (2017). According to the same author, the ranking of Fortune-World's Most Admired Companies is one of the most often used measures of corporate reputation in the literature.

As a way to measure the stock liquidity, the Amihud (2002) – ILLIQ was used. Amihud's (2002) liquidity measure has the advantage of including the price impact characteristic and it takes into account data that is easy to obtain in addition to being one of the most used measures in the literature.

To analyze the reputation's impact, the sample was subdivided into two groups: a group of firms listed in the Fortune ranking and a group of non-listed in the same ranking.

To test the hypothesis, non-parametric tests will be performed. In particular, the study tests if there are differences between medians of Amihud's (2002) illiquidity ratios of the listed and the non-listed firms in the ranking. Furthermore, we will examine, within the Fortune listed group, if there are differences between firms with a high ranking and a low ranking.

Equation (1) presents Amihud's (2002) measure:

$$Illiq_{i,t} = \frac{1}{D_{i,t}} \sum_{d=1}^{D_{i,t}} \frac{|R_{i,d,t}|}{VOL_{i,d,t}} \quad (1)$$

where: $|R_{i,d,t}|$ is the return of the stocks of firm i , on day d , in week t ; $VOL_{i,d,t}$ is daily trade volume in USD of the stocks of firm i , in week t ; $D_{i,t}$ is the number of transaction days of firm i , in week t . Note that the higher the value obtained for this measure, the lower the liquidity.

4. Sample and Data

In order to test the hypothesis formulated the sample was selected based on the World's Most Admired Companies of 2015 ranking, published by Fortune magazine. From a list of 350 worldwide firms, the U.S. firms which were listed on New York Stock Exchange (NYSE) were selected, comprising a sample of 174 firms. Even though the World's Most Admired Companies of 2015 ranking contains firms from various markets, to concentrate the analysis on a single market with homogeneous characteristics, the U.S firms listed on the NYSE (since the objective of the study is not to analyze the effect of belonging to different markets) are used. To analyze the reputation effect, a matched sample with the same number of U.S. firms was done. This matched sample is a control group of firms not listed in Fortune but listed in the NYSE. The selection of these firms was based on the market value. The market value was chosen as a proxy of firm size in line with the literature, for instance, Fombrun and Shanley (1990), since larger firms usually have a higher reputation. Additionally, one of the factors that affect liquidity is the firm size, which reinforces the importance of the criterion used (Chordia et al., 2004).

Furthermore, it is analyzed if the reputation level influences the liquidity within the group of listed firms in the Fortune ranking. To do that, a subsample of firms belonging to the ranking was constituted, which in turn were subdivided into two groups: high rank and low rank. The subdivision was done considering if its score was higher or lower than the median of the classification.

The information needed to calculate Amihud's (2002) illiquidity measure and market value was obtained from the DataStream database. The information was collected weekly in the year 2015, achieving a total of 18,444 observations for each variable.

Table 2 summarizes descriptive statistics for Amihud's (2002) illiquidity ratio. Panel 1 includes the total sample, Panel 2 presents the listed and non-listed firms in Fortune's ranking subsamples, and Panel 3 reveals high rank and low-rank subsamples.

Table 2. Descriptive statistics on Amihud's (2002) illiquidity ratio

Variable	Mean ⁽¹⁾	Median ⁽¹⁾	SD ⁽¹⁾	Minimum ⁽¹⁾	Maximum ⁽¹⁾	Skewness	N	% on the total sample
PANEL 1: Amihud's (2002) illiquidity ratio								
TOTAL SAMPLE	3.38	1.26	13.84	0.01	662.19	24.52	348	100
PANEL 2: Amihud's (2002) illiquidity ratio of LISTED and NON-LISTED firms in Fortune's ranking								
LISTED	2.66	0.92	5.44	0.01	91.77	5.81	174	50
NON- LISTED	4.10	1.57	18.77	0.06	662.19	19.41	174	50
PANEL 3: Amihud's (2002) illiquidity ratio of subsamples constituted by the firms listed in the ranking with HIGH RANK and LOW RANK								
LOW RANK	3.77	1.55	6.82	0.04	91.77	4.90	87	50
HIGH RANK	1.56	0.58	3.21	0.01	55.09	6.07	87	50

⁽¹⁾ Unit: 10⁻⁷

In Table 2, Panel 2, it can be observed, that the mean and the median of Amihud's (2002) illiquidity indicator is higher in non-listed firms. This may indicate, as the hypothesis of this study defines, that the stocks of non-listed firms in the Fortune ranking may have less liquidity than the listed stocks firms. The dispersion of the values of Amihud's (2002) illiquidity ratio, standard deviation, is higher in non-listed firms. Compared with the values obtained for the total sample (Panel 1), the mean and median of liquidity of listed firms is higher than for the total sample.

In Table 2, panel 3, through the values obtained for the average of each subgroup of the sample, it can be verified that Amihud's (2002) illiquidity ratio is lower for the firms with a high rank. The same happens to the median value, where low-rank firms have a higher value. In line with the results obtained in panel 2, the results of panel 3 may indicate that even within reputable firms, the most reputable ones have a higher level of liquidity.

5. Results

For the purpose of the study, namely, to test if there is a positive relationship between corporate reputation and the stock liquidity, non-parametric tests will be used. The U Mann-Whitney test was performed to compare the illiquidity median between the subsamples presented in the previous section are statistically significant.

For a significance level of 1%, firms listed in the ranking and firms with high reputation have higher liquidity (lower illiquidity), thus corroborating the hypothesis (see Table 3). This result corroborates not only the hypothesis formulated but also the results obtained for the descriptive statistics, which may indicate that firms with a better level of corporate reputation present a higher level of liquidity stocks. Additionally, the results obtained do not support the idea defended by Delgado-García et al. (2013), whose indicate that what is important to explain risk is not the level of reputation but rather whether it is or not reputable. Since in our study we conclude that, in relation to the stock liquidity, it is important not only to be listed or not listed in Fortune's ranking, but also the reputation score.

Table 3. Difference between medians

Amihud's (2002) illiquidity ratio of LISTED and NON-LISTED firms in Fortune's ranking	-0.65***
Amihud's (2002) illiquidity ratio of firms listed on Fortune's with a HIGH RANK and a LOW RANK	-0.97***

Unit: 10^{-7}

Note. The table summarizes the Mann-Whitney test for the difference of the medians of Amihud's (2002) illiquidity ratio between the subsamples: difference of the median between listed and non-listed firms in Fortune's ranking illiquidity; difference of the median between firms listed on the ranking with a high and a low rank. The significance levels are indicated by *, **, and *** which represent 10%, 5%, and 1% levels, respectively.

Based on availability bias referred by Barber and Odean (2008), these results can be explained by the fact that the reputed firms are more visible and more mentioned (resulting from the speed of information flow), and consequently, are given greater attention and more trade. As noted above, the increase in reputation may make firms more competitive and therefore more attractive to investors.

Such conclusion it is important for both firms and investors since investors are looking for more liquid stocks and therefore firms may be motivated to raise their reputation.

6. Conclusion

This study explored an uncovered relationship between corporate reputation and stock liquidity, using Amihud's (2002) measure. In the literature there are studies that relate financial performance to reputation, and there are studies that relate liquidity to return and lastly, return to reputation. But there is a lack of studies that directly analyse the effect of the corporate reputation on the stock liquidity, so this work is an important contribution to the financial literature.

To accomplish the study aim, secondary data about corporate reputation retrieved from Fortune Ranking (a widely available media ranking that takes eight attributes into account) and financial market information from DataStream, for the period year of 2015, was used. In total, we analyzed 18,444 observations and 348 firms. To test the research hypothesis, a nonparametric test was applied.

The results obtained allow us to conclude that there is a positive and significant relationship between the level of reputation and the stock liquidity. Since firms listed in the Fortune Ranking have higher liquidity than firms that are not listed, and firms classified with a high rank have higher liquidity than firms classified with a low rank. In this sense our result indicate that it is important not only to be listed or not listed in Fortune's ranking, but also the reputation score. This result may be consistent with the availability bias referenced by behavioral finances because the reputed firms are the most mentioned, and consequently, more traded.

The findings offer important practical implications, for the literature, for investors' stock decisions, and for firms' and government policies.

For investors, our findings emphasize the importance of taking into account the corporate reputation in the investment decisions as it increases stock liquidity and consequently decreases the cost of equity (Amihud and Mendelson, 1986). Among other advantages of

corporate reputation on stock markets, namely the impact on stock return and risk mentioned in the literature, our results provide empirical support for the positive impact of corporate reputation on stock liquidity.

For firms, these results may encourage firms to seek improvements to their reputation level to increase the liquidity of their stocks and consequently get a fairer market value. These results highlight the importance of transversely in the various business areas (in particular, marketing, strategy, and finance). Additionally, this study contributes to the literature in the communication area, emphasizing its importance in the financial markets and in defining corporate strategy.

Finally, for the government, our results highlight that corporate reputation may induce an increase in stock liquidity, which may contribute to capital market development and subsequently economic development. In this sense, government policies should take into account the support of firm reputation investment as the domestic economies can be strengthened.

Although the contributions of this study to the literature, we acknowledge some limitations that could be addressed in future research. For future work developments, it would be interesting to extend the sample to other types of markets, namely, to verify if the results are different between emerging markets and developed markets. In addition, future studies are encouraged to apply multivariate analysis and consider a different stock liquidity measure, considering the diversity of existing measures and the complexity of these variables.

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