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RESEARCH ARTICLE

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Does reputation matter for firm risk in developing country?

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Abstract

This research examines the effect of corporate reputation for firm risk in a developing country for a sample of 256 Indonesia firms for the period 2011–2015. Using two-step generalized method of moments approach, this research documents five important findings: (a) firm with higher reputation exhibits lower total risk (stock return volatility) and lower tail risk, yet, no significant effect on default risk; (b) Firms with high leverage use reputation effect for less total risk, tail risk, and default risk; (c) Firms with low leverage only enjoy the reputation effect on less total risk, but no reputation effect on tail risk and default risk; (d) Firms with high profitability utilize reputation to reduce the tail risk and default risk; and (f) firm with low profitability has less tail risk when their reputation is high. This evidence contributes to the literature by uncovering important and previously unidentified determinants of risk, namely, reputation. It offers an insight to stakeholders that reputation does matter.

KEYWORDS

corporate reputation, corporate strategy, extreme risk, financial risk, total risk

1 | INTRODUCTION

The reputation of a firm is a strategic intangible asset that may help inducing firm's value (Gonzalez Sanchez & Morales de Vega, 2018; Roberts & Dowling, 2002), and it is also a signal about how manager run the organization (Herbig & Milewicz, 1995; Silver & Shaw, 2018). In the perspective of resource-based view theory, manager characterized corporate reputation as the most important assets (Lee & Jungbae Roh, 2012; Rindova, Williamson, & Petkova, 2010; Veh, Göbel, & Vogel, 2019; Walker, 2010), accordingly, researchers extensively investigate that proposition by testing the association between corporate reputation and firm performance. The consensus is that higher reputation leads to better performance (e.g., Inglis, Morley, and Sammut (2006)—Australia; Rose and Thomsen (2004)—Denmark; Dunbar and Schwalbach (2000)—Germany; Gillet, Hübner, and Plunus (2010)—the United States and Europe).

Meanwhile, the literature of signalling theory and brand-image theory find empirical support for the relationship between corporate reputation and perception towards the organization (Connelly, Certo, Ireland, & Reutzel, 2011; Heinberg, Ozkaya, & Taube, 2018; Weigelt & Camerer, 1988). For instance, Connelly et al. (2011) review the use of signalling theory in management studies and address that reputation as a critical factor in a signal of quality. They describe that firms gain credibility for their organizational performance by renting the reputation of auditors, or owners, or even lenders. As a consequence, banks or other stakeholders make a business decision based on that perception. It

explains why banks use reputation to screen applicants and lend to those having a signal of quality. Heinberg et al. (2018) use signalling theory in examining the reputation impact on product quality image. They argue that the reputation of a firm helps consumers in making their decision at the point of purchase, especially in a condition where reputation is an essential factor to signal product quality to consumers before the purchase decision.

In an efficient market, reputation serves as the stronghold of excessive sentiment. Studies have shown the role of reputation as valuable assets and how it drives the volatility sentiments in the market (Baker & Wurgler, 2007; Bohl, Goodfellow, & Bialkowski, 2010; Morck, Yeung, & Yu, 2000; Srivastav, Keasey, Mollah, & Vallascas, 2017). A firm with a high reputation has incentives to have less volatility due to the trust and confidence of shareholders compared to a firm with a low reputation (Delgado-García, de Quevedo-Puente, & Díez-Esteban, 2013). It explains the existence of investor reaction and volatility towards CEO turnover (Srivastav et al., 2017), scandals (Jory, Ngo, Wang, & Saha, 2015), policy reformation (Kutan & Sudjana, 2003), or corporate action (Rosen, 2006). In other words, reputation does matter in dictating the risk behaviour of a firm.

Intriguingly, there is not much attention of researchers examining the effect of corporate reputation on firm risk amid several exceptions conducted in developed countries context (Delgado-García et al., 2013). Most reputation studies are more on the signal of good quality rather than the cost of reputation. Reputation is most likely reported as incentives for efficient and productive business operation, which may also correct as described by the proponents of Resources Base View rather than a camouflage signal, where a firm disguises a potential liability to achieve their interest. Building from those theories and issues, this research empirically analyses the effect of firm reputation on reducing three types of risk.

Literature in financial stability has addressed different conception of risk (Adhikari & Agrawal, 2016; Ahmed & Hla, 2019; Davis & Stone, 2004; Delgado-García et al., 2013; Gregory, 1998; Ibrahim, Salim, Abojeib, & Yeap, 2019); a fact that opens different lines of research but may limit the possibilities of generalizing their conclusions. Each type of risk may not always associate with performance; thereby, firm reputation may have different effects depending on the type of risk. In general, literature has classified three types of risks, namely, (a) total risk, (b) extreme risk, and (c) financial default risk.[1]

It is noteworthy that this research is different from previous research such as Gregory (1998) and Delgado-García et al. (2013) in several manners. Gregory (1998) only caters to one type of risk, such as volatility in a time-series manner. Moreover, Gregory (1998) argued that reputation is measured using perceived brand power, which is only suitable for the manufacturing industry. Meanwhile, Delgado-García et al. (2013) is the close peer of this current research, where Delgado-García et al. (2013) and this article are using panel data set and has the same measure of reputation. However, Delgado-García et al. (2013) test reputation effect only on total risk (including it is unsystematic and systematic), meanwhile this current research extends risk definition into extreme risk and financial default risk. As our standpoint is that reputation is a strategic resource; hence, it will also affect financial performance, rather only on sentiment such as total risk. It is not to mention that financial fluctuation, including its sentiment, has a more significant impact on developing countries (like Indonesia) rather than in developed countries (like in Spain; Davis & Stone, 2004).

Indonesia offers an interesting research setting for this area in several ways. First, Indonesia is a good proxy of developing countries, especially for developing Asian nations. The market risk behaviour of Indonesia is not much different from Malaysia, Thailand, Philippines, and Korea (Baig & Goldfajn, 1999). Therefore, Indonesia can be used to generalize reputation-risk findings. Second, the market imperfection and market efficiency of Indonesia are relatively at par with other developing Asia countries, providing an excellent background to test sentiment effect like the reputation on risk. Notably, the culture towards the reputation of Indonesia can represent developing countries because it has a similar view with other developing countries (Hofstede & Bond, 1988; Hofstede & Minkov, 2010).[2] Importantly, since reputation provides information signals to shareholders, the reputation-risk association will be more interesting to be tested in a less efficient market like Indonesia. With relatively huge information asymmetry and less good governance exercise, Indonesia might give a good insight into how reputation can be used as a strategic resource.

In sum, this research provides three main objectives. First, this current study investigates the relationship between firm reputation and risk, and test the relation with comprehensive risk measurement. Second, we frame the investigation using two major theories (signalling theory, and resource-based view theory) in determining the relationship between reputation and risk. Lastly, we further examine the dynamics of firm characteristics such as debt and profit towards the association between reputation and risk.

This research's contribution is threefold. First, we add to the literature by extending the understanding of reputation and risk within developing country context. This research aims to test the reputation effect on firm risk in a weakly efficient market and family-firm dominated

ecosystem like Indonesia. In a weak efficient market, reputation will not have a strong signal to shareholders. Meanwhile, in a family-firm dominated ecosystem, agency cost is lower, resulting in lower risk. Second, we contest three major theories in management studies such as resource-based view theory, and signalling theory in revealing the cost of reputation in a risk perspective. Those theories surmise that reputation is a strategic resource that can generate better performance. Third, this research proposes a new platform for further study in firm risk, where three risk measurements are utilized in capturing an overall conclusion about risk as an outcome.

The rest of the article is organized as follows. Section 2 presents the conceptual and hypothesis development of the study. We then describe the research methodology used along with its estimation model. The fourth section discusses the result analysis. Finally, Section 5 includes a conclusion and followed by an explanation about the implication and limitation of the research.

2 | CONCEPTUAL AND THEORETICAL ARGUMENTS

The research of reputation has been investigated by researchers of a wide range of fields, including finance, accounting, economics, marketing, sociology, and organization theory (Gois, Lima, Luca, & Silva, 2020). However, there is no consistent consensus for reputation. In this article, settings the relationship between reputation and risk under signalling theory and RBV theory. The premise is that reputation is a key factor in a competitive and complex business world. Without managing or governing reputation as part of resources, it sends signals to the stakeholder about the mismanagement, hence, increasing the risk (Góis, Luca, Lima, & Medeiros, 2020; Heidinger & Gatzert, 2018). Intriguingly, the argument on the effect of reputation on risk has less attention (Delgado-García et al., 2013; Gangi, Daniele, & Varrone, 2020; Góis et al., 2020; Gonzalez Sanchez & Morales de Vega, 2018; Henkel, 2009).

Signalling theory is another structure in depicting the connection between reputation and risk. Notwithstanding, reputation connected studies building on signalling theory have frequently been verified in the low-risk or low-uncertainty. This theory contends that reputation is a signal of risk, where higher reputation means lower risk in developed countries (Heinberg et al., 2018; Smith, Smith, & Wang, 2010; Wu, Liao, Hung, & Ho, 2012). Thus, we discuss emerging countries like Indonesia and provide a useful context with firm risk, reputation, and signalling theory.

RBV sees reputation as the post-action stage, explicitly, as a vital asset that leads to sustained and competitive performance (Walker, 2010). RBV argues that reputation is a valuable intangible resource since it is hard to mimic. Since it is hard to mimic it causally, a good reputation can prompt various vital advantages. Reputation can reduce risk or uncertainties (Delgado-García et al., 2013; Rindova, Williamson, Petkova, & Sever, 2005), aid achieves and sustain high financial performance (Gatzert, 2015; Roberts & Dowling, 2002; ter Huurne, Ronteltap, Guo, Corten, & Buskens, 2018) and creates competitive advantage (Barney, 1991; Hosseini et al., 2019).

2.1 | Reputation and risk

The literature review discovers the relationship between firm risk and reputation and recommends the need to examine it further. Most of the previous study only focuses on either on financial risk (Gangi et al., 2020; Góis et al., 2020; Gonzalez Sanchez & Morales de Vega, 2018) or systematic risk and ignoring unsystematic risk (Bravo, 2016; Ruefli, Collins, & Lacugna, 1999). By far, the only paper attempts to evaluate the impact of corporate reputation on systematic risk, non-systematic risk, and total risk (Delgado-García et al., 2013). This is intriguing considering the postulation from resource-based view theory, where it posits that a good firm reputation offers companies with useful resources in more favourable conditions and more stable resources. The more stable resources, the higher stability leads to a decrease in the unsystematic risk. The main element of total risk is unsystematic (Brown & Kapadia, 2007; Goyal & Santa-Clara, 2003); thus, this study shows a good firm reputation to decrease firm total risk (Luo & Bhattacharya, 2009). Therefore, we hypothesize:

H1 Higher corporate reputation leads to lower firm's total risk.

There are limited empirical studies about the relationship between extreme risk and firm reputation. Extreme risk is known as risk can be avoided (Al-Tamimi & Al-Mazrooei, 2007). In case the firm faces higher short-term liability, the firms forced to take extreme risks. It provides an idea about how good the firm reputation is controlling its liability to increase customer retention (Walsh, Mitchell, Jackson, & Beatty, 2009), reduces employee turnover (Fombrun & van Riel, 2004), improve the stability of financial and lessen the extreme risk. Firms which are more excellent in controlling the liabilities are more inclined to reduce extreme risk. It is

claimed that there is a negative relationship between extreme risk and firm reputation (Al-Tamimi & Al-Mazrooei, 2007).

H2 Higher corporate reputation leads to lower firm's extreme risk.

There are not many prior studies about association among financial default risk and firm reputation. Most of the previous studies explore the relationship between financial default risk and performance. Opler and Titman (1994) found that there is a positive relationship between performance and financial default risk. Gangi et al. (2020) and Góis et al. (2020) surmise that reputation may affect the distress condition of a firm. Lower reputation is related to the contingency cost and operational risk leading to lower trust from stakeholders; hence, increasing the financial distress. Thus, a higher firm reputation may lead to less financial default risk.

H3 Higher corporate reputation leads to lower firm's financial risk.

3 | METHODOLOGY

3.1 | Data and sample

Our sample consists of all non-financial listed firms in Indonesia for the period of 2011–2015.[3] In the end, our total samples contain 256 listed companies with total observations of 1,280 firm years. Data are collected through three primary sources, which are reputation award, annual report, and world scope. We take financial data from Worldscope to obtain profitability, stock return, total debt, and total assets. We take controlling shareholder data from the annual report (substantial shareholder report). Lastly, the reputation award is taken from Forbes Indonesia magazine.

3.2 | Measuring risk

Following prior studies, we construct total risk, extreme risk, and financial default risk, namely an Altman *Z*-score. Total risk, also name as stock return volatility, is the standard deviation of a corporate's daily stock returns during the fiscal year; it is the risk caused by both corporate-specific and systematic factors. Extreme risk is based on Acharya et al.'s (2010) expected shortfall measure, which is average risk conditional on returns being less than some 'α'-quintile. Extreme risk is an important risk measure for companies because it estimates how much a company is likely to lose in extreme adverse events or crises. Following Acharya et al. (2010), and Ellul and Yerramilli (2013), we define extreme risk as to the negative of the average of the 5% worst daily returns (i.e., $\alpha = 5\%$) of a company's stock over the fiscal year. The third variable of interest is financial default risk, which measures risks coming from a corporate's actions. We calculate financial default risk as the Altman *Z*-score (Altman, 1968) using subtracting the total score from mean and then dividing it by standard deviation.

3.3 | Measuring firm reputation

The independent variable of this research (firm reputation) is constructed by three dimensions, which are Forbes Top 50 Best Companies, the excess profit of the company, and excess dividend (Delgado-García et al., 2013). Forbes is a global authoritative business magazine, and it is well known for its ranking and list. The information about Forbes Top 50 Best Companies in Indonesia is collected from Forbes Indonesia. We also retrieve the financial information about the profit of the company and dividend given to stockholders from the firm's annual reports. Excess profit is the ratio of the nominal value of profit (or dividend) to the industry median value of each firm.

The measurement construction is as follows. First, we rank the firm following its 20th percentile per year per industry. A firm that falls into the highest 20th percentile group is given score 5. Meanwhile, the lowest 20th percentile group is given score 1. We did this procedure for each dimension. However, for the Forbes ranking, we give score 0 for those firms which were not part of the Forbes list.

Second, we sum the score from each dimension and take the average for each year. It is a similar procedure like in survey research with a 5-Likert scale, where we take the mean value from three items (in our case, three dimensions). In the end, the minimum value is 1, indicating a low reputation, and the maximum value is 5 indicating a high reputation.

This procedure is taken for two reasons. First, having only the nominal value will create a concomitant variation issue. Our sample consists of 256 listed non-financial firms, and the Forbes ranking for the top 10 firms is less likely to change. Second, reputation is not solely due to Forbes ranking, but it is closely related to their excess profit and dividend payout compared to their peers. We standardized the mean value to avoid data variation bias (Table 1).

TABLE 1 Variable definition

Abbreviation	Variables	Calculation
Dependent variables		
FIRMRISK	The risk from firm-specific and systematic factors	The standard deviation of a corporate's daily stock returns during the fiscal year
TAIL	Expected shortfall risk	The negative of the average of the 5% worst daily returns (i.e., $\alpha = 5\%$) from stock price over the fiscal year
DEFAULT	Financial risk	Altman *Z*-score
Main independent variable		
REPUTATION	Firm reputation	Standardize mean of firm reputation according to Forbes Asia, profitability ranking, and dividend payment ranking
Control variables		
LEVERAGE	Firm's leverage	Total loan to total assets
AGE	Firm age	Natural logarithm of the firm's age since the date of establishment
SIZE	Firm size	Natural logarithm of the firm's total assets
ROA	Firm profitability	Net income to total assets ratio
FAMILY	Family-owned firm	1 if the controlling shareholder is family, otherwise, 0

3.4 | Specification and empirical model

Our estimation model is built deductively from the baseline model to the full model. We adapt to Delgado-García et al. (2013) and explore the importance of reputation on firm risk by modifying the model. Even though in many reputation studies (Frey & Van De Rijt, 2016; McNamara & Doodson, 2015; Milinski, Semmann, & Krambeck, 2002) do not have dynamic relationships nor tackling the endogeneity issue, we argue that the instrumentation is vital in risk study. We follow Wintoki, Linck, and Netter (2012) approach by utilizing the generalized method of moments (GMM) approach to fix this issue where the system GMM adds the one-lagged of risk. This approach also provides an empirical specification that corresponds to an intuitive, dynamic performance regression. Thus the parameter estimates have a readily understandable interpretation even if some of the assumptions required of the underlying structural model do not strictly hold in the data.

Basically, the function of risk consists of leverage, age, size, and profitability. However, our study takes Indonesia due to most of the firms and family business in nature as the sample, where it is believed risk behaviour from family firms is different from risk behaviour from non-family firms (Gomez-Mejia, Makri, & Kintana, 2010). It is noteworthy that the Indonesia business is dominated by family ownership (Efferin & Hartono, 2015; Jiang & Peng, 2011). Therefore, we add family ownership as another control variable. As our study is framed under resource-based view theory and signalling theory, we propose reputation as the main effect of the risk function. Hence, our estimation model will be:

$$\begin{aligned}\mathrm{RISK}_{i,t} = {} & \beta_0 + \beta_1 \mathrm{RISK}_{i,t-1} + \beta_2 \mathrm{Reputation}_{i,t} \\ & + \beta_3 \mathrm{LEVERAGE}_{i,t} + \beta_4 \mathrm{AGE}_{i,t} + \beta_5 \mathrm{SIZE}_{i,t} \\ & + \beta_6 \mathrm{ROA}_{i,t} + \beta_7 \mathrm{FAMILY}_{i,t} + \varepsilon_{i,t}\end{aligned}$$

As explained above, this study has three measures of risk, namely, Firm Risk, Extreme risk, and financial default risk. From the equation above, our study using firm risk, tail risk, and financial risk as to the measurement for firm risk. The estimation model is run for each type of risk to reveal the different effects of a reputation for a different type of risk. Meanwhile, LEVERAGE refers to the firm's leverage (total loan to total assets). AGE refers to the firm age (natural logarithm of firm's age since the date of establishment); SIZE is the firm size (natural logarithm of firm's total assets), ROA is firm performance (net Income to total assets ratio), FAMILY is family-owned firm (1 if the controlling shareholder is family, otherwise, 0), μ is the error term in the regression model, and the parameters need to be estimated are β.

4 | RESULT AND DISCUSSION

4.1 | Descriptive statistics result

Table 2 displays the summary statistics at the firm-year level, which we later use to infer the economic significance of our regression estimates. Due to the non-uniform distribution of firm-year across industries, the summary statistics at the industry and firm-level are not identical. The average annual total risk and tail risk are 0.0219 and 0.0409, respectively. For the annual default risk, the average value is 2.86, indicating that Indonesia companies are not having higher default risk nor lower default risk averagely. The

TABLE 2 Descriptive statistics

	Mean	*SD*	25th	Median	75th
FIRMRISK	0.0219	0.1991	−0.0875	0.0251	0.1405
TAIL	0.0409	0.0418	0.0350	0.0470	0.0560
DEFAULT	2.8665	0.4871	−3.2800	2.8188	3.5100
REPUTATION	3.0322	0.8300	2.3333	3.0000	3.6667
LEVERAGE	0.2138	1.1798	−0.5848	0.0775	0.9746
AGE (LN)	3.3295	0.5087	3.0910	3.4012	3.6635
AGE	31.4123	15.4712	22.0000	30.0000	39.0000
SIZE (LN)	21.4456	1.8011	20.2298	21.5540	22.6713
TOTAL ASSETS (IN THOUSAND)	2,060,000	193,000	611,000	2,300,000	7,020,00
ROA	0.0324	0.3627	0.0025	0.0332	0.0810
FAMILY	0.5943	0.4912	0.0000	1.0000	1.0000

TABLE 3 Pearson correlation results

	1	2	3	4	5	6	7	8	9
1. FIRMRISK	1								
2. TAIL	0.0871***	1							
3. DEFAULT	0.0639**	−0.0016	1						
4. REPUTATION	0.0784***	0.1079***	0.2875***	1					
5. LEVERAGE	−0.314***	0.0796	0.1964***	0.3841***	1				
6. AGE	0.0792***	0.1022***	0.0458	0.0665**	0.0917	1			
7. SIZE	0.1102***	0.0768***	0.0572**	0.0878***	−0.2600***	0.1712***	1		
8. ROA	0.0402	0.0208	0.0982*	0.2163***	0.3619***	0.0785***	0.1142	1	
9. FAMILY	0.0288	−0.0421	−0.0465	−0.0329	0.023	0.0166	−0.0624	−0.0103	1

theoretical threshold of the *Z*-score is lower than 1.8 for the distressed company and higher than 3 for a healthy company. Looking at the 75th value of default risk is 3.5100, it implies that a quarter of Indonesia listed companies are healthy companies.

Meanwhile, the 25th value of default risk is −3.28, implying a quarter of Indonesia listed companies have a financial distress situation. It is tally with the profitability data shown in Table 2. It shows the profitability for pooled of Indonesia listed companies from 2011 to 2015 is averagely 3.2%. The 75th value is only 8.1% averagely, indicating that not many Indonesia companies have high profitability. For the distribution of reputation data, Table 2 shows a mean value of 3.0322, with a median value of 3. The 25th value is 2.33, and the 75th value is 3.6 implying the reputation data are distributed well.

Table 3 reports the Pearson correlations for the variables included in our models. All correlations among the independent variables are lower than 0.6, implying the absence of multicollinearity in our regression model. It was confirmed by the fact that the variance inflation factors of all variable models reported in all estimation models were all below the commonly accepted multicollinearity threshold of 10 (Sekaran & Bougie, 2010). Meanwhile, the correlation matrix indicates there is a significant correlation between the independent variables and its dependent variables.

4.2 | Regression results

We control the influences of the possible endogenous relationship by utilizing the GMM method (Arellano and Bond, 1991). This GMM model is suitable to eliminate the endogeneity issue that appeared in the model (Wintoki et al., 2012). Further, the GMM estimator has several advantages. On the one hand, it controls for the potential issues of endogeneity of explanatory factors, and, on the other, it keeps away from the non-observable constant heterogeneity emerging out of the particular

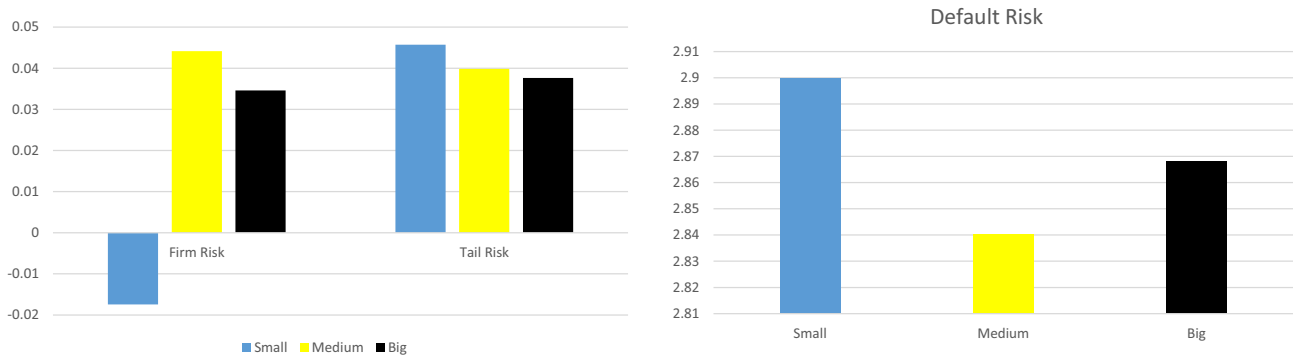

FIGURE 1 Graphical plot of firm size quadratic effect on risk [Colour figure can be viewed at wileyonlinelibrary.com]

highlights of each firm that stays over time. This estimation method permits the introduction of a higher number of instruments than other GMM estimators, accordingly improving effectiveness.

We also employ the diagnostic check for all the models. First, we proceed to control the period effect, and standard error to avoid heteroscedasticity issue. Each model was estimated under Likelihood ratio, Random Effect Breusch Pagan LM test, and Hausman Fixed Effect test in deciding the final model.

Additionally, we introduce the size quadratic effect to ensure reliable statistical inferences. We argue that size and risk are theoretically non-linearly associated under risk framework. Small firms have similar risk characteristics with big firms while they are different from medium firms. Hoffmann, Bertín, and Warleta (2014) and Chia, Lim, and Goh (2020), for instance, provide the U-shape evidence of liquidity following the size. Figure 1 is consistent with previous research, such as which found a negative association of firm size on the firm value within the Southeast Asia context. We empirically tested the anecdotal evidence by using Lind and Mehlum's (2010) non-linear shape relationship and found that support for our proposition about the size quadratic effect on the firm tail and default risk, but not in tail risk. However, we still add the size quadratic effect on our tail risk estimation model for consistency and model efficiency issues.

Table 4 presents the results of GMM panel regressions of different measures of firm risk for the full sample. We run six specifications using different risk measures. The first two specifications use firm risk as to the dependent variable. Then, we run the specification models by changing the dependent variable to tail risk (Column 3 and 4), and lastly, to default risk (Column 5 and 6). In Column 2, reputation has negative association with firm risk ($\beta = -0.0261$; $SE = 0.0124$). Consistent with our first hypothesis (H1), this result suggests that a firm with a higher reputation exhibits lower stock return volatilities. In economic terms, the estimated coefficient of −0.0261 on reputation suggests that a one standard deviation increase in the fraction of reputation adherents leads to a decrease of about 0.0216 (=0.0261*0.830) in total risk, which is about 10.88% (0.0216÷0.1991) of its standard deviation.

Similarly, in Column 4, reputation is found to have negative effect on tail risk ($\beta = -0.0059$; $SE = 0.0030$). The point estimate of −0.0059 suggests that, on average, firms with a higher reputation experience less extreme negative returns. In terms of economic significance, a one standard deviation increase in reputation leads to a decrease of 0.0049 (=0.0059**0.830), which is about 11.72% (0.0049÷0.0418) of its standard deviation. This result supports our second hypothesis (H2) that firm with higher reputation has less extreme risk.

In Column 6, the results offer a different conclusion. It rejects our third hypothesis (H3). The result shows that reputation has no statistical effect on default risk. It reveals that reputation, which is a non-financial resource, has no significant value to induce or deduce the financial distress of a firm.

In sum, the research structure of this examination is worked under the assumption of signalling theory, and resource-based view theory. The majority of these theories concur that corporate goes about as the primary chief that may influence the firm risk or may not. The outcomes from our full model reveal fascinating discoveries. Such as firm with higher reputation level has less firm risk and tail risk. This is consistent with Delgado-García et al. (2013), who found the same conclusion from the bank's perspective. Meanwhile, the findings document that no matter how good or bad the reputation of a firm, it does not have a significant influence on a firm's financial distress. It is aligned with the finding of Goyal and Park (2001).

All control variables obtain expected signs in predicting the risk variables except size, size2, and age.

TABLE 4 Panel GMM results

	Firm risk	Tail risk		Default risk		
	Baseline [1]	**Full [2]**	**Baseline [3]**	**Full [4]**	**Baseline [5]**	**Full [6]**
RISK(−1)	0.5009**	0.4507***	0.3358**	0.3373**	0.0444*	0.0538**
	(0.2141)	(0.1564)	(0.1423)	(0.1404)	(0.0259)	(0.0258)
REPUTATION		−0.0261**		−0.0059**		0.0589
		(0.0124)		(0.0030)		(0.0427)
LEVERAGE	0.0190**	0.0357*	0.0044**	0.0043**	0.0372**	0.0359**
	(0.0088)	(0.0186)	(0.0017)	(0.0019)	(0.0188)	(0.0171)
AGE (ln)	0.0002	−0.246	0.003	0.0027	0.0345***	0.0324***
	(0.0205)	(0.1917)	(0.0048)	(0.0049)	(0.0104)	(0.0106)
SIZE	0.0593	2.3184***	−0.0177	−0.0079	−0.1221	−0.1196
	(0.1258)	(0.8016)	(0.0136)	(0.0134)	(0.2534)	(0.2541)
SIZE2	−0.0015	−0.0515***	0.0001	0.0001	0.003	0.0029
	(0.0029)	(0.0173)	(0.0003)	(0.0003)	(0.0057)	(0.0057)
ROA	−0.0556**	−0.0620**	−0.0278*	−0.0311**	−0.9305***	−0.6747**
	(0.0282)	(0.0292)	(0.0151)	(0.0145)	(0.2480)	(0.3135)
Family	−0.0253	0.0063	−0.0051	−0.0043	0.0076	0.0149
	(0.0181)	(0.0233)	(0.0056)	(0.0057)	(0.0353)	(0.0351)
Constant	−0.4478	−0.8867	0.1246	0.1110	−1.9322	−2.1493
	(1.3508)	(0.7529)	(0.1382)	(0.1319)	(3.0719)	(3.1492)
Cluster industrial effect	YES	YES	YES	YES	YES	YES
Control standard error	Yes	Yes	YES	YES	YES	YES
No. instrument	13	14	13	14	13	14
AR(1)	0.003	0.0029	0.0007	0.0016	0.0001	0.0002
AR(1)	0.6805	0.6962	0.0682	0.0781	0.7686	0.7646
Sargan	0.3255	0.1638	0.1039	0.1057	0.5226	0.5178

Note: The models are estimated with the two-step Arrelano–Bond GMM test. Standard errors are in parentheses after coefficient. The estimation model clustered the industrial effect and controlled the standard error to tackle heteroscedasticity issues. AR(1) and AR(2) tests are under the null of no first-order and second-order serial correlation, respectively, in the first-differenced residuals. Sargan test of over-identification is under null that all instruments are valid. The level of significance is denoted using the asterisk symbol with *, **, and ***, which are equivalent to 10%, 5%, and 1% level of significance, respectively.

The firm's size has a non-linear effect only on the firm risk. Specifically, positive coefficient estimates on size but negative on Size2 suggest that larger size increases the volatility of their stock returns up to a point (perhaps due to the acquisition of riskier assets), after which size contributes negatively to risk. Not surprisingly, profitability (ROA) negatively related to all three risk measures, while leverage is positively related to it. The age of the firm has a negative effect only on default risk, but no effect on firm risk and tail risk. This is a common conclusion for developing markets, where stock return volatility (including its tail) is a problem for young or mature firms. Finally, the family as controlling shareholder does not have any significant effect on all risk measures. It implies that there is no significant difference between family firms and non-family firms in terms of risk.

4.3 | Further Examination I: Debt effect

The previous section has provided the estimates for the effects of reputation on risk. It is characterized reputation as the risk factors for firm risk and tail risk, but not for default risk. In this section, we further test the hypothesis that reputation-risk contains variation towards the debt level. Prior research, like Liberman (2016), argues that low-cost debt may allow companies to build a credit reputation and reduce risk. Therefore, it is theoretically important for low debt firms to gain stakeholders' confidence.

TABLE 5 Results of sub-sampling high versus low loan

	Firm risk		Tail risk		Default risk	
	High loan [1]	Low loan [2]	High loan [3]	Low loan [4]	High loan [5]	Low loan [6]
Risk (−1)	0.7669***	0.6458***	0.3513	0.3035	−0.325	0.0203
	(0.1151)	(0.1604)	(0.2140)	(0.2218)	(0.2190)	(0.1919)
Reputation	−0.0144**	−0.0163**	−0.0094***	0.0042	−0.0801**	0.186
	(0.0073)	(0.0077)	(0.0031)	(0.0039)	(0.0402)	(0.1329)
AGE (ln)	0.0231*	0.002	−0.0064**	−0.0017*	−0.0512	0.0269*
	(0.0132)	(0.0060)	(0.0027)	(0.0010)	(0.0592)	(0.0158)
SIZE	0.0027	0.00324	−0.0304**	−0.03496	−0.1646*	−0.07726
	(0.1481)	(0.1629)	(0.0124)	(0.0232)	(0.0976)	(0.2170)
SIZE2	0.0001	0.0044**	0.0007	−0.0091**	0.0015	0.0624*
	(0.0034)	(0.0019)	(0.0005)	(0.0044)	(0.0046)	(0.0352)
ROA	−0.0325**	−0.0354***	−0.0068**	−0.0237***	−0.1204**	−0.3386**
	(0.0158)	(0.0122)	(0.0031)	(0.0083)	(0.0521)	(0.1704)
Family	−0.0012	0.0003	−0.0046	0.0005***	−0.0061	−0.0079**
	(0.0084)	(0.0010)	(0.0053)	(0.0002)	(0.0408)	(0.0039)
Cluster industrial effect	Yes	Yes	Yes	Yes	Yes	Yes
Control standard error	Yes	Yes	Yes	Yes	Yes	Yes
AR(1)	0.0038	0.001	0.0084	0	0.0144	0
AR(1)	0.4711	0.5848	0.5961	0.6549	0.8655	0.7067
Sargan	0.2064	0.3344	0.4262	0.113	0.2971	0.5197

Note: The estimation model is run under the two-step Arrelano–Bond GMM test. Standard errors are in parentheses after coefficient. The estimation model clustered the industrial effect and controlled the standard error to tackle heteroscedasticity issues. AR(1) and AR(2) tests are under the null of no first-order and second-order serial correlation, respectively, in the first-differenced residuals. Sargan test of over-identification is under null that all instruments are valid. The level of significance is denoted using the asterisk symbol with *, **, and ***, which are equivalent to 10%, 5%, and 1% level of significance, respectively.

To test this conjecture that there is a different effect of reputation on risk from a leverage perspective, we divide the sample into two groups: high loans and low loan groups. The sub-sampling threshold is based on the median value of each industry in each year. Companies with debt higher than that median value are categorized as a high loan, and companies with debt lower than median value are categorized as low loans. We re-estimate the Model (1) and (2) on these new two data sets and report the findings in Table 5.

Columns 1, 3, and 5 of Table 5 are for high loan groups, while Columns 2, 4, and 6 are for low loan group. Each sub-sample has similar findings except for firm risk measures. For firm risk (stock return volatility), both high loan groups and low loan groups have the same conclusion. It shows firm with a high reputation has less firm risk, no matter whether those firms have high leverage or low leverage. When the risk is measured by tail risk, Columns 3 and 4 reveal two different findings. For high loan groups, a high reputation helps them to reduce tail risk.

Nevertheless, that effect is not found for low loan groups. Lenders seem not to take reputation as a significant factor if the firm has low leverage. Column 5 and 6 presents a similar conclusion of different levels of leverage effect on the relation between reputation and default risk. The findings document a significant effect of reputation on default risk when the sub-sample is a high loan, but that significant effect is gone when the sub-sample is the low loan. It surmises that financial distress will be affected by reputation if the firm has a large amount of loan. For small leverage firms, reputation does not have a significant impact on financial distress.

4.4 | Further Examination II: Profit effect

We also address the concern that reputation-risk association may relate to their profitability. Gomez-Mejia, Haynes, Núñez-Nickel, Jacobson, and Moyano-

TABLE 6 Results of sub-sampling high and low profitability

	Firm risk		Tail risk		Default risk	
	High profitability [1]	Low profitability [2]	High profitability [3]	Low profitability [4]	High profitability [5]	Low profitability [6]
Risk (−1)	0.6704***	0.7015***	0.4217*	0.1515	−0.0418	0.0059
	(0.1520)	(0.1309)	(0.2195)	(0.2138)	(0.1932)	(0.2148)
Reputation	0.0195	−0.0257***	−0.0076***	−0.0040**	−0.2109***	0.0478
	(0.0129)	(0.0091)	(0.0025)	(0.0018)	(0.0295)	(0.0417)
LEVERAGE	−0.0051	−0.0011	−0.012	−0.029	−0.0075	0.002
	(0.0080)	(0.0001)	(0.0220)	(0.0280)	(0.0184)	(0.0050)
AGE (ln)	−0.0017	0.0254**	−0.0102***	−0.0059	−0.0532*	0.0753**
	(0.0105)	(0.0106)	(0.0033)	(0.0042)	(0.0293)	(0.0383)
SIZE	0.0699**	−0.0954	−0.0307***	−0.0224*	0.3197	0.0993
	(0.0321)	(0.0753)	(0.0083)	(0.0120)	(0.2669)	(0.1913)
SIZE2	−0.0013	0.0022	0.0007***	0.0005	−0.0107*	−0.0026
	(0.0014)	(0.0018)	(0.0002)	(0.0003)	(0.0062)	(0.0043)
Family	−0.0025	0.0135	−0.0017	0.0023	−0.0055	0.1674
	(0.0114)	(0.0122)	(0.0027)	(0.0016)	(0.0342)	(0.1261)
Cluster industrial effect	Yes	Yes	Yes	Yes	Yes	Yes
Control standard error	Yes	Yes	Yes	Yes	Yes	Yes
AR(1)	0.0041	0.0014	0.0002	0.0014	0.0000	0.0000
AR(1)	0.2909	0.2004	0.9628	0.7621	0.658	0.8117
Sargan	0.1045	0.3339	0.1196	0.4467	0.6994	0.4361

Note: The estimation model is run under the two-step Arrelano–Bond GMM test. Standard errors are in parentheses after coefficient. The estimation model clustered the industrial effect and controlled the standard error to tackle heteroscedasticity issues. AR(1) and AR(2) tests are under the null of no first-order and second-order serial correlation, respectively, in the first-differenced residuals. Sargan test of over-identification is under null that all instruments are valid. The level of significance is denoted using the asterisk symbol with *, **, and ***, which are equivalent to 10%, 5%, and 1% level of significance, respectively.

Fuentes (2007) postulate that profitable firms may not need a reputation as their strategic resource to have less risk. Consistent with this idea, Bowman (1982) find that profitable firms tend to have less risk, while risk persistently incurred for losses firms. Hence, we test this postulation further by considering the profit effect.

To verify whether there is a profit effect on the estimation model, we again conduct a sub-sampling approach. The sample is divided into two groups: high-profit and low-profit group. The sub-sampling threshold is based on the median value of profitability for each industry in each year. Companies with ROA higher than that median value is categorized as high profit, and companies with ROA lower than median value is categorized as low profit. We re-estimation Model (1) and (2) on these new two data sets and report the findings in Table 6.

For firm risk measure, Column 1 and column 2 have a different conclusion. A firm with a high reputation will have less stock return volatility if the firm has low profitability. However, a high profitability group will not enjoy the reputation effect on firm risk. Perhaps, low profitability firm utilizes reputation strategically to achieve low firm risk. However, high profitability firm will not utilize their reputation because their firm will have a low risk by default as they achieve high profit.

Column 3 and Column 4 document that both high profitability groups and low profitability groups enjoy the reputation effect on tail risk. The firm with a high reputation will have less tail risk, no matter the firms have a high profit or low profit. Tail risk is an extreme risk that may result in bankruptcy or crises. Both groups need a reputation to avoid this type of risk for their going concern.

Moreover, when the risk is measured by default risk, our findings show another conclusion. The firm with a high reputation will have less financial distress for the high-profit group. However, reputation has no effect on

financial distress for the low-profit group. It makes sense because profitability is closely related to default risk. No matter the firm is highly reputable or not, losing profit will make the firm in a distress condition. So, if the firm has less profit, reputation does not affect assisting the default risk.

According to firm debt and firm profit, this study found that there is no difference in the reputation effect. RBV literature states that high debt and high profit are the factors in driving the risk from reputation. A higher reputation will lead to lower risk because of the debt and profit effect. However, our findings show that low debt and low-profit firms also need a reputation to reduce their risk. Therefore, it can be surmised that no matter whether the firm is high-low debt or high-low profit, reputation does affect the risk.

In fact, a conceivable clarification maybe, that a higher reputation prompts more attention combined with stronger desires. Thus, investors might be more sensitive. Since the Indonesia non-financial industry has encountered many scandals amid the most recent couple of years, investors might also be exceptionally sensitive. This is not to mention the sentiment-driven market embedded in most developing countries like Indonesia. The recent scandals of Tiga Pilar Sejahtera (AISA) and Garuda Indonesia (GIAA) are examples of how reputation plays an important role in moving the market sentiment resulting in high volatility (total risk). Intriguingly, those two cases show that even though scandal affects their stock prices, but it does not affect their financial performance. Nevertheless, our findings might hold for other industries as well. In this way, there is still a requirement for further research to explore the impact of reputation on total risk more in-depth.

5 | CONCLUSION

Prior literature in economics and finance has extensively examined the connection between corporate reputation and organizational performance, especially within developed countries context. Despite the abundant empirical evidence on reputation-performance relationships, reputation as a strategic resource is rarely being engaged with the firm's risk. To answer this call, we build mainly on signalling theory, and resource-based view theory, and propose reputation as an important factor for a firm's risk. The premise is that reputation as strategic resources is closely related to the trust and perceived of going concerned for stakeholders. A firm with a bad reputation is most likely will be abandoned by stakeholders, especially in the sentiment-driven market such as Indonesia. With 256 listed companies in Indonesia from 2011 to 2015, we test our hypothesis by employing GMM panel regression.

Our findings reveal two interesting outcomes. First, the firm reputation brings a negative effect on firm risk and tail risk (Brammer, Millington, & Pavelin, 2009; Delgado-García et al., 2013; Walter, 2007). It implies that reputation is an important factor for market-based risk, especially for emerging financial markets such as Indonesia. Second, reputation does not affect default risk implying that bad reputation firms will not cost them financially. Additionally, our findings offer that different levels of loans and different levels of profitability will have a different reputation effect.

The major practical implication from our findings is that firm has to strategize their reputation to gain better risk exposure in the financial market. Even though reputation, overall, does not affect financial performance, firms with high loans and firms with high profitability still need a high reputation to reduce their default risk. Creditors, investors, suppliers, and other stakeholders may lose interest in gauging business with those types of firms if their reputation is lower, resulting in higher default risk.

However, there is an issue that remains an open research question and gives an impulse for future investigations. Researchers in this area are often confronted with the question in terms of reputation measures in the digital era. The findings in our article clearly show that a higher reputation leads to better risk. Only when the firm received reputable awards, higher profitability, and better dividend payment, then it is perceived as a reputable firm. Consequently, a firm with massively using public relations consultant and media buying or firm with actively in social media or firm with more product may have a different effect on the firm's reputation. We thereby encourage future research to identify and engage reputation proxy from the digital economy perspective. We also encourage future studies to consider political ties and corporate governance as a moderation factor for reputation effect, especially for developing countries context. Overall, we have recognized some significant early visions of knowledge into inadequately examined topics, which could serve for future research to expand upon.

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DATA AVAILABILITY STATEMENT

Data sharing is not applicable to this article as no new data were created or analyzed in this study.

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ENDNOTES

[1] Total risk is defined as firm-specific and systematic risk. Traditionally, total risk is built using two components which are risk that is idiosyncratic to a particular firm; and risk that can be attributed to environmental and macroeconomic factors affecting the firm (Miller, Wiseman, & Gomez-Mejia, 2002). Firm reputation may have different effect on this type of risk apart from the performance of the firm. Total risk captures the degree of variation in a firm's performance (as reflected in its income stream or stock returns) that cannot be explained by overall market trends. The second type of risk, extreme risk, or more known as tail risk, is defined as the shortfall probability in extreme events or crises. It is the risk of a crisis in the financial system and its spillover to the economy at large (Acharya, Pedersen, Philippon, & Richardson, 2010; Li & Perez-Saiz, 2018; Rehman, Chaudhry, & Hussain, 2019). Studies like Jones, Jones, and Little (2000) and Ruiz, García, and Revilla (2016) have shown that highly reputable firms have better perseverance in coping an economy shortfall event. Lastly, financial default risk is defined as a probability of firm inability to meet its financial obligation and to pursue their going concern due to business performance. In Altman's *Z*-score calculation, profitability is one of the risk factors. This leads to higher performance means that lower financial default risk (Opler & Titman, 1994). Firm with low profitability implies higher probability of default risk. If reputation is a strategic resource to achieve higher performance, it also implies the firm's ability to attain lower probability of default risk.

[2] The long-term orientation scores from Indonesia was in upper-middle, meanwhile, most Asia and developing countries are also in the same class (Hofstede & Bond, 1988).

[3] The main challenge to this research area is to have a comprehensive and rich set of reputation data. Certain countries have different reputation ranking system, where the award is solely based on perceived reputation. In Indonesia case, reputation award neglects the importance of profitability and dividend for the reputation. Hence, we re-modify the reputation score by including profitability and dividend as part of reputation index.

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