Reputation Matters – Company Reputation Effects on Labor Efficiency and Productivity

By Marty Stuebs, Li Sun and C. William (Bill) Thomas

Anyone who's ever held a job knows that working in an organization with a good reputation makes one feel good and just makes work more enjoyable. However, the benefits of having one goes beyond just producing a "warm fuzzy feeling." Research shows that companies with good reputations are often more efficiently run than those without them.

In today's challenging economy, utilizing resources and managing costs is more important than ever. Effectively and efficiently managing labor resources is critical for service-oriented entities of all types – for-profit, as well as nonprofit. This article shows how building a good reputation as an entity helps build not only more effective, but more efficient relationships (both internal and external), improving labor efficiency, enhancing productivity and improving profitability.

An Increasing Struggle

Businesses are increasingly struggling with the challenges of a volatile global economy. Often, however, discretionary expenditures directed toward protecting an entity's reputation can take a back seat to other seemingly more urgent issues in an effort to control costs. As CPAs, we recognize the importance of building and maintaining integrity even during turbulent economic times. Several recently published professional articles document the value of reputation.[1] This article offers additional support for the argument that it's usually good business.

The reality is that reputation can become even more valuable during tough economic times. We document the labor management benefits of investment in an entity's reputation, and offer some suggestions for incorporating strategies to build a corporate reputation and to foster strong stakeholder relationships.

During economic downturns, revenue growth in many industries tends to stagnate. Therefore, controlling costs, like labor, and improving efficiencies often becomes the key to continued improvement in business performance and profitability. Labor costs are a likely target for efficiency and control efforts, because labor often represents the most significant of all operating costs. This is particularly true for service firms like CPA firms, but it is also true across a broader spectrum of both for-profit and nonprofit enterprises.

Because labor costs are a significant production cost, effectively and efficiently using resources to manage labor costs is important. One recent study of starting salary data from the National Association of Colleges and Employers (NACE) found that the average annual growth rate for starting salaries in human resources positions was between 6 and 6.5 percent from 1998 to 2008, and that human resources was consistently among the top five categories for largest salary growth rates[2]. Therefore, managing labor costs is important and doing so has become more expensive over the last decade.

The Value of Reputation

As professionals, CPAs recognize the value of integrity and maintaining one's reputation. A number of recent articles document that being recognized as a trusted business partner improves relationships with a number of stakeholders.[3]

For example, a reputation grounded in objectivity and integrity forms the foundation for the CPAs' relationship with the public. Former American Institute of CPAs (AICPA) Chairman S. Scott Voynich recognized that "a CPA's most important asset is his or her reputation."[4] It is critical in creating an efficient, effective relationship with the public that is based on trust.

Similarly, a good reputation can create efficient, effective client and customer relationships. "Successful businesses are built on reputation,"[5] which, in turn, can be used to gain more business through increased contacts with potential clients. It generates business in two primary ways:

- The *attraction* effect. For example, potential clients are attracted to a CPA in public practice because of his/her reputation in the community. Alternatively, current clients may refer other potential clients to a CPA because of his/her reputation.
- The *loyalty* effect. Clients or customers who are initially attracted to a CPA by a good business reputation, and who continue to be satisfied, keep coming back for additional services. Thus, it tends to stabilize revenue streams, an important advantage in today's economy.

In an auditing practice, a good reputation can improve the efficiency and effectiveness of the business relationship between auditee entities and independent auditors. Auditors recognize its impact on audit risk.[6] Client integrity and reputation can often decrease the amount of necessary audit evidence collected and thus reduce fees charged by independent auditors.

Labor Management

There is reason to believe that a good reputation can improve

Figure 1: Labor Benefits for High-Reputation Firms

Labor Measure	High-Reputation Company Average	Matched Company Average	Percentage Change
Efficiency	1.571	1.033	52.08%
Productivity	118.469	68.354	73.32%
Cost	73.362	69.449	5.63%

EFFICIENCY = OPERATING INCOME PER LABOR COST DOLLAR = (OPERATING INCOME / LABOR COSTS)
PRODUCTIVITY = OPERATING INCOME PER EMPLOYEE = (OPERATING INCOME / EMPLOYEES)
COST = LABOR COSTS PER EMPLOYEE = (LABOR COSTS / EMPLOYEES)

Figure 2: Labor Benefits Within High-Reputation Firms

Labor Measure	Excellent-Reputation Company Average	Good-Reputation Company Average	Percentage Change
Efficiency	1.801	1.340	34.40%
Productivity	142.200	94.719	50.13%
Cost	77.317	69.408	11.39%

EFFICIENCY = OPERATING INCOME PER LABOR COST DOLLAR = (OPERATING INCOME / LABOR COSTS)
PRODUCTIVITY = OPERATING INCOME PER EMPLOYEE = (OPERATING INCOME / EMPLOYEES)
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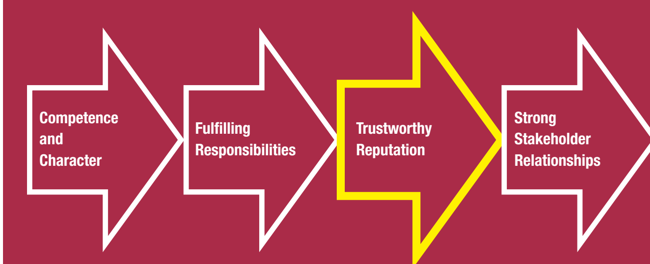
Figure 3: Reputation-Building Process



labor management and efficiency. Labor efficiency measures the relative production of goods and services (i.e., *labor productivity*) per unit of labor input (i.e., *labor cost*). The idea is that a good reputation can attract more and better employees who then compete for future employment opportunities. The increased labor supply tends to keep labor costs under control. Additionally, employees may work harder for reputable firms, because good employees are motivated by the firm's reputation (i.e., *increased labor productivity*). Lower labor costs and increased labor productivity should increase labor efficiency.

Southwest Airlines provides an example of how a good reputation can affect labor efficiency (http://www.cbsnews.com/stories/2007/08/30/sunday/main3221531.shtml). Throughout its history, Southwest has built partnerships with employees. Even in the difficult period after the 9/11 terrorist attacks, the company never laid off employees or cut salaries. "You put your employees first and if you take care of them, then they will take good care of you," Herb Kelleher, Southwest's former chairman once said. "Then your customers will come back, and your shareholders will like that, so it's a real unity." This reputation fosters increased labor productivity, labor efficiency and business success. Southwest Airlines has been continuously profitable every year since 1973, a statistic that is shared by no other airline.

Our analysis of firms on *Fortune's* Most Admired Companies list from 2006 to 2008 shows that good reputation improves labor productivity and labor efficiency. We compared the average labor efficiency, labor productivity and labor cost for high reputation firms on *Fortune's* Most Admired Companies list to a representative matched sample of firms not on *Fortune's* list.

Although labor costs are slightly higher for high-reputation firms, Figure 1 shows that these firms have a 73.32 percent higher average labor productivity and a 52.08 percent higher average labor efficiency than firms that did not make the high-reputation list.[7]

We further divided the sample of high-reputation companies into two sub-groups based on *Fortune's* average-reputation score. We placed companies above the average-reputation score in a sub-group we called the "excellent" group. We placed companies below the average-reputation score in a category called the "good" group. We then compared labor costs and labor productivity for these two sub-groups.

The results shown in Figure 2 are similar to those shown in Figure 1. Specifically, although labor costs are slightly higher for "excellent-reputation" companies, we find that excellent-reputation companies have 50.13 percent higher average labor productivity and 34.40 percent higher labor efficiency than those marked "good." Our analysis thus shows that the better the reputation a company has, the higher its labor productivity and labor efficiency.

Steps for Building and Maintaining Reputation

To re-phrase the words of Abraham Lincoln, a good reputation is the result of good character. The first step, then, is building a strong character. Figure 3 presents the steps in the process.

Building a strong reputation begins with developing the character of an entity's workforce and acquiring the competencies needed to fulfill responsibilities. Competencies are comprised of the knowledge, skills and abilities that meet responsibilities. Character is having the integrity to actually use one's competencies to fulfill his/her responsibilities. Activities to build a company's character and culture can include establishing an ethics code for conduct and consistently communicating its importance, ethics

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Figure 4: Reputation-Building Strategies

		Time	
		Present Short-Term **Develop**	Future Long-Term **Deliver**
Focus	Internal	I Dynamic Exploitation of Existing Assets	II Develop and Utilize Core Competencies
	External	III Image Management	IV Strategic Alliances

training programs, rewarding ethical conduct, fair treatment of employees, positive and open communication, and feedback systems. Meeting those responsibilities is a process that takes time, but as time goes by, it builds trust, which in turn forms the bedrock of strong stakeholder relationships.

Strategies for developing a positive corporate reputation can bring this process to life. Four possible strategies, focused on different time horizons (short-term vs. long-term) and different focus areas (internal vs. external) are presented in Figure 4.[8]

The short-term strategies are strategies for developing and communicating responsibilities to stakeholders. Dynamic exploitation of existing assets involves utilizing current internal resources to rapidly seize market opportunities. Using forms of compensation (e.g., salary, bonuses, benefits, etc.) and descriptive, aspirational job titles would be examples related to employees. Image management involves short-term development and marketing of visionary advertising associated with successful firms. Publicizing and marketing employment opportunities and benefits would be an example involving employees. Both short-term strategies develop and communicate aspirational responsibilities.

The long-term strategies develop competencies and character to consistently deliver on responsibilities to stakeholders resulting in a trustworthy reputation and strong stakeholder relationships. Developing core competencies involves significant investments in building internal capabilities. Building flexible work options, work challenge, job security and career opportunities would be examples of corporate competencies related to employees.

Strategic alliances involve networking and joint ventures that develop and share in a strong name. An alliance changes the form, or character, of the company. A corporation could form alliances with human resource firms to better meet responsibilities to employees. These long-term investment strategies in developing corporate character and competencies help a business consistently deliver on responsibilities that engenders a reputation of trust and fosters strong stakeholder relationships.

> “CHARACTER IS LIKE A TREE, AND REPUTATION IS LIKE ITS SHADOW.”
> —ABRAHAM LINCOLN

A tangible example of using these reputation-building strategies to improve employee relationships is KPMG’s recent efforts to change its reputation and communicate a higher visionary purpose to employees to improve retention.[9] KPMG invested in initiatives to reframe and elevate the meaning and purpose of its employees’ work. They actively engaged employees in this process by encouraging employees to share their own stories about how their work is achieving a higher purpose and making a difference. Results exceeded expectations. Morale scores soared; turnover plummeted; productivity and efficiency improved.

This approach of using responsibilities to build a reputation of trust shifts the focus of the firm. Often, the focus is on the corporate right to maximize profits. Managers use resources to maximize profit from stakeholder relationships with customers, employees, suppliers and others. This is predominantly a transactional approach. Focusing on using resources to fulfill responsibilities to stakeholders shifts strategy to a relational approach. Resources used to fulfill responsibilities are viewed as investments in developing the intangible asset of reputation.

The Pay-Off

It takes a long time to build a good reputation, but it can be lost overnight. It matters all the time, but is particularly important when times are tough. Good reputation preserves the confidence and trust of various stakeholders, as well as the public. It can preserve the loyalty and trust of customers and stabilize revenues during turbulent times.

Good reputation can also affect costs. For example, a business’s good reputation as a client can impact perceived audit risk and

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reduce audit fees, and we document that it improves labor productivity and efficiency.

These benefits should provide incentives for not only accounting firms, but other types of entities (both for-profit and nonprofit) to build and maintain good reputations. Employees are a primary production cost in service firms like accounting firms. We provide practical suggestions for building and improving relationships with employees by incorporating reputation-building processes and strategies. ■

Footnotes

1. For example, see: Marty Stuebs' and Li Sun's 2010 *Journal of Business Ethics* article, "Business Reputation and Labor Efficiency, Productivity and Cost" for discussion of the documented effects and value of reputation.
2. See Kent Gilbreath's forthcoming *Journal of Legal Economics* article, "Trends in Starting Salaries of College Graduates 1970 – 2004."
3. For example, see Joel Podolny's 1993 *American Journal of Sociology* article "A status-based model of market competition" for a discussion of the effects of good reputation on stakeholder relationships.
4. See Robert Tie's November 2003 *Journal of Accountancy* article, "The Profession's Roots," p. 57.
5. See Stephen Godfarb's and Linda Dunbar's July 2002 *Journal of Accountancy* article, "Meet the Press," p. 39.
6. See: Philip Beaulieu's *Journal of Accountancy* January 2002 article, "Reputation Does Matter."
7. See: Marty Stuebs' and Li Sun's 2010 *Journal of Business Ethics* article, "Business Reputation and Labor Efficiency, Productivity and Cost" for more details.
8. See: Albert Goldberg et al.'s 2003 *Journal of Small Business Management* article, "Reputation building: Small business strategies for successful venture development."
9. See Bruce Pfau's 2015 *Harvard Business Review* article, "How an accounting firm convinced its employees they could change the world."