Long-Term Reputation Effects in the Global Financial Industry: How the Financial Crisis Has Fundamentally Changed Reputation Dynamics

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Introduction

The financial market crisis of 2007, global economic crisis, and subsequent debt crisis have moved the concept of reputation into the very center of public debate. Ever since the reputation meltdown of the Wall Street banks, insurance companies, rating agencies, supervisory authorities, and entire national economies, there has been a veritable boom around this concept—in the media and scientific discourse, but also in the daily practice of management consultants.

In fact, reputation performs fundamental functions for society as a whole, as well as for the economy. Selective nurturing of the parameter of reputation thus acquires central significance. However, many companies, authorities, and other actors of public life frequently suffer the problem of continuing to depend too strongly on gut feeling in managing their reputation. There is, in particular, a lack of instruments that can validly...
Reputation Management

determine long-term reputation dynamics as a basis for a reputation management that benefits the organization.

This chapter responds to this weakness with an approach to reputation that places long-term reputation dynamics at its center. It starts by clarifying the fundamental significance of media-broadcast communications in the process of reputation formation. The novel Memorizing Resonance Reputation Index (MRRI) procedure for determining long-term reputation dynamics is then introduced. Finally, a case study is presented on the effects of the financial market crisis on reputation dynamics in the global bank sector.

Public Communications—The Conditio Sine Qua Non of Reputation Formation

Without public communications, and in particular without the permanent background of media reporting, we would be unable to develop a clear idea of society. The media arena is the principal access portal to modern society; we look into this arena and form a picture of our society, the economy, and the companies in the news. The sociologist Niklas Luhmann has described the media arena as a gigantic mirror of society, reflecting its events and processes, and mirroring them back to its members: “What we know about our society, indeed about the world in which we live, we know via the mass media” (Luhmann, 1996, p. 9). The significance of the media arena as an information source quickly becomes clear when we imagine scenarios in which we struggle to find something to talk about, such as in classic small-talk situations. Even if nothing else relates to us, we can converse about the latest news and most current media topics at any time, with anyone, no matter how little we know them.

However, the media arena is more than just a gigantic social mirror. It also forms a communications platform, comparable to an infinitely large stage, which has become further extended with the advent of social media. Not only journalists appear on this stage and express their views and opinions, but all relevant social actors striving for attention, including those from the sectors of politics, economics, science, and society, concentrate their activities on this media platform. Hence, the financial market crisis was turned into a significant communications event merely because it was not only journalists who expressed opinions on the causes and consequences of the crisis in the media, but also prominent politicians and government representatives, economics professors, Nobel laureates, analysts, stock market legends, and leading investors. So it’s not enough to reduce media communications to journalists alone. Politicians, scientists, experts, analysts, and nongovernmental organizations (NGOs) bestride the media platform with their topics and events, and, in this way, make it truly powerful.

What, thus, also makes the media arena significant in the economic sector are the circumstances below.

- Broad segments of society follow economic events ever more exclusively via the media (media as mirror).
- All key economic actors—such as analysts, investors, and economic experts—concentrate their estimates and ratings on the media arena (media as platform).
How the Financial Crisis Has Fundamentally Changed Reputation Dynamics

When rating agencies such as Standard & Poors, Moody’s, or Fitch downgrade indebted countries such as Greece, Portugal, or even the superpower United States, we can know this immediately only because these agencies announce their ratings via the media. It is precisely this double function—as mirror and platform—that explains the central significance of the media for the economy: the media arena is the most important information source for economic events, and it is simultaneously the central platform and stage for all those actors who determine how share prices, markets, or business cycles develop. So, it is hardly surprising that empirical reputation research shows a close correlation between reputation curves and share prices. Experts, analysts, and investors observe economic events via the specialist and mass media, and simultaneously announce their assessments via media channels.

Instruments that aim to record key reputation dynamics in the economy and society are consequently obliged to specialize on an analysis of the media arena, i.e. that place where trust in companies and the economy grows or fades. Moreover, such instruments require a long-term perspective. Nothing harms the reputation of an actor more than chasing fast-changing ephemeral trends in an inflationary manner. Reputation management means validly recording the truly decisive reputation dynamics that have grown over the long term and harmonizing them in an authentic way with one’s own organizational profile. The lack of suitable instruments for modeling the long-term changes of relevant reputation dynamics results in the risk of reputation management overlooking key trends or weighting them incorrectly.

MRRI—The Basis of Long-Term Reputation Management

It is precisely at this point that a novel procedure designed to record the sedimented (i.e. long-term) reputation dynamics comes in. The MRRI is used to model the historically grown perception of a company or other publicly exposed actor that is anchored in the public memory (see Sidebar 1). This procedure, developed by commsLAB in conjunction with the Research Institute for the Public Sphere and Society (fög) at the University of Zurich, permits the presentation of long-term sedimented reputation trends.

The MRRI is calculated over time and takes into account—on a daily or weekly basis—the values of the previous period, weighted with a “forgetting” rate. It measures the ratio of resonance (number of media contributions) and media reputation (overall positive or negative evaluation) by considering the corresponding values of the previous period, while adding a forgetting rate. High-resonance events thus determine reputation for a longer period than short-term ones, whose perception produces a volatile reputation effect. The MRRI is expressed on a scale ranging from +100 (exclusively positive resonance) to –100 (exclusively negative resonance).

The method is based on the insight that an actor’s reputation is defined not only by current events but—always to a certain degree, and for a certain period of time—also by past events that have caught the attention and interest of the public. Thus, the MRRI does justice to the circumstance that, in the long term, it is above all high-resonance key events (such as the financial market crisis) determine reputation dynamics.
The Method of Long-Term Reputation Analysis

Reputation Relevance
The reputation ratings are calculated on the basis of the media coverage relevant to reputation. The latter is identified as relevant if the companies under review are mentioned in the title, in the lead section, or prominently in at least one paragraph of the text. The measurement of an information-yielding reputation trend consequently depends on substantial public resonance or the relevance of the analyzed actor.

Reputation Ratings
The reputation ratings reflect the value that results from the average rating of all reputation-relevant media reports. The range goes from +100 (all reports positive) to –100 (all reports negative). A reputation value of zero can stand for a neutral or controversial (balance between positive and negative) perception. The reputation ratings incorporate a specific weighting factor, which takes into account the prominence of the company in the respective media report.

Memorizing Resonance Reputation Index (MRRI)
The Memorizing Resonance Reputation Index (MRRI) is used to model the historically developed reputation anchored in the public memory. This method, developed by commsLAB in conjunction with fög at the University of Zurich, permits the presentation of long-term sedimented reputation trends.

The MRRI measures the ratio of resonance and reputation by considering the corresponding values of the previous period, while including a “forgetting” rate. High-resonance events thus determine reputation for a longer period than short-term ones, whose perception produces a volatile reputation effect.

The sedimented reputation thus covers the historically developed reputation anchored in the public memory in a way that is comparatively fixed with respect to time. In metrological terms, it includes the after-effects of reports from earlier periods with a strong impact on public opinion.

Separate presentation of sedimented resonance provides additional evidence by showing how strongly collective memory has been infused with these events, and how their impact has evolved over time.

It is crucial that the MRRIIs compiled on a daily or weekly basis be based on a meaningful and stable initial value. As a rule, this requires data covering a period of six to twelve months.

Case study

Long-Term Reputation Effects of The Global Financial Industry
On the basis of the MRRI, the long-term reputation trends of selected globally active major banks are presented below for the period from 2002 to 2011. We are interested in seeing how the financial market crisis changed reputation dynamics on the public opinion “market” from 2007.

Figure 1 shows the reputation trends of globally active major banks of the United States, Switzerland, Germany, the United Kingdom, and China (gray curve) between 2002 and the
end of May 2011 (see Sidebar 2). The graph also displays the sedimented media resonance (number of media articles, shown as the solid gray area) underlying the reputation curve.

The long-term sedimented reputation of all analyzed major banks (“Total MRRI global banks”) reached a peak on February 21, 2007. As a consequence of the financial crisis, the reputation of the major banks suffered a massive slump, reaching a low point on March 8, 2009. This was associated with a fundamental rise in the underlying sedimented resonance, i.e. the volume of reporting; although this comprised about 23,000 reputation-relevant media articles per day before the financial crisis, it shot up at times to more than 28,000 articles per day from 2008.

![Figure 1. Long-term reputation trends of major global banks. International media sample January 1, 2002 to May 31, 2011](image)

However, even before the financial crisis, the reputation trends of the globally active major banks were subject to large fluctuations from 2007. Thus, at the beginning of 2002, in the aftermath of the accounting scandal at Enron and in the context of the burst dotcom bubble, the discussion of managerial pay that broke out initially in the United States, and subsequently in Europe, proved to be of unparalleled vehemence.

In mid-2002, the discussions about financial scandals, accounting fraud, and the dishonest behavior of individual analysts became more extensive. This resulted in a more fundamental perception of the problems presented by a lack of firewalls around investment managers and a comprehensive debate on the structure and conduct of the large investment banks. Although excessive managerial pay and stock-option programs, a lack of corporate governance, and the threat of layoffs had already been the focus of the media, the ever worsening economic climate now led to talk of a veritable crisis of confidence with respect to the big financial institutions—with correspondingly negative consequences for the reputation of the globally active major banks.

In an environment that was, in any case, already bedeviled by strong uncertainty (September 11, the war against terror), the call for reforms soon rose to new levels: stirred up by New York State Attorney General Eliot Spitzer, it forced the hand not only of other regulatory authorities, but also of political actors.
Although at its core an economics issue, the debate on the crisis of confidence of the years 2002 and 2003 was by no means limited to the media’s economic and stock market columns; in fact, this whole topic diffused widely into the sector of social policy. Thus, the reputation dynamics of the crisis of confidence of 2002 represents a true precursor to the financial crisis that broke out in 2007—although with a decisive difference in the ability of the actors involved to learn from it: it did not cause any immediate economic damage to the major banks and did not limit their growth potential in any way, as we will show in detail shortly.

To the contrary, what followed from mid-2003 to spring 2007 was an almost uncanny increase in reputation that peaked on February 21, 2007, as noted above. The crisis of confidence, and its implied criticism of the global financial industry, appeared more remote than ever, and it was the profits of the investment banking sector in particular—a sector that was widely condemned at the time—which contributed largely to this dazzling reputation.

But the discussions held at that time about accounting fraud, excessive managerial pay, and a lack of corporate governance had by no means disappeared from collective memory. Indeed, they formed the breeding ground for the US subprime crisis—which became acute from mid-2007—to expand quickly into a global financial market crisis, because the global financial industry in particular could no longer rely on any broad-based confidence bonus. It had already lost that in the crisis of confidence of the years 2002–03.

There followed a reputation slump of unequalled magnitude and speed. The financial market crisis led from 2008 to a veritable collapse of the global financial industry’s reputation. The international financial services sector was held responsible for the dynamics of this crisis. Short-term shareholder-value thinking, short-term business models, and irresponsible risk policies, as well as the dominance of derivative financial products in whose economic power it was necessary to “believe” in a proverbial sense, were all branded scandalous.

As will be shown, the sedimented reputation curve of the global financial industry reacted significantly more sensitively to the basic impending crisis events than the comparable stock market index.

## Analyzed Banks and Description of Data

<table>
<thead>
<tr>
<th>Bank</th>
<th>From</th>
<th>To</th>
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<tbody>
<tr>
<td>UBS</td>
<td>January 1, 2001</td>
<td>May 31, 2011</td>
</tr>
<tr>
<td>CSG Partners</td>
<td>January 1, 2001</td>
<td>May 31, 2011</td>
</tr>
<tr>
<td>Deutsche Bank</td>
<td>January 1, 2001</td>
<td>May 31, 2011</td>
</tr>
<tr>
<td>Goldman Sachs</td>
<td>January 1, 2001</td>
<td>May 31, 2011</td>
</tr>
<tr>
<td>Hongkong and Shanghai Banking Corporation (HSBC)</td>
<td>July 1, 2009</td>
<td>May 31, 2011</td>
</tr>
<tr>
<td>Industrial and Commercial Bank of China (ICBC)</td>
<td>July 1, 2009</td>
<td>May 31, 2011</td>
</tr>
<tr>
<td>Citibank</td>
<td>January 1, 2002</td>
<td>June 30, 2009</td>
</tr>
<tr>
<td>Merrill Lynch</td>
<td>January 1, 2001</td>
<td>June 30, 2009</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>January 1, 2001</td>
<td>June 30, 2009</td>
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Table 1. Periods over which reputation data per bank were analyzed
How the Financial Crisis Has Fundamentally Changed Reputation Dynamics

Scope of Media Reporting
Reputation-relevant reporting by 24 media from the US, Swiss, German, UK, and Asia-Pacific arenas. The time frame was January 1, 2001, to May 31, 2011, covering a total of about 200,000 reputation-relevant articles (for details see Table 1). Due to the fact that the MRRI has to be based on a meaningful and stable start value, each graph’s time frame starts with a one-year delay and ranges from January 1, 2002, to May 31, 2011.

Resonance Strength MRRI on Daily Basis
On average about 21,300 reputation-relevant articles (while including the forgetting rate and a specific weighting factor, which takes into account the prominence of the company in the respective media report).
Start value: 16,706 (January 1, 2002).
Highest daily value: 28,229 (November 28, 2008).

Dow Jones Banks Titans 30 Index (DJTBAK)
The DJTBAK represents leading companies in the global banking sector. The index includes 30 stocks selected based on rankings by float-adjusted market capitalization, revenue, and net profit. The index covers the bank supersector of the Industry Classification Benchmark (ICB). The DJTBAK was first calculated on February 12, 2001.

Finding 1: Long-Term Reputation Effects Correlate Significantly with Economic Development
Figure 2 compares reputation trends of the analyzed global banks (solid gray curve—MRRI) with comparable share price trends (dashed black curve). The comparative parameter here is the Dow Jones Banks Titans 30 Index (DJTBAK), which covers the 30 most important companies from the global banking sector. It can be seen that the reputation dynamics of the global financial industry show a highly significant correlation with the stock market index.

Figure 2. Comparison of the reputation curve and share price of the major global banks. International media sample January 1, 2002 to May 31, 2011
Comparison of the maximum and minimum values of both curves gives a surprising discovery: whereas the lowest values of reputation trends and share prices are effectively concentrated on the same day (March 8, 2009 for the MRRI; March 9, 2009 for the DJTBAK), we see a marked difference at the onset of the financial crisis in 2007: the MRRI reputation, measured over the long term, starts to dip about three months earlier than the comparative DJTBAK reputation (February 21, 2007 as against May 23, 2007).

In other periods of this time series, too, the reputation curve generated a trend early on that was followed, after a lag, by share prices. Thus, the MRRI of the major global banks already foreshadowed the stock market upturn that started in 2004 and, to some degree, clearly anticipated it up to the turning point of February 21, 2007 we have already mentioned.

We see a similar picture in the downturn phase starting in spring 2007; whereas stock market trends recorded sporadic periods of rising prices again in 2008, the MRRI showed a constantly negative development during the same period. Public opinion continued to insist that the problem of confidence in the bank industry had by no means been overcome.

This last observation in particular provides a series of additional explanatory patterns for the interaction between the long-term reputations and stock market trends of the actors featuring strongly in the public eye (cf. previous section).

The coverage of individual companies is embedded in a broader scenario of media reporting, which transports industry-specific, as well as overall economic and business-cycle expectations, to future developments.

Media reporting goes beyond merely reflecting the performance and stock market trends of individual companies. Indeed, media coverage also extends in large measure to sectors such as research and expertise, products and services, and strategy and management, as well as political, regulatory, and, above all, social components. It can be seen, then, that the correlation between reputation curve and share price remains, even when stock market reporting is not considered.

Finally, the reporting is largely permeated by actors originating from subsectors other than the economy. Thus, the media regularly offer considerable space in the public arena to politicians, experts, and other personalities to feed disclosures and developments that are as sensational as possible, with the aim of lending plausibility and credibility to their assessments of the way the economy is heading.

The consequence is the formation of powerful optimistic or pessimistic moods with respect to the economy or individual companies, which have a clearly considerable impact on value-creation indicators such as share prices.

It is perfectly understandable that this plethora of partly contradictory opinions and assessments should lead to a need for simple black-and-white explanations, especially in times of crisis. In view of the increasing complexity of economic and political processes in an age of globalization, however, it is hardly possible to maintain an overview any longer. In addition, even if individual actors were to succeed in achieving such an overview, we must assume that they would be unable to make any headway
among the prevailing mainstream and herd instincts of the economy and society, but would, at most, be seen merely as Cassandra voices uttering warnings in the wings.

Indeed, it appears that not only is the mood of the broad mass of the population formed by media reporting, but also that the behavior of powerful actors such as analysts, investors, customers, regulators, and (not least) politicians is oriented to this basic mood relayed by the media. In this context, it is irrelevant whether the perception mediated in this way is really correct. The decisive factor is simply whether it can potentially produce economic or social effects, which must be correspondingly anticipated in the actions of these actors.

To record and map these dominant moods in the economy and society, in their positive or negative tendencies, empirically, and over time, is the core of the approach developed by commsLAB and the Research Institute for the Public Sphere and Society (fög) of the University of Zurich for the measurement of long-term sedimented reputation trends.

Against this background, the question arises as to why the development of sedimented reputation and stock market value, which showed a close correlation up to the end of 2009, increasingly lost this parallel pacing after 2010. As will be shown, from 2010 we can see a fundamental change in the reputation dynamics of the global financial industry which had held true up to that point.

**Finding 2: The Recasting of Social Reputation Limits Economic Growth Potentials**

Figure 3 compares the social reputation trends of the major globally active banks (“Social MRRI global”) with the functional ones (“Functional MRRI global”). At the same time, the respectively assigned media reporting is divided proportionally according to social (dark area at bottom) and functional resonance (light gray area). Whereas social reputation is subject to overall standards of social evaluation and is a measure of ethical integrity, functional reputation is an indicator of technical competence and business success or failure (see Sidebar 3). The overall reputation curve (“Total MRRI global”) is also shown.
An initial comparison of the development of functional and social reputation shows that the consolidation of the global banks' reputations is based essentially on their economic power and expertise ("Functional MRRI global"). The social reputation component ("Social MRRI global") is significantly lower in most cases, but is regularly marked by strong negative effects, especially during major crises, like the crisis of confidence in 2002–03 that has already been noted or during the course of the financial crisis from 2008.

These crises are invariably associated with an increase in underlying social resonance (dark shaded area in Figure 3). This comprised about 25% of the whole volume of reporting during the crisis of confidence, while an escalation could be observed especially from 2010. This peaked on July 20, 2010, with a maximum share of almost 40%—a clear sign that the perception of the major global banks was subject at this time to completely different parameters than at the beginning of the financial crisis, in spring 2008. Thus, the share of functional reporting on May 7, 2008 was still almost 90% (light shaded area). In other words, at the beginning of the financial crisis the reputation trends of the major banks depended almost exclusively on economic factors, whereas from 2010 they were increasingly determined by social assessments. It thus appears that the share of social resonance—i.e. reporting which covers companies in social, ethical, or politico-regulatory contexts—gained in significance progressively from mid-2008 and markedly from 2010.

However, the dimension of social reputation has not only increased quantitatively, its contents have also been exposed to a fundamental change in significance. Against the background of the perspective that the financial market crisis brought national economies to the brink of ruin (Iceland, Ireland, and others), the pressure of expectations is growing not only on banks, but also on companies in general, to assume macroeconomic responsibility. Social responsibility is thus being reinterpreted toward insisting that the primary social responsibility of companies consists of serving their respective economic location or preserving it from harm. This expectation can also be read from the fact that indicators such as tax contributions, dividend payouts, or share price trends (i.e. performance indicators, which benefit both respective economic locations and collective institutions such as social provision funds) have become markedly more powerful reputation drivers.

That the social dimension of reputation—understood as macroeconomic responsibility—is not only desirable, but also very directly influences future economic expectations, becomes clear from the fact that stock market trends unlike during the crisis of confidence of the years 2002–03—are increasingly decoupled from the functional reputation dynamics, which return to positive values from 2009 (Figure 4).
How the Financial Crisis Has Fundamentally Changed Reputation Dynamics

Figure 4 compares the development of functional and social reputation with that of the DJTBAK on the basis of an indexed display.

It is striking that the functional reputation and stock market trends for the major global banks were subject to the same dynamics between 2002 and the end of 2009, and thus run a parallel course. But the reputation dynamics start to change fundamentally from 2010. Whereas functional reputation continues to improve from this time, and already stands significantly above its initial values of 2002 at the close of the analysis period at the end of May 2011, the corresponding share price trend stagnates.

The reason for this is that the massive recasting of social reputation shown in Figure 4 after 2010, as well as the extremely low values of social reputation (“Social MRRI” curve), prevent the exploitation of the existing economic potential in the shape of improved share values—or at least greatly limit them.

Three-Dimensional Reputation
Irrespective of which actor we consider, be it a company, a politician, or perhaps a scientist, successful reputation management must always keep the same three reputation dimensions in mind (Eisenegger, 2005; Eisenegger, Schranz, and Schneider, 2010).

- First, one’s own competence and the associated successes must be demonstrated. This functional reputation—linked to the performance targets of the respective function systems (politics, economy, etc.)—is measured in the economy by how profitably a company is managed.
- Second, all reputation-bearers must prove their mettle in the social world, where certain norms and moral ideas apply. This is the field of social reputation. It centers on the extent to which an actor is a good citizen.
- Third, every actor also possesses an expressive reputation. This dimension is dominated by emotional judgments of taste. Actors with a positive expressive reputation appear fascinating and unique.
The assumption of greater macroeconomic responsibility by the global financial industry is not just a social obligation but a *conditio sine qua non* for its economic survival. The instrument used to record the long-term communications dynamics described in this chapter shows that the financial market crisis of 2007 and its aftershocks have fundamentally changed the nature of reputation dynamics. As a consequence of the crisis, functional reputation, which is central to companies and oriented to economic performance criteria, progressively lost importance in favor of more comprehensive social expectations. It became apparent that a tarnished, and simultaneously highly resonant, social reputation prevents the functional reputation from evolving further, a phenomenon that also has a negative impact on share prices.

It is, therefore, crucial to ascertain whether, and if so, how, the gap between positive functional and negative social reputation that limits the global banks’ share price trends can be closed. In light of this, what is urgently required is to influence the social dimension of reputation in a clearly self-initiated way, by taking practical action that is aligned with the principles of macroeconomic responsibility. For, as we have shown, as a consequence of the financial crisis social responsibility becomes reinterpreted in a direction which indicates that the primary social responsibility of companies consists in shouldering their macroeconomic responsibilities—i.e. by serving their economic locations or preserving them from harm.

The concept of macroeconomic responsibility renders social responsibility more acute by insisting that it be linked to the company’s core economic competence in order that it appears credible. So, companies must not “somehow” act charitably or for the common good, but rather must apply their own economic performance and competence primarily for the benefit of the national economy, as well as of those countries that act as their hosts.

This orientation to national economic principles not only makes sense from the standpoint of reputation, but also promises to deliver solid economic benefits. A gap has opened up between functional reputation and actual prices in the reputation trends of the major global banks since 2010. This is because the dynamics of social reputation have remained strongly negative following the public perception of an insufficient response, particularly by the bank industry, to national economic expectations, which have been recast by regulatory discourse. Thus, the failure of the companies concerned to address their social commitment so far has tended to inhibit their further success. A greater assumption of macroeconomic responsibility can thus represent an effective way not only of consolidating a company’s own reputation profile in a sustainable manner, but also of closing this gap and thus redeeming lost economic potential.
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