Locational responsibility as a value-adding factor

Reputation and public perception of the Swiss economy in transition

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Study in brief: The hypotheses. Summary and key findings

December 6, 2018

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Study in brief

1. The hypotheses

Locational responsibility as a legacy of the financial crisis

The financial and economic crisis began in 2007. Like all major economic crises, this latest one left behind it – as a 'by-product', so to speak – fundamental changes in society's expectations with regard to social, political and economic organisations. The crisis also prompted a shift in society's expectations regarding corporate responsibility.

This change manifested itself particularly in increased public awareness of the locational or site-specific benefits offered by businesses since the financial crisis hit (cf. Eisenegger & Künstle 2011). From a social point of view, companies were no longer primarily expected to make some kind of charitable, non-profit or environmental contribution, but rather more so to use their own economic capacity and expertise first and foremost for the benefit of the countries and regional locations in which they actually operate.

Bearing in mind this initial hypothesis that, since the financial crisis, society's expectations have been directed more strongly towards the locational benefits offered by businesses, this inevitably raises the question of what tangible impact this change has had on the organisations themselves. The next hypothesis therefore assumes that, as far as companies are concerned, adapting to this new social environment is not just desirable, but will also ultimately pay off for them in economic terms.

Hypotheses of the publication:

- In the wake of the financial and economic crisis, the perception of companies as locationally responsible actors has become a central and powerful narrative for businesses with regard to their reputation.
- Assuming locational responsibility also creates both tangible and intangible value, thus making it worthwhile for companies both on a financial level and in terms of boosting their reputation.

Structure of the study

The main study is divided into three principal sections, which focus on the following issues and questions:

Reputation as a value-adding factor:
Based on a sample of 132 Swiss companies, section 2.1 sheds light on the fundamental turning point of the crisis with reference to the media-driven reputational dynamics of Switzerland's economy since 2005. Cross-comparisons with the trends in public opinion, gross value added and share prices reveal that, *generally speaking*, the Swiss economy and its businesses enjoying an outstanding reputation on the whole also produces positive tangible and intangible effects:

- ❖ How did the reputation of the Swiss economy develop before, during and after the financial and economic crisis? Which industries were particularly affected by the loss of confidence and who benefited from it?
- ❖ How do the reputational dynamics relate to actual economic key indicators? Does an outstanding corporate reputation mean an above-average stock market performance as well?

Reputation and changing narratives:
Reputations are built on the fulfilment or non-fulfilment of various, changing expectations. At the same time, they are crucially dependent on (media) communication. Section 2.2 therefore analyses the concept of «reputation» as a whole as a function of its constituent narratives:

- ❖ What areas of responsibility are companies particularly being scrutinised for at which points in time? Or what narratives relating to corporate responsibility have a decisive impact on reputation during which phases?
- ❖ Is the increased significance of locational responsibility as set out in the hypotheses evident in the public discourse relating to the 132 companies?

Locational responsibility – a mark of distinction and an extra value-adding factor:
Finally, section 2.3 looks into the effects that arise when the expectations associated with the narrative of locational responsibility are met:

- ❖ Does assuming locational responsibility pay off in terms of enhancing a company's reputation? And does it have a positive impact on a business's public positioning and power of definition?
- ❖ Does being perceived as a locationally responsible company provide an extra boost in terms of outperforming the rest of the stock market?

2. Summary and key findings

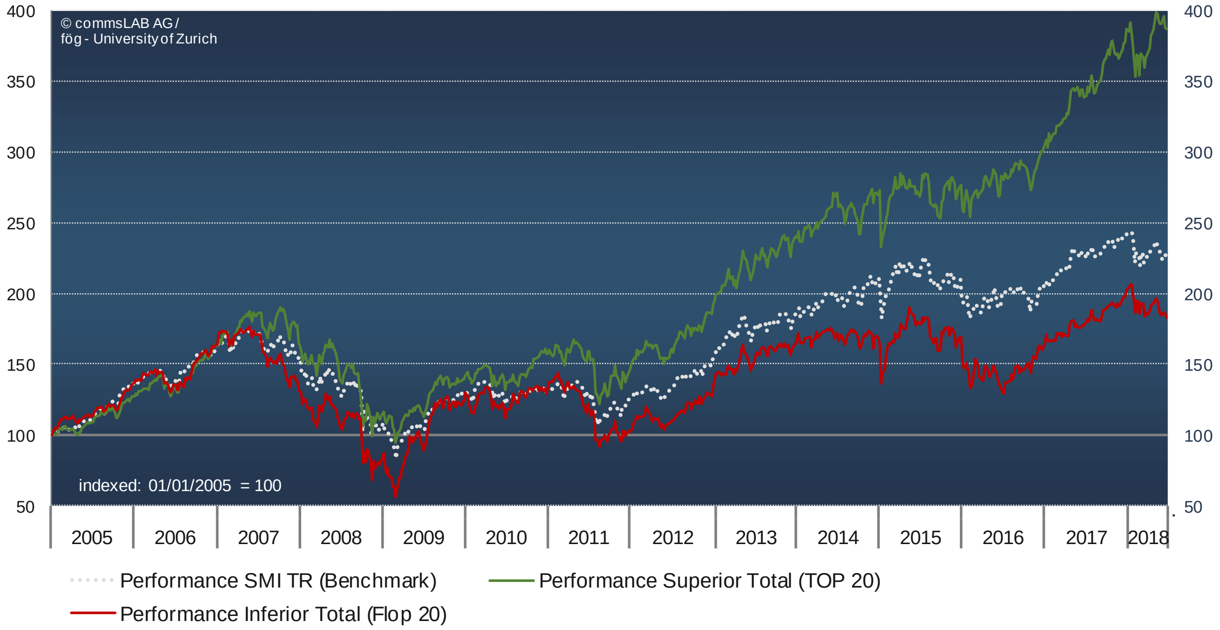
It is worth investing in companies with a good reputation

Does a good reputation pay dividends? In both theory and practice, it is largely agreed that reputation is a crucial value-adding factor and is therefore useful for carving out competitive advantages over rivals. The fact that public perception – especially the views conveyed by the media – plays a key role not only in building reputations but also in destroying them is most apparent in the case of companies that attract a particularly high level of media coverage.

This study shows that the upheavals resulting from the financial crisis in the second half of the 2000s represent a fundamental turning point in the reputational development of the Swiss economy, and that this has left its mark in the form of a radical change to the way topics are structured in public discourse.

Using historical simulations based on sample portfolios weighted by reputation, the study demonstrated once and for all that channelling investments into companies that boast an outstanding reputation really does pay off in the long term. In both a rigid 1:1 straitjacket as in the case of the SMI sample portfolio and an open stockpicking procedure across 75 listed Swiss companies, it was clear that the reputational effects on listed Swiss firms conveyed via key media provide an excellent basis for estimating these companies' actual ability to generate added economic value. Incidentally, this does not just apply in positive cases, but also – and in particular – in demonstrating extremely negative impacts on reputation from a public perspective.

Fig. 1: Sample portfolio, SRI®-weighted (overall reputation) versus SMI TR (with dividend)



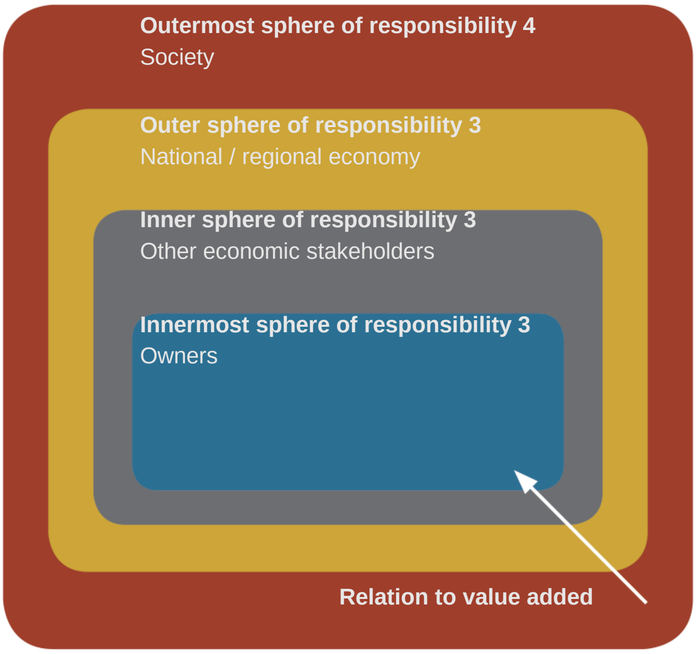
The historical 1:1 simulation using SMI TR as a benchmark (white dotted line) shows that the companies with the best reputations (green line) achieve a substantially better share performance than the benchmark in a weekly trading period. Conversely, the performance of companies with the poorest reputations (red line) is significantly below average.

Locational responsibility as insurance against crises

For this study, the media coverage of the 132 Swiss companies included was categorised according to four "spheres of responsibility" (cf. Fig. 2). In ascending order, the four spheres of responsibility have less and less of a bearing on economic value added. The individual spheres refer to specific areas of corporate responsibility, which come with various societal expectations and differ from one another in terms of their underlying central narrative.

The dominant narratives in spheres of responsibility 1 (economic responsibility) and 2 (stakeholder-specific responsibility) are mainly geared towards fulfilling a company's business function. Meanwhile, the underlying narrative for sphere 3 (locational responsibility) is aimed at firmly embedding a company's economic performance and expertise in a meaningful way, primarily for the benefit of the national or regional economy in which the company operates. This connection with company-specific competence and expertise is what distinguishes this area of responsibility from exclusively social/charitable activities performed outside the company's own value chain and irrespective of its core area of expertise (sphere 4: philanthropic responsibility).

Fig. 2: The four spheres of corporate responsibility



Philanthropic responsibility
No relation to core areas of expertise
Corporate giving, voluntary work, philanthropy

Locational responsibility
Relation to core area of expertise
Responsibility for company's own locations, conveying company-specific expertise

Stakeholder-specific responsibility
Other economic stakeholders
Responsibility towards employees, customers, suppliers

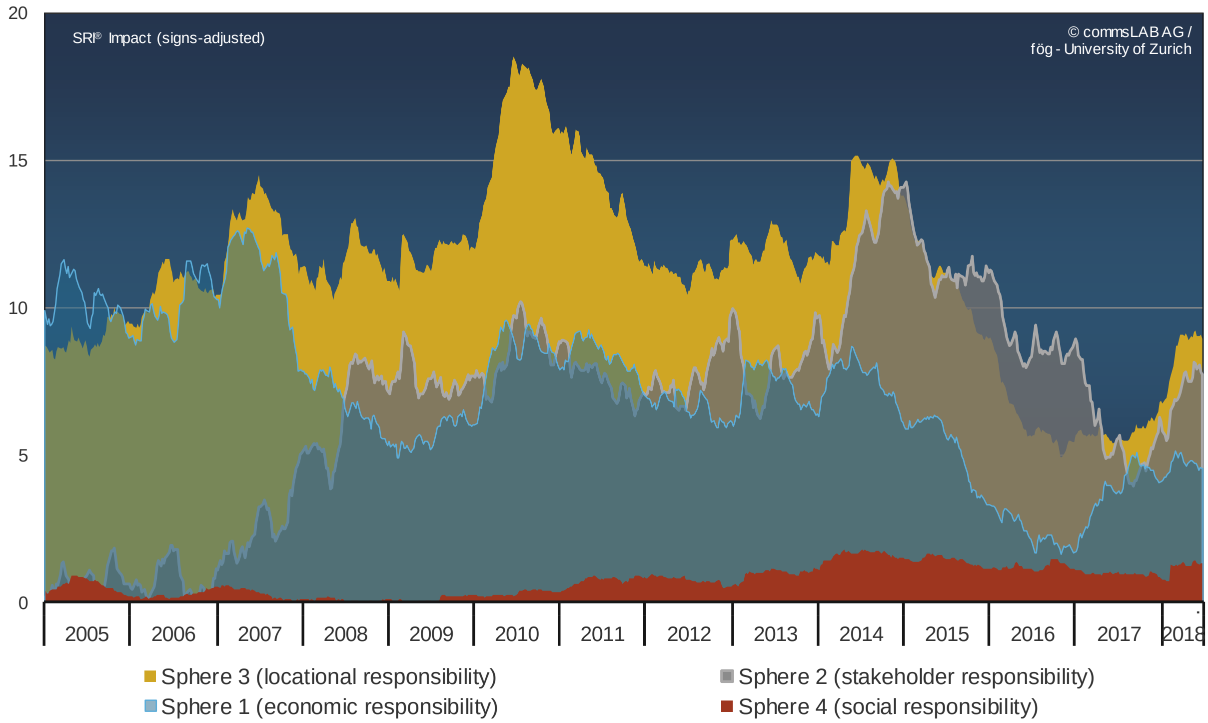
Economic responsibility
Business owners, shareholders
Business efficiency, performance, share price

The diagram shows the definitions of the four spheres of corporate responsibility used in this study.

Fig. 3 shows how influential each sphere of responsibility has been in terms of shaping reputation over the years: the larger the area covered by the four spheres, the greater the impact – be it positive or negative – the corresponding narrative has had on public perception or the reputation of the Swiss economy. It is clear that the locational narrative became a driving force in building the reputation of the Swiss economy as a result of the bailout schemes introduced for financial institutions and the escalation of what started out as a mortgage and financial crisis into a full-blown economic and debt crisis.

One distinctive feature of this phase was that supposedly «boring» companies with a strong focus on long-term business models grew more attractive. At the same time, the period between 2009 and 2014 in particular was marked by a reappraisal on the part of society and extensive regulatory adjustments, many of which were set by actors whose assessment criteria were more social/moral in nature than functional/economic.

Fig. 3: Significance of the four spheres of responsibility in terms of how the Swiss economy is perceived



The graph illustrates how heavily the individual narratives have influenced the perception of the Swiss economy over time, regardless of whether their impact was positive or negative.

The fact that the locational narrative lost influential power from 2015 onwards in the wake of the sharp fall in the Swiss franc (when the Swiss National Bank abolished the franc's euro exchange rate floor) but then regained it to some extent in 2018 suggests that an increase in the significance of locational responsibility can generally be interpreted as a classic crisis phenomenon. Measures taken to bolster locational responsibility in non-crisis situations can therefore be seen as a way of investing in an uncertain future. In effect, they serve as insurance against crises and are essential when it comes to managing reputational risks, as it is primarily in times of crisis, rather than in periods of relative normality, that measures of this kind come into their own.

Locational responsibility as an extra value-adding factor

The ascent of locational responsibility to become the central narrative in the wake of the financial crisis can mainly be attributed to Switzerland's global banks. The crisis of confidence triggered by banks such as UBS and Credit Suisse became a negative foil for the performance of the other sectors of the Swiss economy: in the period from 2009 to 2014 in particular, simply not being a global bank was enough to be considered a locationally responsible enterprise.

However, when the Swiss National Bank scrapped the Swiss franc's euro floor on 15 January 2015, this highly socially/morally charged contrast logic fuelling locational responsibility began to deteriorate. This transformed locational responsibility changed from a passive contrast mechanism – global banks as the "baddies" versus everyone else as the "goodies" – into a mark of distinction that could be actively put to use. In other words, a company can successfully manage its own positioning through targeted cultivation as long as the following societal expectations are met:

- Its activities serve the locations in which it operates or help to protect them from harm.
- There is a tangible link between its activities and its specific areas of competence and expertise.

Finally, the study concludes that assuming locational responsibility offers real benefits for individual companies and sectors on both an intangible (in terms of effects on reputation) and a tangible level (in terms of economic effects).

Added value I: additional boost to reputation

If a company is perceived as being locationally responsible, this not only enhances its profile in general, but also makes the managers responsible appear more credible from the public's point of view. This show of trust in the management is more than just an end in itself; it also has various desirable effects for an organisation: firstly, it gives the managers more power of definition (e.g. to put their views across more effectively in debates on regulation) and, secondly, it can create more overarching room for manoeuvre (e.g. enabling the enforcement of comparatively high levels of remuneration).

Companies which are recognised for their locationally responsible actions ultimately have greater power to direct public communications. They are therefore much more likely to be able to exert an influence on their positioning in the public eye, bringing in their own messages, and are thus less reliant on evaluations by third parties.

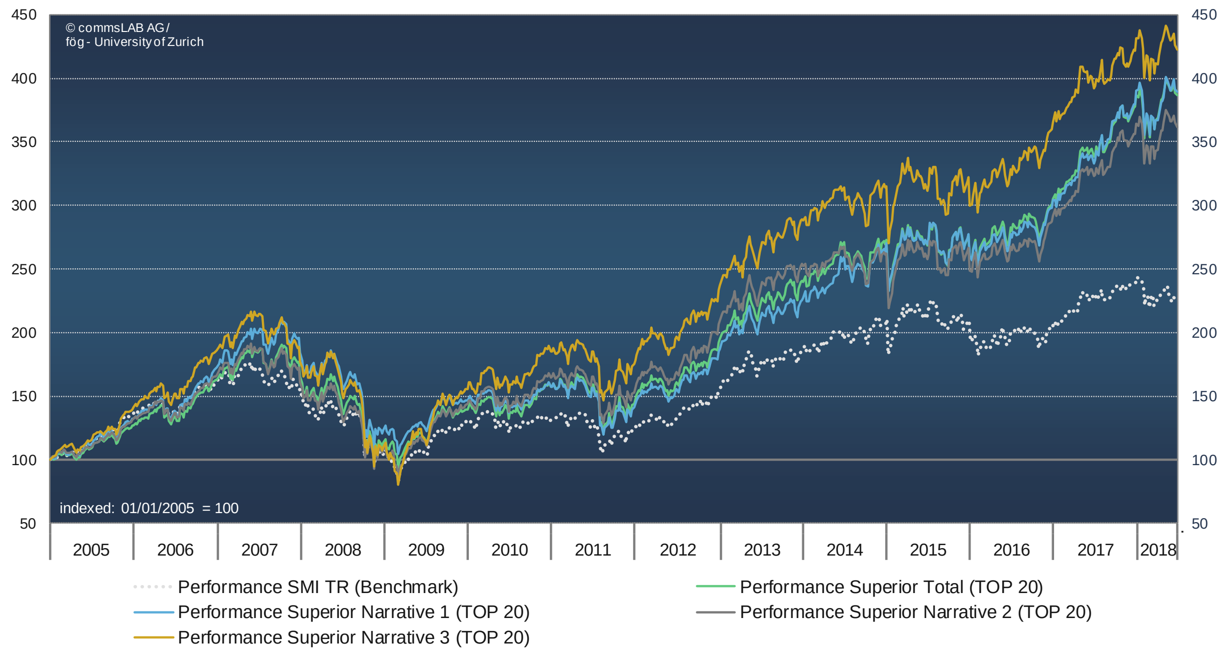
Added value II: additional economic boost

Finally, the study has demonstrated that a selection mechanism on the stock exchange which focuses on companies perceived as above average in terms of locational responsibility also reaps significantly above-average benefits.

For instance, historical simulations for the period from 2005 to June 2018 reveal that an investment focus on companies considered to be exceptionally locationally responsible generates the greatest enhancement in value of all the narratives investigated, producing an even better result than in the simulation based on the overall reputation sample portfolio (Fig. 4).

All four of the reputation-weighted sample portfolios studied therefore not only considerably outperform the SMI TR benchmark, but also do so consistently in almost all periods between 2005 and June 2018, most notably since the low point in spring 2009. This provides tangible proof that being perceived as a locationally responsible company can actually be understood as a kind of insurance against crises. Companies regarded as locationally responsible are clearly in a better position to benefit from recovery phases on the stock market than those which are not recognised for their locational responsibility.

Fig. 4: Sample portfolio, SRI®-weighted (narratives 1-3) versus SMI TR (with dividend)



The historical 1:1 simulation using SMI TR (white dotted line) as a benchmark shows that an investment focus on narrative or sphere of locational responsibility (narrative 3) generates the greatest added value (golden line). The value created is even higher than in the simulation based on overall reputation (green line) and significantly higher than the value added with an investment focus on the other two narratives, 1 (blue line) and 2 (grey line).