THE REPUTATION'S VALUE OF CAPITAL

VALOAREA DE CAPITAL A REPUTAȚIEI

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Abstract: *The role of organizational reputation was studied as a source of sustainable competitive advantage and superior performance. Organizations, like individuals, have reputations that create consequences. The effects of organizational reputation on a firm's financial performance are reviewed, particularly in terms of goodwill valuation.*

Rezumat: *Reputația organizațională este abordată ca sursă de avantaje competitive solide şi performanțe financiare superioare. Organizațiile, ca şi indivizii, au reputație fapt care generează anumite consecințe. Efectele reputației organizaționale asupra performanțelor financiare ale firmei pot fi studiate printre altele cu ajutorul evaluărilor bazate pe goodwill.*

An organization's reputation has as main external effects the loyalty confidence and guarantee. In other words, an organization with solid reputation inspires confidence and the feeling that it would be loyal in its relations with partners [1]. Or, an organization which presents from the perspective of the public's segments with whom it is in contact such characteristics is an organization with predictable and reliable behavior. And anticipation and security confer certainty and, consequently, control. Or, at least, the feeling of these. Certainty and control are, it is well known, in great demand in the modern world of organizations, world characterized by an extreme complexity and a big fluctuation as they facilitate decision making and the promotion of behavior directed to fixed objectives. This explains the organizations' attraction with good reputation. From the reasons exposed above, with reputed organizations, nobody is afraid to do business: you are not excited with all kinds of surprises, besides the attractive ones, certainly. Thus, reputation is something very beneficent for the organization it has but also for the organizations which communicate and interact with this. Reputation simplifies relations much. A solid reputation has the function of reducing the transactional costs sensitively [2]. The transactional costs are the costs of the contractual relations of the firm unfold on the market. The main elements of the transactional costs are:

1)costs for finding suppliers of good quality, especially in the case of products/services sole exemplar;

2)costs of drawing up valid agreements with specifications concerning quality, confidentiality, delivery terms, performance guarantees, penalties paid in case of unperformance;

3)costs of following the agreements execution;

4)costs of litigation;

5)specific costs, such as the firm's vulnerability towards the suppliers and customers' behavior or the disadvantage given by the competitors's capacity to have access at know-how and the technologies developed by the suppliers;

6)costs of reports concerning the market's conjuncture;

Reputation saves these costs, making the commercial relations cheaper and, consequently, more efficient. At the micro-organizational level, the positive consequences of reputation are expressed in two manners:

1)the market-share's extension of the organization (quantity factor);

2)the increasing of financial performances of organization (quality factor), especially the ratio flux inclusively by the possibility of practicing higher prices.

The above mentioned are arguments under which we have the reason to state that reputation has a value of capital. The conclusion is that reputation functions like a "lubricant" of the organizational business. The practicing of this function is based on the principle of reciprocity in inter-individuals and inter-groups relations: the tendency of paying somebody back in his own coin, respectively of responding at the behavior of the others by a similar behavior. The fact that an organization benefits by a good reputation means that all its partners assign a high probability to it that will give reliable answers at questions of maximum importance:

1)for customers these are quality, price, diversity, accessibility, service, guarantees;

2)for suppliers – to honour payments and the issue of supplementary orders;

3)for shareholders – controlled financial risks and investments return;

4)for creditors – solvency and guarantees;

5)for partners – respect the terms, flexibility and efficiency;

6)for state – the laws' respect and the tax payment;

7)for the community – civic involvement and social responsibility, etc.

How is it possible, however, the assigning of a financial value to the reputation held by the organization? For an economical organization, this investigation can start from the simple statement that between the business volume achieved by the organization – expressed directly with the help of the turnover – and reputation, there is a positive relation; the increasing of reputation determines an extension of the turnover, the altering of reputation leading, on the contrary, to its decreasing. This means that reputation is an important source of competitive advantages for a firm.

Consequently, the turnover can be regarded as a function of reputation. A firm with a better reputation will have, as a rule, a higher turnover than a firm with parameters of similar operations but with a "common" reputation. Certainly, the turnover is also due to other factors than reputation, especially to factors of patrimonial nature. Starting from these theoretical premises, we can build the following relation which point out the size of that part of the turnover which was won by virtue of holding by the firm of a solid reputation:

$= \quad CA - CA_{sect} - CA$, where :

= the turnover due to a better reputation of the firm;

= the total turnover got by the firm;

$\overline{CA}$ = the medium turnover achieved by the firms from the sector. This index shows how much wins on the average under the form of sales' volume, a "common" firm of the sector. By "common" we have in view both technical, commercial, financial conditions of operation and the reputation. The advantage of this index consists in the fact that it also expresses the action of some specific factors of market, such as conjuncture or seasonality etc. which have repercussions on all the operators from the sector;

CA = the increasing of the turnover explained by factors of patrimonial nature. It is, in fact, the variation of the breakeven of the firm expressed as turnover, variation that takes place between two successive periods. At the turnover level corresponding to the breakeven, the firm ensures the equality between income and total expenses and the profit is null. The breakeven is the result of the structure of the firm's costs, more exactly, of the manner in which these divide into fixed costs and variable costs. Generally, more important the fixed costs are, higher the breakeven is. And the costs' structure is, in its turn, the expression of the dimension and the structure of the firm economical patrimony. A patrimonial structure dominated by liabilities and assets on long term (immobilizations) and/or liabilities of fixed payments will generate, as a rule, more important fixed costs. On the contrary, a patrimony formed particularly by current liabilities and assets (on short term) and/or liabilities of variable payments will especially generate variable costs. In the former case, we shall have a higher breakeven, in the latter – a lower one. As reputation is created on time and must also be used and held in a lasting perspective, it can be assimilated to non balance, intangible, immobilized assets. Certainly, reputation does not appear in a balance but, by the synergies it produces, facilitates a more efficient valorization of the assets inscribed in the balance. For this reason, the expenses of creation, entertainment and operation of the balance liabilities and assets can be considered like a "mirror image" of the reputation. By virtue of this argument, a better reputation can sustain an efficient operation even in the conditions of a higher breakeven or which has increased.

Undoubtedly, in the special literature, other models of financial evaluation of reputation can be encountered: Interbrand, Sorgem, Marken-Bilanz, etc. The characteristic of the model proposed by us consists in the fact that it allows a direct and quick evaluation but, in spite of this, objective of reputation. We draw attention that value got on the basis of the above relation is not the financial expression of reputation but only a part of the turnover that the firm obtains due to reputation. To be able to confer to reputation a financial value we must have in view that as reputation generates a flow of economical gains (turnover), it can be considered a kind of capital. Knowing that , to get the value of capital of reputation, this flow of gains must be capitalized. By capitalization operation, an economical gain (V) is turned into the size of capital (investment) which relieved (C) with the help of a rate of capitalization (k);

$$C = V / k$$

The rate of capitalization used in calculus can be weight medium cost of capitals attracted by the firm increased with a special risk premium (*cmpc risc*). Thus, the value of capital of reputation (R) is established as follows:

$$R = CA_r / cmpc,\text{ where:}$$

$cmpc$ = the weight medium cost of capitals corrected with the level of the specific risks of the firm.

Why can be considered the weight medium cost of capitals in the quality of rate of capitalization? Because the process of creation of the economical patrimony of the firm, inclusively its intangible part expressed generically by reputation, is sustained by financial efforts which imply certain costs in function of financing resources – the capitals – used. To correct the weight medium cost of capitals with the size of the financial risks and of specific operation, it is necessary as reputation is not, however, a balance assets. Or, the weight medium cost incorporates only the characteristic risks to the "official" economical patrimony. Also, it is well known that a good reputation is won very hard, but it can be lost very quickly. The reputation's loss occurs as a natural result of risks' accumulation associated to the firm. That is why, as a protection measure against the fluctuations of the value of capital of reputation, the weight medium cost of capitals must be appreciated with a premium of special risk.

The organization's reputation, as essential element of the image of this, expresses synthetically the valorization of some particular functional characteristics such as credibility, loyalty, notoriety, honesty, reliability, correctness. These characteristics claim their origin in elements which, in the special literature, are designated overall with the help of the concept of goodwill [3]. Some authors assimilate reputation with brands detained by organizations but reckon that the market of the brands adds a supplement at the net value of the organization's assets contributing to form the overall value of this.[4]. The brand is considered, consequently, an important resource of goodwill. That is why the reputation's value of capital can be used further on to determine the organization's overall value which would include both balance elements and non balance elements:

The overall value = The accounting net assets + Reputation (Goodwill)

Let's come back, however, at the initial relation = $CA - CA_{sect} - CA$. If we move the term CA at the left part of this relation, we get another important equality:

$$CA - CA_{sect} = CA_r + CA_{patr}$$

The difference $CA - \overline{CA}$ signifies the increasing or the excess of the turnover of the firm with a good reputation over the medium turnover, specific to the firms with a common reputation. It shows, in other words, how bigger is the turnover of a reputed firm compared to the turnover characteristic to the firms with normal image and credibility. The right part of the last equality, $CA_r + CA$ part, specifies the influences of the two factors which have determined the excess issue of the turnover. Thus, a higher turnover in the case of a firm with solid reputation is the result of reputation accumulation, on one hand, and the variation of the breakeven expressed as a turnover, on the other hand. The existence of this turnover is one of the direct quantity expression of the market extension and of the firm's operations, with immediate effects upon the overall value of this. Equality $CA - CA_{sect} = CA_r + CA$ can be used to prevision the turnover volume, the reputation capital and the firm overall value. It is extremely interesting the prevision approach of this equality with the help of intervals of certainty (of confidence) and generally of the fuzzy multitude [5]. Let us follow the next example to see how the model functions:

Index	Current year	Previous year
1. Turnover	20000	18500
2.Costs total variables	11000	10000
3.Costs total fixed	2100	1870
4.Margin upon costs variables (1-2)	9000	8500
5.Margin upon costs variables in % (4/1)	45%	46%
6.Breakeven as turnover (3/5)	4667	4065

The result is that the variation of the breakeven as turnover (CA) is 4667 – 4065 = 602. If $\overline{CA}$= 16250, then = 20000 – 16250 – 602 = 3148. The equality $CA - CA_{sect} = CA_r + CA$is affected in this case, as follows: 20000 – 16250 = 3148 + 602 = 3750. This means that a turnover increasing with 3750 is due to the accumulation of reputation with 3148 and to the variation of the breakeven with 602.

If we take into consideration an cmpc = 11 %, in the conditions of total absence of risks (the premium of risk being, then, equal with 0), the value of capital of the reputation is: R = 3148 / 11% = 28618. If the accounting net assets of the firm is, for example, of 15000, the result is the next overall value of the firm: 15000 + 28618 = 43618.

But if we take into consideration the existence of very little risks which, according to the method of the premium evaluation overall risk of risks, are supposed a premium risk of 0,25, we shall get the following level of cmpc risc: cmpc x (1+ premium of overall risk) = 11% x (1 + 0,25) = 13,75 %. In this case, R = 3148 / 13,75% = 22894 and the firm's overall value is 15000 + 22894 = 37894.

CONCLUSIONS

The increasing of risks erodes the value of capital of reputation. In the moment, the risks of operation and financial specific to the firm begins to increase, the reputation of this how solid it was in the past, begins to lose its value of capital. The higher risks reduce the positive estimates made by the economical background concerning the good-faith and the potential loyalty of the firm. A complementary conclusion drawn is that the firm, in the conditions of superior risks, must make more consistent efforts in view to maintain, develop and valorize its image and reputation.

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