THE ROLE OF FIRM REPUTATION IN CORPORATE GOVERNANCE PROCESSES

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ABSTRACT
The paper deals with the idea of building more efficient and effective system of corporate governance by making use of the corporate reputation potential. Corporate governance is viewed as an integrative system of stakeholders' relations as well as a form of meta-management that joins legal, financial, ethical and organizational issues of the firm performance. On the other side, corporate reputation is regarded as a multidimensional phenomena and unique strategic relational resource, able to provide assistance in achieving various goals of a company, as well as in shaping the preferable kind of relations with its numerous stakeholder groups. By examining its mediating role in the company's interaction with its ecosystem, the aim of the paper is revealing the powerful role of corporate reputation in the corporate governance processes.

While the relevant literature is very ample, such a paradigm has not been constructed up till now. Beside, an integrated strategic approach to corporate reputation is still blurred. This article is aiming to fill those important gaps by proposing the strategic corporate reputation framework and an enriched reputation taxonomy that allows for shaping a reputational capability, an emerging integrated corporate governance mechanism, designed as a driver of the firm's market and non-market based competitiveness and suitable for auditing quality of the firm governance system, as well.

Starting with the corporate governance theoretical background and shading lights on paradoxes of companies' goals plethora, the paper continues with strategic approach to corporate reputation, and concludes with some potentially useful managerial implications. The empirical research results analysis that supports the insights proposed will be presented.

Keywords: *corporate governance, corporate reputation, strategic stakeholder management*

1. INTRODUCTION

A contemporary vision of the firm as an institution of modern society (Cingula *et al.,* 2011, p.61) has brought a shift in values and consequently, an emerging higher standard of corporate performance demand in terms of more corporate responsibility. An understanding of a company as a nexus of relationships (Wu and Eweje, 2008, p.7) instead of a nexus of contracts (Jones, 1995, p. 407; Jensen and Meckling, 1976) highlights its interconnectedness with and embeddedness into surrounding and global ecosystem. Such a new pattern which integrates the business and society has increased requirements of performance, so companies are expected to conform while performing, or put differently, to do well and good to be regarded as successful in today's business reality. Hence, as the first related benchmark, in 2004 OECD set the Principles of Corporate Governance, which position the corporation in the global economy system.

It is not suggesting that the convergence of outsider and insider control system is going on, but noticeably, until recently predominant influential profit maximization business paradigm is fading away (Blair and Stout, 2007), due to the augmented accountability, as well as the transparency issues, while stakeholder value maximization and sustainable success concepts rob authority. All in turns motivate a movement for governance practice beyond its traditional bottom line towards an extended one. The extension is headed for organizational level of governing the corporation that comprises regulative, social and environmental dimension, even political, beside economic. Neither of them should be neglected, since each one plays an influential role in shaping overall corporate performance and related responsibilities.

The concepts of corporate governance and corporate reputation both involve stakeholders and while corporate reputation depends on the perception and judgment of and attitude toward a corporation's actions, which implies the certain actions are more desirable for certain stakeholder group than the others, corporate governance aims at managing and controlling corporate actions in general and as well towards specific stakeholders. Hence, at a point in time, the company could be evaluated upon its reputation as outcome that comprises all aspects of its business operation: it's achieved overall performance (Fombrun, 1996, p.399) and furthermore, its identity, legitimacy, appearance and behavior. Having in mind that corporate reputation is created both inside and outside of the company, it reflects the quality and the efficiency of the way the company is conduct. Thus, the quests of direction, control and responsibility could be well sustained by use of corporate reputation, within this article suggested as an integrated, internal and external corporate governance mechanism.

This newly constructed paradigm is grounded in stakeholder theory (Andriof and Waddock, 2002; Freeman, 1984), dynamic capability view of strategic management (Teece, 2007; Helfat *et al,* 2007; Teece *et al*., 1997) and its dynamic managerial (Kor and Mesko, 2013; Adner and Helfat, 2003) and relational capability approach (Dyer and Singh, 1998). The challenge of this article is to reveal the role corporate reputation plays in the interactions between the firm and its stakeholders, therefore empowering or weakening its corporate governance system. A special challenge will be the linking of corporate learning with governing processes, provided by reputational dynamic capability. In this vein, within the article, governance mechanisms are viewed as "performance-enhancing constraints to managerial autonomy to control information on the company or disregard obligations to the company and stakeholders in general and shareholders in particular" (Podrug *et al.*, 2010, pp. 1227-1228). Corporate reputation is viewed through economic and social contexts, as intangible resource and as corporate liability, in parallel. Within the resource view, reputation is considered as strength and opportunity making construct (Fombrun, 1996), while within governance view, reputation is regarded as corporate behavior' restrictive effects generating and binding construct, due to fulfillment of stakeholder expectations (Mahon, 2002).

2. CORPORATE GOVERNANCE

According to OECD, corporate governance (CG) involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performances are determined (OECD, 2004). Corporate governance can thus be defined as a kind of management of the management or meta-management (Tipuric, ed., 2011, p.1).

The complexity of the issue has been recognized and shaped into three basic theoretic approaches: agency, stakeholder and stewardship theory. All three theories ponder the questions of the position and supervision of managers and their responsibility, behavior and achievement of corporate goals. Despite of agency theory's longevity and still salient assumptions (Jensen and Meckling, 1976), the stakeholder and the stewardship theories of corporate governance offer more comprehensive approach to contemporary acceptable mode of governing the corporation. Born within strategic management field, the former has fundamentally shook up regulatory and contractual agency postulates. The later has emerged within the field of corporate governance as an alternative to agency theory. Stakeholder theory begins with the assumption that values are necessarily and explicitly a part of doing business, and rejects the separation thesis (Freeman, 1984), while the fundamental postulate of stewardship theory is that managers always act in such a way to maximize the interests of a company, while the contemporary business environment is forcing management towards ethically responsible, innovative, but profitable businesses (Davis *et al.*, 1997.)

Three mentioned theories may be considered as a partial dominant logic. Evaluated separately, each one offers good solutions to corporate governance problems that Sir Cadbury has defined as "the system by which companies are directed and controlled", more than two decades ago (Cadbury, 2000, p.8, Cadbury report, 1992). A narrow view of CG portrays it as an enforced system of laws and financial accounting. There is, however, a broader CG conceptualization, emphasizing every business' responsibilities toward the different stakeholders that provide it with the necessary resources for its survival, competitiveness and success (MacMillan *et al.*, 2004). Such an approach highlights the relational aspect of the field, dealing with the relations of governance structures within corporations determining the components of the governance system and the supervision of the corporation (Cadbury report, 1992). In this vein, governance could be seen as concerned with the mechanism by which business' relationships are directed and controlled (MacMillan *et al*, 2004, p.15).

It is important to differentiate between two main approaches to stakeholder management: the traditional approach that focuses on buffering stakeholders and the proactive approach that emphasizes the building of stakeholder relationships (Harrison and St John, 1997). Recent studies (e.g., Wu and Eweje, 2008; Andriof and Waddock, 2002) have increasingly underlined the proactive approach that advocated the use of the term "stakeholder engagement" instead of "stakeholder management" to highlight the importance of partnership and moreover, collaboration between the firm and its stakeholders.

The essence of CG lies in the crafting and continuously refining of codes, laws, regulations, and processes that govern companies' operations, ensuring that shareholder rights are safeguarded and stakeholder and manager interests are reconciled. The control aspect of CG encompasses the notions of compliance, accountability and transparency (MacMillan *et al.,* 2004), and how managers exert their functions through compliance with the existing laws, regulations and codes of conduct (Cadbury, 2000). The direction aspect of CG includes corporate goals and related strategic choices, i.e. leadership and strategy aspects, which implies broader, organizational frame of governance, that involves: defining of roles and responsibilities; orienting management toward a long-term vision of corporate performance; setting proper resource allocation plans, contributing know-how, expertise, and external information; performing various watchdog functions; and leading the firm's stakeholders in the desired direction (MacMillan *et al.*, 2004; Cadbury, 2000;). The leadership and control aspects of CG are thus not mutually exclusive; rather, they go hand in hand, and they both define the extent of power accorded to various stakeholders, including executives, managers, employees, and, to a lesser extent, external constituencies and actors (MacMillan *et al.*, 2004).

Neither control, nor direction part of CG could be performed excluding corporate processes, defining how power is exerted, how decisions are reached, how company informs and reports and the manner it performs. The process view of CG implies continuity in crafting and reconfiguring the corporate level processes in order to optimize corporate practice. Such an approach allows well governed company to possibly make advantage of its effective and efficient corporate governance system (Tipuric, ed., 2008, p.6).

2.1. CORPORATE GOALS' PARADOXES

Complexity of ongoing business reality indicates that corporation should be able to cope with obstacles to its sustainability by using opportunities and assets that are legitimately available. Steiner and Sterner has defined basic postulates of sustainable business as "be ethical, responsible, and profitable" (Stainer and Stainer, 1998, p.5). Each of the three postulates has its own issues, thus the implementation of sustainable development on an organizational level requires governing model oriented towards long-term economic, ecological and social performance. Intuitively, a model of a kind is expected to suffer from the goal paradoxes, since company's goals are multidimensional in business realm and often conflicting. The most salient dimensions that colors company's goals plethora are: organizational, social, environmental, legal, institutional, and political ones. For their executing, a strategic decision-making and directing is required, but moreover, a paradox solving approach that could help boards in creating the sound business goals hierarchy out of mutually exclusive and contradict factors, sometimes even opaque. The solid platform for corporate goals' paradox solving is joining of ownership and stakeholder, as well as stewardship perspective of CG in an integrated frame, where the stewardship theory interaction principles are to sustain efficacy and effectiveness of stakeholder engagement. In such a framework, it is the duty of managers to make decisions that will increase value for shareholders and all relevant stakeholders' principals of the company, taking into account its competitiveness and efficiency, as well as its sustainable development (Tipuric, ed., 2008, p.vii).

Beside, executives' duty implies the resolution of diverse pressures and requirements raised from the corporation's governing authorities as well as diverse external pressures consequently reflecting on gaining or loosing of corporate reputation (Tipuric and Podrug, 2010). For solving mentioned problem, the Mitchell, Agle and Wood (1997, p.853) influential principles of stakeholder identification and their salience based on stakeholders' possessing one or more of three relationship attributes: power, legitimacy, and urgency are widely used, since by combining these attributes, executive can generate a typology of stakeholders and relating objectives and claims hierarchy at a point in time. Because their model is not aimed to provide the answers of the extent to which those objectives and claims are fulfilled to meet the expectations of stakeholders without significant gaps, it represents, metaphorically, a company's goal setting equation. But company's goals achieving equation is to be calculated as well, in terms of expected outcomes that those goals, if realized will produce, and particularly regarding the manner of their accomplishing. Thus metaphorically, two equations form a system whose solutions in form of key outcomes would be: quantitatively - operating result, qualitatively - corporate reputation.

2.2. CORPORATE RESPONSIBILITIES

It is not within the scope of this article to enter into corporate governance and corporate social responsibility relationship debate. Instead, overall corporate performance is considered, and stakeholder engagement view is followed, that both require responsibility and behavior issue to be outlined. The overall expectation for genuinely good corporate behavior is ever increasing, while irresponsible mode entails stock exchange, market and non-market unfavorable consequences. In this vein, Hillenbrand and Money perspective of corporate reputation and corporate responsibilities overlapping seems as a promising avenue for better understanding of corporate governance and corporate reputation fields interplay (Hillenbrand and Money, 2007:275). Thus, using of more descriptive and normative approaches (Donaldson and Preston, 1995) is suggested, because it seems like they suiting better as a long term corporate strategy drivers within broader corporate governance view, while the instrumental one fits better for a short term performance support.

By obeying to legal and regulatory institutional framework of the environment they operate within, corporations meet a minimum of requirements, in particular a necessary part of their legitimacy. But beside regulative terms, there are normative and cognitive ones (Wang, 2010, Deephouse and Carter, 2005) company should not disregard in order to assure the sustained development of its business activities and an acceptable reputation, as well. Going back to the fundamental governance questions about who supervises the corporation and why (Kaen, 2003), how the corporation is managed and in whose interest (Blair, 1995) and in which way changes in corporate control positions occur (Tipuric, ed., 2011), the emerging quest is: how to sense the relevance of corporate responsibilities plethora in order to sustain and enhance corporate performance.

MacMillan, Money, Downing and Hillenbrand argue that corporate responsibility is concerned with the way a business conducts its activities, and in particular how it relates to its primary and secondary stakeholders (MacMillan *et al*, 2004, p.15). According to Waddock, responsibilities are integral to corporate actions, decisions, behaviors and impacts (Waddock, 2003, p.15). So, pursuing of corporate principles, practices and values represents the board-chosen path that deliberately shapes corporate behaving. Consequently, board of directors - an institution whose members are appointed predominantly by particular shareholders, but representing the company as a whole – in their mediating role regarding the requirements of external bodies and the strategies/policies enacted by corporate management (Tipuric, ed., 2008), are in need of a tool that will help them in better understanding of company's responsibility dimensions in order to achieve ecosystem's corporative fitness. Within this notion, the industrial, social and institutional dimension of business fitness is understood, all three considered as antecedents that support corporate sustainable success.

Such an approach may be qualified as over-compliance from the narrow corporate governance perspective, but from wider governance view, company's behaviors as well as its reputation are surely essential strategic management relational assets (eg. Dyer and Singh, 1998 for review) that outline an overall corporate performance in terms of economic, financial, social, and environmental outcomes (Fombrun 1996, p. 399) and related relevant responsibilities, since, while operating, companies interact. These interactions "take place both in the marketplace of goods and services (where strategy is focused) and in the marketplace of ideas (where corporate social performance and political strategy research are focused)"(Mahon, 2002, p.417). As the consequence of company's interactions, its reputation emerges, encompassing; on the one hand, it's both market actions and behaviors that praise the corporation's competitiveness and conformance at the same time; on the other hand, the extent of stakeholder expectation fulfillment.

3. CORPORATE REPUTATION

Though being a powerful strategic relational resource, able to provide assistance in achieving various goals of a company, as well as in shaping the preferable kind of relations with its numerous stakeholder groups, corporate reputation (CR) within corporate governance literature has received surprisingly little direct attention in and of itself. But, witnessing late adverse corporate and economy occurrence, the academic and business community started to pay much more attention to the topic.

While reputation is clearly a company's asset, it is also clearly a concept held in the minds or cognitions of stakeholders (Bromley, 2000). Reputation is not really possessed by the company, since it is an idea that exists in minds of stakeholders (Hall, 1992). It is a reflection of social evaluation of the firm (Deephouse and Suchman, 2008), whose value steams from the positive collective perception of stakeholders (Pfarrer *et al.,* 2010). While summarizes all what is known about the company (Schultz *et al.*, 2001), firm reputation may be considered as a mirror in which the company can accurately see its history, current market reflection and its internal situation (Dortok, 2006; Fombrun, 1996). Since CR encompasses all of the company's explicit and implicit promises toward its stakeholders (Devine and Halpern, 2001), based on past actions in similar situation (Mahon, 2002, p.418), it reflects corporate conformance and performance, simultaneously. Thus without an acceptable reputation, it is very difficult for a company to survive or to make progress.

Reputation entails two main components: p*erception* - how the company is perceived by all stakeholders; and *reality* - the truth about a company's policies, practices, procedures, systems and performance (Schultz and Werner, 2005). Consequently, due to its informational asymmetry power, it is a suitable corporate tool for influencing stakeholders' perception (Weigelt and Camerer, 1988). CR is formed directly through stakeholder's experience in relations with the company, or indirectly, through a recommendation of intermediates, media or participants of direct interaction (Fombrun in Hitt *et al.,* 2001, p.296). Companies can have reputations for different characteristics, behaviors or outcomes (MacMillan *et al*., 2005, p. 217), but whatever kind, reputation is fragile, easy to ruin, hard to recover, its safeguarding is employees and employers job, but its managing is board's duty. Factors that help companies in building strong and favorable reputations with their principal constituencies are: credibility, reliability, trustworthiness, and responsibility (Fombrun, 1996). Trying to make sense of the field, Lewellyn argued that future research needs to answer three basic questions: reputation for what; reputation to whom; and reputation for what purpose (Lewellyn, 2002, p.451).

Researches suggests that reputation is, along with human capital, the most valuable intangible assets (Hall, 1992), which stimulates the overall superior performance of firms (Roberts and Dowling, 2002). Though the firm reputation has all the characteristics of strategic resources (Itami and Roehl, 1987), an integrated strategic approach to corporate reputation is still blurred. In the forthcoming doctorial thesis, aiming in fulfilling this important gap, reputation is considered in wider cross disciplinary and multifunctional paradigm[1], the one that encompasses higher level of its dimensions, not only its contingent roles (Tomsic, 2013).

To date the most leading definitions of reputation have regarded it predominantly from a positivist perspective, as asset, assessment, or awareness, with lots of confusion among the concepts of corporate identity, image and reputation[2]. For example, Fombrun (1996) defines reputation as the "overall estimation of a firm by its stakeholders, which is expressed by the net affective reactions of customers, investors, employees, and the general public" (pp. 78-79). Fombrun and Rindova (2000) describe corporate reputations as aggregate perceptions about the salient characteristics of firms. Viewing reputation as a social construction started

[1] Chun (2005, p.92) first pointed to a need of reputational paradigm.
[2] A detailed overview is at Barnett *et al*, 2006.

with Rao's insights noticed long ago (Rao, 1994), but scholars are just beginning to examine these socio-cognitive processes, in particular the social judgments through which stakeholders translate information about an organization into a particular reputation (Mishina *et al*, 2012; Love and Kraatz, 2009). Late offered definitions have entered into evaluative perspective, encompassing judgments, attitudes, experience, expectations, emotions and behavior of stakeholders toward a company (Schwaiger, 2004; MacMillan *et al*., 2004, 2005; Eberl i Schweiger, 2005; Chun, 2005; Hillenbrand and Money, 2007).

Most usually, reputation is considered as two dimensional construct[3] that reflects organizational capability and appearance. Examples of salient dimensions are: perceived quality and favorability (eg. Rindova *et al*. 2005), competence as cognitive component and sympathy as affective component (Schwaiger, 2004), or to put more generally, “stakeholders make two primary types of reputational assessments when evaluating a target organization: what the organization *can* do (i.e., its abilities and resources) and what the organization *would likely* do (i.e., its goals and behavioral intentions)” (Mishina *et al.,* 2012, p.460). Respecting assessment types, as well as the reputational constructionist nature, the phenomena is not to be regarded (only) instrumentally, but inseparable from firms’ responsibilities (Hillenbrand and Money, 2007), as it is from the firm itself, due to its stickiness (Ang and Wight, 2009; Schultz *et al.*, 2001). The reputational stickiness has its foundation in social psychology, and is based on the path dependency of social judgment form and change processes that strive to observers’ maintenance of evaluative consistency (Mishina *et al.*, 2012, p.462).

Corporate reputation is the fundamental bond between company and its stakeholders, which by shaping the way of their behavior, can generate many favorable consequences to a company (Fombrun and Shanley, 1990, p.233). Having that in mind, as well as that an understanding of corporate reputation through the constructionist framework suits better for strategic stakeholder management, there is no much use of stakeholder overall perception estimation and measurement, neither for decision making neither for corporate governing. From a theoretical point of view, for better understanding of the corporate reputation and corporate governance interconnectedness, a higher level generic conceptualization of corporate reputation is needed that is applicable as a sensor of different stakeholder groups’ expectation gaps. Therefore, an enriched generic reputational taxonomy is developed and proposed below.

4. CONCEPTUALIZATION[4]

Within this article, corporate reputation is regarded as an emotional intelligence of the firm, and the stakeholder proactive approach in term of stakeholder engagement is applied for conceptualization. Respecting Chun’s evaluative, impresional and relational approach to reputation (Chun, 2005, p.94) in terms of its functional, social and expressive dimensions (Eisenegger in Klewes and Wreschniok, eds., 2009, p.12)[5], as well as MacMillan *at al.,*

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[3] In Fombrun's (1996) conceptualization, reputation is encoded in six dimensions, namely: products and services, financial performance, vision and leadership, workplace environment, social responsibility and emotional appeal that aggregately form company’s reputation. Same dimensions are the pillars of Harris-Fombrun Reputation Quotient (RQ), one of the most used measurement technique developed within Reputation institute and Harris Interactive, beside *Fortune’s* Global Most Admired Companies (GMAC).

[4] Conceptualization is based upon forthcoming doctorial thesis theoretical and empirical research: Tomsic, D. (2013): The role of corporate reputation in building dynamic capabilities of firms. Zagreb: Faculty of economics and business.

[5] Eisenegger has developed a theory of reputation on the basis of the three-world concept of Habermas (1984) as a three-dimensional construct composed of a functional, a social and an expressive dimension. His functional

(2005) reputation in relationship and the Mahon's market and non market competitive arena (Mahon, 2002), the doctorial thesis empirical research results performed in Croatia in 2012 on a simple of 1000 biggest companies (ranked by total annual income), point out to emergence of the relational dimension of reputation.

Conducted explanatory factor analysis showed that reputation is actually an eight dimensional construct (rotation method: Varimax with Kaiser Normalization, variance explained 71,95% of the original information). Moreover, first two factors with highest explanatory power were relational (6,922 rotation sums of squared loadings) and functional dimension (4,415 rotation sums of squared loadings). Rotation converged in 16 iterations showed that with four, out of eight factors, rotation sums of squared loadings has cumulative 60,728% of the original information, that pointed out to confirmatory factor analysis with 4 factors default (eigenvalue >1). Rotation converged in 58 iterations (loadings < 0,450 suppressed), and confirmed the functional, relational, affective and social dimensions as a newborn taxonomy of corporate reputation (Tomsic, 2013).

Following above mentioned authors work, the functional dimension was always present, which is also consistent with other fields' already confirmed and cited empirical insights. Within quoted research result it consists of performance, quality and capability sub-dimensions. The relational dimension consists of confidence, commitment, reliability and responsibility, and surprisingly legitimacy, the social dimension consists of CSR and citizenship, while the affective dimension consists of communication, emotions and character. The reputational taxonomy summary is given in Table 1.

Tracking Eisenegger typology, it seems that the expressive dimension could be better described if it is systematized in two new dimensions: affective and relational. The affective one is close to the corporate image and personality, while the relational one is close to corporate culture, behavior, identity and values, and is much more interesting for new reputational insights. The empirical research results have also shown that for the chosen strategic reputational approach, the social dimension is better converged when legitimacy[6] is extracted and merged with the relational dimension components. Although upon one conducted empirical research, firm conclusions cannot be delivered, hopefully those new insights might bring a fresh beam to a clearer sight of the complex CR construct.

Table 1: Corporate reputation generic four dimensional taxonomy

REPUTATION	Functional	Social	Affective	Relational
Reference	Objective world of the true Performance tags of functional system	Social world of the good Ethical standards Expectation gap	Subjective world of the beautiful Individual character Image	Experiential world of (direct and indirect) interactions Values, culture, behavior organizational identity,
Indicators	Competence Success	Integrity Responsibility	Attractiveness Uniqueness	Relationship mode Fairness
Appraisal style	Cognitive-rational	Ethical	Emotional	Behavioral
Sub dimensions	Performance	CSR	Communication	Trust and credibility

reputation is linked to the performance tagets of the respective function system, the social reputation is linked to ethical standards, while expressive is linked to individual character and identity (pp. 12-14)

[6] The occurrence might be linked to the different approaches of organizational and institutional legitimacy. Within the doctorial thesis research, organizational legitimacy is viewed as strategic resource (eg. He and Baruch, 2010; Deephouse, 1999 for review), while Eisenegger has followed macrotheoretically-oriented approach, that fits better within his media society research.

	Quality Capability	Citizenship	Emotions Character	Commitment Reliability and responsibility Legitimacy

Tomsic, D. (2013): The role of corporate reputation in building dynamic capabilities of firms. The doctorial thesis in preparation. Zagreb: Faculty of economics and business. The model is built on the basis of Eisenegger and Imhof (2008, p.130).

A four-dimensional taxonomy fits better within broader corporate governance view. Besides, it is much convenient within the stakeholder engagement perspective, since it covers overall corporate performance and related responsibilities issue, like a kind of holistic corporate monitoring tool. Thus could be contrasted to expectations of any stakeholder group of board's particular interest whether for performing or for the adjusting of corporate direction process.

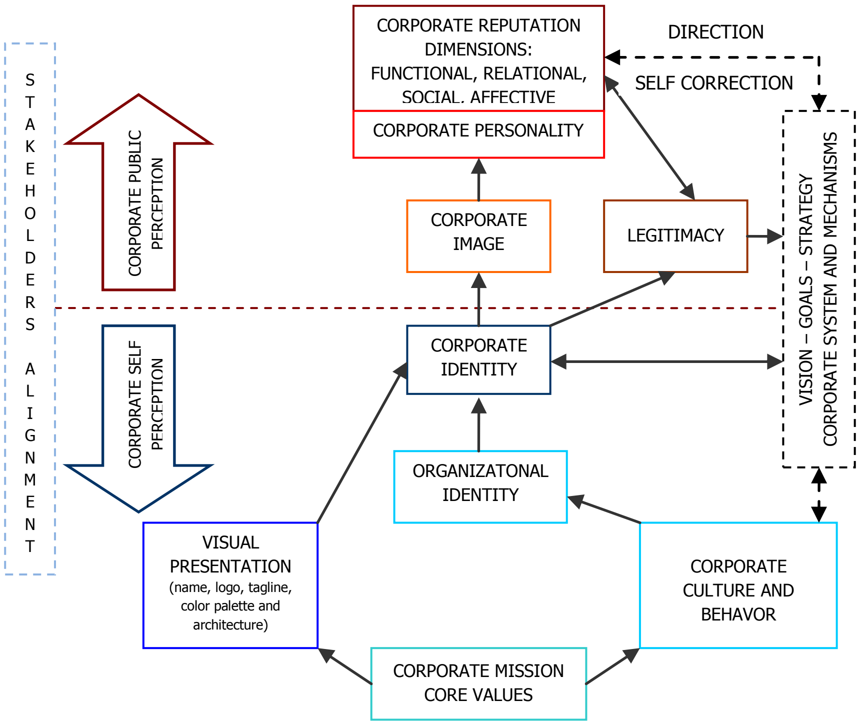
To continue with the conceptualization of corporate reputation as a resource (even more as capability)[7] of use for strategic direction and governance, reputational paradigm would be helpful, the one able to comprise relevant approaches to corporate reputation, its constructive key elements and its dimensions. Using enlarged generic reputational taxonomy, such an approach is systematized and conceptualized in a strategic reputation framework, offered by figure 1. Assuming that operating successfully is an intrinsic governance goal, as well as achieving and sustaining acceptable corporate reputation, the following suggestion is made:

Proposition 1: corporate reputation can be used as implicate corporate governance direction mechanism.

The framework reveals reputational constructive elements and paths, linking them with corporate goals, system and mechanisms in order to calibrate stakeholder alignment. Thus, boards have got both market and non market evaluating tool, suitable to audit corporate direction process in form of achieved positive or negative reputational change. Moreover, direct and indirect relations between framework elements point to a dynamic process view of corporate governance that places reputation in a mediating position for the corporate goals setting and for the manner the performance is to be conducted.

[7] Due to a limitation of space, the constructing of reputational capability would not be explained in details.

Figure 1: Integrated governance-strategy-reputation framework



Tomsic, D. (2013): The role of corporate reputation in building dynamic capabilities of firms. The doctorial thesis in preparation. Zagreb: Faculty of economics and business. The model is built on the basis of Alessandri's model of identity (Alessandri, 2001, p.178).

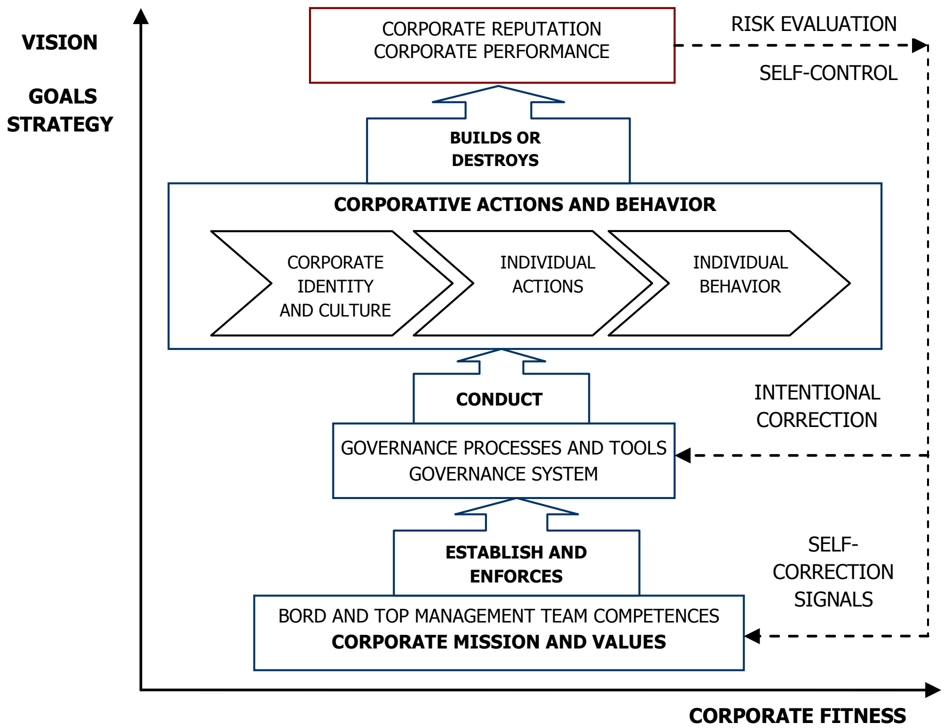
It is worth to notice that each suggested dimension in the proposed generic framework has its own path of emergence, which implies that interpreting changes in corporate reputation might be much more accurate than it presently is, if is evaluated through each of four proposed dimensions. Herewith, market performance could be matched with functional reputation, behavior with relational reputation, corporate social responsibility and citizenship with social reputation, and appearance with affective reputation. Besides, such a framework allows for matching, even mapping of relevant primary and secondary stakeholders' requirements toward a company, and thus achieving more calibrated decision making, regarding the targeted extent of stakeholder satisfaction.

Companies that act and perform below stakeholder expectations are gaining unfavorable reputation, which restricts their prospects of long term successful performance (Scandizzo, 2011). The company's behavior mode shape reputational assessment to a great deal. To meet the stakeholder expectation(s) regarding overall corporate performance without significant gap is a hard corporative goal to achieve, but could be calibrated better by delving into the mode of meaning(s) (re)construction to reputational dimensions change. Assuming again that operating successfully is an intrinsic governance goal, as well as achieving and sustaining acceptable corporate reputation, the following suggestion is made:

Proposition 2: corporate reputation can be used as implicate corporate governance control mechanism.

By using of social discourse, reputation could be portrayed as a control mechanism because it tells others about company's compliance with norms and even about how the business is conducted from the moral point of view. In this normative sense, the discourse is based on the kind of social control and is therefore understood as a mechanism to ensure compliance with norms (Lähdesmäki and Siltaoja, 2010, p. 214-215). But moreover, the reputation role as a control mechanism expands when is supported by reputational risk management approach. Building on Scadizzo, reputational risk can be seen as a function of the gap between stakeholder expectations and the company performance, with the former measured through regular attitude surveys and the latter through specialized audits (Scandizzo, 2011, p.50). Thus the management of reputational risk is as much a matter of governance, information gathering, accountability and controls as it is a by-product of a firm and its people's commitment to stay true to its mission and its values in their day-to-day work. Figure 2. depicts the governance-reputational interrelatedness. Corporate reputation here is situated as corporate performance consequence, and antecedent in a next business cycle, as well.

Figure 2: A corporate governance-reputational framework



Tomsic, D. (2013): The role of corporate reputation in building dynamic capabilities of firms. The doctorial thesis in preparation. Zagreb: Faculty of economics and business. The idea for the framework comes from Oriesek, 2004.

Further while, in the light of newly proposed four-dimensional corporate reputation taxonomy, and in line with the constructed reputational paradigm, the interconnectedness of corporate reputation and internal and external governance mechanisms will be presented. Consistent with the relevant theoretical background, internal control mechanisms are: boards, management compensations, ownership concentration, relationship to stakeholder groups and corporate reporting, while external mechanisms include: corporate control market, legislative and regulatory framework, protection of minority shareholders and competition conditions (Tipuric, ed., 2008).

Due to its inseparability of a focal company, reputation tackles primary and secondary stakeholders, intermediates and regulators "that can affect or are affected by the achievement of a corporation's purpose" (Freeman, 1984, p. 25) every time a company enacts and interacts. Consequently, corporate reputation incorporates overall governance mechanism reflections, which makes it eligible for auditing the quality of a firm governance system. Moreover, here considered as a driver of the firm's market and non-market based competitiveness, it is argued that corporate reputation empowers or weakens the effectiveness and efficacy of other known internal and external governance mechanisms. Assuming again that operating successfully is an intrinsic governance goal, as well as achieving and sustaining acceptable corporate reputation, the following suggestion is made:

Proposition 3: corporate reputation incorporates the overall governance mechanism reflections, thus can be used as implicit integrated corporate governance mechanism.

Respecting previously stated theoretical and empirical research results of CG and CR field, as well as proposed conceptualization insights, the governance control mechanisms and reputation dimensions relationship could be accessed through high-medium-low scale, a kind that is common at risks management practice. Thus, corporate board decision making, in order to safeguards or to reshapes stakeholders' alignment and corporate reputation, has to be performed with a high awareness of reputational risks and its effects on companies control governance mechanisms.

Reputational effects to the internal governance mechanism could be assumed as directly correlating. Following facts shape their relationship: a firm reputation could be assessed through its board members individual or collective reputation perspective, thus it is important to create and sustain positive individual and collective favorable reputation of board members; management compensation can be considered as too high and even more not transparent, thus generating dissatisfaction of primary stakeholders; relationship to stakeholder group is to be assessed from descriptive, instrumental and normative view of their salient expectations in order to calibrate overall corporate performance, and; corporate reporting content will be considered more credible, when it is about an esteemed company.

The analogy goes for external control mechanism too: corporate control market will be more competitive, when it deals with highly regarded company possible overtaking; legislative and regulatory framework will remain the same for god and bad reputed companies, but in case of unfavorable reputation, the company reaching or entering a new market will meet more obstacles than the acceptably reputed one; protection of minority shareholders is a meter of corporate codes, as well as company's act and here is not considered as to relate to corporate reputation in any way except that prominent company, who is aiming to stay evaluated in such a manner would not allow offering an unsatisfactory protection to any of its stakeholder groups, thus, here an indirect reputation-governance mechanism correlation could be assumed; and finally, competition conditions would be more favorable for respectable company in any kind of business perspective.

The assistance of a good reputation in empowering company's relational skills within stakeholder network, for the company is important not only from the perspective of the influential groups for its survival and achievement, but also as an external source of new information, ideas and knowledge that could help boards in better decision making and direction of the company, in terms of sensing and seizing opportunities and deterring threats. To be able to, company has to have developed dynamic capabilities (Teece, 2007; Teece *et al.*, 1997). Dynamic capability is the capacity of an organization to purposefully create, extend, or modify its resource base (Helfat *et al.*, 2007, p.1). Dynamic capabilities can be disaggregated into the capacity: to sense and shape opportunities and threats; to seize opportunities; and to maintain competitiveness through enhancing, combining, protecting, and, when necessary, reconfiguring the business enterprise's intangible and tangible assets (Teece, 2007, p.1319).

One of the most important kinds of firm dynamic capability is relational dynamic capability (Helfat *et al*, 2007). Dyer and Singh (1998, p.662) has established four relational capabilities in interfirm relations. The first is the relation-specific assets of the firm, which concerns the genesis of specialized assets in conjunction with them of their collaborating partners. The second are the interfirm knowledge-sharing routines, which are strongly related to partner-specific absorptive capacity (Cohen and Levinthal, 1990). The third aspects are complementary resources/capabilities within and between firms. The general inherent idea is the overlapping, the complementarity of partners through a similar strategic direction. The fourth relational capability is an effective governance, which includes also the basal reflection of institutional economics. But, having in mind that stakeholder' relations could be regarded as the firm specific network, the same logic could be applied widely. Here lies the hidden talent of corporate reputation: a company that posses positive reputation, and is perceived as behaving fairly within its complex network of internal and external relationships may use its reputational platform as a kind of privilege information and knowledge sharing space that Nonaka and its colleagues labeled as *Ba*: the shared context for knowledge creation (Nonaka *et al.*, 2000). Thus, respecting again previously made conceptualization assumptions, another proposition is made:

Proposition 4: reputation capability can be used as the integrated implicit corporate governance mechanism, eligible for auditing the quality of a firm governance system.

Corporate reputation, viewed in such an dynamic mode, actually means its transformation from one-directional (inside out) oriented emitting resource to bidirectional, two ways (inside out and outside in) operating capability. Reputational capability is defined as the ability of companies to make use of their reputational potential in order to create, develop, maintain and exploit interactions with stakeholders within the overall performance context for the purpose of knowing valuable and relevant information, ideas and knowledge, and for the effective balancing the company's resource base.

In accordance with the definition of organizational capabilities, reputational capability is composed of resources and routines. The main resource in the reputational capability is corporate reputation, and related routines are: the ability of company to interact with its stakeholders; the ability to transfer corporate messages that contain desired characteristics, behaviors and outcomes through direct or indirect interaction; the ability to receive stakeholder' messages in terms of valuable information, ideas and knowledge and to gain understanding of stakeholders attitudes that convey their expectations of the company in direct and indirect interaction; and the ability of company to behave collaborative.

Since stakeholders in interaction with the company gain experience and feelings of it, directly or indirectly, that form their attitude, and moreover their behavior toward the company in focus, by making use of its reputation capability a company may achieve better understanding of its arms length as well as embedded relationships, thus cutting the expectation gap. Moreover, stakeholder-oriented discourse emphasizes the communal aspects of reputation by reconstructing the business in a reciprocal relationship with its surrounding community (Lähdesmäki and Siltaoja, 2010, p. 213). According to Bosse *et al.,* (2009) people behave reciprocally by rewarding others whose actions they deem fair and willingly incurring costs to punish those they deem unfair. The underlined logic here it that company whose behaving and acting is considered as fairly can expect to be treated in the same way by its stakeholders.

The idea that norm-based social control mechanisms - like reciprocity - commonly influence the behavior of parties to an incomplete contract is well established. Therefore, the level of contribution nonemployee stakeholders provide to the firm can also be expected to vary according to their perceptions of reciprocity. That is, variance in stakeholders' reciprocal behavior toward a firm hinges on the same thing that influences employees' reciprocal behavior—their perceptions of fairness (Bosse et *al.*, 2009, p.451). Thus, any stakeholder that perceive a firm as fair across all three types of justice, distributional, procedural and interactional will have an incentive to contribute more positive effort to the firm than those that perceive the firm is unfair on every or one of these dimensions.

Highly engaged stakeholder behavior, mediated by corporate reputation capability, supports company performance in terms of more valuable information, ideas and knowledge beside within Bosse *et al.,* (2009) considered rent creating, that otherwise would not be available to the company's board and management. Therefore, reputation capability could be used as the integrated implicit corporate governance mechanism, eligible for auditing the quality of a firm governance system.

5. CONCLUDING REMARKS

Corporate reputation is constantly considered as one of the most valuable intangible assets of the firm, but its function as the corporate goals' paradox solving tool, or as a governance mechanism has somehow remained unrevealed. Moreover, reputation as a valuable, even unique relational resource could be transformed into organizational capability with a variety of talents that, along with the firm's dynamic capabilities help the company in increasing its effectiveness and efficacy of governance system, and in sensing and implementing change and renewal in a manner that is highly regarded in market as well as in non market arena. Its significance is expected to increase in the future, as it is a constituting part of the business sustained success.

The article has followed Zahra's suggested strategies for creative and constructive theory building (Zahra, 2007). Presented theoretical and empirical insights embody the attempt of approaching to highly complex corporate reputation construct from the corporate strategy perspective, and are in line with the contemporary corporate governance and strategy states of arts. The insights and propositions offered need to be further empirically tested to gain the firm inference and explanatory power, which is considered as the major limitation of the article.

Nevertheless, the suggested interpretation of corporate reputation phenomena as a four-dimensional construct, and the insights on its interplay within the direction and control processes of corporate governance, hopefully will serve as more comprehensive path for viewing the both constructs' interconnectedness mode. Understanding reputation as a capability highlights its unexploited potential for managerial implication. Introducing of corporate reputation in the integrative corporate governance mechanism position also seems as a promising path for the initiative of developing more efficient and effective corporate governance practice.

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