

# Investing in Reputation

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*This paper examines whether consideration of corporate reputation is useful in forming investment portfolios. Portfolios are constructed using the Harris Poll Reputation Quotient and rebalanced periodically. We find that an equally-weighted allocation consisting of stocks with high corporate reputation outperformed those with low reputation and benchmarks. Individual investors can incorporate these findings in making portfolio decisions that consider social values as well as in generating wealth and managing risk.*

*Keywords: corporate reputation, Harris Poll Reputation Quotient, trading strategy, Fama and French*

## INTRODUCTION

Some investors choose assets for portfolios based on nonfinancial information, and there is evidence that demand for nonfinancial data is growing (Cohen et al., 2015). Naveed et. al. (2020) find that, in particular, demand for corporate reputation information for investment decisions is growing. Corporate reputation and reputation risk are also increasingly relevant for firms (Gatzert, 2015). Helm (2007) argues that corporate reputation influences both the affective and behavioral loyalty of investors, and Chang and Cheng (2015) find investors show strong confirmation bias in interpreting intangible information about firms. Information on corporate reputation may therefore generate a significant investment response.

In terms of asset return, choosing portfolios based on corporate reputation can be rewarding, enhancing future shareholder value (Black et al. (2000), Deephouse (2000), Krueger and Wrolstad (2007), Krueger et al. (2010), Krueger and Wrolstad (2016), Eckert (2017), and Beck et al. (2022)). Additionally, studies have demonstrated that reputation and other nonfinancial factors mitigated losses during the COVID-19 pandemic. Manabe and Nakagawa (2022) find that Japanese firms with a positive reputation perform better than those with a low reputation score during the pandemic, suggesting that the former could act as a hedge in times of crises. Further, Huang et al. (2021) examine whether firms with popular brands perform well during the COVID-19 crisis, and they determine that “firms with the top brands experience higher stock returns, lower systematic risk, and lower idiosyncratic risk”.

We examine whether consideration of corporate reputation is useful in forming investment portfolios. Portfolios based on reputation ranking are rebalanced periodically and compared to benchmark returns to determine whether firms with highly ranked corporate reputation outperform those with low corporate

reputation. This will assist individual investors in making portfolio decisions that consider social values as well as return and risk. The remainder of this paper will discuss data, methodology, results, and conclusions.

## DATA

There are several measures available for ranking corporate reputation. Sarstedt et al. (2013) find that the Harris Poll's Reputation Quotient (RQ) is better than other corporate reputation measures, e.g., Fortune's Most Admired Companies (MAC) index, Walsh and Beatty's (2007) customer-based corporate reputation construct, and methods by Schwaiger (2004) and Helm (2005). Using conceptual, theoretical, and empirical methods, they find the RQ and Schwaiger's method have the highest levels of criterion validity and that RQ is conceptually superior to MAC. Hence, RQ is our reputation measure of choice.

Each year, the Harris Poll ([theharrispoll.com](http://theharrispoll.com)) screens for the 100 most visible firms, then ranks them by 20 attributes of reputation across six dimensions: social responsibility, products and services, emotional appeal, vision and leadership, financial performance, and workplace environment. The RQ categories are Excellent, Very Good, Good, Fair, Poor, Very Poor, and Critical. As there are very few publicly traded stocks listed in the categories Very Poor and Critical, we combine these stocks with those in the Poor category. Wells Fargo (WFC) was rated Very Poor in 2019, and Wells Fargo (WFC), Altria (MO), and Phillip Morris (PM) were considered Critical in 2017, 2018, and 2019, respectively.

Our sample includes all publicly traded firms in the RQ ranking for 2015 to 2023, a total of 126 companies. Firms that were merged/acquired are replaced by their post-merger/acquisition tickers. The stock data are from Commodity Systems Inc., and closing prices are adjusted for splits and dividends. The date range is from February 4, 2015 to May 21, 2024, a sample size of 2,340 daily observations. The RQ index has a longer history, but changes to the methodology were made in 2014.

## METHODOLOGY

While well-diversified portfolios are often touted by investment professionals and academics, individual investors may not have the technical know-how in forming them, and are usually advised to invest in exchange-traded funds such as the SPDR S&P 500 ETF (SPY), which is not guaranteed to avoid sector concentrations, and the Invesco S&P 500 Equal Weight ETF (RSP). Should an individual wish to construct his/her own portfolio, issues relating to concentrated portfolios, naïve diversification, and survivorship bias tend to arise.

### **Portfolio Construction and Rebalancing**

We begin on February 4, 2015, when equally weighted portfolios are established using RQ categories. These portfolios are then revisited on the announcement dates of each year and rebalanced with their respective component stocks until the last rebalancing date on May 23, 2023. The return of each portfolio over the entire study period are then chain linked for performance evaluation.

### *Concentrated Portfolios*

As mentioned earlier, individual investors tend to have concentrated portfolios with few stockholdings (Goetzmann and Kumar, 2008; Ivković et al., 2008). This could be a result of behavioral biases, e.g., overconfidence, trend-chasing (Lhabitant, 2017) and/or a lack of financial wealth (Roche et al., 2013). Yet, there is academic support that a more concentrated portfolio could outperform one that is less concentrated (Choi et al., 2017; Fulkerson and Riley, 2019; Brown et al., 2020; Kim et al., 2021). Further, little benefit is gained from large stockholdings; although Evans and Archer (1968) concluded that 10 stocks would be sufficient for diversification, Chong and Phillips (2013) arrive at 31 as the average number of stocks needed to attain best results for 18 measures of interest in 5 categories, e.g., return, risk, downside risk, risk-return ratios, and comovement.

### *Naïve Diversification*

Besides having concentrated portfolios, individual investors are inclined to utilize rules of thumb. In social cognition/psychology, this is labelled ‘cognitive miser’, “that people are limited in their capacity to process information, so they take shortcuts whenever they can” (Fiske and Taylor, 1991). Not surprisingly, individual investors prefer naïve diversification in the form of equally weighted portfolios, with a small number of stockholdings.

A concentrated (also known as high conviction or focused) portfolio is antithesis to a well-diversified portfolio. The latter is usually constructed via an optimization process (Markowitz, 1959), which is susceptible to estimation error. Consequently, it is found that optimization-based approaches, by and large, are inferior to naïve diversification (DeMiguel et al., 2009; Gelmini and Uberti, 2024). While highly influential, the study by DeMiguel et al. (2009) utilizes datasets of portfolios. Zakamulin (2017) points out that many studies in favor of naïve diversification (e.g., DeMiguel et al., 2009; Duchin and Levy, 2009; Gelmini and Uberti, 2024) and optimized diversification (e.g., Kritzman et al., 2010; Tu and Zhou, 2011; Kirby and Ostdiek, 2012) construct portfolios of portfolios instead of portfolios of stocks. Using stock data, Hwang et al. (2018) find that small equally weighted stock portfolios outperform their mean-variance optimized counterparts, while over long horizons, they surpass buy-and-hold stock portfolios (Farago and Hjalmarsson, 2023). We employ stock data as well.

### *Survivorship Bias*

Individual investors are especially vulnerable to survivorship bias since their (backtested) investment strategies use databases which exclude companies that are no longer listed due to delisting, failure, merger, etc. (e.g., Yahoo Finance). In such cases, performance results would have to be adjusted (Carhart et al., 2002). In the 2015 through 2023 RQ rankings, there is a total of 126 publicly traded stocks in the U.S., of which 7 are delisted while Volkswagen (VWAGY) now trades on the over-the-counter market and is not included in the buy list. The seven stocks are Bed Bath & Beyond (BBBYQ), Dish Network (DISH), Fiat Chrysler Automobiles (FAU), JCPenny (JCP), Sears Holdings (SHLD), Sprint (S), and Twitter (TWTR). Since only 6.35% of RQ stocks are unaccounted for, no adjustments are made to our findings.

### **Volatility and Risk**

In estimating (conditional) volatility, we use the sample standard deviation and the GJR(1,1) model (Glosten et al., 1993). The latter accounts for salient features of financial time series (fat tail distributions, volatility clustering, and volatility asymmetry), and its conditional variance is represented by

$$h_t = \gamma + \alpha \varepsilon_{t-1}^2 + \omega \varepsilon_{t-1}^2 S_{t-1}^- + \beta h_{t-1} \quad (1)$$

where  $\gamma$ ,  $\alpha$ ,  $\beta$ , and  $\omega$  are parameters, and  $S_{t-1}^-$  is an indicator function that takes the value of 1 when  $\varepsilon_{t-1} < 0$  and zero otherwise. Unlike volatility, risk is associated with negative returns, and maximum drawdown—the largest decline in a portfolio’s value from peak to trough—is our preferred risk measure.

### **Fama-French Factors**

We also examine risk-adjusted return factors using the Fama-French model, which is now an industry standard. The Fama-French five factor model (Fama and French, 2015) with a momentum factor (Carhart, 1997; Fama and French, 2018) is presented as

$$(R_j - R_f)_t = \alpha_j + \beta_j (R_m - R_f)_t + s_j SMB_t + h_j HML_t + r_j RMW_t + c_j CMA_t + m_j MOM_t + \varepsilon_t \quad (2)$$

The factors in Equation (2) are the market beta, size (i.e., difference between returns on small stocks and big stocks, SMB), value (i.e., difference between returns on stocks with high book-to-market and low book-to-market, HML), profitability (i.e., difference between returns on stocks with robust and weak

profitability, RMW), investment (i.e., difference between returns on stocks of low and high investment firms, CMA), and momentum (MOM).

## RESULTS

In this section, we compare RQ category portfolios with their benchmarks (SPY and RSP) and appraise their out-of-sample effectiveness. Although our study period (approximately nine years and three months) could be considered short, it nevertheless spans a business cycle, an appropriate time horizon for performance evaluation. This period involves an economic/healthcare recession amid the unprecedented COVID-19 pandemic. Testing the efficacy of the RQ-filtered strategies in such tumultuous times ensures the robustness of our results.

### Performance Evaluation by Business Cycle

#### *Whole Period*

For the initial evaluation, we employ summary statistics by U.S. business cycles, with cycles determined by the National Bureau of Economic Research (NBER). The only economic contraction covered was the COVID-19 recession, from February 2020 to April 2020, the shortest in U.S. history. Following a brief but steep economic downturn, SPY rebounded swiftly, propelled to greater heights despite encountering high inflation and interest rates in 2022 (see Figure 1). Its annualized return was 12.84% (annual standard deviation was 17.87%) for the whole period (see Table 1, Panel A).

While the portfolio comprising all tradable RQ stocks (denoted by “All”) was slightly inferior to SPY, portfolios consisting of RQ stocks in the Excellent category (annualized return = 14.36%, standard deviation = 21.05%), and the Very Good category (annualized return = 13.90%, standard deviation = 17.71%) outperformed SPY and RSP (annualized return = 10.21%, standard deviation = 18.70%). However, in terms of the return-to-standard deviation ratio, only the Very Good portfolio (ratio = 0.7847) surpassed SPY (0.7186). In Figure 1, we see that in addition to the COVID-19 recession, the Excellent portfolio’s elevated volatility was also due to its severe decline in late-2021 to early-2023 and this resulted in a conditional volatility of 40% to 60%. However, the trajectory of the Very Good portfolio wasn’t as jarring; its conditional volatility was slightly above 40% in mid-2022.

Of significance to an individual investor is that the Very Good portfolio’s annualized return is accompanied by an annual standard deviation that is lower than those for SPY and RSP despite an average portfolio size of 29.11 (see Table 2). Too few stockholdings may lack diversification (e.g., the Excellent portfolio) and too many does not guarantee lower volatility (e.g., SPY and RSP). This is consistent with Chong and Phillips (2013). The result bodes well for the individual investor, in that a concentrated equally weighted stock portfolio can outperform a well-diversified stock portfolio (Hwang et al., 2018; Farago and Hjalmarsson, 2023) in terms of return and volatility.

**TABLE 1**  
**SUMMARY STATISTICS BY U.S. BUSINESS CYCLE, ESTIMATED DAILY, FEBRUARY 4, 2015 TO MAY 21, 2024**

	Excellent	Very Good	Good	Fair	Poor	All	SPY	RSP
<b>Panel A: Whole Period (2/4/15 - 5/21/24)</b>								
Annualized return	14.36%	13.90%	7.88%	10.63%	7.17%	11.71%	12.84%	10.21%
Ann. standard deviation	21.05%	17.71%	19.25%	20.43%	23.57%	17.77%	17.87%	18.70%
Ratio*	0.6820	0.7847	0.4093	0.5203	0.3044	0.6592	0.7186	0.5459
Maximum	8.76%	8.36%	9.66%	7.82%	11.34%	8.86%	9.06%	10.68%
Minimum	-10.23%	-10.48%	-11.96%	-12.89%	-13.77%	-10.98%	-10.94%	-12.04%
Correlation	0.7738	0.9380	0.8838	0.7848	0.8173	0.9528	1.0000	0.9550
Sample	2339	2339	2339	2339	2339	2339	2339	2339
<b>Panel B: First Period (2/4/15 - 1/31/20)</b>								
Annualized return	15.15%	13.05%	5.03%	14.56%	9.32%	11.05%	11.75%	9.14%
Ann. standard deviation	16.40%	13.74%	13.18%	14.60%	16.50%	13.15%	13.33%	13.37%
Ratio*	0.9238	0.9495	0.3814	0.9971	0.5647	0.8398	0.8817	0.6834
Maximum	0.0673	0.0447	0.0446	0.0509	0.0452	0.0481	0.0505	0.0452
Minimum	-0.0443	-0.0423	-0.0388	-0.0459	-0.0554	-0.0408	-0.0421	-0.0414
Correlation	0.8217	0.9199	0.8794	0.8516	0.8512	0.9615	1.0000	0.9729
Sample	1256	1256	1256	1256	1256	1256	1256	1256
<b>Panel C: Second Period - COVID-19 Recession (2/1/20 - 4/30/20)</b>								
Total return**	-0.26%	-10.23%	-18.45%	-16.42%	-18.49%	-14.07%	-9.85%	-15.06%
Annualized return	-1.06%	-35.51%	-56.35%	-51.76%	-56.45%	-46.00%	-34.40%	-48.50%
Ann. standard deviation	53.75%	55.44%	62.16%	58.01%	66.70%	57.56%	59.56%	64.77%
Ratio*	-0.0198	-0.6405	-0.9066	-0.8923	-0.8462	-0.7992	-0.5775	-0.7487
Maximum	8.76%	8.36%	9.66%	7.82%	11.34%	8.86%	9.06%	10.68%
Minimum	-10.23%	-10.48%	-11.96%	-12.89%	-13.77%	-10.98%	-10.94%	-12.04%
Correlation	0.8958	0.9826	0.9783	0.9250	0.9767	0.9880	1.0000	0.9880
Sample	62	62	62	62	62	62	62	62

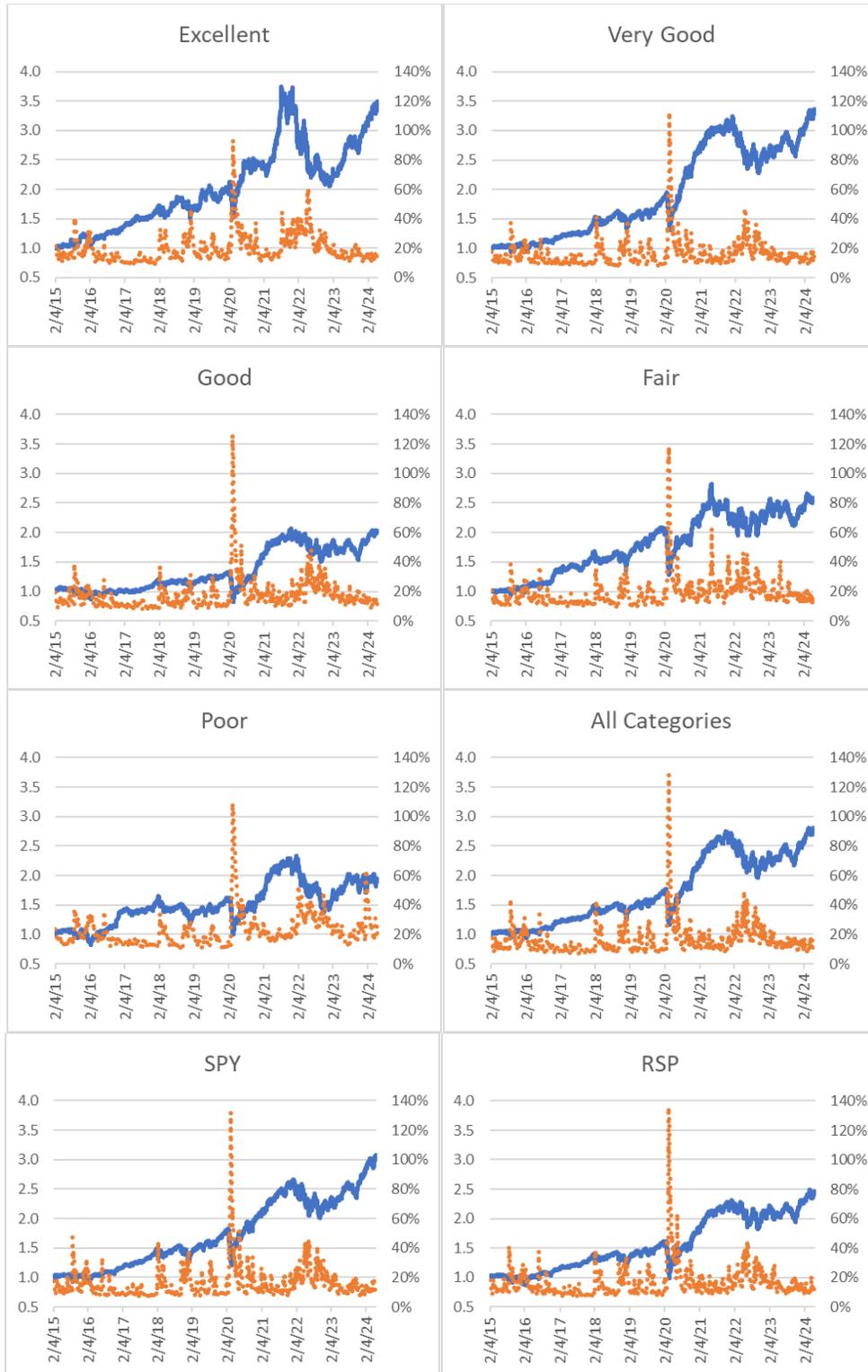
**Panel D: Third Period (5/1/20 - 5/21/24)**

Annualized return	15.76%	19.26%	18.61%	12.13%	10.75%	18.14%	18.59%	17.69%
Ann. standard deviation	22.64%	17.39%	20.07%	22.18%	25.90%	17.66%	17.35%	18.17%
Ratio*	0.6962	1.1073	0.9271	0.5471	0.4149	1.0275	1.0715	0.9736
Maximum	5.75%	4.68%	5.76%	5.49%	7.59%	4.97%	5.50%	5.47%
Minimum	-6.35%	-5.66%	-6.13%	-7.81%	-11.59%	-5.49%	-5.76%	-6.92%
Correlation	0.6999	0.9242	0.8313	0.6787	0.7256	0.9237	1.0000	0.9195
Sample	1021	1021	1021	1021	1021	1021	1021	1021

\* Ratio is the annualized return to annual standard deviation.

\*\* Due to the short period, total return is a more relevant measure.

**FIGURE 1**  
**CUMULATIVE WEALTH (LEFT AXIS) AND CONDITIONAL VOLATILITY (RIGHT AXIS),**  
**ESTIMATED DAILY, FEBRUARY 4, 2015 to MAY 21, 2024**



**TABLE 2**  
**PORTFOLIO SIZE OF RQ CATEGORY PORTFOLIOS**

Start Date	Excellent	Very Good	Good	Fair	Poor	All
2/4/15	7	23	14	12	11	67
2/18/16	6	26	17	13	8	70
2/9/17	13	22	17	10	9	71
3/13/18	8	27	17	9	9	70
3/6/19	2	30	22	12	9	75
7/30/20	5	28	27	11	4	75
5/13/21	7	30	25	6	3	71
5/24/22	4	37	26	7	3	77
5/23/23	6	39	17	5	4	71
Average	6.44	29.11	20.22	9.44	6.67	71.89

Of significance to an individual investor is that the Very Good portfolio's annualized return is accompanied by an annual standard deviation that is lower than those for SPY and RSP despite an average portfolio size of 29.11 (see Table 2). Too few stock holdings may lack diversification (e.g., the Excellent portfolio) and too many does not guarantee lower volatility (e.g., SPY and RSP). This is consistent with Chong and Phillips (2013). The result bodes well for the individual investor, in that a concentrated equally weighted stock portfolio can outperform a well-diversified stock portfolio (Hwang et al., 2018; Farago and Hjalmarsson, 2023) in terms of return and volatility.

#### *Pre- and Post-COVID-19 Recession*

As before, a similar pattern is observed for the Excellent and Very Good portfolios in the first period (see Table 1, Panel B); this time their annualized returns (15.15% and 13.05%, respectively) and return-to-risk ratios (0.9238 and 0.9495) surpassed those of SPY (11.75% and 0.8817) and RSP (9.14% and 0.6834). Somewhat surprising is the Fair portfolio, with an annualized return of 14.56% and ratio of 0.9971, respectively ranked second and first among all portfolios. Pre-COVID-19, the Fair portfolio grew at a faster rate than the Good and Very Good portfolios (Figure 1). Such an 'anomaly' was observed by Krueger et al. (2009) when firms with diminished reputations had higher return than firms with improved reputations. Krueger et al. (2009) speculated that "firms with diminished reputations might be making management decisions that enhanced profitability at the expense of positive public perceptions of the firm", while Krueger et al. (2010) attributed this phenomenon to when "a company's reputation for financial success can adversely affect its overall reputation".

In contrast, for the third period, SPY performed exceedingly well (see Table 1, Panel D, and Figure 1). SPY's annualized return (18.59%) was a close second to the Good portfolio (18.61%), with the Very Good portfolio ranked first (19.26%). SPY also registered the lowest standard deviation (17.35%), boosting its ratio to 1.0715, slightly trailing the Very Good portfolio's 1.1073 (with the second lowest standard deviation of 17.39%). This time round, the Excellent portfolio did not deliver a sufficiently high return to counteract its high volatility. Its annualized return of 15.76% was third from the bottom, and its standard deviation of 22.64% was the second highest. The 'anomaly' we witnessed earlier dissipated, with the Fair portfolio registering a lower annualized return and ratio than the Good and Very Good portfolios.

#### *During the COVID-19 Recession*

In the second period (COVID-19 recession), we witnessed a reversal to the upward market trend of previous years. SPY saw a -9.85% total return, with only the Excellent portfolio (-0.26%) experiencing lower losses (see Table 1, Panel C). Due to a short second period, we consider total return to be a more relevant measure of performance. The Very Good portfolio came in third, with a total return of -10.23%.

The remaining portfolios had losses ranging from -14% to -19%. Across the board, standard deviations were exceedingly high, in the mid-50% to the mid-60%, with conditional volatilities (Figure 1) ranging from 93% (for the Excellent portfolio) to 136% (for RSP).

### Maximum Drawdown

One may have noticed a conditional volatility spike whenever there's a sizeable stock price decline (see Figure 1), otherwise known as volatility asymmetry. Hence, the conditional volatility provides the timing but not the magnitude of the price drop. As such, we rely on maximum drawdown (MDD), i.e., the largest decline in a portfolio's value from peak to trough, a risk measure widely used in practice.

**TABLE 3**  
**MAXIMUM DRAWDOWN**

	Excellent	Very Good	Good	Fair	Poor	All	SPY	RSP
MDD	-45.06%	-31.72%	-38.03%	-38.54%	-40.84%	-34.65%	-33.72%	-39.04%
Start date	9/8/21	19/2/20	12/2/20	26/12/19	14/1/22	19/2/20	19/2/20	12/2/20
End date	28/12/22	23/3/20	23/3/20	18/3/20	3/11/22	23/3/20	23/3/20	23/3/20

The MDDs (see Table 3) for the Excellent and Poor portfolios were severe (-45.06% and -40.84%), occurring amidst the inflation and interest rate surge of late-2021 to late-2022, while the rest had MDDs during the COVID-19 downturn, when SPY plummeted 33.72%. The Very Good portfolio had the lowest MDD (-31.72%). If indeed “a fund's past MDD has unique predictive power with respect to subsequent performance”, then this augurs well for the Very Good portfolio as “among funds with relatively strong past performance, those with relatively low past MDD outperform those with relatively high past MDD” (Riley and Yan, 2022).

### Risk-Adjusted Return With the Fama-French Model

The final assessment is via risk-adjusted return against a set of factors that has a tendency of explaining sources of return. The Fama-French factors were indeed sources of added value for all portfolios and benchmarks with their statistically significant factor loadings (see Table 4). Momentum, though, was not applicable to the Excellent and Very Good portfolios. In addition, the high adjusted R2 for the “All” portfolio and benchmarks suggest that the six factors do explain most sources of return. Despite the positive alphas for the Excellent, Very Good, and Fair portfolios, the alphas were not statistically significant but were economically meaningful and could have a big impact with a high degree of uncertainty (Israel and Ross, 2017). The relatively low adjusted R2 demonstrates that other factors had yet to be accounted for.

From our analysis, it appears that filtering stocks by reputation has valuable information for generating wealth and limiting volatility and risk. On balance, a concentrated equally weighted portfolio consisting of Very Good RQ stocks is a simple strategy worthy of the individual investor's consideration.

**TABLE 4**  
**RESULTS FROM THE FAMA-FRENCH MODEL AND MOMENTUM, FEBRUARY 4, 2015 to MAY 21, 2024**

	Excellent	Very Good	Good	Fair	Poor	All	SPY	RSP
Ann. Alpha	2.66%	1.33%	-2.77%	1.53%	-2.89%	0.14%	-0.07%	-1.34%
Mkt-RF	0.8588 **	0.9252 **	0.9174 **	0.8759 **	1.0207 **	0.9204 **	0.9815 **	0.9728 **
SMB	-0.1447 **	0.0609 **	0.1463 **	0.1417 **	-0.0681 *	0.0691 **	-0.1101 **	0.0940 **
HML	-0.1396 **	-0.0462 **	0.1550 **	0.2347 **	0.3363 **	0.0862 **	0.0128 **	0.1593 **
RMW	0.0771 *	0.1900 **	0.1067 **	-0.1236 **	-0.1620 **	0.0819 **	0.0659 **	0.0741 **
CMA	-0.3688 **	0.1718 **	0.0862 **	0.1783 **	-0.1299 **	0.0556 *	0.0438 **	0.1592 **
MOM	0.0256	-0.0060	-0.0973 **	-0.0496 **	-0.1150 **	-0.0469 **	-0.0111 **	-0.0919 **
Adj. R <sup>2</sup>	0.6567	0.8936	0.8431	0.6934	0.7180	0.9351	0.9956	0.9693

Note: \*  $p$ -value < 0.05; \*\*  $p$ -value < 0.01

## CONCLUSION

The Harris Poll Reputation Quotient (RQ) ranks firms across six dimensions: social responsibility, products and services, emotional appeal, vision and leadership, financial performance, and workplace environment. Choosing equities based on RQ ranking considers the social behavior of firms since social responsibility is one of the attributes weighed by the Harris Poll. This gives an investor a method of considering his/her values in investments without focusing solely on 'green' firms. Further, the dimensions of emotional appeal and workplace environment can help investors avoid firms complicit in human rights violations and oppressive labor practices. Investing in stocks using RQ rankings may help investors make a positive impact rather than just avoiding socially irresponsible firms.

In addition, we find that utilizing the RQ ranking for stock selection is useful on the basis of portfolio risk and return. Equally weighted portfolios constructed with Very Good stocks, more often than not, perform better than the benchmarks. Individual investors can incorporate this simple and effective tool in their investment research. Prioritizing highly ranked RQ firms is a non-quantitative method of identifying favorable assets which may lessen the need to outsource portfolio management.

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