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Research Paper

The Impact of Corporate Reputation on Financial Leverage and Trade Credit[1]

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ABSTRACT

This study examines the relationship between corporate reputation and financing decisions. To align with the research objectives, a sample of 174 companies listed on the Tehran Stock Exchange was selected, covering the period from 1390 to 1401 (Iranian calendar years, approximately 2011–2022). Corporate reputation was assessed using a composite scoring method that incorporated four components: the price-to-earnings ratio, Tobin’s Q, the long-term investment ratio, and firm age. Additionally, inclusion in the Industrial Management Organization’s top 100 company rankings served as an alternative measure of corporate reputation. The primary method for model estimation was multiple regression, employing the generalized least squares (GLS) technique, with the generalized method of moments (GMM) used as a complementary approach. The findings revealed a positive and statistically significant relationship between the corporate reputation score and financial leverage. In contrast, an inverse and significant relationship was observed between corporate reputation and trade credit.

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These results remained consistent when corporate reputation was measured using the Industrial Management Organization’s top 100 rankings. Supplementary tests conducted with the GMM approach further confirmed the robustness of these findings.

INTRODUCTION

In recent years, firm reputation has emerged as a pivotal concept in the fields of marketing, management, and finance, owing to its role in creating competitive advantages and sustaining long-term performance. It has attracted growing attention from the media, researchers, and stakeholders alike (Chun, 2005). Simply put, a company’s reputation can be defined as the public’s perception of the firm. Many managers view reputation as one of the most enduring factors contributing to a firm’s sustainable growth and success (Hall, 1992). Reputation serves as a mechanism to reduce uncertainty for customers, enhance the effectiveness of marketing strategies, and ultimately boost customer satisfaction (Lee & Roh, 2012). Moreover, numerous researchers consider reputation a valuable intangible asset for firms (Wang, 2008; Rindova et al., 2010; Trotta & Cavallaro, 2012). Milgrom and Roberts (1982), employing game theory and the concept of repeated games, demonstrated that reputation emerges from information asymmetry. Asymmetric information about an actor—shaped by general beliefs based on past actions—underpins their reputation. They argued that managers and companies can shape their reputations through strategic actions. By prioritizing actions without formal or explicit contracts, actors can cultivate a reputation for unique qualities, which helps mitigate agency problems and increase profits over time. Since acquiring and maintaining a strong reputation entails costs, it must yield future benefits to justify the investment. Economic theory further suggests that companies with stronger reputations benefit from advantages such as lower financing costs (Diamond, 1989; 1991). A robust reputation acts as a positive signal, indicating that the company prioritizes the interests of its investors. Consequently, firms that take steps to enhance their reputation are rewarded by investors and creditors with more favorable financing terms (Anginer et al., 2015).

HYPOTHESIS

H1: There is a significant relationship between corporate reputation and financial leverage.

H2: There is a significant relationship between corporate reputation and trade credit.

METHODOLOGY

The statistical population of this research consisted of all companies listed on the Tehran Stock Exchange from 2012 to 2023. The selected companies were required to meet specific criteria: their fiscal year had to end on March 29, they needed to maintain consistent fiscal year reporting throughout the research period, and companies operating in financial intermediation industries—such as banks, insurance firms, and investment companies—were excluded. Furthermore, the availability of data necessary for calculating variables was a prerequisite. Ultimately, a total of 174 companies, analyzed as a balanced panel dataset (2,088 firm-years), were included in the study. The data required for variable calculations were sourced from financial statements, accompanying notes, and supplementary financial disclosures. Data analysis was conducted using EViews software, with multiple regression analysis employed to test the research hypotheses.

RESULTS

The findings indicated a significant relationship between corporate reputation and financial leverage. Similarly, a significant relationship was observed between corporate reputation and trade credit. Further analysis using the generalized method of moments (GMM) confirmed that corporate reputation exerts a direct and significant effect on financial leverage, whereas its effect on trade credit is inverse and significant.

DISCUSSION AND CONCLUSION

Corporate reputation reflects a company’s past performance across various domains and significantly shapes its current and future outcomes (Lee & Roh, 2012). The findings of this study suggest that corporate reputation plays a critical role in financing decisions. Specifically, companies with stronger reputations tend to utilize higher levels of financial leverage while relying less on trade credit for financing. These results align with Milgrom and Roberts’ (1982) game-theoretic explanation, which posits that firms initially build a robust reputation to secure future advantages, such as access to low-cost financing. Furthermore, the findings are consistent with signaling theory, which argues that a company’s reputation serves as a signal to external stakeholders about its credibility and customer relationships, thereby reducing information asymmetry and lowering financing costs (Batrancia, Nikita, & Kukis,

2022). Based on these insights, it is recommended that companies treat reputation as a strategic asset. Cultivating and sustaining a strong reputation yields significant long-term benefits, including reduced financing costs and improved profitability.

Keywords: Corporate Reputation, Financial Leverage, Trade Credit, Generalised Methods of Moments.

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