

Corporate social responsibility and financial performance – the role of corporate reputation, advertising and competition

Corporate
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responsibility

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Makhmoor Bashir

*Department of Business Administration, College of Business and Economics,
Qassim University, Buraydah, Saudi Arabia*

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Abstract

Purpose – The research on corporate social responsibility (CSR) and firm performance (FP) has seen a surge over the years. However, the role of corporate reputation (CR), advertising strategy and market competition is still unclear. The purpose of this study is to consider this gap and test an integrative model of CSR-FP, in the context of India.

Design/methodology/approach – The data for CSR expenditure were collected from the annual reports of the selected companies. CR was captured using the ranks of Fortune India 500, Business Standard 1,000 and Economic Times 500. The financial data were collected from CMIE (Prowess) database.

Findings – Results of structural equation modeling (SEM) revealed a significant relationship between CSR expenditure of the firm and its reputation; but no relationship between CR and performance. When CR increases, the performance of a firm may not improve. Competitive intensity (CI) had no statistically significant role in the CR-FP relationship for performance. Results suggest that reputed firms perform well despite high competition within an industry. High reputation is effective in improving performance irrespective of competition. CI has a positive impact in the reputation–performance linkage. Advertising intensity (AI) played a significant moderating role in the CSR intensity and CR relationship.

Originality/value – This research represents an added value for the literature on CSR by highlighting the importance of CR, advertising strategy and market competition in the relationship between CSR and FP. The findings have several implications for theory and practice, which have been discussed in the study.

Keywords Corporate social responsibility, Corporate reputation, Advertising, Competition, Financial performance

Paper type Research paper

1. Introduction

The role of business in society has undergone sea changes over the past few decades. The role of business is no more confined to making profits but also giving back a part of such profits to society. Corporate social responsibility (CSR) is the organization's efforts to enhance the socioeconomic welfare over and above its profit-making motives and a socially responsible firm catering to the best interests of all its stakeholders prospers in the long run (Pradhan, 2016). The concept of responsible business is a global phenomenon, and CSR is now a buzzword both in academia and in the business world. Firms are socially involved for very different reasons: to meet stakeholder demands; to gain appreciation, positive image and reputation; differentiation, etc (Pradhan, 2016; Sen *et al.*, 2006; Maignan and Ferrell, 2001).



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Irrespective of the reasons, CSR has been evidenced to help increase the profitability of a firm and can be considered as an investment.

There are a plethora of studies that have studied the relationship between CSR and firm performance (FP) (AL-Shammari *et al.*, 2021; Otto *et al.*, 2020; Zhou and Ki, 2018). Despite extensive research on the CSR-FP relationship, there is high ambiguity in the nature of the relationship (Aupperle *et al.*, 1985). Some research has highlighted that the relationship is positive, and effective CSR can give firms a competitive advantage (Bernal-Conesa *et al.*, 2017; Farooq *et al.*, 2017), whereas others argue that the agency cost incurred by CSR has the potential to damage performance (Ting and Yin, 2018; Barauskaite and Streimikiene, 2021). This leads one to question other factors that may play a role in the relationship. Some scholars believe in a direct linkage in CSR-FP, while others stress an indirect relationship (Hsu, 2012a, b; Lai *et al.*, 2010a, b). Previous empirical studies on CSR have tried to find a relationship between CSR and profitability (Quéré *et al.*, 2018; Aupperle *et al.*, 1985) but did not address potential consequences of CSR, such as corporate image (Hoeffler and Keller, 2002), customer perceptions (Pradhan, 2018); corporate reputation (CR) (Hsu, 2012a, b), customer satisfaction (Hsu, 2012a, b), etc. that may affect the performance of a firm indirectly. Therefore, this study has attempted to fill this gap in the CSR-FP relationship.

This study makes several contributions to the research on CSR and FP relationship. First, we contribute to the existing empirical research on CSR and FP (Al-Shammari *et al.*, 2021; Otto *et al.*, 2020; Zhou and Ki, 2018; Pradhan, 2016). We broaden the scope of CSR research, which has mainly focussed on the link between CSR-FP. Second, there are other factors, like advertising strategy and competitiveness of the market, that can influence the relationship as well (Pradhan, 2016; Neville *et al.*, 2005). The same phenomenon has been observed in the context of emerging economies as well. In India, factors such as the government, nongovernment organizations (NGOs) and social activists (Pradhan, 2016, 2018; Mishra and Suar, 2010) influence CSR. Third, we have studied CSR in the Indian context. The majority of the CSR studies have been conducted in the context of developed nations. This study has been conducted in the Indian context due to its uniqueness in the country. CSR attracted the attention of managers in India post (Companies Bill, 2013), which mandated firms to invest 2% of their net profits (NPs) in social activities. Therefore, this study looks into India as the subject of its study. This study analyses the role of CR, competition and advertising in influencing the profitability of firms involved in CSR.

The paper is structured as follows: we begin by providing an introduction and motivation behind conducting this study. The second section deals with a review of literature and hypothesis development followed by a proposed theoretical model. The fourth section discusses the process used to analyze data using structural equation modeling (SEM). The fifth section provides the results and discussion. The sixth and final section provides the theoretical and managerial implications and concludes after providing the limitations and future scope of research.

2. Literature review and hypothesis development

The literature provides expansive studies on CSR but fails to provide any unified definition of the concept. As per Moir (2001, p. 17), CSR considers numerous issues, such as marketplace (customers and suppliers), human rights, employees, community, corporate ethics and environment. Businesses contribute optimally to society when they are efficient, profitable and philanthropic. The concept captures the economic, social and environmental motives of an organization while being a good corporate citizen (Lee *et al.*, 2009). Firms that are profitable can easily engage in social activities as compared to their less profitable counterparts. Generally, larger entities that are widely known to the public tend to perform CSR activities and inform about such activities publicly. This provides a firm with benefits, like improved

brand image, innovation, efficiency, CR (Schwaiger, 2004) and customer and employee satisfaction. Consumers tend to believe that responsible firms provide superior quality products (Maignan and Ferrell, 2001). Potential employees are attracted to such firms as CSR is an indication of organizational attractiveness. Existing employees tend to identify themselves with firms (Aaker, 1994) subsequently creating superior value for the firm (customer loyalty, positive word-of-mouth, etc.) (Sen *et al.*, 2006; Hoeffler and Keller, 2002).

2.1 CSR intensity and corporate reputation (CR)

CR is “a collective representation of a company’s past actions and future prospects that describes how key resource providers interpret a company’s initiatives and assess its ability to deliver valued outcomes” (Fombrun, 1996, p. 293). It is the “overall impression reflecting the perception of a collective stakeholder group” (Lai *et al.*, 2010a, b, p. 458). CR is a function of identity, desired identity and image of a firm (Chun, 2005; Davies and Miles, 1998) and is easily influenced by the quality of management and demonstration of social responsibility. It is the stakeholders’ evaluation of the credibility of a firm’s projection (Chuah *et al.*, 2022; Neville *et al.*, 2005) and includes perceptions of an organization formed through information conveyed through interpersonal communication and advertising (Dalla-Pria and Rodríguez-de-Dios, 2022; Pradhan, 2016). Firms can therefore influence their reputation by effective social communication. A good reputation can be a source of competitive advantage by attracting potential investors (Fombrun, 1996). CSR activities help in developing intangible assets, such as CR. CSR activities can improve CR through various marketing initiatives (Dalla-Pria and Rodríguez-de-Dios, 2022; Khan *et al.*, 2021; Ullah *et al.*, 2020; Özcan, and Elçi, 2020). Therefore, we hypothesize that

H1. CSR intensity has a positive effect on CR.

2.2 Corporate reputation and firm performance

CR is considered to be an intangible asset that differentiates a firm and encourages customers to pay a premium and repurchase (Pradhan, 2016, 2018). FP signifies performance indicators associated with a firm’s objectives (Le, 2022). So, FP is determined based on the organizational goals (Vij and Bedi, 2016). For this study, we have considered return on capital employed (ROCE), NP ratio and market-to-book ratio as indicators of financial performance. Numerous studies have looked into the reputation and performance linkage, but the results remain inconclusive (Lee and Jungbae Roh, 2012). Highly reputed firms possess the ability to charge a price premium for their products and services (Fombrun, 1996). Most firms, therefore, spend highly on improving their CR with anticipation that it will enhance their performance (Roberts and Dowling, 2002; Singh and Misra, 2021). CSR is one of the factors that helps improve performance through enhanced reputation (Fourati, and Dammak, 2021). Firms that strictly abide by social standards form an impression regarding their CSR commitments, which improves their CR and subsequently its performance (Pradhan, 2016; McGuire *et al.*, 1988). Sanchez and Sotorrio (2007) concluded that companies gain limited profits from high reputation. By using CSR strategically, an organization improves its CR, which affects customers positively, purchase intentions, supplier choice and finally supporting higher profits (Neville *et al.*, 2005). Firms with good reputation have higher word-of-mouth recommendations, enhanced customer trust and loyalty (Su *et al.*, 2017), customers’ repurchase intentions (Foroudi, 2019), higher revenues (Xie *et al.*, 2017) and higher FP (Liu *et al.*, 2022; Nguyen *et al.*, 2021). Furthermore, studies have also shown that positive influence of environmental, social and governance disclosures on firm value (Aboud and Diab, 2018). Additionally, firms that are ethical and responsible gain competitive advantages in terms of image and reputation, which leads to improved performance (Nguyen *et al.*, 2021). Therefore, we hypothesize that

H2. CR has a positive impact on the performance of a firm.

2.3 CSR and competitive intensity (CI)

Competition is important from a strategic view as it can impact performance. It is shown to have an impact on survival (Barnett, 1997), firm growth, collaboration (Ang, 2008) and innovation (Schumpeter, 1942; Liu et al., 2021). CI is the “degree of competition among co-operating partners” (Ramaswamy, 2001, p. 990) in a market. It has also been considered “the extent of tension imposed by the firm’s rivals that might solicit strategic response” (Ang, 2008). Simplistically, the CI of the industry is nothing but the market structure. A monopolistic market structure simply means there is low competition in the market, while a perfectly competitive market reflects higher competition. When firms undertake CSR activities, consumers have a positive impression of the firm, and they tend to admire the firm (Sen and Bhattacharya, 2001). The strategic view of CSR believes that firms in highly competitive environments need to invest in social causes for visibility (Dupire and M’Zali, 2018; Aziz et al., 2021; Woo et al., 2021). CSR helps reduce extra-financial risks, which help in reducing the cost of capital (El Ghouli et al., 2011). As low capital cost is a significant source of competitive advantage, firms use CSR to improve their competitive position, build capabilities and attain differentiation, which leads to positive performance (Porter, 1980; Zahid et al., 2021). Value of a firm through reputation is a combined effect of several factors, such as competitive intensity (CI), differentiation strategy, etc. Hence, we hypothesize that

H3. CI has a moderating role in the relationship between CR and a firm’s performance.

2.4 The moderating role of advertising intensity (AI) in the CSR-FP relationship

CSR is known to improve the CR of a firm. Firms communicate their CSR activities through a formal reporting process as well as advertising (Pradhan and Roy, 2011; Du et al., 2010), which tends to improve the CR of a firm (Odrizola and Baraibar-Diez, 2017; Ajayi and Mmutle, 2021). The CSR-CR-FP linkage is also influenced by the firm’s initiatives to influence such reputation. CR can and should be managed (Weiss et al., 1999). So, the ability to manage CR affects the extent to which CSR improves the CR. Firms should plan how to manage them strategically (Mahon and Waddock, 1992). Organizations have been known to influence significant stakeholders through effective advertising. It can be both proactive (initiatives to enhance the reputation) and defensive (minimizing prior negative image/reputation) (Bromley, 2000). Advertising has been proven to be effective in improving the profitability of a firm (Paton and Williams, 1999). Market-oriented CSR advertising/communication also improves customer perceptions positively, which subsequently leads to higher profitability (Dai and Reich, 2022; Yang and Basile, 2021; Roberts and Dowling, 2002). When firms communicate CSR activities to relevant stakeholders, it improves CR and subsequently performance. As advertising affects the CR and performance of a firm, we hypothesize that

H4a. Advertising intensity (AI) of a firm moderates the relationship between CSR and CR.

H4b. AI of a firm moderates the relationship between CR and financial performance.

2.4.1 Proposed Model. The reputation of a firm is created in the short run, but is formed and could change over a period of time. Thus, the bond between CSR, CR and FP is a continuous process. Based on the above literature and hypotheses formed, we propose a model (Figure 1) and test it empirically.

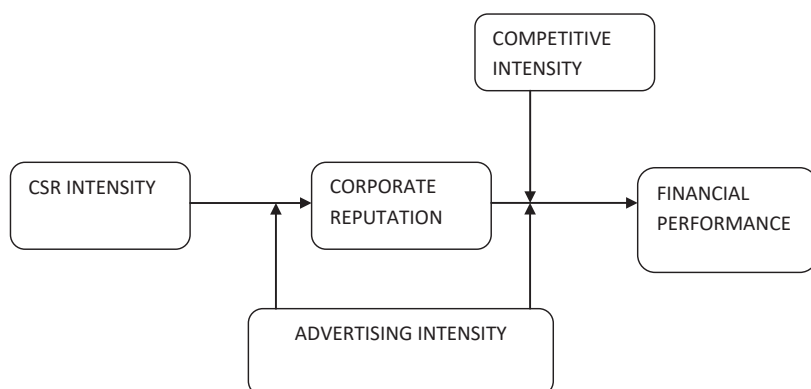


Figure 1.
Proposed model

3. Methodology

3.1 Variables

CSR intensity: We use the term CSR intensity here which is the extent to which a firm uses its current year's profits in CSR activities in the following year (as used by Pradhan, 2016). CSR intensity is measured as the ratio of a firm's expenditure on CSR over the operating profits of the previous year (as suggested by Paton and Williams, 1999; Pradhan, 2016). CSR expenditure takes place only when there are profits in the previous year, so the lag was taken.

Corporate reputation: Studies analyzing CR and CSR in the US context have used data available by the Fortune 500 list (Dutton and Dukerich, 1991; Zadek et al., 1997). To analyze firms in the Indian context, we used ranks provided by Indian ranking agencies, such as *Fortune India 500*, *ET 500* and *Business Today 500*. To achieve accuracy, a standardized reputation rank was created going for a nonlinear principal component analysis amongst the rankings provided by *Fortune India 500*, *ET 500* and *Business Today 500*. This resulted in an objective score.

Advertising intensity was measured by the ratio of advertising expenditure of a firm over operating expenditure (Paton and Williams, 1999). Endogeneity was removed by using a one-year lag (as followed by Paton and Williams, 1999; Pradhan, 2016). The advertising expenditure was standardized to remove any existing industry effects.

Competitive intensity was captured using the Herfindahl–Hirschman Index (HHI) (used by Ho et al., 2012; Jo and Harjoto, 2012). It is a numerical measure of concentration calculated by taking the squares of market shares of all firms and then adding the squares. The formula for HHI, which is used in this study, is as follows: $\sum_{i=1}^n (MS_i)^2$.

Financial performance was measured using ROCE, NP ratio and market-to-book ratio. The final sample was collected from across 36 industries as classified by the CMIE (Prowess) database.

3.2 Data sources

The study focussed on a neutral third-party perspective rather than the managerial or customer perspective commonly used in CSR studies. To remove bias, published audited data were used for the analysis. CSR Expenditure (2019) – the data for CSR expenditure were collected from the annual reports of the selected companies. Corporate Reputation (2020) – the data for CR were captured using the ranks of *Fortune India 500*, *Business Standard 1,000*, and *Economic Times 500*. Financial Data (2017–2020) – the financial data were collected from

CMIE (Prowess) database. To remove the effect of any anomalies and portray the true picture of the business, the average value of three years was used (as suggested by [Rajan and Zingales, 1995](#)).

4. Data analysis

4.1 Industry identification

The industries were classified into 47 groups as per the Fortune India 500 list. The industries finally used for analysis were as follows: airlines, auto, auto ancillaries, basic materials, spirits, capital goods, cement, coal, consumer durables, diversified, pharmaceuticals, construction, fertilizers, fast-moving consumer goods (FMCG), agriproducts, jewelry, hotels and restaurants, infrastructure development, iron and steel, leather, lubricants, metals and mining, drilling services, oil and gas, packaging, paper, plastic products, power, real estate, retail, ship building, shipping services, storage batteries, sugar, tea and coffee, telecommunication, textiles and garments, and tyres and tubes.

4.2 Data analysis and results

SEM was used for data analysis. Before testing hypotheses, common method variance was assessed. Path analysis using SEM was run to find the influence of CSR intensity on CR and FP measured by NP, price-to-book ratio (PBR) and ROCE. The moderating effect of advertising intensity and competition was also tested using the framework.

4.2.1 Confirmatory factor analysis. We checked the model fit indices using Amos 23. Taking a cue from the suggestions of [Hair et al. \(2010\)](#), we used only three model fit indices (i.e. χ^2/df , CFI and RMSEA) to avoid redundancy. The results suggested a satisfactory model fit (i.e. $\chi^2/df = 2.60$, CFI = 0.927 and RMSEA = 0.056) ([Hair et al., 2010](#)). Next, the convergent validity of the measures was established by measuring the average variance extracted (AVE) of all the factors in the measurement model. The AVEs of all the constructs were greater than 0.50, which provides ample evidence of convergent validity ([Fornell and Lacker, 1981](#)). Furthermore, discriminant validity was established by comparing the MSV with the AVE of each construct ([Table 1](#)). MSV values for each construct were lower than the AVE values, which gives evidence about discriminant validity ([Fornell and Lacker, 1981](#)).

4.3 Hypotheses testing

As the model fit indices of the framework were found to be satisfactory, it was statistically relevant to test the hypotheses proposed in the framework. The results of the hypothesis testing for all the three dependent variables of the study have been presented in [Table 2](#).

5. Results

There was evidence of a statistically significant relationship between CSR expenditure of the firm and its reputation (CR) ($\beta = 8.1$; $p = 0.02$) when analyzed using NP as the dependent

Table 1. Composite reliability (CR), average variance extracted (AVE) and maximum shared variance (MSV)

	CR	AVE	MSV
CSR intensity	0.82	0.58	0.54
Corporate reputation	0.91	0.59	0.52
Advertising intensity	0.80	0.57	0.51
Competitive intensity	0.79	0.57	0.52
Financial performance	0.78	0.55	0.50

variable. So, high expenditure on CSR activities results in higher CR. The findings are similar to several past studies (Lai *et al.*, 2010a, b; Hsu, 2012a, b; Khan *et al.*, 2021; Ullah *et al.*, 2020), which came up with a positive relation between CSR and CR. Keeping PBR as the dependent variable, it was observed that there was a significant relationship between CSR and CR ($\beta = 8.1; p = 0.02$). ROCE as the dependent variable came up with similar results ($\beta = 8.1; p = 0.02$). These three sets of analyses revealed that high CSR expenditure tends to improve its CR. So, we accept H1.

Results reveal a positive but statistically insignificant relationship between CR and FP. When CR increases, the performance of a firm tends to improve. The relationship between CR and PBR is higher ($\beta = 0.09; p = 0.34$) compared to CR and ROCE ($\beta = 0.06; p = 0.5$) and CR and NP ($\beta = 0.01; p = 0.68$). Though the results suggest a positive relationship, we cannot conclude that an increase in CR of a firm, performance (measured in terms of PBR, ROCE and NP) tends to improve. This is analogous to findings by Wood and Jones (1995), Clarkson (1995), Roberts and Dowling (2002), Pradhan (2016). This study failed to find a statistically significant relationship between CR and performance. One can argue that reputation is built over years, and the effect of such reputation may be witnessed over a period of time, not instantly. So, we do not find enough evidence to accept H2. CI had no statistically significant role in the CR-FP relationship for any of the three measures of performance (NP – $\beta = 0.01; p = 0.46$; PBR – $\beta = 0.02; p = 0.9$; ROCE – $\beta = -0.06; p = 0.68$). Results suggest that reputed firms perform well despite high competition within an industry. A high reputation is thus effective in improving performance irrespective of competition. Though insignificant, CI plays a positive role in the reputation–performance linkage. Reputed firms have the added advantage of being differentiated and reputation, hence decreasing the effect of competition on the firm.

AI was found to have a significant moderating role in the CSR intensity and CR relationship ($\beta = 8.9; p = ***$) in the model using NPs, PBR as well as ROCE. Firms that spend large amounts on advertising have better chances of improved reputation (as found by Park (2017), Greening and Gray (1994), Shimp (1997), Bromley (2000), Roberts and Dowling (2002)). Hence, investing in advertising has positive benefits as far as reputation is concerned. The study however failed to find any significant effect of advertising in the CR–performance linkage (NP – $\beta = 0.01; p = 0.85$; PBR – $\beta = 0.15; p = 0.33$; ROCE – $\beta = 0.03; p = 0.87$). This fails to conform to prior studies that have established that advertising improves the performance of a firm (Chauvin and Hirschey, 1994; Conchar *et al.*, 2005). Though advertising improves the reputation of a firm, it fails to improve the performance of such highly reputed firms. This can be justified by arguing that highly reputed firms perform well on their own and need no CSR advertisement to boost their sales or performance. So, reputed firms fail to make any profits by advertising.

	Model 1: NP		Model 2: PBR		Model 3: ROCE	
	β -value	p -value	β -value	p -value	β -value	p -value
CSR_I \rightarrow CR	8.1	0.02	8.1	0.02	8.12	0.02
AI \rightarrow CR	0.97	***	0.9	***	0.97	***
CSRI_AI \rightarrow CR	8.9	***	8.9	***	8.98	***
CR \rightarrow FP	0.01	0.68	0.09	0.34	0.06	0.5
CI \rightarrow FP	-0.04	0.57	0.04	0.8	-0.27	0.05
AI \rightarrow FP	0.01	0.81	0.14	0.3	0.01	0.94
CR_AI \rightarrow FP	0.01	0.85	0.15	0.33	0.03	0.87
CR_CI \rightarrow FP	0.01	0.46	0.02	0.9	-0.06	0.68

Table 2.
Results of hypothesis testing

6. Discussion and conclusion

This study tried to address the burgeoning role of CSR in the Indian context. Globalization brought in several legislations, stakeholder groups and customers who had a different set of expectations and demands. This was one of the major reasons why Indian firms shifted their stance from passive philanthropy to active involvement. The amended legislation, i.e. The (Companies Bill, 2013) was another milestone and a central force that mandated Indian firms to spend on CSR (if they met the criteria). From a strategic viewpoint, one can argue that companies should now reconsider their CSR spending to earn sustained growth. Despite its significance, CSR studies focusing on image, reputation, etc. in the Indian context, are few (e.g. O'Connor and Assaker, 2022; Aparna and Amilan, 2022; Bihari and Pradhan, 2011; Pradhan, 2016). CSR has its potential benefits. It helps a firm in differentiating itself, improving its image and reputation, employee satisfaction and motivation (Schwaiger, 2004). It plays a role in improving credibility amongst its significant stakeholders (Pradhan, 2016, 2018). The three sets of analyses provided interesting insights. Intuitively, one can say that high spending on CSR helps in improving its reputation, and the findings confirm the same. So, from a practitioner's perspective, firms can confidently spend on CSR activities for higher reputation and consequent benefits. The study failed to find any significant impact of CR on performance. The literature, however, suggests that improved reputation is a source of sustained competitive advantage (Porter, 1980, Porter and Kramer, 2006; Pradhan, 2016). Advertising also plays a major role in improving the reputation of a firm. The results suggested that communicating social activities tends to improve the reputation of a firm. Competition has no significant impact on performance as highly reputed firms tend to make profits despite the high CI.

6.1 Theoretical implications

The study has several theoretical contributions. First, this is one of the few studies that has linked CSR with CR and FP. Most of the studies conducted have studied the direct impact of CSR on other variables. This study contributes to the existing body of literature by proposing an exhaustive model capturing several variables. Customers across industries have a varied set of expectations from firms in terms of their social responsibility. This affects CR and consequently financial performance. This seemingly simple relationship is augmented in the presence of competition and advertising. Second, this study tries to generalize the model by addressing the role of CSR across several industries in the Indian context. Third, this study was conducted a few years after the Companies Act 2013 was implemented. During this time, a lot of Indian firms started spending actively in CSR to fulfill the regulatory requirements. This study contributes to the existing body of literature by looking at the impact of CSR on performance, post the legislation. As per the knowledge of the author, there are very few studies that have made efforts to do so.

6.2 Managerial implications

In terms of managerial contributions, the study certainly provides significant observations for practitioners. Firms spend highly on CSR activities to improve their reputation and make sustained profits. It is therefore imperative to understand reputation intrinsically to develop strategies to affect stakeholder perceptions of the firm. The study also looked into the significance of advertising in managing reputation and found that CSR communication does positively affect their reputation. So firms should invest in CSR wisely and communicate it to relevant stakeholders. Managers need to decide amongst issues whether to look into stakeholder demands and whether to publicize their socially responsible efforts. Probing into these issues would provide an insight to managers on the significance of CSR on reputation and profitability. The findings of this study have a strategic implication as firms need to reconsider CSR spending for sustainability.

6.3 Limitations and future scope of the study

This study has few limitations that persevere in studies using reported data. Data were collected from 36 industries (as listed in Prowess), as we accounted for firms that were in the Fortune India 500 and the other ranks considered. This led to the exclusion of data from a lot of firms. As we considered highly reputed firms for this study, there are chances that they are less likely to be affected by other factors, such as competition, advertising, etc. Including firms that are not included in any lists may give different results altogether. An industry-wise analysis would help managers from that particular industry significantly to look into the issue and provide them with alternatives. A qualitative approach may be used to gain other insights and explain a certain phenomenon that cannot be captured empirically. So, future studies can be conducted on these lines. As reputation takes a long time to grow, a longitudinal study would provide interesting insights.

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About the author

Dr Makhmoor Bashir is currently working as an Assistant Professor of Business Strategy at the college of business and economics (AACSB Accredited), Qassim University. His recent research has been published in international journals of repute such as *Journal of Travel Research*, *Management Decision*, *Studies in Higher Education*, *Education and Information technologies*, *Corporate Reputation Review* and *International Journal of Innovation Science*, etc. Dr Bashir has also presented his work at many international conferences, such as the Strategic Management Society and North American Marketing Society for Education in India. He has developed teaching cases on Uber, Airbnb, Xiaomi, Spice Jet, Connect Broadband, etc. Dr Bashir is also the reviewer for the *International Journal of Hospitality Management* (Elsevier) and *Journal of Modelling in Management* (Emerald). Dr. Bashir has also received an outstanding reviewer award in 2018 from the *International Journal of Hospitality Management*. His research interests include business model innovation, competitive advantage, technological developments and knowledge hiding. Makhmoor Bashir can be contacted at: m.dar@qu.edu.sa

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