

# THE INFLUENCE OF CORPORATE REPUTATION AND MARKET COMPETITION ON COMPANY'S GROSS PROFIT

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## Abstract

*To have a profitable business you have to make a big effort. There are two important things that can influence the profitability of a company: the rivalry among stakeholders or market competition and an important intangible asset, corporate reputation. In this paper I will develop a study about how reputation and competition influence the market position of an important cosmetics business from Romania.*

**Keywords:** corporate reputation, competition, gross profit, trend, time series.

## Introduction

Corporate reputation refers to the perception of a person on certain intentions or rules. It can explain the implication of stakeholders in repeatedly actions in conditions of uncertainty. Competition is the confrontation from different economical agents which wants to reach their interests. Competition has a significant growth at macroeconomic and microeconomic level, determines the development of the market and plays an important role in economical and social life as well. Reputation is an important element which determines the competitive position of a company. A good reputation determines the competitive advantage of a company.

In this paper I will speak about the influence of reputation and market competition on gross profit of a company and I will do a case study on Avon Company. At the beginning I will make a short review on corporate reputation and reputation. After this I will put in discussion a way to quantify corporate reputation. In the third part I will speak about Avon's history and her reputation. In the end I will make a study on Avon's gross profit.

## A short review on corporate reputation and competition

Corporate reputation is an intangible asset defined as the firm value that exceeds the physical asset. A Latin Maximum says that a good reputation worth more than money. Reputation mirror expresses firm performance over the last customer confidence and business partners and also its promise for the future in an uncertain environment which is in continuously changing. This determines the stakeholder's credibility and determines their decision to continue or not working with the company in question. Reputation can be defined as a distribution of opinions about an entity<sup>1</sup> or as an interaction among and between business partners over which the company has no direct role or not investing<sup>2</sup>. Also, reputation is the result of past actions<sup>3</sup>, the result of repeated actions and of the experience gained<sup>4</sup>, and that element that will determine achievement expectations by comparing the company with competitors<sup>5</sup>.

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<sup>2</sup> Mahon, J.F., "Corporate reputation: a research agenda using strategy and stakeholder literature", *Business and Society*, vol 41, no4, 2002.

<sup>3</sup> Herbig, P., Milewicz, J., The relationship of reputation and credibility to brand success, *Journal of Consumer Marketing*, vol 10, no 1.

<sup>4</sup> Flatt, S.J. and Kowalczyk, S.J., Do corporate reputations partly reflect external perceptions of organizational culture, *Corporate Reputation Review*, vol 3, no 4.

<sup>5</sup> Roberts, P.W. and Dowling, G.R., Corporate reputation and sustained superior financial performance, *Strategically Management Journal*, vol 23, no 1.

Reputation is seen as "an overall assessment of their impact on society stakeholders-time"<sup>6</sup> or on firm valuation by business partners. "Reputation is how people feel about the organization, taking into account the experience and networking with various information available from different people but also through the media"<sup>7, 8</sup>. Bromley<sup>9</sup> believes that reputation is a social impression, a consensus about what is considered a firm will behave in a given situation. Fombrun<sup>10</sup> says that reputation is based on a set of beliefs of a community about the company's ability and about her desire to meet the interests of different partners.

The public constructs his relation with a certain company based on perceptions results on his direct experiences with companies products, investments, clients services, employment; based on what the company says about herself by advertising, public relations, marketing and social responsibility; based on what other people like media, experts, leaders, family/ friends says about the company. This experience has different impact about respondent perception according the company.

Whether we are talking about economic or social life, competition plays an important role as an element providing a foothold situation of the individuals. Also, it ensures the functioning and development of different markets. We can say that the presence of competition is a positive factor if we see a significant increased performance at macroeconomic and microeconomic level.

In economics, firms that operate in the same market compete for both customers and suppliers seeking supremacy. We deal with direct business competition - they produce identical or similar goods that meet customer needs in the same way and in this case corporate reputation plays an important role in consumer choice; and indirect business competition - firms produce different goods but which satisfy similar customer's needs (for example road and rail or air)<sup>11</sup>.

To gain competitive advantage, companies acting on the same market making significant efforts to build and maintain a reputation.

#### **A way to quantify reputation**

As we said before, reputation is the perception of a person according to a company. Reputation Institute survey (2012)<sup>12</sup> measure the way that respondents interact with the company and determine the way that different experiences determine the level of trust, admiration, respect and good feeling. Based on dates furnished by Forbes Global 200 list about companies revenue, big companies from USA are choose to participate at this study. All of these companies are activating in commercial field and are well known for the public. None of these companies was held by another one in the past. In January and February 2012, 10 198 clients answered about their perceptions about 5 different companies. Every company has at least 100 characteristics assigned by the respondents. The sample was a representative one and respected the criteria about age and gender. The USA respondents were 20.8% from West, 16.3% from Northwest, 24.4% from Midwest and 38.5% from South. The level of education is the following: 3.3% low, 21.2% medium and 75.5% high. The chart from figure 1 shows us the age dispersal of the group:

<sup>6</sup> Gotsi, M and Wilson, A.M, "Corporate reputation: seeking a definition", *Corporate Communication: An International Journal*, vol 6, no 1, 2001.

<sup>7</sup> Wartick, S.L., *Measuring corporate reputation*, *Business and Society*, vol 41, no 4, 2002.

<sup>8</sup> Fombrun, C., Gardberg, N.A., Barnett, M.L., *Opportunity Platforms and Safety Nets: Corporate Citizenship and Reputational risk*, *Business and Society Review*, vol 105, no 1, 2000.

<sup>9</sup> Bromley, D.B., "Psychological aspects of corporate identity, image and reputation", *Corporate Reputation Review*, vol 3, no 2, 2000.

<sup>10</sup> Fombrun, C, "Reputation: Realizing value from the corporate image", Boston: Harvard Business School Press, 1996.

<sup>11</sup> <http://www.comunicatedepresa.ro/concurenta/definitie/>

<sup>12</sup> Forbes 2012, Reputation Institute U.S. RepTrak™ Pulse Study, Top-Line Findings Report Spring 2012.

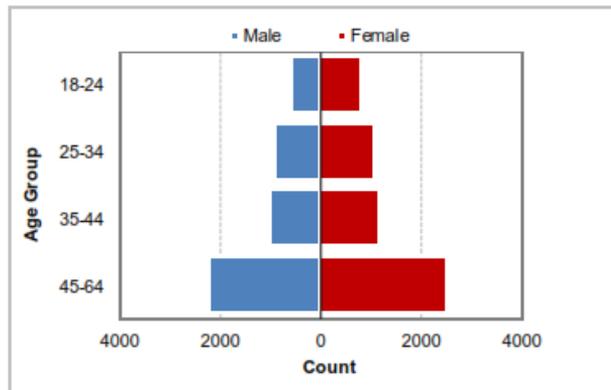


Figure 1. The age dispersal of the respondents<sup>13</sup>

For every company that participates to the study, based on respondents trust, admiration, steam and good feeling we determine the dependent variable – the Reputation Trak-Pulse. In the study, 150 companies were analyzed according to this score. To have a strong reputation, companies have to reach all of next seven dimensions: performance, products/ services, innovation, leadership, citizen, governance and working place. In 2012 the most important dimensions summed 47.3% from reputation components as it follows 17.5% for products/ services, 15.6% for governance and 14.2% for citizen. So, if consumers perceive a company as being very good in these dimensions, than the reputation is very strong. Contrary, perception and support will suffer.

#### A short review of Avon's history and company's reputation

According to 24/7 Wall St.<sup>14</sup>, Insightful Analysis and Commentary for U.S. & Global Equity Investors, Avon is one of the ten brands in USA that will disappear in 2013. This conclusion is based on some major criteria like: a rapid fall-off in sales and steep losses; disclosures by the parent of the brand that it might go out of business; rapidly rising costs that are extremely unlikely to be recouped through higher prices; companies that are sold; companies that go into bankruptcy; companies that have lost the great majority of their customers; operations with rapidly withering market share.

On Avon's official site<sup>15</sup> it says "As the world's largest direct seller, Avon markets leading beauty, fashion and home products to women in more than 100 countries through more than 6 million active independent Avon Sales Representatives". The company<sup>16</sup> was founded in 1996 by book sales David H. McConnell which observed that women are more interested in his free samples of perfume than his books. More, he wanted to offer women an opportunity to earn their own money. At the beginning, the business was door-to-door selling. In 1970 when a big part of people have jobs and nobody was home all day long to answer the door, a brochure that included samples was left on a doorknob. Later, in 1986 were opened some workplace selling where the customers could access more easily the products. Until 1990 the only possibility to earn money within company was by selling the product to the customers. That thing changed with the launch of Avon's Sales Leadership Program. Representatives could earn money, not just by selling, but also recruiting and training other people. In our days when the technology had evolved so much, Avon developed the e-commerce. In 1996 Avon was the world's first beauty company to launch an e-commerce site.

<sup>13</sup> Forbes 2012, Reputation Institute U.S. RepTrak™ Pulse Study, Top-Line Findings Report Spring 2012.

<sup>14</sup> <http://247wallst.com/2012/06/21/247-wall-st-10-brands-that-will-disappear-in-2013/2/>.

<sup>15</sup> <http://www.avoncompany.com/aboutavon/avonmarkets.html>.

<sup>16</sup> [http://investor.avoncompany.com/phoenix.zhtml?c=90402&p=irol-IRHome\\_](http://investor.avoncompany.com/phoenix.zhtml?c=90402&p=irol-IRHome_)

Avon started her activity in Romania<sup>17</sup> in September 1997. Company offered these years the possibility to buy products at an accessible price, delivered directly at home. In a very short period, Avon created a strong image in Romania. In 2002 the company was the leader on Romanian cosmetic market and it maintained the position until now.

Principal competitors<sup>18</sup> of Avon Company on Romanian market are Oriflame Cosmetics, Amway Romania and Zepter. In 2009, the year of economic crises when real estate market and auto market recorded important decreases in sales and profit, the advantage of Avon was on line market. To have a good on line reputation you have to focus on social engagement and outreach, to develop a social media policy, to coordinate social media management with other marketing efforts and to be prepared for crisis communication. It seems that Avon was very careful at all of these tips and in 2009, the year of economical crisis her sales have increased.

### The study about Avon's gross profit

We will study Avon's gross profit<sup>19</sup> (table 1) registered between 2003 and 2011. Based on this data we will predict pre profit registered in 2012 and we will compare the results with the real one.

Year	Quarter	Gross Profit	Year	Quarter	Gross Profit	Year	Quarter	Gross Profit
2003	1	902,1	2006	13	1223,5	2009	25	1341,4
	2	1028,5		14	1303		26	1507
	3	1014,1		15	1243,8		27	1567,5
	4	1288,6		16	1559		28	1963,8
2004	5	1103,7	2007	17	1352,7	2010	29	1511,6
	6	1197,3		18	1407,8		30	1666,4
	7	1133,1		19	1460,1		31	1679,4
	8	1404,1		20	1776,9		32	1964,1
2005	9	1182,9	2008	21	1578	2011	33	1679,3
	10	1253,9		22	1742,7		34	1838,4
	11	1161,5		23	1669,7		35	1764,1
	12	1417,6		24	1750,6		36	1861,2

**Table 1. Avon's Company Gross Profit**

The graphic representation of observed values (blue points) and trend values (red points) shows us a linear growing tendency. We will work in multiplicative model hypothesis for a time series analysis:  $y_t = T_t * S_t * \varepsilon_t$ , where  $T_t$  is the trend,  $S_t$  is seasonality and  $\varepsilon_t$  is the noise.

<sup>17</sup> <http://www.avon-reprezentant.ro/avon-reprezentant-istoria-avon.html>

<sup>18</sup> <http://ycharts.com/>

<sup>19</sup> <http://investor.avoncompany.com/phoenix.zhtml?c=90402&p=irol-IRHome>

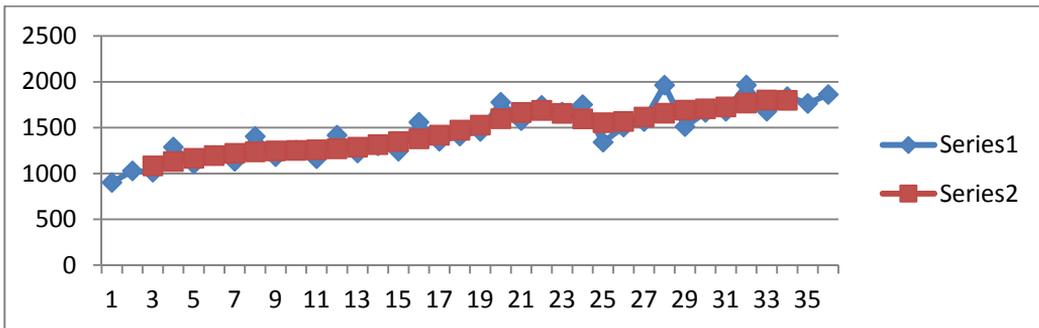


Figure 2. The graphic representation of the quarterly gross profit and of the trend

We will analyse quarter’s values using time series analysis. Using specific calculations we determined the following seasonality factors: 0.93% for the first quarter, 0.99% for the second quarter, 0.95% for the third quarter and 1.13% for the fourth quarter. So, we can say that in the first quarter the gross profit is with 7% under the quarter media, in the second quarter the gross profit is with 1% under the quarter media, in the third quarter the gross profit is with 5% under the quarter media and in the fourth quarter the gross profit is with 13% over quarter media. This can be explained by buyer’s appetite for shopping during holiday season and also by the offers made by the company.

Using least square method we intend to determine trend equation,

$$T_t = \widehat{\beta}_0 + \widehat{\beta}_1 \cdot t$$

So, with the help of a statistical soft called SPSS<sup>20</sup> we determine the following trend equation:  $T_t = 1022,83 + 23,54 \cdot t$ .

Using SPSS we determine that the coefficient of determination is 0,772 which means that 77,2% from the variation of the gross profit is influenced by the time (quarter of the year), the rest of 22,8% being influenced by others factors.

We want to test the significance of the relation between values. For this we will use the Fisher test. The critical value determined with the use of SPSS, which is calculated as the ratio between two sums of squares,  $F_c$  is equal with 114,936. If we want to test the significance for a 99% confidence, for a level of significance  $\alpha = 0,01$ , from Fisher table for 1 degree of freedom at numerator and 34 degrees of freedom at denominator we have  $F_\alpha$  equals with 7,44. Comparing those two values, we see that  $F_c$  is bigger than  $F_\alpha$  which means there is an significant relation between time and gross profit.

Based on this equation we can predict the trend value in every quarter of 2012 that means in quarter noted by 37, 38, 39 and 40. The predicted values are:  $T_{37} = 1893,81$  millions dollars for the first quarter from 2012;  $T_{38} = 1917,35$  millions dollars for the second quarter from 2012;  $T_{39} = 1940,89$  millions dollars for the third quarter from 2012 and  $T_{40} = 1964,43$  millions dollars in the fourth quarter of 2012.

Adjusting the forecast with seasonality factors we obtain the predicted values of gross profit from the fourth quarter from 2012:  $y_{37} = 1761, 2433$  million dollars for the first quarter from 2012;  $y_{38} = 1898, 1765$  million dollars for the second quarter from 2012;  $y_{39} = 1843,8455$  millions dollars for the third quarter from 2012 and  $y_{40} = 2219, 8059$  million dollars in the fourth quarter of 2012.

If we look at real data from Avon’s official site we can see that the gross profits from the four quarters in 2012 were: 1566 million dollars in the first quarter, 1627 million dollars in the second quarter, 1560 million dollars in the third quarter and 1795 million dollars in the fourth quarter. It is

<sup>20</sup> <http://www-01.ibm.com/software/ro/analytics/spss/products/statistics/>.

truth that Avon's general manager Andreea Jung was changed with Sherilyn S. McCoy and this could cause a decreasing of the profit. Another important element is high competitiveness on beauty products market. The profit of the main competitors of Avon like Revlon, Inter Perfumes and Colgate-Palmolive Company grew from 888,8 million dollars, 386,77 millions dollars and respectively 959 million dollars in 2011 to 919,6 million dollars, 414,47 millions dollars and respectively 993,2 millions dollars in 2012. The estimation of gross profit made using time series is closer to the real one.

### Conclusions

According to Reputation Institute survey (2012) Avon Company has the rank 32 in reputation ranking. In 2012 Reputation Trak was 73,13% lower with 0.53 than 2011 when Avon had the rank 37; the rank from 2010 was 50. Based on these data, we can see that even the Reputation Trak is lower in 2012, the company is better placed in reputation ranking. Even we can observe an improvement of reputation 24/7 Wall St. says that Avon Company is one of the brands that will disappear in 2013. Colgate Palmolive Company, one of Avon's competitors had rank 14 in Reputation Institute survey and her Reputational Trak grew from 74,40% in 2011 to 76,14% in 2012. The other two competitors, Revlon and Inter Perfumes are not in the ranking of Reputation Institute. In this case, according to Avon's trend of gross profit and to Reputation Institute ranking we can say that Avon is a strong company that will survive all problems.

In our days Avon is on socialization site like Facebook, Linked in or Tweeter. Also, Avon has an electronic catalogue so you can see and command products online. This development of electronic commerce determined important sales for many companies. Also, the development of on line communication determined important problems for corporate reputation. Not only good news like company offers and promotions but also bad ones are on the internet. In conclusion, company have to be always in alert to stop or to correct every problem that appears.

For on line market, reputation is an important element because you buy something that is intangible. Past experience with the company or with that product, but also the others consumers experience and beliefs is very important in decision to buy and remain loyal.

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