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Image – part of the company culture

(How to incorporate the value of an image into the value-added of a company)

SUMMARY

1. INTRODUCTION

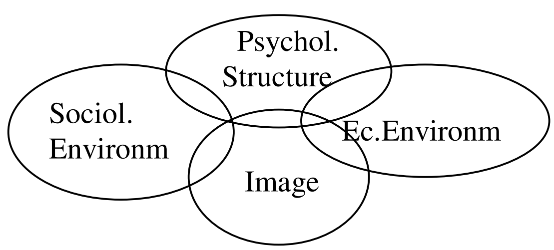
Nowadays the term of "image" became widely used. We may say that we live in a society of image, we are the witnesses of mass-image communication, we make our consumption decision based on images (advertisements) that we see each day on the TV or on billboards, we are interested in the image that an organization has on a market and in what other people think about this. It is obvious that the term of image is fashionable. But it is important also to think about its content. Deeper than it seems at the first sight, image is an even more interesting concept when we refer specifically to the business world.

Willing or not, any company has a specific image on the market where it operates and not only! But this fact is not new. Even the first forms of business, in the antiquity, had an "image". The question that arises is "why we became especially aware of company image just few decades ago?" And "why this subject of discussion remains in the actuality? Does the image of the company means more than we knew before? Does it have special implications on the economic results of a company? And, in case of an affirmative answer, which are these implications? Where is image created? Based on which elements? Which is the economic basement of this term?

2. *THE CONCEPT OF IMAGE* (*DEFINITIONS AND CLASSIFICATIONS*)

We may say that, generally, **the image of a company**[1] has the role of mediator between clients and organizations (*social image of an organization*[2]). It's a *form of communication* between the mentioned subjects; based on this "dialogue", people get information – both subjective and objective - about the company and its products and, in return, the company receives informational inputs about how clients perceive the organization and its products (*psychological approach of the image*) and how they really react to it. It is a wide definition that leads both to the psychological and social approaches of the image. It places the image in the communication[3] field, meaning that, based on the information they receive – directly or indirectly – from the organization, people will have opinions, attitudes, convictions about the company and these ones will influence their behavior from now on.

The social environment and the psychological structure of people are very important in the case of company image creation. Not only people filter through their personal psychological structure the impulses sent – directly or indirectly – by a company, but also, they let themselves influenced by social factors as community that they are living in, family, friends and reference groups. That's why later on, in the chapters dedicated to image measurement, references to sociological and psychological factors will be made! It is obvious that both dimensions – social and psychological – are projected on the global economic environment in which the company is developing its commercial activities and business actions.



[1] The term „company's image" is (sometimes) synonim (in the specialized litterature) with „company reputation"
[2] Halic, Bogdan-Alexandru; Chiciudean, Ion – Analiza imaginilor organizatiilor (Analyse of organizations' image), Comunicare.ro, Bucharest 2004
[3] McQuail; Windahl, Sven – Modele ale comunicarii (Models of communication), Comunicare.ro, Bucharest 2001

Remaining in the same field of communication, we can introduce another concept: "**brand image of companies**". Through communicational means, the company transfers to its public information concerning its *identity*. We should mention that this form of communication is narrower than the first one and is entirely dedicated to the "personality" of a brand. There are many situations when the brand identity is substituted to the product / service brand and vice-versa (Halo Effect)

Starting from the communicational approach of the image (above-presented), it is possible to speak about sub-divisions of the image in order to understand it better and to try to get to its roots, to the core where image itself is formed. We may speak about the following types of image: "Barometer Image (Ib)" – is a result of questionnaires and opinion analyses and it is measured by the level of admiration, trust, confidence that respondents have in the organization; "Power-Image (Ip)" – official public declarations of political leaders; "Non-Power Image (InP) – declarations concerning the company, made by the opposition; "Media image (Im)" – obtained as a result of the analyze of articles and news found in the media; "Opinion-leaders Image (IoL)" – analyze of their opinion transmitted through different communication channels; "Self image of the company (Is)" – analyze of the company's message itself.

Therefore, the **General Image of a Company** = Ib + Ip + InP + Im + IoL + Is[4]

The "*desired image*" should also be mentioned as important concept of the present analyze. It could be different than the real present image and shows the trends, in terms of image, that the company intends to follow.

The problem of company image arises lively in the case of international companies too. A company has an image on the local market, but the management of the image at international level requires more attention and more action. At international level, the company image may be the same as on the local market (it should be a powerful image that people already know and understand!) or it can be a copy of the local image with bigger or smaller modification required by the adaptation to the new environment.

[4] It is really difficult to obtain real and accurate information about all the types of images mentioned. In the real business world, we may speak about „partial images".

3. MEASURING COMPANY IMAGE

So far, categories of terms connected with image where identified. Image remained in the dimension of the communication process[5].

Models

There are different models that help to "measure" the company's image[6]. Just some examples will be given!

Media analysis: It's a model helping to determine the image of the company through written medias (revues and newspapers). The principle is quite easy. The company that we are going to analyze is called company X. We consider the period of time during which we intend to "measure" the image[7]. Marks from –5 to +5 will be given to attributes concerning the company, used in the written media during the mentioned period of time (-5 being the worst attributes & +5, the best). Data will be introduced in weekly and then monthly tables. Sums of the marks will be calculated / week, month. We will also consider the number of issues at national / local level and, based on the results, we will be able to draw the graph of the evolution of company's image.[8]

Willing to develop an indicator that could measure company's reputation **Charles J. Fombrun and Christopher B[9]. Foss** developed another study. They asked people to name companies they liked and respected, as well as companies they didn't like or respect. "We then asked them why they felt this way. When we analyzed the data from different groups and industries, the findings demonstrated that people justify their feelings about companies on one of 20 attributes that we grouped into 6 dimensions": *Emotional Appeal* **(**How much the company is liked, admired, and respected), *Products & Services* (Perceptions of the quality, innovation, value, and reliability of the company's products and services), *Financial Performance* (Perceptions of the company's profitability, prospects, and risk), *Vision & Leadership* (How much the company demonstrates a clear vision and strong leadership), *Workplace Environment* (Perceptions of how well the company is managed, how it is to work for, and the quality of its employees), *Social Responsibility* (Perceptions of the company as a

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[5] There is refference to the classical model of communication (company – message – public and vice-versa)
[6] Company's image is an abstract concept. There are different models for measuring it where developped
[7] longer periods of time (e.g. 1 year) offer a more detailed (and real) analyse.
[8] This model doesn't offer much information about the image (just attributes) and will be exclussively related to the opinion of the articles' authors (subjective).

good citizen in its dealings with communities, employees, and the environment). Then, they created an index that sums up people's perceptions of companies on these 20 attributes and called it the Reputation Quotient (RQ). Various empirical studies to benchmark the reputations of some key companies were conducted on the basis of this model.

Both models (and there are many of the same type) are based strictly on perceptions (what people think about the company, how do they feel about company's actions etc). Therefore both models are quite subjective and their result is based on **values** attributed to companies.

Results of the measurement (place of image within the company)

Considering image as part of a communicational process (as we did from the very beginning of this paper!) and trying to measure this image helped to obtain a set of attributes that media representatives, respectively people, give to images (company is admired, is involved in social activities, is interested in its employees, has good quality products, high or small prices, good advertisements in all the medias etc).

There are two important comments that should be made here.

First comment: Image as part of the communicational process - which helps people perceive the company and form attitudes about it -, places the image within the *marketing (marketing communication) activity* of the company (image could be, in this case, placed among the marketing mix elements: the 4 Ps / 7Ps, which are the engine that attract the client and make him buy). As presented above, image is a *psychological and social answer* to the impulses that the company sends to its public.

In order to have a powerful image built on the communicational process (marketing mix), some principles should be observed:

a. **The Principle of Distinctiveness** - Strong images / reputations result when companies own a distinctive position in the minds of the public. E.g. Intel and AMD, the two titans of microprocessors in the semiconductor industry. Both offer products of comparable quality, speed, and power. Yet Intel dominates AMD in the minds of computer buyers and other observers. Why? Because Intel owes its reputation, not to the quality of its products, but to the "Intel Inside" campaign that virtually defined those products as essential components of quality and high-tech ingenuity "powering"

[9]. Fombrun, Charles J; Christopher B, The Reputation Quotient – Internet article

the better computers. The campaign assured Intel's reputation as the guarantor of excellence to the end user.

b. **The Principle of Focus** - Strong image results when companies focus their actions and communications around a *single core theme*. E.g. Johnson & Johnson. The company ranks tops in public trust. This is no accident: trustworthiness is a focal point of all J&J's communications. It is evident in advertisements that single-mindedly portray J&J as a nurturing and caring company, with babies and children invariably featured or mentioned (despite the fact that J&J's baby products division represents less than 7% of the company's portfolio).

c. **The Principle of Consistency** - Strong images result when companies are consistent in their actions and communications.

d. **The Principle of Identity** - Strong image result when companies act in ways that are consistent with espoused principles of identity (in time, all efforts to manipulate external images that rely purely on advertising and public relations fail when they are disconnected from the company's identity. E.g. In 1996, Royal Dutch/Shell embarked on an ambitious effort to rebuild a corporate reputation that was torn apart by the media following the company's mishandling of two major crises in 1995. The program it developed was rooted in a soul-searching process that required identifying the company's business principles and "core purpose" — the authentic values it supports and the behaviors it is willing to endorse. Focus groups held around the world unearthed that Shell's core purpose as defined by employees and leaders was about "Helping to Make the Future a Better Place," and this has since become an anchor for many of the company's internal communications.

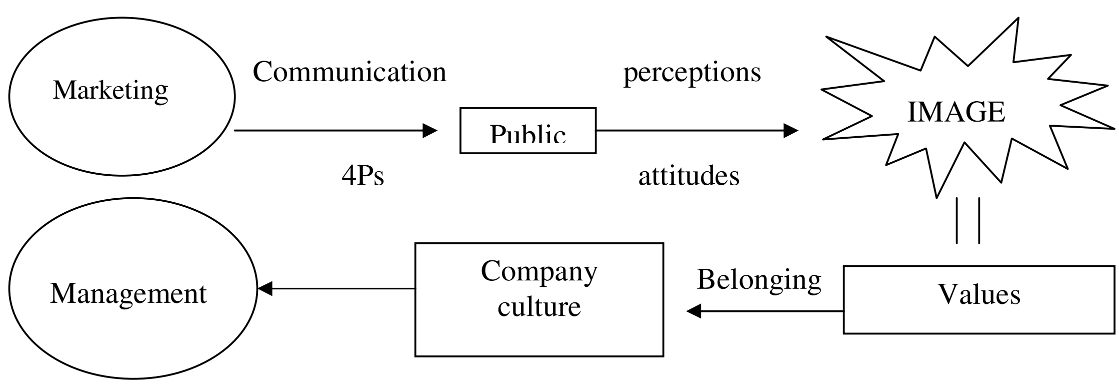
e. **The Principle of Transparency** - Strong images result when companies are transparent in the way they conduct their affairs. Transparency requires communication. The Reputation Institute recently contrasted the communications of a group of companies with strong image against direct rivals with lower indicators of image. The findings support the idea that companies with stronger reputations are more visible across all media. They disclose more information about themselves and are more willing to engage stakeholders in dialogue. Of course one may ask the well-known question: does media make the image of a company or image is the engine that gives subjects to media? The answer will be easy to give by the end of the paper…An image that is not supported by strong and real values of the company won't survive in the confrontation with media and, vice versa,. A company with a strong and powerful image will get advantage from the media.

Second comment: the results of the studies mentioned above, showed that the image is measured and expressed in ….***values***. In order to have a coherent, stable and real image, these values should be true and consistent, transparent and focused, they should be strongly linked to the identity of the company and to its actions. The communication process mentioned above is not that simple. It should be based on the real values of the company in order to be able to create a long-lasting image!

But, on the other hand, we know that, by definition, values of a company belong to the core of the company and are managed carefully by high-level management. Values belong, to the **company's culture**.

Generally, corporate culture is the company's way of life. It is the company's general attitude toward the world.

It is true that, in most of the cases, *corporate image means much more than the image* built on the company's values and sent, through different communicational channels, to people. Corporate culture is wider than the image! The main thing that the present paper tried to demonstrate is that the *image of a company overpasses the borders of a simple communicational process and find its roots in the strong values – core of the corporate culture of a company*!



To the same conclusion (not as a demonstration as the one above, but as a real fact that comes to underline once again the conclusion that **image is strongly connected to values** of the company) leads also a very actual trend. In order *to built strong images*, to make publicly known their values, in order *to attract people to buy* and also to protect themselves of unreal accusation for non-ethical actions, companies started more and more to create (ethical) *codes of conduct* which make customers aware of the social responsibility that companies assume.

Codes of conduct are public statements of corporate responsibility.[10] Differing in profoundness, in number of issues covered and in number of prohibitory rules, all codes of conduct are based on the *values of the company*; they are based on companies' culture. Therefore, one can found other element – the code of conduct - , more and more developed, in order to strengthen and develop image, which is built (once again!) on the company's culture!

[10] Kolk, Ans; Van Tulder, Rob – International Codes of Conduct – University of Rotterdam

4. ECONOMIC IMPLICATIONS OF THE IMAGE AS PART OF THE COMPANY'S CULTURE

The concept of corporate culture[11] is best described by the sentence: "the way a company does things". Company's culture includes all values and practices shared by a company' members.

"Corporate culture includes your company's reputation, environment as perceived from the outside and the 'feeling' of the environment inside"[12].

There is no one right culture for an organization. There are only cultures that fit more or less to the particular situation of the organization.

In practice, several cultures can exist within one organization. This may more often happen in larger, diversified companies, when some divisions / departments start to develop their own *ways to do things*.

After explaining the terms of image, its classifications, its meaning and its roots, its connection with the company culture, it is interesting to try to identify and explain the economic implications that a strong image, based on strong values (part of the company's culture) may have.

Academic efforts to quantify the value of image confirm that there are large economic premiums associated with corporate images. For instance, a study conducted at the University of Texas at Austin[13] compared ten groups of companies with similar levels of risk and return, but different average reputation / image scores. Results showed that a 60% difference in reputation score was associated with a 7% difference in *market value*. Since an average company in the study was valued at $3 billion, that means a 1-point difference in reputation score (from 6 to 7 on a 10-point scale) would be worth an additional $53 million in market value.

Another project conducted at the University of Kansas suggests that reputation capital may involve even higher returns. A team of professors examined the relationship between market value, book value, profitability, and reputation for all the firms rated as the "most admired companies" survey between 1983 and 1997. They concluded that a 1-point change in reputation was associated with an average of $500 million in market value.

[11] Explaining Corporate Culture – Internet article
[12] Miles - The Miles/LeHane Group, Inc (Internet Article)
[13] Fombrun, Charles J.; Foss, Christopher B. - How Much is a Corporate Reputation Worth? – Internet Article

More recently, the Reputation Institute examined some 35 companies in both 1999 and 2000. An analysis of the stock prices of these companies revealed that a strong relationship exists between a change in RQ indicator and a change in a company's market value. Specifically, a positive 1-point increase in the RQ was associated with higher average market values of some $147 million, while a 1-point decrease was associated with market values that were lower by about $5 billion. These results suggest that a 'value spiral' operates through which better-regarded companies attract more investors who bid up their market value and further improve their image.

The good news is that research confirms that **images are valuable assets,** however intangible. The bad news is that the size of the effect is still in question. It's a safe bet to conclude from these studies, however, that image is worth a lot more than companies are now spending to manage them.

Image as part of the added-value

Researches mentioned above compared the image score (based on social an psychological aspects: how much people like or dislike a company) with economic indicators based on accountings and economic realities. The comparison showed an obvious connection between the two terms.

There are two problems that arise: a) these researches don't create an algorithm to calculate company's image (this is an intangible asset difficult to measure!). If the two terms are compared and a positive direct connection on their evolution may be observed, however they don't offer a calculation method; b) the two terms (image indicator as sum of attitudes and perceptions that people have about one company, on one hand, and added value – market value added and economic value added, on the other hand - don't have the same roots of calculation (the first is psychological and social, the second is strictly economic).

It is interesting to find out if image can be placed among the elements that form the added value itself.

General considerations about value-added

Many companies started to be more and more interested in performance measures that depart from the traditional accounting based measures such as earnings per share and return on investment. The new "value-based" measures include economic value-added (EVA), market value added (MVA) etc.

Definitions

We say that a firm has **added value** over a period of time when it has generated a profit in excess of the firm's cost of capital. This profit is typically referred to as the **economic profit**, a concept developed by economists in the 19th century. This is also referred to as economic value added (EVA), a registered trademark of Stern Stewart.

A related concept is market value added (MVA) which is the sum of book value of equity and present value of future EVA

Before starting to analyze the calculation model of EVA, it may be of interest to see **where this value-added comes from**. Value is not created out of nothing. In fact, if product and factor markets are perfectly competitive, there should be no excess profits (as per basic economic theory). It is only through market imperfections that firms can earn excess profits - that is, invest in positive net present value projects.

Sources of EVA

The sources of value-added are from basic economics:

A) *Economies of scale*: a given increase in production, marketing or distribution results in less than proportional increase in cost (i.e. there are cost advantages to being large and there are high capital requirements).

B) *Economies of scope*: efficiencies are gained when an investment can support many activities.

C) *Cost advantages*: companies enjoy cost advantages that are not available to new entrants (e.g., McDonald's and its locations).

D) *Product differentiation*: invest in capacity to differentiate products, through patents, reputation (brand name), technologically innovative, service (e.g., Coca-Cola (advertising), Disney, McDonald's).

E) *Access to distribution channels*: well-developed distribution channels provide a competitive advantage.

EVA is **more than just performance measurement system** and it is also marketed as a motivational, compensation-based management system that facilitates economic activity and accountability at all levels in the firm. Stern Stewart reports that companies that have adopted

EVA have outperformed their competitors when compared on the basis of comparable market capitalization.

EVA looks at the firm's residual profitability net of both the direct cost of debt capital and the indirect cost of equity capital. In this way EVA serves as a modern measure of corporate financial success because it is closely aligned with the shareholder wealth maximization requirement.

EVA is not whether the business is profitable, but whether that profit is sufficient to compensate the equity capital invested in the firm at its opportunity cost and has any revenue remaining after compensating the cost of all resources. In other words, is there any **value** created after invested capital has been compensated at a market determined required rate of return? In essence, a firm can **report a positive net income** according to Generally Accepted Accounting Procedures rules, but has a **negative** economic **value** added if that accounting profit is inadequate to compensate the equity capital at its required rate of return. Even profitable firms do not always create **value** unless they earn enough to cover the cost of debt as well as the opportunity cost of equity capital.

Improving EVA

What insight does **EVA** provide about financial performance of a business and how to improve it? First, like any financial measure, the trend may be more valuable than the absolute **value** of **EVA**. Even if **EVA** is positive, a declining **EVA** suggests that financial performance is deteriorating over time, and if this trend continues **EVA** will become **negative** and financial performance unacceptable. A **negative EVA** indicates that the firm is not compensating its capital resources adequately, and corrective action should be considered if this **negative EVA** persists over time.

So what are some corrective actions? First, operating performance with respect to operating profit margins or asset turnover ratios could be improved to generate more revenue without using more capital. Second, the capital invested in the business might be reduced by selling under-utilized assets; this strategy will simultaneously improve operating performance through a higher asset turnover ratio, as well as a reduced capital charge against those earnings because of a reduced debt or equity capital investment. Third, redeploys the capital invested to projects and activities that have higher operating performance than the current projects or investments are exhibiting. And fourth, if the business is not highly leveraged, change the capital structure by substituting lower cost debt for higher cost equity. Although this last strategy will decrease net income because of the higher interest cost, it will improve the **EVA** of the business because the total cost of debt and equity is reduced, and **EVA** measures the **value** created after all costs of capital (debt and equity) have been taken into account.

Calculation of EVA

EVA = NOPAT - $ Cost of Capital

NOPAT = Net Operating Profit After Tax

NOPAT = EBIT – Taxes

EBIT = Earnings Before Interests and Tax

$ Cost of Capital = [%Cost of capital / 100] x investment

%Cost of capital = [debt Weight x % After Tax Debt Cost + Equity Weight + % Cost of Equity]

EVA = NOPAT – WACC% * TC

The equity risk premium is adjusted with the company's risk level

The risk level of a company depends on the business risk (business field) and on the financial risk (solvency)

Value added is the preferred measure of the wealth created by the activities of a company. It shows how much wealth each company creates, how efficiently it creates it. This gives a completely new perspective on company's performance and strategy, which is securely anchored in measurements of the wealth created by companies and of whether they are able to grow that wealth year by year.

Added value evaluates efficiency by measuring its inputs to its own outputs

There is no one standard calculation but the usual basis is the difference between sales income and the cost of goods and bought –in services, adjusted for changes in level of stocks and work in progress.

The added value remaining therefore represents that amount available to cover salaries, interest charges, rent and rates, company's taxes and depreciation. Any remaining net income is profit from which dividends are paid.

There is also another indicator – Market Value Added **(MVA)**. It is the difference between the equity market valuation of a listed company and the sum of the adjusted book value of debt and equity. The higher the MVA, the better!

MVA represents the present value of future expected EVAs.

Therefore all the attention will be dedicated to the calculation of EVA and to its components. The main aim of our approach will be connected to a possible identification of image inclusive elements among the basic terms of EVA's calculation method.

Interpretations of EVA

The bigger expected **EVA** the company has, the bigger is the market value of the company and the stock price. Especially profitable growth (growth in **EVA**) gears up stock prices. Therefore companies like Intel, Microsoft and Nokia trade many times above their book values. Stock prices reflect the future **EVA** expectations. Those expectations are very uncertain and continuously changing and thus also stock prices are volatile. Therefore it might be in short term difficult to see the underlying connection between **EVA** (financial performance) and stock prices. Long-term perspective helps in this sense.

EVA and Image – general considerations

We go back to the main EVA's equation:

EVA = [(net sales – operating expenses) – taxes] – cost of capital% * total invested capital

We will try to provide some general information about the connection between EVA and company image starting from the component parts of the EVA equation..

a) <u>net sales</u> – are directly influenced by the marketing mix (all the 4 Ps – product, price, place, promotion). But as we mentioned in the first chapters the 4Ps are the engine that start to send information to people and let them build in their minds an „image" about the organization. There is, therefore, a direct connection. :

   4Ps=> info=> positive image=> sales.

b) <u>Operating expenses</u> – are also connected with the 4Ps. In order to develop the marketing mix and to let it send positive impulses that help to company's image creation, expenses will be higher.

In order to get important net sales, between the parts of expenses dedicated to the development of the 4Ps and the values of the company (forming the company culture) should exist a narrow connection.

c) Total invested capital & cost of capital – are indirectly connected with the image indicator.

The question is now „how can be calculated the influence of the global image of the company on its total net sales“, as

- marginal cost of financial capital invested on promotional campaigns? (how much increases the sales one more financial unit invested in the promotional campaign – ATL or BTL)
- number of values (ref to company's culture) promoted? (e.g. Johnson&Johnson – value of child care)
- Price reduction in connection with one value promoted (e.g. Carrefour Romania – „low prices for a better life!“)
- New quality of a product [14]
- Distribution strategy?

….probably as all together…and many others. There are not new indicators, but they should be calculated temporary in strict connection to the image evolution and company's values promoted.

Calculating the global image indicator on the basis of economic figures, would be almost impossible, but trying to find out the number of company's values promoted by each of the 4Ps and their impact on the total sales, on one hand, and on expenses, on the other hand (as parts of EVA) maybe would help in a general image analysis.

As it is quite difficult to tell that "x" expenses contributed to the promotion of the (e.g.) 2 values selected, maybe we should speak about marginal expenses.

After making these calculations, the company should repeat them in time and compare the final result with the RQ (reputation index presented in the first chapter), which will show if people's perceptions about the company are showing the same trends as the economic calculations.

The evolution of EVA indicator should also be followed in time and, in case of changes, the analysis of its components is, once again, required.

[14] attributes' theory - microeconomy

The negative point of the above-mentioned approach is that it would calculate only the values considered important and promoted by the company. But as mentioned in the first chapters, image is a result of the psychological traits and social environment. If a company selling clothes is promoting the following values: high quality of products, social care, youth and dynamism and if in the image analysis approach, based on questionnaires, people will mention values as: low price, fashionable, high quality of products and social care, without mentioning the other values considered by the company, means that the comparison between RQ and economical approach is not realistic and that the communicational process company-people is not the right one!

Company reputation and financial results – specialists opinions

Even if it is difficult to measure, image has its important role within a company. A mathematical approach of the image will have certainly a great success, but as an intangible asset, image doesn't offer many concrete and standardized possibilities of quantification.

There are also voices that consider image as a more important **measure** of success than stock market **performance**, profitability and return on investment, according to a survey[15] of some of the world's leading CEOs and organization leaders. Only the quality of products and services edged out **reputation** as the leading **measure** of corporate success.

The World Economic Forum sent a survey to all 1,500 participants to the 34th Annual meeting currently under way in Davos, Switzerland. About 10% of the participants (132 respondents), whose membership is primarily drawn from the world's 1,000 leading global companies, responded. This "Voice of the Leaders Survey" was released by the World Economic Forum and Fleishman-Hillard International Communications. It reveals fresh insights into the issues that concern top business leaders.

"The **reputation** of a company and its products used to be regarded as an intangible asset that was very hard to quantify" said John Graham, Fleishman- Hillard's Chairman and Chief Executive Officer. "Now it is clear that **reputation** is a vital component of a company's value and is becoming a key **measure** of a company's **performance**".

Three-fifths (59%) of the survey respondents estimated that corporate brand or **reputation** represents more than 40% of a company's market capitalization. And more than 77% believe that **reputation** has become more important over the last two years.

[15] Conference, 22 January 2004 – Davos, Switzerland (Internet article)

“Clearly, the recent wave of corporate scandals has made CEOs reappraise the importance they attach to their corporate brand” added Graham. “One of the results of this reappraisal is that business leaders no longer regard traditional financial measures as the ultimate indicator of a company’s success.”

Ninety-two percent of corporate survey respondents (103 leaders) perceive **reputation** as important to their corporate strategy

24% rated corporate **reputation** as the most important **measure** of success

17% rated profitability as the most important **measure** of success

13% rated return on investment as the most important **measure** of success

6% rated sustainability as the most important **measure** of success

5% rated stock market **performance** as the most important **measure** of success.

5. CASE STUDY (AVENTIS / HOECHST & OLIVETTI / TELECOM ITALIA)

We tried before to show the possible connections between a company's image and its financial results. But the analysis would me more interesting if we try to speak about international companies and mergers. Does a merger influence the new created company's image? Is there any connection between merger decision and image of the future company?

The answer is, certainly, difficult to give. Even if there are not many information available that could help to give an answer to the above-mentioned question, we tried to give two well-known examples of mergers that could direct us toward a conclusion.

Aventis Group

The **Aventis** Group, one of the largest pharmaceutical corporations worldwide, was created in 1999 by a merger between Hoechst AG and Rhône-Poulenc S.A. The four core businesses of **Aventis** are organized into divisions:

- Prescription-only medicine (**Aventis** Pharma),
- Vaccines (**Aventis** Pasteur),
- Therapeutic proteins (**Aventis** Behring)
- Animal health (**Merial**: Joint venture with Merck & Co.)[16]

Aventis is dedicated to improving life through the discovery and development of innovative products in the fields of prescription drugs, vaccines, therapeutic proteins, crop production and protection, animal health and nutrition. With global corporate headquarters in Strasbourg, France, Aventis employs around 90,000 people in 150 countries and recorded pro forma sales in 1998 of $21.3 billion.

The image of pharmaceutical companies / Aventis

Which is the image that doctors have about pharmaceutical companies? How do they judge their products? Which is the impact of communicational campaigns on the doctors' recommendations?[17]

[16] http://www.**aventis**.com

[17] Analyze – Last biyearly study „ image of pharmaceutical laboratories"

The study[18] was developed by IMS Health on about 1000 doctors generalists[19] that answered IMS's questions.

Having already a strong image, these pharmaceutical groups seem to, at least, keep their position if they don't increase in the top of the best companies in the mentioned field.

Aventis was mentioned by 59,8% of doctors – being on the first position - , Pfizer comes the 3rd (after leaving the 5th position) with a notoriety rate of 36.5% (19,4 % in 2001)… seems that the laboratories born as the result of a merger won a great notoriety percentage.

Notoriety and image – spontaneous method

1 Aventis	59,8 %
2 GlaxoSmithKline	39,7 %
3 Pfizer	36,6 %
4 Novartis	24,8 %
5 MSD	24,1 %

In the assisted method analyze, the above mentioned laboratories are also present in the top 3, however, followed by 2 middle-sized laboratories: Pierre Fabre and UPSA.

1 Pfizer	7,4/10
2 Aventis	7,2/10
3 AstraZeneca	7/10
4 Pierre Fabre	6,9/10
5 UPSA	6,9/10

The result of the study showed that, *in the future*, the *doctors will give special trust* to **the big international groups that have a really promising portfolio.**

Aventis is once more the first in this category, before:

- Pfizer, who confirms its spontaneous image of "modern" laboratory , offering products based on "high-quality scientific research"
- GSK and AstraZeneca, appreciated for their "products"
- MSD appreciated for the "value of the research"

Among the communication strategies preferred by the doctors, the visit to the doctor is on the first place, followed by media.

Even if Aventis was accused of different non-ethical actions[20], the values promoted by the new group resulted from the merger of Rhone-Poulenc and Hoechst, helped it get upper in

[18] June 2003, Paris

the top 5 groups in the field. The way in which the group presented the new values and the new identity was the right one and the economic results weren't expected for a long time!

Olivetti / Telecom Italia

The reasons for the Operation

One aspect of interest to shareholders is that the Operation will lead to the Company Resulting from the Merger being **more contestable** since, upon completion of the Operation, the holding of the present relative majority shareholder of Olivetti will be reduced with a consequent **increase in the security's liquidity** and the reasons for the market to view it favorably, to the **benefit of all the shareholders**. The proposed Operation will also bring a **major simplification in the structure of the Group**, in line with the expectations of the market and the objective of an overall improvement in **Olivetti's financial position**. Among other things, the integration of corporate functions will ensure **faster decision-making** in the context of an organizational structure comparable to that of the leading international operators.

The Operation is also intended to bring additional advantages by: - **optimizing financial and income flows within the Group** through a more efficient management of Group debt and **more efficient use of financial leverage**. In fact the Operation will permit the whole financial debt to be **allocated directly to a level closer to the operational activities that generate cash flow and eliminate the dependence of Olivetti on the dividend policy of the Company to be Absorbed**. It is also likely that these effects will lead to an improvement in the creditworthiness of the Company Resulting from the Merger, which, in turn, could lead to a more favourable rating and a **reduction in the cost of future debt**;

- allowing the Company Resulting from the Merger to optimize its financial structure and reduce the average cost of capital employed compared with that of Telecom Italia today. This effect should help to sustain the price of the shares of the Company Resulting from the Merger and therefore create value for the shareholders of Olivetti and Telecom Italia;

- improving the tax efficiency of the Company Resulting from the Merger under the current tax rules, through the complete and faster recovery, including the part currently not stated, of

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[19] 304 doctors – phone questionnaires; 740 doctors – assisted method

[20] http://www.scottishga.vispa.com/Aventis.htm

the tax benefits in connection with the value adjustments to equity interests decided at the time of the approval of Olivetti's draft financial statements for the 2002 fiscal year

Eva calculation

EVA = NOPAT - $ Cost of Capital

NOPAT 2003 = 5041,9 2004= 5129 2005 = 5266.7

WACC = 8,4%

Capital (Investment) 2003 = 51114 2004 = 48526.3 2005 = 47307.7

Data from: **http://www.axiaonline.it/2003/zoom/ReportAlertTelecom261103.pdf**

EVA (2003) = 5041,9 – (8.4% * 51114) = 748.324

EVA (2004) = 5129 - (8.4% *48526.3) = 1052.79

EVA (2005) = 5266.7 - (8.4% *47307.7) = 1292.85

In the period of time 2003-2005, EVA is positive and ascendant which shows that the company is a **value added creator**. The financial performance is increasing over time, and the company should keep the trend (if decreasing EVA continues in long periods of time, **EVA** will become **negative** and financial performance unacceptable). The results obtained from the calculations show that the firm is compensating its capital resources adequately, creating wealth for its shareholders.

Market Prices Valuation

The method of Market Prices Valuation assessed the value of the capital on the basis of the stock exchange quotations of Telecom Italia and Olivetti gathered during a significant period prior to the announcement of the Operation.

On the basis of the market data as of March 7, 2003 (last day of trading of the securities prior to the date on which the Boards of Directors announced the Operation), it was considered that:

a) both companies participating in the merger have a high market capitalization and a significant and broadly diffused float;

b) high volumes of the ordinary shares of Telecom Italia and Olivetti are traded daily (on the average approximately 1% of the float is traded); in addition, during the course of the twelve months preceding the announcement of the Operation:

– trading of the shares of Olivetti was carried out for approximately 240% of the share capital (not considering the quota held by Olimpia S.p.A.) for a countervalue of approximately 16,9 billion Euro;

– trading of the ordinary shares of Telecom Italia was effected for approximately 289% of the social capital of the company represented by such category of shares (excluding the shares held by Olivetti) for a countervalue of approximately 54 billion Euro;

c) both Telecom Italia and Olivetti represent a considerable quota of the total capitalization of Mibtel and MIB30. As of January 31, 2003, according to the data provided by the Italian Stock Exchange S.p.A:

– Olivetti represented 2% of Mibtel and 2,5% of MIB30; and

– Telecom Italia represented 8% of Mibtel and 11% of MIB30;

d) the float of Telecom and Olivetti proved to be significantly divided among Italian and foreign institutional investors and Italian retail investors, none of which enjoyed a position such that it could influence the course of the securities.

Book results

We have mentioned that EVA is different from the normal accounting profit. But the trend of this indicator is also important in order to analyze company's performance over time. Unfortunately data are available only for 2001-2002 (the years after merger don't have available data concerning the accounting profit).

Group *revenues* amounted to 31,408 million euros, compared with 32,016 million euros in 2001, a decrease of 1.9% (up 3.1% on a comparable basis and net of the exchange-rate effect). Revenues at the Telecom Italia Group, which accounted for 96.8% of the total, increased by 3.8% excluding the exchange rate effect and the changes in the consolidation area.

The revenue increase at the Telecom Italia Group reflected the positive performance of the Mobile Business Unit and revenue growth at the Internet and Media Business Unit, offset by a lower contribution from the Domestic Wireline Business Unit, where, despite a 2.4% increase in minutes, traffic revenues fell by 8.3% due to the lower average traffic yield. (see table below)

6th CONCLUSIONS

Motto: „There is no direct link between the value of a company and the effectiveness of its marketing. It is VITAL to create this link“

(Building Brands directly – Stewart Pearson – Macmillan Press Ltd 1996

The aim of the present paper was, on one hand, to define image both from the marketing and management point of view, to point out its role within the company culture and, on the other hand, to try to find out and explain possible correlations between image and company value added.

Image is a complex term, which becomes more and more modern. Image is a bridge between consumers and values – part of the company culture – which one company promotes.

The second purpose of the paper is, however, more difficult to approach.

As we have mentioned before, economic value added is the difference between the company‘ net operating profit after tax (NOPAT) and its weighted-average cost of capital. It is the return of the capital invested, therefore important for shareholders wealth. The question is – once again! - if EVA has any connection with image quantification or if image has any role in the EVA value.

The theoretical approach from the beginning of the paper, as well, as general data included in the examples used, point once again, the importance of image in today's business and social life. Both characters which are – willing or not – part of the communicational system company-public, are aware of this fact! But the researches made on image in general and on the methods of measuring it, in particular, put, lately, the image on the main business, media, and social stage.

Not only image is a communicational mean, but it is also part of the company's culture, having a great influence on the economic results of a company.

Even if methods for measuring the exact "amount" of image elements that can lead to an increase of the economic results, more exactly on the added value of a company, are not very well set, this influence is obvious. Researches showed a direct connection between RQ and economic value-added, some of the elements helping us calculate EVA being, at their turn, influenced by image (or image creators?). All these facts make image an important asset of a company based on strong, real and coherent values.

On one hand, this means that image can produce the non-equal treatment of companies on the market (image as competitive advantage)[21] [22]. On the other hand, the fact that image is based on strong values, part of the company's culture, leaded to the apparition of a new science: "Values' Management" which should be approached in narrow connection with image management and also with some important area from the marketing science (from which the analyze started!).

We will try to approach this problem from different points of view.

Brand value

„A brand is created when marketing adds values to a product and in the process differentiates it from other products with similar features and benefits)[Building Brand Directly – Stewart Pearson, Macmillan Business 1996]. Values mean the perceptions and beliefs about a product that consumers want to associate with it and buy it. As we showed before, values make a brand / company (Pepsi is associated with "the new generation", Volkswagen plays on dependability as a value, Volvo emphasizes a product benefit – safety etc) and, as a result, a brand has value added. That's why we may say that brands are sources of competitive advantage.

But, as brands are considered intangible, it is difficult to measure the value added of a brand and to see which portion it occupies within the company value-added. One measure of the brand value is the size of the price premium that the brand commands. In other words, it is about the premium price that the consumer accepts to pay in order to get the branded product whose values suit its expectations, the product that he considers to have the right image for him.

Brands have values, this is for sure, but we can't introduce the measurement of this value into EVA's formula. An easier method to show that image brings value added (for branded companies) is *to compare the earnings of the branded company* (revenues that are based on the premium price) *with the earnings with a similar unbranded company*. The result will be obvious but they won't necessarily show completely correctly measured value added. Also, just few companies include in their accounting the value of a brand

[21] „If competition is the motor of the market economy, reputation / image is the fuel that makes it run

[22] Alan Greenspan, Chairman of the US Federal Reserve - speech at Harvard University on June 10, 2000:

EVA /department

We have mentioned before that in order to be efficient, EVA calculation should be done at the level of a company, on long periods of time (if possible by comparing also the data from more successive years).

But as it is difficult to find out how much EVA brings the image of a company, a solution would be to calculate it at the level of the marketing department.

Values included in the company culture are transmitted through different channels to the consumers. The investment made on this „promotion" of the values (investments in advertising, events, promotion campaigns etc) certainly bring shareholder wealth creation. EVA / marketing department can be calculated in order to see which is the revenue on the capital invested.

Valuing customers

Customers are not used in current valuation methods, but it seems logical to include them in such calculations. Customers are the ones who pay price premiums to buy a product of a certain brand and who contribute to the value added of the company. All brand revenue flows from customer transactions and future brand revenues depend on future customer behavior. Marketing in itself can't change the product, but it can change the relationship company – customer.

Customer lifetime value is a value that can help in this approach. It represents the net present value of customer profitability. An element of the price commanded by the brand value, and thus the profitability generated by the brand, is the premium which customers are willing to pay for the perceived value of the brand.

The *lifetime value* (LTV) is achieved from developing customer relationships, and the cost of managing the relationship cost (CRC). These two figures determine the allowable investment in new customers. Long-term profit results when lifetime value exceeds the investment cost in a new customer.

Return on investment = (LTV – CRC) / AIM.

Profit grows when lifetime value exceeds the costs of acquitting new customers, and increasing lifetime value generates more profit that can fund more investment in marketing.

Investment in customer relationships is more likely to generate the highest returns; to determine how much to spend on new customers, it is first necessary to determine the profitability of existing ones.

Sources of EVA and their connection with image/ reputation

Maybe it is also interesting to look for a connection between value added and company's reputation directly in the sources themselves of the value added. As we have mentioned before, 2 of EVA's sources are: economies of scale and scope economies.

Economies of scale: The economic theory states that a plant's marginal cost of production decreases as the plant's operation increases. The more of a good you produce, the less it costs for each additional unit. For example, a plant that produces 1,000 cars would be more efficient than a plant producing five cars.

Economies of scope: They exist when there are cost savings associated with the broadening of a firm's scope of activities. The result is seen as increases in the number of products or services produced. In essence, joint production is less costly than production of a single product line.

Apparently this has no connection with the image, but with economic theory and economic performances of the company (both produce value added!) only.

Both concepts are playing with higher production in order to reduce costs, which will be the equivalent of higher profits if the product / service produced is sold on the market at the same price or at lower price, but in higher quantities.

The indirect connection that we can find out between the value added and reputation of the company passes through DEMAND. If there is a demand big enough on the market in order to absorb the higher production (economies of scale result), the company's performance will have an ascendant trend. But the demand is linked with the reputation of the company. If people recognize the values of the company producing economies of scale and trust its products and services, then the demand will maintain its level. The connection is, therefore, indirect!

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8th ANNEXES

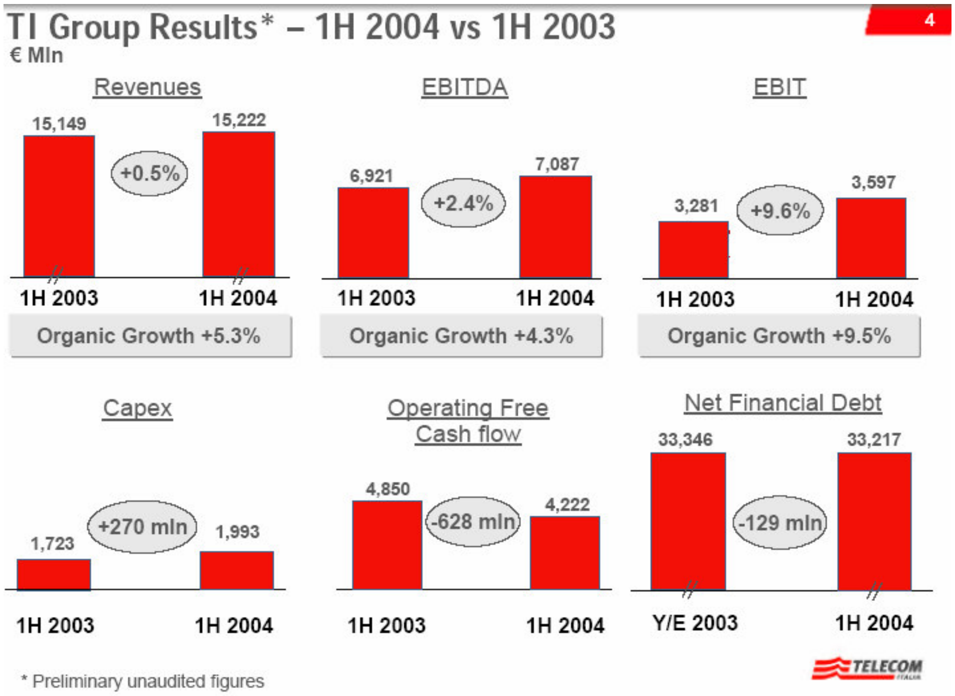
FINANCIAL DATA & EVA CALCULATION

Aventis

Top nine agrochemical companies in 1999[23]			
Top companies	**1999 Sales**	**1999 Rank**	**(1998)**
European Companies			
Aventis*	**4,320**	**2**	
**AgrEvo ** **			(5)
**Rhône-Poulenc ** **[24]			(7)
Novartis (Swiss)*	3,757	3	(1)
Zeneca (UK)	2,657	5	(4)
Bayer	2,316	6	(6)
BASF	1,856	8	(10)
European total	**$14,906**		
US Companies			
Monsanto*	5,102	1	(2)
DuPont*	3,020	4	(3)
Dow AgroSciences*	2,273	7	(9)
Cyanamid (AHP)	1,669	9	(8)
US Total	**$12,064**		
The top nine	**$26,970**		

[23] *Source: Agrow No 349, 31 March 2000, p. 8.*
[24] ** Sales cover both agrochemicals and seeds.*
*** Merged to form Aventis in 1999.*

Olivetti



TI Group Profit and Loss

€ Mln

	1H 2004	1H 2003*	Δ Abs	Δ %
REVENUES	**15,222**	**15,149**	**73**	**0.5**
Capitalized Cost and Others	370	370	0	0.0
Operating costs	6,453	6,371	82	1.3
Personnel	2,052	2,227	-175	-7.9
EBITDA	**7,087**	**6,921**	**166**	**2.4**
% on Revenues	*46.6%*	*45.7%*		
Depreciation and Amortization (net of Goodwill)	2,434	2,375	59	2.5
Other Provisions	169	273	-104	-38.1
Net Other Income/Expense	-110	-10	+100	n.m.
EBIT before Goodwill Amortization	**4,374**	**4,263**	**111**	**2.6**
% on Revenues	*28.7%*	*28.1%*		
Goodwill Amortization	777	982	-205	-20.9
EBIT	**3,597**	**3,281**	**316**	**9.6**
% on Revenues	*23.6%*	*21.7%*		
Headcount (EoP)	93,178	102,541	-9,363	-9.1

Divisional breakdown

€ Mln

Business Units	REVENUES 1H 2004	REVENUES 1H 2003	REVENUES Δ Abs	REVENUES Δ %	EBITDA 1H 2004	EBITDA 1H 2003	EBITDA Δ Abs	EBITDA Δ %	EBIT 1H 2004	EBIT 1H 2003	EBIT Δ Abs	EBIT Δ %
Wireline	8.684	8.569	115	1,3	4.125	3.979	146	3,7	2.639	2.433	206	8,5
Mobile	6.152	5.534	618	11,2	2.918	2.624	294	11,2	1.967	1.826	141	7,7
of which TIM SpA	4.803	4.499	304	6,8	2.632	2.388	244	10,2	2.057	1.824	233	12,8
of which Int'l & Eliminations	1.349	1.035	314	30,3	286	236	50	21,2	-90	2	-92	-
Internet & Media	306	863	-557	-64,6	17	246	-229	-93,0	-39	80	-119	-
of which TI MEDIA Restated	306	300	6	1,9	17	4	13	n.m.	-39	-48	9	18,5
IT Market	354	358	-4	-1,1	29	30	-1	-3,3	12	9	3	33,3
Olivetti Tecnost	307	332	-25	-7,5	20	17	3	17,6	10	-3	13	-
Latin America (Cile, Bolivia)	533	559	-26	-4,7	195	197	-2	-1,0	67	69	-2	-2.9
IT Group	454	465	-11	-2,4	31	24	7	29,2	-39	-39	0	-
TI Lab	67	67	0	-	0	9	-9	-100	-5	1	-6	-
Other / Eliminations & Adj.	-1,635	-1,598	-37	-2.3	-248	-205	-43	-21,0	-1,015	-1,095	80	7,3
TOTAL TI Group	15.222	15.149	73	0,5	7.087	6.921	166	2,4	3.597	3.281	316	9,6

The values attributed to Olivetti and Telecom Italia for the purpose of determining the exchange ratio

(in millions of euros)	Year 2002	%	Year 2001	%	Changes absolute	Changes %
Net revenues	31,408	100.0	32,016	100.0	(608)	(1.9)
Operating costs:						
Labour	(4,727)	(15.1)	(4,877)	(15.2)	150	3.1
Materials and services	(12,668)	(40.3)	(13,458)	(42.0)	790	5.9
Grants	20	0.1	26	0.1	(6)	(23.1)
Depreciation of tangible assets	(3,807)	(12.1)	(4,080)	(12.7)	273	6.7
Amortisation of intangible assets:						
Consolidation goodwill	(2,142)	(6.8)	(2,278)	(7.1)	136	6.0
Other	(1,320)	(4.2)	(1,283)	(4.0)	(37)	(2.9)
Provisions for writedowns and risks	(776)	(2.5)	(758)	(2.4)	(18)	(2.4)
Other income (charges), net	28	0.1	30	0.1	(2)	(6.7)
Result before interest and taxes (EBIT) and non recurring income and charges	**6,016**	**19.2**	**5,338**	**16.7**	**678**	**12.7**
Non recurring income:						
Gains on disposals and other non-recurring income (*)	2,990	9.5	999	3.1	1,991	199.3
Non recurring charges:						
Losses on disposals and other non-recurring charges (*)	(8,486)	(27.0)	(4,354)	(13.6)	(4,132)	(94.9)
EBIT	**520**	**1.7**	**1,983**	**6.2**	**(1,463)**	**(73.8)**
Income from equity investments, net	57	0.1	221	0.7	(164)	(74.2)
Financial charges, net	(2,307)	(7.3)	(3,105)	(9.7)	798	25.7
Value adjustments to financial assets	(786)	(2.5)	(2,196)	(6.9)	1,410	64.2
Result before taxes	**(2,516)**	**(8.0)**	**(3,097)**	**(9.7)**	**581**	**18.8**
Taxes	2,210	7.0	(579)	(1.8)	2,789	91.7
Result after taxes before minority interest	**(306)**	**(1.0)**	**(3,676)**	**(11.5)**	**3,370**	**(554.3)**
Minority interests	(467)	(1.5)	586	1.8	(1,053)	(179.7)
Net result for the year	**(773)**	**(2.5)**	**(3,090)**	**(9.7)**	**2,317**	**75.0**

(*) the amounts concerning the Telecom Italia Group have been classified as extraordinary items in the consolidated accounts of this latter.

	Minimum	Mean	Maximum
Values per Telecom Italia ordinary share (euros)	8.1	8.6	9.1

	Minimum	Mean	Maximum
Values per Telecom Italia savings share (euros)	5.4	5.8	6.1

	Minimum	Mean	Maximum
Values per Olivetti ordinary share (euros)	1.13	1.26	1.39

	Minimum	Mean	Maximum
Values per Olivetti savings share (euros)	0.76	0.84	0.93