BUILDING REPUTATION IN FINANCIAL MARKETS

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ABSTRACT

Reputation for accountability and trustworthiness is a critical variable affecting a company's capacity to gather the financial resources required to support the realization of corporate strategies. However, how companies build and preserve the trust of financial markets is still underexplored. Our research highlights the complementary role of leadership, strategic plans and internal control systems in underpinning the formation of corporate reputation in financial markets. Collectively, our findings indicate how knowledgeable, respected and committed leadership, detailed and transparent communication of corporate plans, and credible and independent control systems contribute to gather the consensus of the financial community around bold strategic plans.

INTRODUCTION

In the early months of 2001, thanks to an aggressive market strategy, Bipop Carire, which a few years earlier was merely a medium-sized local player, had become one of the major regional banks in Italy. Earlier on, in order to sustain its fast growth, the bank's management had turned to the stock market. Its daring and innovative growth strategy had gathered the consensus of financial analysts and institutional investors, attracted by increasing profits and fascinated by the bold, risk-taking attitude of its management. In November 2001, however, an investigation carried out by the Bank of Italy raised concerns about the proper functioning of the internal control systems: it seemed that in the last few years, fast decision making and rapid action had been achieved at the expense of accountability and control. These results undermined the confidence of analysts and investors in the company's management. Its shares plummeted, and in mid 2002 Bipop was eventually acquired by a large competitor.

Bipop is not an isolated case. Its case is illustrative of a fundamental tension between risk-taking and innovation, on one side, and accountability and control, on the other, that affects listed companies in major financial markets. In the last few years, we have studied how companies listed on the Italian Stock Exchange, but interacting with a global financial community, have addressed this "accountability-risk taking" dilemma. Our research relied on several data sources that helped us develop a broad understanding of the factors that underlie – or undermine – the capacity to simultaneously address analysts and investors' concerns for accountability and expectations for growth.

Findings from our research indicate that, in assessing the risk profile of a company and the credibility of its growth strategies, financial analysts and investors tend to rely on a range of cues, which collectively affect their confidence in the corporate claims and forecasts. More specifically, our findings point at the complementary role of a company's leadership, of the structure and content of its strategic plans, and of the perceived accountability of its internal control systems in driving the formation, preservation and loss of consensus around corporate strategies.

CORPORATE REPUTATION AND STOCK MARKET PERFORMANCE

Past studies in the fields of finance, accounting and management consistently indicate a relationship between the reputation of a company, its top managers or other critical stakeholders, and the market performance of its shares (see Exhibit 1).

Exhibit 1. Reputation and stock market performance: Findings from past research

Since the mid 1980s, researchers have studied if and how reputation affects performance on the stock market.

Early research investigated the effects that the association with highly-reputed or prestigious actors, such as underwriters and auditors, may bring for companies undergoing initial public offerings (IPOs). Beatty and Ritter[1] initially observed how IPOs gain higher initial valuations when firms recruit prestigious auditors that reassure investors about accounting figures and forecasts. Similarly, research by Carter and colleagues[2] and Balvers, McDonald and Miller[3] highlighted how IPOs reduce underpricing by associating with prestigious underwriters and reputed investment bankers. Collectively, these studies suggest that the endorsement of highly reputed stakeholders reduces the perceived risk in corporate plans and help a company increase the amount of capital raised in the offering, as well as influencing post-IPO volumes and share price performance.

Later research focused on the personal reputation of chief executive officers, board members as well as members of the top management team, showing how their prestige positively influences the behaviour of financial markets in extraordinary occasions such as bankruptcies, takeovers. D'Aveni and Hambrick[4], for instance, suggest that bankruptcy occurs when creditors withdraw their support from a firm's top management and that support for the top team depends upon the team's prestige. In a later study, D'Aveni and Kesner[5] highlight how the power and connection of managers deeply affect their responses to takeovers. Furthermore, CEO and management reputation has been shown to influence the perceived credibility of corporate communication[6] and to help the company acquire much needed internal and external consensus to implement its strategies[7].

A number of other studies traced several links between the reputation of organizational leaders and the success of initial public offerings. According to Higgins and Gulati[8], for instance, the experience of organizational leaders legitimizes young firms to critical resource-holders and help the former secure the endorsement of prestigious underwriters, with positive impact on the success of their IPOs. Jackson and Hambrick[9] found evidence that top managers' prestigious ties attract prestigious backers, and both of these factors influence initial IPO valuation. In a study of the biotechnology industry, Finkle[10] observed how prestigious board members help young ventures reduce their gap in managerial resources and thus contribute to lower underpricing and to increase IPO size. Similarly, Cohen and Dean[11] and Certo, Daily and Dalton[12] state that the legitimacy of, respectively, top management teams and board of directors was negatively associated with post-IPO stock value run-up.

More recently, research focus seems to have shifted from personal to corporate reputation and from its effects on stock market price, both under normal as well as extraordinary circumstances. These studies converge on the idea that corporate reputation affect stock market performance, in that it indirectly influences a company market value through its impact on operational performance, it helps a company attract capital at a lower cost than rivals, and it helps reducing the perceived financial risk of company's shares.

For a company, being held in high regard seems to indirectly affect market value[13], possibly through its positive impact on operational performance and profitability[14]. However, good reputation among financial analysts and institutional investors also helps a company become an 'investment of choice', enhancing its ability to attract capital and to do it at a lower cost than rivals. [15] On the one hand, market perceptions of the company's future prospects tend to influence the level of demand for a company's shares, hence its market capitalization. On the other hand, analysts and investors tend to consider well regarded companies as comparatively less risky. In these cases they seem to be willing to accept higher financial risk for the same level of returns or lower returns for the same level of risk[16].

Also, companies with stronger reputation seem to face market volatility better than those with weaker reputation. During market crises, corporate reputation may act as a reservoir of goodwill, helping companies recover from drops of share prices faster than poorly regarded companies[17]. Similarly, research shows that shares of companies that enjoy a good reputation suffer less and recover faster from stock market crashes due to corporate crises – product recalls, financial scandals, etc. – than shares of poorly regarded companies do[18].

Reputational capital, then, seems to be a valuable asset and an important component of market value, along with its physical, financial and intellectual capital[19]. Despite its increasingly evident importance, however, how companies can build and leverage on their reputation among analysts and investors is still an underexplored area.

RESEARCH METHOD

Between 2002 and 2004, we have studied extensively the formation of corporate reputation among financial analysts and investors. Our research relied on a number of sequential stages which were meant to i) develop an understanding of how financial analysts and investors assess corporate strategies and react to corporate action and communication, ii) identify exemplary cases of construction or loss of reputation among financial audiences, iii) investigate these cases tracing a connection between corporate actions and consensus on the stock market. During each stage, additional evidence was gathered from new data sources, in order to test, extend or refine insights generated in previous stages.

In a preliminary phase, 37 semi-structured interviews with international sell-side and buy-side analysts and 15 semi-structured interviews with investor relation officers helped us familiarize with the object of our research. In particular, it helped us develop a better understanding of how sell-side financial analysts assess corporate plans and forecasts and how they formulate their recommendations. This phase also generated insight on the interaction between managers and investor relation officers of listed companies and between the various actors in the financial community.

Based on indications gathered in preliminary interviews, we prepared a questionnaire, investigating dimensions of corporate reputation among financial analysts, which was distributed to 350 analysts, 60 of which replied (15% of the analysts covering stocks listed on the Milan Stock Exchange). The questionnaire aimed at fleshing out central issues affecting how analysts evaluate companies, by testing insights emerging from the previous stage. Our results pointed at the relevance of corporate leadership, governance mechanisms and corporate communication – along with financial performance – in driving analysts' evaluations[20]. Indirectly, our results also helped us distinguish, based on quantitative evidence, highly regarded companies from poorly reputed ones.

As both the content of the interviews and the results of the questionnaire pointed at the relevance of corporate communication in affecting reputation among the financial community, we content-analysed 62 strategic plans presented to the financial community by companies listed at the Milan Stock Exchange between 2001 and 2004. Additional data about the plans – how they were presented, by whom, etc. – was gathered through an archival search. Next, we looked at the short-term variation of the stock price right after the presentation, as well as at comments and reactions of the financial community – both in the financial press and in analysts' reports – for evidence that helped us discriminate between effective and ineffective plans and presentations. A comparative analysis helped us identify the distinctive traits of plans that seemed to positively or negatively influence the evaluations and reactions of financial analysts and investors[21].

In addition, as preliminary interviews had highlighted connections between reputation and internal control systems, we analyzed mandatory corporate governance annual reports. Supplementary information gathered on twelve companies, selected on the basis of indications collected in previous stages, helped us trace the configuration of their internal control systems and structures, and to study the actual composition and the role of internal auditing committees. Additional interviews with analysts and investors helped us capture reactions of the financial community to how governance structures and internal control systems were designed and communicated, and surfaced features that seemed to be beneficial – or detrimental – to the evaluation of financial analysts.

Finally, in order to sharpen our understanding of the mechanisms that underlie the formation of reputation in financial markets, we selected and studied ten exemplary cases of effective or ineffective management of relationships with the financial community (see Table 2). Evidence collected in prior phases guided the selection of cases and events to be investigated more in depth. Data collection relied on archival search of published documents, press articles and releases, and semi-structured interviews with managers and members of the financial community. Again, we looked at analysts' reports, press interviews and changes in stock prices for evidence of increasing or decreasing consensus around the corporate plans. Data analysis helped us refine and link insights emerging from previous stages, and develop an overall explanatory framework for the phenomenon under study.

Insert Table 2 here

BUILDING AND PRESERVING REPUTATION IN FINANCIAL MARKETS

Listed companies in major financial markets face a fundamental tension: on the one hand, they feel the pressure of analysts and investors for two-digit growth: innovative, risky strategies seem to be crucial in preserving the consensus of the financial community and in avoiding that highly mobile capital will quickly migrate towards more promising investments. On the other hand, a recent wave of corporate scandals seems to have heightened the sensitivity of analysts and investors to the trustworthiness of corporate leaders, the credibility of corporate claims, and the proper functioning of internal control systems. Effectively building and preserving trust and consensus among the financial community, therefore, requires the capacity to simultaneously address coexisting pressures for continuous growth through wealth creating innovation, and widespread expectations about appropriate strategic conduct and governance practices. In this respect, findings from our research indicate that highly regarded companies are able to provide financial analysts and investors with a broad range of cues, reassuring them about the credibility of corporate claims and forecasts. One of our informants explicitly connected the capacity to raise consensus around strategic plans with the reputation that a company enjoyed among its financial audiences:

> There are companies that are considered reliable, and analysts believe them regardless of how challenging their targets appear. Others are considered as less reliable and analysts are sceptical even when their forecasts are conservative. The truth is that the financial community seems to be inclined to trust – or mistrust – companies largely regardless of the actual content of their strategies.

In this respect, our research suggests that a company's reputation among analysts and investors – and the related capacity to aggregate consensus around risk-taking strategies – rests on synergy among three elements (Figure 1): a reputed and committed leadership, detailed and realistic presentations of strategic plans, and credible and independent internal control systems.

Insert Figure 1 here

A knowledgeable, respected and committed leadership

Research on investor relations and financial disclosure indicates that management quality and personal factors are of high interest for analysts and investors[22], and that interpersonal interactions with managers are central to understanding how these factors contribute to stock market performance[23]. In this respect, our findings indicate that the personal reputation of top managers and whether and how they personally engage in relationships with the financial community have considerable impact on the consensus of the latter around the corporate plans (Table 3).

Insert Table 3 here

First, as analysts and investors find themselves facing plans and environments fraught with uncertainties, the *personal reputation* of a company's CEO and a strong record of past achievements are likely to reassure the financial community about his/her capacity to deliver the promised results in the future. Research consistently shows that the reputation and prestige of a company's CEO and its top management team positively affect the behaviour of financial markets in extraordinary occasions such as IPOs, bankruptcies or takeovers. Even under normal circumstances, the reputation of a company may benefit from association with prestigious top managers, as the reputation of corporate leaders tends to affect the perceived credibility of corporate communication, and their personal aura and charisma may help the company garner the internal and external consensus required to implement its strategies.

In the cases we analyzed, when highly reputed CEOs moved from one company to another, considerable variations in the value of the respective stocks were frequently observed, as the financial markets revised their evaluations of the corporate prospects in light of the gain or loss of a credible leader. Such were the cases, for instance, of Andrea Guerra moving from home-appliance manufacturer Indesit (formerly, Merloni Elettrodomestici) to luxury eyewear producer Luxottica, or Corrado Passera moving from Poste Italiane to BancaIntesa (see Table 3). Hiring a respected top manager, then, may be an important step in building or recovering reputation among the financial audiences (see Exhibit 2).

Exhibit 2. Rebuilding trust at Capitalia

Capitalia, is a large banking group born in July 2002 from the integration of Bancaroma Group and Bipop. At that time, both groups didn't enjoy a good reputation in financial markets: Bancaroma was perceived as an old, conservative and poorly performing institution, strongly affected by political interests; Bipop, as we have mentioned in the introduction, had been under investigation by the Bank of Italy, the Italian authority for the banking industry. Analysts' reports were sceptical about the management's capacity to carry out their plans[24]. The alleged implication of Capitalia in large financial scandals, Parmalat and Cirio among them, contributed to reinforce the mistrust of the financial community.

This embarrassing situation urged Cesare Geronzi, Chairman of Capitalia, to take measures to regain the trust of the financial community. In July 2003, Matteo Arpe was appointed CEO of Capitalia at the age of 39. Before arriving at Capitalia, Mr Arpe had worked as central director in Mediobanca, the largest and most prestigious merchant bank in Italy, which he had eventually left in 1999 to become vice-president of the Italian branch of Lehman Brothers and responsible for M&A Europe. In both assignments, his excellent performance had earned him a solid reputation for competence and transparency. On the day after he was appointed, the financial markets saluted his arrival with a substantial raise in the stock price of the company. Soon after, leveraging on his personal reputation Mr. Arpe managed to tighten up the consensus of the financial community around essentially the same restructuring plan that a year earlier had raised much scepticism, and in two months, Capitalia's shares went up by 40%.

The effect of a top manager's prestige and personal reputation seems to be amplified by his/her *personal involvement in investor relations and financial communication*. Research indicates that, on average, analysts and investors tend to interact mostly with the CFO and the investor relations officers, seldom with the chairman or the CEO[25]. However, when asked about with whom they would like to have more contact, both groups overwhelmingly indicate the CEO. Investor relations officers are often perceived as gatekeepers rather than providers of information. Conversely, investors and analysts like to discuss their concerns and impressions with managers, since through direct interaction they believe to develop a better understanding of a company's performance and future prospects. As one of our informants remarked:

> To me it is important to understand who's leading the company. I want to look into his eyes and understand his three-year vision for the company and his commitment to the achievement of the corporate goals.

In particular, analysts appreciate reviewing their models and interpretations with company managers, in order to test their understanding of the company's businesses, and to be reassured that their own projections, deductions, and calculations capture reality appropriately.

Despite this evidence, in many companies the importance of CEO's and top managers' involvement in investor relations seems to be still underestimated. As an investor relation manager at Telecom Italia remarked, top and line managers may feel uncomfortable in diverting their time and attention from their day-to-day operations. As a consequence, several financial analysts we interviewed lamented the apparent lack of commitment of many top managers, who – with a few notable exceptions such as Unicredito's Alessandro Profumo and Andrea Guerra, formerly at Indesit – rarely participated to meetings with the financial community or did not display an open and responsive attitude. Corrado Passera, CEO of Banca Intesa, seems to be an outstanding exception in this matter (see Exhibit 3).

Exhibit 3. Corrado Passera and Banca Intesa

Born from the merger of ex state-owned Banca Commerciale Italiana, Cariplo and Banco Ambrosiano Veneto, Banca Intesa was at the time the second largest banking group in Italy by total revenues. Since its foundation, the new bank group had enjoyed a poor reputation in financial markets, being perceived as an old and static institution, unable to successfully complete the post merger phase. This situation changed in 2002, when Corrado Passera was appointed CEO of the bank. Mr Passera had previously been CEO of three companies: Gruppo Editoriale L'Espresso (a large media conglomerate), Olivetti (at that time, a producer of office and system solutions) and Poste Italiane (the public provider of mailing services). As CEO of Poste Italiane, he had been able to lead an overstaffed, inertial and traditionally poor performing company through major restructuring, substantially improving the company's image and performance. These results were acknowledged by the financial markets as they eventually welcomed his arrival at Banca Intesa with a substantial increase in the company's share price[26].

Later, the company's reputation among the financial community has benefited also from Mr Passera's direct involvement in investor relations and communication to financial markets. Not only has he presented the latest strategic plan personally, but he would also regularly attend meetings with financial analysts and institutional investors to provide additional explanations about the information disclosed by the company. According to the financial press and community, in September 2002, during the illustration of the 2003-2005 strategic plan, his reassuring presence and effective presentation helped convince analysts and investors of the credibility of ambitious earning forecasts[27]. As a financial analyst reported later: "The latest presentation showed a clear break with tradition in Italian banks' usual approach to financial communication. In an innovative scene, Mr. Passera, in shirtsleeves, made the presentation alone (…) whilst striding around the stage. The emotive impact was strong, giving the impression that the CEO is the sole leader in the bank, with the situation well under control and clear ideas in mind."

Finally, while personal prestige and commitment obviously have a positive influence on the audience, our research suggests that *profound knowledge of the business*, of its key value drivers and economics, is fundamental in gathering the consensus of the financial community. Developing an intimate understanding of the business is fundamental to "crafting" good strategies and help managers formulate and implement challenging but realistic strategies[28]. Also, financial analysts and investors tend to appreciate a manager's solid knowledge of the business and its practical aspects, because it reassures them about their capacity to carry out the proposed plans, regardless of occasional unforeseen events that may require rapid changes in the strategic course of the company. In this respect, relatively small companies such as component producer Sabaf and the luxury group Tod's have earned visibility and respect among financial analysts based on the experience and competence of their founders and CEOs (see Table 3).

Take for instance the case of Tod's, a luxury conglomerate, around which the CEO and major shareholder Diego Della Valle has managed to preserve the trust and consensus of the financial community despite occasional poor operational performance. Tod's was formally founded in 1986 by Diego Della Valle, whose family had been producing shoes since the early 1900. Since the mid 70's, Mr Della Valle had been running the family business gradually transforming a family-operated small concern into a medium-sized industrial company. Since Tod's went public in October 2000, the company has steadily expanded its brand portfolio and product range, turning into the operating holding of a group which now includes footwear brands Tod's and Hogan, and casual wear Fay. In recent years, the group has adopted a challenging strategy, based on the simultaneous expansion of its geographic scope, its network of proprietary stores, and its product range. Despite recent poor performance – not only has the company not grown significantly in the last years, but in 2003 it experienced also a substantial reduction in net profits and EBITDA – the confidence of financial analysts and investors in the long term growth prospects never faltered. According to prominent members of the financial community, Mr. Della Valle's insight in the luxury market and his considerable experience of the industrial and commercial aspects of the business support his capacity to articulate his plans during his frequent meetings with analyst and investors, and reassure them about the foundation of his forecasts[29].

Strategic plans, sensegiving and the reduction of ambiguity

Past research has observed how strategic plans may act as consensus catalysts inside and outside the company[30]. In particular, within the financial community, periodic presentations of strategic plans to financial analysts and investors are among the most important devices to disclose information about company's strategic intentions, action plans and expected results[31].

As we comparatively analysed how companies illustrate their plans to the financial community, we observed high heterogeneity in content and structure. Evidence from our study, however, indicates that how a company communicates its strategies may substantially affect its reputation in the financial community, and points at three factors that seem to affect the perceptions and evaluations of analysts and investors (Table 4).

Insert Table 4 here

First, good presentations of strategic plans do not merely indicate goals and expected results, but *provide a clear and consistent explanation of the causal relationships linking environmental trends, strategic intentions, action plans, and the end results*. Strategic plans are often surrounded by uncertainties regarding environmental changes, competitors' moves, and market reactions. Even in relatively stable competitive contexts, uncertainty and ambiguity are intrinsic to critical stages in the lifetime of a company such as mergers and acquisitions, restructuring, repositioning, takeovers, etc[32]. Helping analysts and investors make sense of emerging competitive contexts and innovative strategies and business models, then, is central to investor relations and corporate communication[33].

Evidence from our research suggests that highly-regarded companies tend to use presentations of strategic plans as a "sensegiving" device, to support managers' efforts to influence how financial analysts interpret the company's strategy in relations to its competitive context. The notion of sensegiving refers to a deliberate attempt to influence how others make sense of an ambiguous reality[34]. By explaining in detail how they intend to reach their goals, companies like Indesit, Unicredito, Banca Intesa and e.Biscom, now Fastweb, (see Tables 2 and 4) seemed to help analysts and investors develop an informed understanding of the causal texture underlying their plans. By providing analysts with a thorough and consistent map of cause-and-effect links by which specific actions are expected to lead to specific results[35], managers can reduce the ambiguity associated to their plans and reinforce the perceived credibility of their strategies. Furthermore, as a sell-side analyst describing Indesit's latest strategic plan observed, clearly articulating managers' assumptions about environmental trends and their links with corporate actions and results may be beneficial even at a later stage:

> Such a detailed plan facilitates honest and loyal interaction between analysts and managers, so that in the future, if they haven't reached their targets, we can sit around a table and analyze results in light of their assumptions about, say, the cost of raw materials, and of what really happened […] It helps figure out what they can be blamed for and what was out of their control. Even if they make a mistake, their reputation may not be affected. Not too much, at least.

Conversely, presentations of strategic plans that contain ambiguous, incomplete information may aggravate analysts' and investors' attempts to make sense of a company's strategies and environmental context. Companies whose future plans are surrounded by uncertainty, in turn, are penalized by financial markets (see Exhibit 4).

Exhibit 4. Ambiguous communication at Telecom Italia

Telecom Italia has been for long time a state owned company and the only provider of telecommunication services in Italy. In late 90's, deregulation and privatisation occurred: a new management was appointed at the head of Telecom and new competitors entered the telecommunication industry. Explaining financial analysts and investors how the new managers intended to steer the company through this fluid and highly uncertain competitive context was critical.

In late September 1998, a press release issued by Telecom Italia summarized the key figures of the 1999 – 2001 strategic plan approved by the board of directors under the leadership of the recently hired CEO Gian Mario Rossignolo, a well respect senior officer with a long experience in managing large companies. The plan was expected to contain detailed information about the new goals and strategies of the company. A few days later, however, Bloomberg diffused different figures, implying a declining income, based on an internal company document distributed to labour unions.

These data were soon indicated as "incomplete" and "misleading" by the chief financial officer, but the rising ambiguity surrounding the corporate plans negatively affected the confidence of investors in the assumptions underlying the plan. In the following days, despite the efforts of the top managers to regain trust in their forecasts, the stock price fell about 25%. Far from improving analysts and investors' understanding of how managers at Telecom Italia planned to address the rising environmental challenges, the new plans and how they were communicated actually increased the uncertainty and ambiguity surrounding the company's strategies and its capacity to carry them out. Serious concerns about the company and its management arose in the financial community[36]. On October 26, the chief executive officer resigned.

Evidence from our research, however, suggests that, while clearly and unambiguously relating corporate strategies with environmental trends is important, effective presentations of strategic plans tend to provide also *comprehensive and detailed information about the implementation of the proposed plans*. While intentions are important, how a strategy is actually implemented is critical for its success[37]. As one of our informants remarked:

> Many companies tell you that they'll do this and they'll do that, but you never understand how they really intend to do it. If somebody comes to me and tells me its earnings will increase in three years by 10%, but he's not able to explain me how, how can I believe him?

Corporate success rests on the possession of unique and valuable resources and competences[38]. In this respect, it is not surprising that financial analysts and investors tend to appreciate precise information about key tangible and intangible assets that the plan will rely on, and help them assess their adequacy to reach the company's targets. Furthermore, as divisional and business unit managers are gradually accorded more decision making discretion and have become more individually accountable for results than in the past, their responsibility for strategy implementation is increasing[39]. In these respects, effective presentations of plans may augment the credibility of a company's strategies by providing analysts and investors with detailed information about the management team that will be responsible for carrying out the plans, the corporate resources that can be mobilized, the external alliances that will be engaged, etc[40]. In absence of clarity about these issues, plans may be perceived as little more than aspirations of arguable credibility. In the early 2000's, for instance, the vagueness of the restructuring plans that were periodically presented to the financial community seems to have contributed to Alitalia's poor reputation among financial analysts and investors. As an analyst we interviewed observed about a recently presented plan:

> The new management told us that they were going to turn the company around. If you asked them how, they would say: "We'll increase turnover with new investments" – but they were in no conditions of borrowing more money. "We'll cut the cost of labour" – but then when they talked with the trade unions they denied it. "We'll be more efficient" – but it was not clear how…

Unicredito, the first Italian banking group in terms of market capitalization, is an exemplary case of how companies may effectively address these demands (see Exhibit 5).

Exhibit 5. Presenting corporate plans at Unicredito

Unicredito was born in 1998 from the aggregation of five banks (Credito Italiano, Rolo Banca 1473, Cariverona, Cassa di Risparmio di Torino, and Cassamarca). Since its foundation, the company has been able to aggregate the consensus of the financial community around an ambitious growth strategy aimed at becoming the leading group on the Italian market. The company's presentations of strategic plans have been highly appreciated by the financial community. As one of our informants observed: "What I liked in the presentation of their latest strategic plan was the fundamental balance between the various parts. They did not only describe in detail the company's targets, but also provided us with a detailed explanation of how they were planning to reach them […] which made their targets look more convincing".

In October 2004, the presentation to analysts and institutional investors of the 2005-2007 plan was structured around a detailed articulation of the ambitious restructuring plan into divisional sub-plans, personally illustrated by divisional managers, who explained how plans would be implemented in their divisions and indicated who would be responsible for them. Reactions of financial analysts consistently emphasized the "credibility", and "feasibility" of the cost-cutting plan proposed by the corporate managers, insofar as, as one analyst observed, it "provided answers to most of the 'hot' issues".

Finally, a third feature that seems to positively affect the effectiveness of presentations of strategic plans and enhance the credibility of corporate forecasts is the *periodic follow-ups on the advances towards the expected results*. The provision of periodical follow-ups on the advances towards the results contained in previous presentations tends to reassure analysts and investors about the companies' commitment to the implementation of its plans. Financial audiences are not only interested in the extent to which expected results have been achieved; they are also interested in understanding if, when, why and how managers have modified their plans[41]. Not all the intended strategies are realized: plans may change and companies may flexibly adapt to evolving circumstances as new strategies emerge and modify old plans[42]. In this respect, strategic plans may help internal as well as external audiences track the realization of intended strategies and evaluate the results of plans that were actually carried out. Tracking and monitoring the progress of corporate plans and comparing expected and actual results is central to analysts' activity and an essential part of their reports. As one of our informants observed:

> Continuously updating us on the "state of the art" is fundamental. And even more so when we are dealing with an innovative strategy or a new project, and we are trying to keep track of its results.

In Italy, however, only a few listed companies provide the financial community with periodical follow-ups of their presentations of strategic plans. e.Biscom, now Fastweb, is an exemplary case of how engaging in constant conversation with the financial community through systematic follow-ups on presentations of strategic plans, may help build and maintain the support of analysts and investors even in the face of persistent – albeit expected – lack of profitability. e.Biscom was founded in 1999, as a financial holding in the field of telecommunication and broadband services, by Silvio Scaglia, former CEO of Omnitel – the second largest Italian provider of mobile telephony, now part of the Vodafone group. A year later, the company went public. As the Internet bubble exploded, however, senior managers at e.Biscom had to strive hard to preserve the confidence of analysts and investors in the feasibility of their plans, while many promising start-ups around them failed. Communication was frequent and comprehensive. Quarterly and annual results were systematically compared with forecasts contained in earlier presentations. In October 2004, the newly crafted presentation of strategic plan went to the length of illustrating in details how managers' forecasts and corporate results had evolved throughout all the plans presented in previous years. The meticulous comparison was meant to reaffirm the original strategic vision – i.e. pursuing organic growth in core business of broadband telecommunication services in Italy – and to provide compelling evidence that the company had systematically respected targets stated since the year 2000, reassuring the financial community that break-even would be reached in 2005.

Effective, credible and independent internal control systems

Finally, a third factor affecting the credibility of corporate plans among analysts and investors seems to be the configuration of internal control systems. Recent research indicates that financial analysts and investors tend to agree on the importance of internal control systems both for corporate accountability and for the future success of the business[43]. Compliance to national regulations and code of conducts is obviously a minimum requirement. What seems to make the difference between highly and poorly regarded companies, however, is not so much the establishment of sophisticated internal control systems *per se*, but reassuring external audiences about their effective functioning. In this respect, three features seem to positively affect the evaluation of financial analysts and investors (Table 5).

Insert Table 5 here

First, highly-reputed companies tend to *voluntarily disclose detailed and reliable information about their auditing practices beyond the legal requirements*, providing evidence of the real functioning of the internal control systems. Recent research shows that voluntary reporting on internal control systems provides additional and valuable information for financial analysts and investors, improves accountability and provides a better indicator of a company's long-term viability[44]. In fact, financial audiences find it difficult to distinguish between effective internal control systems and mere formal compliance to regulations. As one of our informants observed:

> Take the case of independent outside directors. […] In a family firm we can even have a majority of outside directors, but most of them will be family friends or worse. How independent can they be? […] What matters is to understand who really controls the company and who influences decisions, regardless of the formal governance practices.

In this respect, disclosing comprehensive and precise information about actual auditing activities – such as the background of the auditors, number of meetings per year, the average length of meetings, the number of auditors attending meetings, etc. –, and issuing reports on internal control may reduce the uncertainties surrounding control structures and systems, and may provide a more convincing account of their actual functioning. Furthermore, some of our informants perceived it as a sign of above average commitment to transparency and of confidence in the effectiveness of internal control systems.

At the time of our research, however, voluntary disclosure of extensive information about auditing activities seemed to be still uncommon, at least among Italian companies. Our comparative study of the composition and the activity of audit committees in Italian listed companies, for instance, revealed that while most companies declared to have established internal control systems, many of them did not really have an audit committee nor had they appointed an internal auditor. While the activity of internal auditors generally complied with the current regulations, they rarely seemed to go beyond their legal duties. Furthermore, auditors seemed to focus mainly on operational auditing, assets allocation and financial auditing, while overlooking other important activities, such as budgeting control, competitive strategy appraisal, and the evaluation of division productivity. In some cases, also, internal auditors met so rarely and for so short periods of time to cast serious doubts about the actual content of their work. Most of this information, however, was usually not available to the financial community – or at least not in such detail.

Conversely, highly regarded companies tend to engage in broad and detailed disclosure of the actual functioning of their auditing practices, providing convincing evidence of the effectiveness of their internal control systems. Take, for instance, the case of Indesit, a large continental producer of home-appliances. In the last few years, managers at Indesit have increasingly acknowledged the importance of disclosing information about the real functioning of company's internal control systems. In fact, the annual corporate governance report of the company goes beyond mandatory requirements, illustrating the various processes designed to reassure stakeholders about the achievement of business objectives, regarding in particular the efficiency of business operations, the reliability of financial information, legal compliance, and more in general, the preservation of the integrity of the company's assets. The report describes in detail the main features of internal control systems – i.e. definition, communication of objectives and levels of responsibility; planning, monitoring and risk assessment, human resources management – and the various controls carried out by individual business functions in order to guarantee their operating efficiency. Finally, the report clearly explains the role of the internal control manager and of the internal control committee and illustrates in details their composition and current activities.

As far as the composition of auditing structures and their location in the managerial hierarchies is concerned, financial audiences seem to appreciate also a *clear distinction between control duties and managerial responsibilities*: Ideally, an internal auditor should not belong to or come from the managerial ranks, lest his real independence from top managers and impartiality may be questioned. In fact, need for fast responses to environmental changes may induce managers to by-pass control systems. The accountability of innovative, risk-taking strategies may be overlooked in favour of fast growth. Such a situation may encourage the adoption of perfunctory procedures and internal controllers who in fact report directly to the CEO. In the United States, the need for independent internal control systems has been acknowledged by a recently introduced regulation[45]. Yet formal compliance with the rules does not necessarily guarantee real independence of audit committee members and of internal auditors from management. As we have mentioned in the introduction, the recent experience of Bipop is illustrative of a how formally effective internal control systems may result into purely formal bodies, subjected to the management's will (see Exhibit 6).

Exhibit 6. The rise and fall of Bipop

Between 1993 and 2000 Bipop developed a bold and innovative strategy, based on aggressive expansion through acquisitions, which earned the company excellent operating results and a leading position in the Italian banking industry. The company's unconventional strategy aimed at increasing earnings through revenue growth driven mainly by non-interest income, and through cost reduction thanks to innovative distribution. Such strategy was indeed more risky than competitors' because of the higher correlation with market performance. Nevertheless financial audiences were enthusiast. In February 1999, a primary international brokerage house argued that Bipop was "possibly the most advanced and dynamic of the regional banks, […] with particular strengths in leasing and asset management within the Italian banking industry". The report concluded inserting Bipop "among the highest quality, and most innovative of the Italian banks"[46].

In mid 2001, even in the face of a declining share price, Bipop was still considered among the best performers in the industry. In the following months, however, Bipop entered a profound crisis, which eventually led to the replacement of the whole top management team and to the acquisition by a larger but far less dynamic competitor. The crisis precipitated when an investigation of the Bank of Italy found internal control systems to be insufficient to cope with the high risk profile associated to the company's aggressive strategy. In particular, investigators pointed out that, in fact, internal auditors reported directly to the CEO, thus reducing the effectiveness of internal controls. Accountability and control had been sacrificed in order to remove any hindrance to the discretion of senior officers. When, soon after, some board members and some managers were accused of accounting frauds, the reputation of the bank was shattered, its risk profile became unacceptable for most shareholders, and despite the potential profitability of its strategies, its share price crashed.

Finally, the appointment of internal auditors characterized by a *personal reputation for integrity and rigor* may help companies reinforce the credibility of their internal control systems among the financial community. Research on IPOs indicates that the association with a prestigious auditing firm tends to increase the amount of capital raised in the offering, as it reduces the perceived uncertainty about the value of company's shares. In fact, not only external but also internal auditors may affect how financial audiences assess the uncertainty surrounding a company's prospects, as the appointment of internal auditors with a strong reputation for independence, integrity and rigor seems to reassure the financial community about the accountability of the company's operations.

In fact, for poorly reputed companies, association with well regarded internal and external auditors may be a way to build or reinforce the confidence of analysts and investors in their commitment to improve the transparency and reliability of their operations. Again, consider the case of Capitalia. Besides the appointment of Mr. Arpe described earlier on, another important step in regaining the confidence of financial audiences was the appointment of Giuseppe Cannizzaro, a former member of Consob (the Italian Stock Exchange Commission), as internal auditor, with the formal title of central director and legal counsellor of the company. At Consob, Mr Cannizzaro had been in charge of the consultancy and regulation office within the Legal Consultancy Division and, later, had been responsible for the Securities Division, where his duties included controlling that listed companies provided financial markets with correct and transparent information, revising annual and quarterly reports, and controlling listed companies' governance structures and mechanisms. His appointment as internal auditor was welcomed by the financial community as a serious effort to put effective corporate governance structures and mechanisms in place, and to improve the accountability of the company.

CONCLUSIONS

Common wisdom and past studies tell us that competitive success and above average profitability are fundamental in earning a good reputation among financial analysts and institutional investors. Our research, however, indicates that financial audiences may develop a more or less favourable attitude towards a company and its strategy based also on the way senior officers and investor relation officers illustrate their plans and internal control systems to their financial audiences, (see Table 6 for a summary).

Insert Table 6 here

Financial analysts and institutional investors are constantly engaged in monitoring and evaluating corporate plans and results. In doing so, they have to make sense of an uncertain and ambiguous reality, relying mostly on information provided by the companies themselves. Appraising the relative credibility of corporate claims and forecasts, then, is fundamental to the assessment of corporate plans and the estimate of the expected future earnings.

In our research, converging evidence from different data sources indicates that some companies are generally perceived by the financial community as more reliable, trustworthy and accountable than others. In turn, this reputation for trustworthiness and accountability seems to positively affect the capacity of these companies to gather the consensus of financial audiences required to carry out ambitious strategic plans. Findings from our research helped us track the formation of a positive reputation among financial analysts and institutional investors down to a range of factors that seem to help financial audiences make sense of corporate strategies and reassure them about the credibility of corporate claims and ambitions.

More specifically, our study highlights the importance of knowledgeable and respected corporate leaders engaging in a constant conversation with financial analysts, providing them with a rich and compelling account of corporate plans and a detailed illustration of how they are to be implemented. Also, frequent updates and follow-ups of strategic plans and the voluntary disclosure of comprehensive information about the real functioning of internal control systems seem to converge in gathering and preserving the consensus of financial audiences around ambitious and challenging growth strategies.

The experience of companies such as Bipop and e.Biscom is illustrative of how financial analysts and investors tend to display a different attitude towards innovative, risky strategies according to the different perceptions they have of the company's trustworthiness and accountability. In other words, financial audiences tend to evaluate fast-growing, market aggressive strategies of well regarded companies more positively than similar strategies developed by poorly regarded companies. In this respect, our findings suggest that innovative and risky strategies may actually coexist with strong internal control systems, as companies leverage on their perceived accountability and trustworthiness to aggregate the consensus of the financial community around their strategies.

Table 1: Reputation and stock market performance: Findings from past research

Corporate reputation…	
…is associated to higher market performance	Knight, & Pretty (1990); Gregory (1998); Black, Carnes, & Richardson (2000).
…reduces the perceived financial risk of a company's shares	Lehn, Netter, & Poulsen (1990); Chaney, & Lewis (1995); Healy, & Palepu (1995); Gardiol, Gibson-Anser, & Tuschschmid (1997); Srivastava, McInish, Wood, & Capraro (1997).
CEO reputation…	
…affects the reaction of financial markets in extraordinary circumstances, such as IPOs, bankruptcies or takeovers	D'Aveni (1990); Hambrick, & D'Aveni (1992); D'Aveni, & Kesner (1993); Finkle (1998); Certo, Daily, & Dalton (2001); Jackson, & Hambrick (2002); Higgins, & Gulati (2002); Cohen, & Dean (2005).
…influences the perceived credibility of corporate communication…	Higgins, & Bannister (1992); Hirst, Koonce, & Miller (1999); Mercer (2004).
Underwriter reputation increases the performance of initial public offerings	Balvers, McDonald, & Miller (1988); Carter, & Manaster (1990); Carter, Dark, & Singh (1998).
Auditor personal reputation increases the performance of initial public offerings	Beatty, & Ritter (1986); Balvers, McDonald, & Miller (1988); Beatty (1989).

TABLE 2. Corporate reputation in financial markets: some illustrative cases

ALITALIA (AIRLINE TRANSPORTATION)

Alitalia, the Italian national carrier, has traditionally suffered from poor reputation among the general public and the financial community. Until very recently, arguable appointments in the managerial ranks and vague and ambiguous industrial plans have increasingly undermined the investors' confidence in the capacity of the company to carry out a much needed restructuring (see Table 3).

BANCA INTESA (BANKING)

Banca Intesa is one of the largest banking group in Italy. In recent times, the solid reputation of a newly-hired CEO and his personal involvement in investor relations and communication to financial markets is credited for the recover of the group's poor reputation among financial analysts (see Tables 2 and 3).

BIPOP (BANKING)

In the late 90's, Bipop Carire, a medium-sized regional bank, was widely acclaimed by the press and the financial community for its aggressive growth strategies. In 2001, despite general recognition of the quality of the corporate strategies, its credibility among the financial community collapsed, after an investigation revealed the improper functioning of internal control systems. Its stock price plummeted and a few months later the bank was taken over by a larger competitor (see Table 4).

CAPITALIA (BANKING)

Capitalia is one of the five major Italian banks. In recent times, its alleged involvement in financial scandals, such as Parmalat and Cirio, and a perceived lack of transparency regarding some of its financial operations had severely tarnished its reputation in the financial community. The appointment of a young and well regarded CEO and the personal integrity of the new overseer of internal control systems helped the company recover credibility in financial markets (see Tables 2 and 4).

E.BISCOM/FASTWEB (TLC)

Fastweb, formerly known as e.Biscom, is the leading broadband telecommunications company in Italy. Founded in 1999, its IPO witnessed the astounding number – for Italy – of two million subscribers. Since then, the company hasn't reported profits. However, consensus has never faltered, also thanks to the personal prestige of its top management team and the impeccable quality of its industrial plans (see Tables 2 and 3).

INDESIT (WHITE GOODS)

Indesit is one of the top three manufactures in the European white goods industry. In recent years, effective internal controls systems and the deep involvement of former CEO Andrea Guerra in investor relations helped tighten up the consensus of investors around a bold growth strategy (see Tables 2 and 4).

SABAF (VALVES, THERMOSTATS AND BURNERS)

Sabaf is a world leader in the production of components for domestic gas cooking appliances. Despite its relatively small size and its low popularity among the general public, it is one of the best regarded companies in the Milan Stock Exchange. The personal competence of its CEO, and its articulation in illustrating the companies plans and economics is credited for its high reputation among financial analysts (see Table 2).

TELECOM ITALIA (ICT)

In the late 90's, despite its high profitability, Telecom Italia, the ex state-owned national telecommunication provider, had experienced troubled relationships with the financial community because of unclear strategic plans and ambiguous financial communication (see Table 3). In the last few years, improved corporate communication and effective internal control systems have helped regain consensus around a challenging growth strategy (see Table 4).

TOD'S (SHOES, LEATHER GOODS AND CASUAL WEAR)

Tod's is a global luxury group, manufacturing and selling brands such as Tod's, Fay and Hogan. The company is held in high regard among financial analysts, mainly because of the personal charisma and competence of its chairman and CEO, Diego Della Valle. Mr. Della Valle's long involvement in the family firm helped him develop a profound knowledge of the business, which he displays as he periodically encounters financial analysts to illustrate his company's plans (see Table 2).

UNICREDITO (BANKING)

Unicredito, Italy's largest banking group in terms of market capitalisation, has earned a solid reputation for transparency and financial disclosure. Since its foundation in 1998, its CEO Alessandro Profumo has been actively involved in investor relations, providing a clear explication of its strategic intentions and action plans, and keeping investors constantly informed about the implementation of the proposed plans (see Tables 2 and 3).

FIGURE 1. Building reputation in financial markets

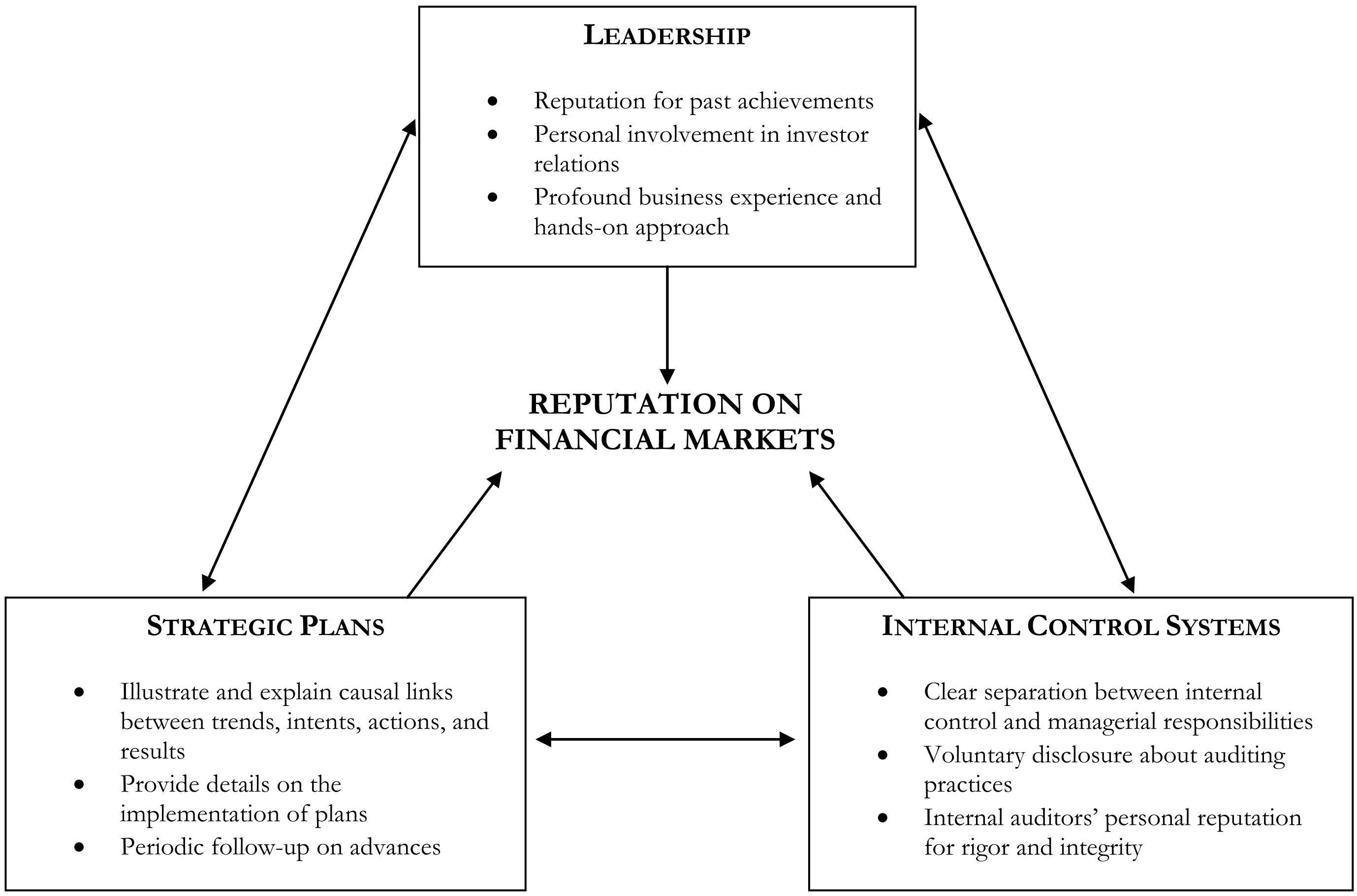

TABLE 3. Building reputation in financial markets: A committed and credible leadership

Features	Examples
CEO's personal reputation for past achievements	• In 2002, the appointment of Corrado Passera as CEO of Banca Intesa helped the company regain credibility and consensus among financial analysts. Earlier on, as CEO of Poste Italiane, Mr Passera had been able to lead an inertial, state-owned company through successful restructuring, significantly improving corporate image and recovering from poor performance. Part of its strategy involved a successful diversification in the banking industry, which had made of Poste Italiane a major player in the arena. • Before joining Capitalia, Matteo Arpe had earned a personal reputation for competence and rigour at prestigious merchant banks Mediobanca and Lehman Brothers. At the time of his appointment as CEO, in July 2003, Capitalia was suffering from its alleged involvement in major financial scandals. His arrival is credited for helping the company rebuilding its credibility within the financial community. • In the early 2000, when e.Biscom went public, the company was merely a start-up in the uncertain field of telecommunications. Founder and CEO Silvio Scaglia, however, had built and developed Omnitel, the first non-public mobile telecommunication provider in Italy. His personal reputation and prestige is credited for having raised more than 1.6 billion euros from institutional investors as well as the general public, for an entrepreneurial initiative that would not have generated profit before five years.
Personal involvement of the CEO in investor relations and financial communication	• At Unicredito, CEO Alessandro Profumo is often directly involved in investor relations. Not only does he illustrate personally the plans of the company, but he also regularly attends meetings with financial analysts and institutional investors to discuss strategic plans, annual and quarterly results, and future growth prospects. Also thanks to his personal involvement, Unicredito has earned a solid reputation for transparency and financial disclosure. • When Andrea Guerra left Indesit in 2004, the company's shares went down by more than 2% in one day. In the past few years, Mr. Guerra had been able to build excellent relationships with financial analysts and institutional investors by providing them with comprehensive information necessary for their decision making process. Mr Guerra had granted the company the consensus of the financial community around its market aggressive strategies leveraging on the accountability of its well-regarded management. • Fastweb's management has always been clear that the company would not have reached break even before 2005. All along, Mr. Scaglia's deep involvement in investor relations was crucial in preserving the consensus of the financial community around his daring and innovative strategy and in reassuring analysts and investors about his personal commitment to it.
CEO's profound knowledge of the business	• Despite recent poor operational performance, the consensus of the financial community around the innovative strategy of Tod's has never faltered. Indeed, the company CEO has proved to share a profound knowledge of the commercial and industrial aspects of the luxury business, which is credited for the establishment of a general attitude of trust towards the company and its future prospects. • While working as CEO for Omnitel, Silvio Scaglia, founder of e.Biscom had developed a deep knowledge of the telecommunication business, its key value drivers and its fundamental economics. In 1999, despite being only one of the many TLC start-ups founded at that time, e.Biscom was able to gather the financial backing needed to become in a short time one of the major players in broadband telecommunications. Mr. Scaglia's personal competence and experience in the filed reassured analysts and investors about the company's capacity to carry out its ambitious plans. • Sabaf is a world leader in the production of components for domestic gas cooking appliances. Despite its relatively small size and its low popularity among the general public, it is one of the best regarded companies in the Milan Stock Exchange. The personal competence of its CEO is credited for its high reputation among financial analysts. Having worked in the same industry for more than 40 years and in the same company for more than 30, Angelo Bettinzoli, has developed a rare insight and an outstanding capacity to articulate the competitive and economic implications of the company's plans.

TABLE 4. Building reputation in financial markets: Detailed and accountable strategic plans

Features	Examples
Clear explication of the causal relationships linking environmental trends, strategic intentions, action plans and end results	• Unicredito enjoys an excellent reputation in financial markets. On the one, its innovative, risky strategy is consistent with the expectations of the financial community for two-digit growth. On the other hand, the credibility of its strategic plans is enhanced by providing financial analysts and investors with balanced and detailed information about the company's goals, action plans, and expected results. • In 1998, the newly established managers of recently privatized Telecom Italia presented a three-year strategic plan. The documents illustrated to the financial community, however, contained serious discrepancies with the content and the figures of a plan presented to the trade unions only a week earlier. Such ambiguity severely damaged the credibility and the reputation of the company among the financial community. Despite sustained profits, in three months, company shares went down by 47%. • In 2001, Alitalia was facing a serious financial crisis: in the first semester, the company had lost 2.60 billion euros and even greater losses were expected in the second. The top management team proposed a capital increase of 1.55 billion euros. However, the strategic plan that accompanied the proposal and should have laid out the restructuring plan was vague and unclear about the destination of the capital. Financial analysts and institutional investors were disconcerted and the shaky plan dealt a further blow to the credibility of the company.
Supply of detailed information about the implementation of the proposed plans	• At Unicredito, periodic presentations of strategic plans to analysts and institutional investors are structured around a detailed articulation of the general plan into divisional sub-plans. Every divisional manager personally illustrates how corporate plans will be implemented in their units and indicates managers responsible to carry out the plans. • Although Banca Intesa has developed a bold, aggressive market strategy, the consensus of the financial community around company's strategic plans has never faltered. At Banca Intesa, the credibility and accountability of managers' claims is reinforced through the ample supply of information about the implementation of the proposed plans, by providing details about the key resources and competences the plans will rely on. • Fastweb, founded in 1999 as e.Biscom, operates in the highly uncertain and dynamic telecommunication industry. Since its IPO in 2000, the management of the company has been clear that break even would not be reached before 2005. The confidence of analysts and investors, however, has never waned. In order to constantly reassure the financial community, Fastweb managers have always provided detailed information about the current implementation of their plans, thus increasing confidence in their capacity to successfully carry out their challenging strategy.
Periodic follow-ups on the advances towards the expected results	• In order to reassure investors and analysts about their capacity to meet medium- and long-term financial goals, managers at Fastweb have constantly provided indications of the extent to which corporate performance has met short-term goals and expectations. In the latest industrial plan (2005-2013), a summary table compares forecasts and actual results since the foundation of the company, including later revisions presented to the financial community. • Capitalia's attempts to recover from poor reputation benefited from a revision of the content of their strategic communication, which more clearly linked expected and actual results by periodically updating priorities and targets presented in previous strategic plans. For instance, the 2003 plan recalled the priorities identified at an earlier stage – i.e. asset quality, capital and risk management, disposal of non core assets, management and corporate culture, revenue enhancement and focus on costs – and, for each of them, illustrated the results obtained until then and the expected new targets. • Every year, during the so-called "Investor Day", the top management team of Unicredito presents follow-ups on the advances towards the expected results indicated in previous industrial plans. In 2004, top managers were not afraid to revise company returns downwards, as, in the words of CEO Alessandro Profumo, "we prefer to revise targets earlier on rather than to divulge belated profit warnings, thus damaging our company's reputation."

TABLE 5. Building reputation in financial markets: effective and independent internal control systems

Features	Examples
Voluntary disclosure of information about the auditing practices	• At Indesit, uncommon disclosure of information about the company's internal control systems has helped reinforcing the consensus of the financial community around an ambitious strategy, based on acquisitions and geographical expansion. The company periodically provides extensive information about the structure and functioning of its internal control systems, disclosing voluntary information regarding its policies and practices. • In the late 2004, in light of major corporate changes, Telecom Italia illustrated in details its auditing practices and risk management policies, in order to reassure analysts and investors about the effectiveness of its internal control systems. The presentation touched issues such as the personal background of members of the auditing committee and the organizational location of internal auditing structures.
Clear distinction between control duties and managerial responsibilities	• In late 2001, results from an investigation of the Bank of Italy, the Italian authority for the banking industry, pointed at the poor performance of the internal control systems of Bipop. In particular, the investigation revealed that internal controls were demanded to formal bodies with no substantial power. Internal controllers were in fact heavily influenced by the top management. Divulgation of these results dealt a fatal blow to the reputation of the company. • At Indesit, the decision to locate the internal control system manager in the Chairman's staff was meant to reinforce and signal its independence from operating officers, and to confer credibility to the internal control systems of the company. Clear separation between control and managerial responsibilities is emphasized also in the corporate governance report of the company. • At Telecom Italia, the responsibility for the revision of internal control systems for the whole group of companies, is assigned to an autonomous subsidiary, Telecom Italia Audit, reporting directly to the Chairman of the company. Telecom Italia takes great care in underlining the fact that employees of Telecom Italia Audit do not have any managerial responsibilities in Telecom Italia, and are therefore independent from the rest of the managerial ranks.
Internal auditors' personal reputation for integrity and rigor	• In 2004, Giuseppe Cannizzaro, a former member of Consob (the Italian equivalent of the SEC), was appointed central director and legal counsellor of Capitalia. His appointment reinforced the idea that Capitalia was striving to improve the effectiveness of its internal control systems, to increase the accountability of its innovative and daring strategies.

TABLE 6. Building reputation in financial markets: A summary

Convincing leaders …	Effective strategic plans …	Credible control systems feature …
• Have a solid reputation for past achievements in related businesses or assignments • Display their commitment and responsiveness to the financial community by personally engaging in investor relations • Display a profound knowledge of the business and an outstanding capacity to articulate their plans • Are willing to discuss their plans personally with analysts and investors	• Provide clear and consistent information about the strategic intents and expected results • Explain clearly causal linkages between environmental trends, strategic intents, action plans and end results • Provide detailed information about the implementation of the proposed strategies • Provide systematic follow-ups about previously presented plans	• Respected and rigorous internal auditors • Clear demarcation between internal auditors and the managerial hierarchies • A broad scope of auditing practices encompassing financial, legal and operational aspects of the business, and an adequate size of the auditing structures • Voluntary disclosure of detailed information beyond the legal requirements

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[27]The leading Italian business newspaper, Il Sole-24 Ore, explicitly links the substantial raise of Banca Intesa stock price (+1,84% in a day) with the "effective and convincing presentation of its CEO". Together with the "transparency" of the plan, Mr. Passera's personal engagement is credited for having reassured analysts, garnered consensus around ambitious income targets, and induced analysts' to revise their forecasts (***Il Sole-24 Ore, Wednesday, 11 September 2002, page 31***).

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[45]Companies are now required to guarantee that: a) each member of the audit committee is independent of management, prohibiting the member from being an affiliated person of the company or any subsidiary apart from his or her capacity as a member of the board and any board committee; b) the audit committee is directly responsible for the appointment, compensation, retention, and oversight of the company's outside auditor, who is expected to report directly to the audit committee; c) the audit committee has authority to engage independent counsel and other advisors it determines are necessary for the committee to carry out its duties; d) the audit committee is granted appropriate funding. See 17 C.F.R. § 240.10A-3 (2003), adopted in ***Standards Relating to Listed Company Audit Commitees, Rel. No. 33-8220 (Apr. 9, 2003), 68 Fed. Reg. 18788***.

[46]Goldman Sachs, ***Industry Spotlight, Regional Italian Banks***, 11 February 1999.