Reducing Return Volatility: The Role of Earnings Quality and Corporate Reputation

Isnayni Sabila¹, Rahmawati², Endang Dwi Amperawati³, Corina Joseph⁴
¹²Accounting Department, Faculty of Economics and Business, Universitas Sebelas Maret
³Management Department, Faculty of Economics and Business, Universitas Primagraha
⁴Faculty of Accountancy, Universiti Teknologi MARA
*isnaynisabila@student.uns.ac.id¹, rahmawati_fe@staff.uns.ac.id², ed4prof@gmail.com³, corina@uitm.edu.my⁴.

Keywords:
Earning Quality, Stock Return Volatility, Corporate Reputation, Public Company, SEM-PLS.

ABSTRACT
This research aims to explore the influence of earnings quality and company reputation on stock return volatility in non-cyclical consumer companies listed on the Indonesia Stock Exchange (BEI) for the 2017-2021 period using quantitative methods. The research sample was 175 non-cyclical consumer sub-sector companies listed on the Indonesia Stock Exchange (BEI) for the 2017-2021 period and using PLS-SEM. The results of this research found that earnings quality has a negative effect on stock return volatility and company reputation has a negative effect on stock return volatility. Results of this research are expected to be useful for investors when investing in the stock market. Apart from that, it is also hoped that it can also be useful for companies so that they can be more careful in carrying out company operational activities so that they can improve their company’s reputation in terms of quality, performance, responsibility and attractiveness which can reduce return volatility. This research is limited to consumer non-cycicals sector in Indonesia and within just 5 years observation and contributes to existing knowledge by empirically testing the relationship between earnings quality and company reputation on stock return volatility. There has been no research in Indonesia that discusses the influence of company reputation on stock return volatility.
INTRODUCTION

Investing in the stock market, investors are often faced with a very high risk due to fluctuating and stochastic stock prices. This will certainly cause stock returns to fluctuate, and this return fluctuation is called stock return volatility (Ikizlerli, 2022). Stock return volatility describes the ups and downs of stocks over a certain period of time. Market actors are very concerned about volatility because it is also used as a measure of risk (Panda et al., 2021). Excessive stock return volatility will jeopardize the stock market and will obscure the stock price as the fairest representation that can reflect the value of the company (Karolyi & Karolyi, 2001). However, controlled volatility indicates that the information dissemination mechanism is working well in a market (Bravo, 2016). Investor interest in investing will be destabilized due to the increased risk and uncertainty caused by high volatility. Companies may struggle to raise funds in the stock exchange, due to greater uncertainty about the return of shares in a volatile market. As a result, investors need to be able to predict how stock prices will change to determine when to buy and sell stocks. By estimating volatility, market actors can control and reduce the market risk of traded assets such as stocks. The calculation or estimation of volatility is considered superior to the calculation of ordinary stock returns because the calculation of volatility is considered to be able to calculate a stock’s risk.

The term “high risk, high return” is well-known in the stock markets which suggests that the bigger the risk, the greater the profit that stockholders will receive (Hui Guo, 2007). Speculative investors prefer markets with high volatility because it allows them to get short-term profits, while low volatility allows investors to hold stocks for a long time in order to get the maximum profit, low volatility also indicates that the risk taken by investors is low (Ridha & Wibowo, 2020). The good condition of the stock issuing company does not solely guarantee that the volatility of its stock returns will be stable. Aboody, Hughes, and Liu (2005) state that companies listed on the United States Securities and Exchange Commission still have high stock return volatility even though the company’s financial condition is categorized as good. This will certainly raise the question of why companies with good financial conditions have high stock return volatility. The Indonesian stock market has very good performance and growth, but also has high volatility which can affect the interest of investors investing in the Indonesian stock market (Sari et al., 2017). Stock returns in Indonesia, particularly in non-cyclical consumer businesses, have been volatile from 2017 to 2021, particularly during the Covid-19 period.

Earning quality is one of the important factors influencing stock return volatility because earning quality can be represented as the sum of operating cash flow and accruals (Rajgopal & Venkatachalam, 2011) so that it will offer investors with signals about the company’s state, which could impact the volatility of stock returns. The results of research conducted by Mitra (2016) and Rajgopal and Venkatachalam (2011) discovered that the volatility of stock returns is negatively impacted by earning quality. Apart from earning quality, the company’s reputation is equally important. Corporate reputation refers to how stakeholders perceive and understand the company’s ongoing communication, which serves as the foundation for evaluating all of the company’s stakeholder attributes (Serrat, 2011). The role of a company’s reputation in shaping expectations for risk and return is being studied. Investors frequently believe that reputable businesses, especially those with high reputation ratings, provide excellent investment prospects (Shefrin & Belotti, 2001). Helm (2007) points out that, particularly for developing countries like Indonesia, reputation plays a significant role in market-based risk. Research conducted by Bravo (2016) discovered that the volatility of stock returns is negatively impacted by the reputation of a company.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Signalling Theory

Initially, signalling theory was proposed by Spence (1973) which clarifies that information demonstrating a company’s success is sent by the sender, the owner of the information, to the receiver According to Brigham & Houston (2011) signalling theory describes management’s perception of future firm growth, which influences investor reactions. Information that describes management’s efforts to fulfill the owner’s wishes acts as a signal, and investors and businesspeople utilize it to their advantage when making investment decisions.
Investors will be given information from the company that will be interpreted and analysed first to determine whether the information is a positive or negative signal (Jogiyananto, 2017).

This signal can be information that claims that the company is superior to other businesses with the intention of increasing the value of the business through financial reporting (Scott, 1997). Signalling theory can also be reflected by earning quality because the variable can reflect the company’s future financial prospects as a signal of the company’s condition which will affect the volatility of stock performance (Mitra, 2016). Furthermore, signal theory can be applied to business reputation, as the variable is explored as a determinant in the creation of risk and return expectations. Investors prefer to believe that good investment chances originate from companies with high reputation ratings (Shefrin & Belotti, 2001).

**Earning Quality and Stock Return Volatility**

Signal theory is based on information asymmetry between individuals and organizations, investors and management, in which certain parties act to convey signals about specific situations to lessen imbalance produced by social selection difficulties under conditions of imperfect knowledge (Connelly et al. 2011). This means that signalling is carried out by management to reduce asymmetric information, where one of the signals is in the form of corporate earnings disclosure. Earnings are a process of recording all company events by considering managerial policies in each process. An earnings information is an important information in the financial statements (Lev 1989). According to Statement of Financial Accounting (SFAC) number 2, earnings information is the most important part of financial statements and has predictive value for its users (FASB 1980). Earnings statements are considered to contain information for investors to use in the analysis of shares issued by issuers whose main focus is profit.

The market response to earnings information can be shown by various responses given by the earnings published in the financial statements (Dwaikat et al., 2023). The response is influenced by the quality of the company’s earnings (Boediono 2005). Investors usually use various ratio analyses to determine the company’s past, present, and future capabilities using this earnings information. Earnings quality has various definitions in the literature, and there is no consensus on it (Khajavi and Nazemi 2011). The definition of earnings quality in accounting can be seen from two perspectives, namely decision usefulness and economic based perspective. From the economic based perspective, Francis, Olsson, and Schipper (2006) indicate the degree of closeness of reported earnings to economic earnings, which is the same amount that can be consumed in one period by maintaining the company’s ability during that period. The meaning of the definition is that the quality of accounting earnings is indicated by the “closeness or correlation between accounting earnings and economic earnings”. From the perspective of decision usefulness, if earnings figures can be used to make decisions, then earnings are considered as having high quality (Eriqat & Al-Khazaleh, 2023). From this perspective, various users of financial statements define earnings quality in different ways. For example, Dechow and Schrand (2004) tend to focus on performance, which is a good way to evaluate firm value and a good summary measure for future operating performance. The declared high quality of earnings is referred to as “sustainable earnings” in financial analysis (Penman and Zhang 1999).

Earnings are considered to have good quality when accounting procedures produce sustainable earnings. Gissel, Giacominio, and Akers (2005) describe earnings quality as the ability of earnings to accurately depict business results in order to help anticipate future earnings while taking into account earnings stability and persistence. Earnings information is used by analysts using various ratio analyses to determine the company’s previous, current and future capabilities. Earnings information disclosed by the company will affect investors’ investment decisions (Aboody, Hughes, and Liu 2005). High earnings quality shows that the company’s financial performance is strong, and profits can reliably forecast future earnings continuity because they are more than or equal to expected earnings. Mitra (2016) states that high earning quality will be able to reduce stock mispricing by restraining irrational trading by noise traders and consequently making the stock market more efficient, which will reduce and stabilise stock return volatility.
Research conducted by Rajgopal and Venkatashalam (2011) found that high earning quality will cause low stock return volatility. This is because companies are considered to be able to disclose information about earnings quality where earnings quality can reflect good future cash flows so that investors will assume that these shares can be used for long-term investment. As a result, the issuer’s shares will be relatively low. Based on signal theory and past research, the following hypothesis is offered, H1: Earning Quality has a negative effect on stock return volatility.

**Corporate Reputation and Stock Return Volatility**

Signalling theory describes the relationship in providing information by companies to investor responses that can affect investment decisions (Rajgopal & Venkatashalam, 2011). If information contains positive value, it can be predicted that the market will also react positively, but if the information contains negative value, it can also be predicted that the market will react negatively. It takes time for all market participants to determine whether the information is a positive or negative signal after it is published. One of the information used is corporate reputation (Bravo, 2016).

The corporate image can be defined as a broad attribute of an organization that displays how much stakeholders, both internal and external, view the business as a good one (Roberts & Dowling, 2002). According to Dalton and Croft (2003), reputation is the total evaluation of a company’s stakeholder characteristics based on their perceptions and interpretations of the company’s continuously communicated image. Walsh et al. (2009) define corporate reputation as an overall assessment of the company by consumers based on their reactions to its goods and services, corporate communication operations, and encounters with the company or its representatives (e.g., employees, management). Gotsi and Wilson (2001) define the corporate image as the long-term appraisal of all the business’s stakeholders. The evaluation is based on stakeholders’ experiences, which provide information about the company’s actions and comparisons with competitors (Cao, 2023). Reputation is also one of the key drivers of sustainable performance (Tischer & Hildebrandt, 2014). A good business reputation has a positive influence on many stakeholder groups (Tischer & Hildebrandt, 2014). Herbig, Milewicz, and Golden (1994) state that a company’s competence and its superiority to other competing businesses are indicators of corporate reputation. A corporation can profit from a favorable corporate reputation in various ways, including influencing consumers’ product selections, reducing competitors’ potential competition, and ensuring social standing within an industry (Hall Jr. & Lee, 2014). As a result of all of these benefits, organizations tend to have higher profitability, market performance, and a stronger competitive edge, which might influence stock return volatility. Corporate reputation represents the perceived quality of corporate management and is believed to improve investor trust in a business (Hammond & Slocum, 1996). This assumption is based on the psychological consequences of business reputation on investors. Corporate reputation is explored as a factor in the development of risk and return expectations. Investors prefer to believe that strong investment chances originate from firms with high reputation ratings (Shefrin & Belotti, 2001). Market actors are primarily concerned with business reputation; they think that organizations with a relatively strong reputation are better equipped to retain superior profits over time (Roberts and Dowling 2002). Helm (2007) in his research states that investors expect high returns from companies with high reputation. This is consistent with studies by Fernández-Gámez, Gil-Corral, and Galán-Valdivieso (2016) which found that the corporate reputation of a company is considered to reduce volatility because investors tend to maintain their share ownership in a company in the hope of making a profit which will be greater in the future due to the company’s good reputation. This research is in line with research conducted by Bravo (2016) which found that corporate reputation can reduce stock return volatility. H2: Corporate reputation has a negative effect on stock return volatility

**RESEARCH METHODS**

This study used secondary data from 175 primary consumer goods industry businesses (consumer non-cyclicals) listed on the Indonesia Stock Exchange (IDX) from 2017 to 2021 using criteria (1) Primary consumer goods industry...
companies (consumer non-cyclicals) listed on the IDX for the 2017-2021 period with criteria, (2) The company published audited reports according to the 2017-2021 observation year period, (3) The company provided complete information related to the research variables. The data analysis approach utilized to test the hypothesis in this study was Partial Least Squares (PLS) - Structural Equation Modelling (SEM), because the data for numerous variables in the study were not regularly normal distributed. According to Ulum et al. (2019) the Partial Least Squares (PLS) - Structural Equation Modelling (SEM) testing stage is divided into 6 steps, consisting of conceptualising the model, determining the algorithm analysis method for the outer model and inner model, determining the resampling method, drawing the path analysis model, evaluating the structural model, and reporting the analysis results.

To determine the relationship between earning quality, stock return volatility, and corporate reputation, the authors adopted (Naufa et al., 2019) who calculated the standard deviation of monthly returns and used that result to make stock return volatility the dependent variable.

\[
\text{Retvol} = \frac{1}{n-1} \sum_{i=1}^{n} (\text{Return} - \text{Mean})^2
\]

Then, the author also composed the independent variables of earnings quality and corporate reputation. The first independent variable is earning quality, in its calculation the author adopted Penman and Zhang (1999) with the following calculation:

\[
\text{EQ} = \frac{\text{Operating Cash Flow}}{\text{Net Income}}
\]

The second independent variable is corporate reputation, the author adopted the calculations made by Bravo (2016) which uses dummy variables for measuring corporate reputation, where 1 is for companies that are included in the Indonesia’s Most Admired Company Award ranking, while 0 is for companies that are not.

The selection of control variables is a variable that allows it to influence the dependent variable in addition to the independent variable. The control variables in this study are size, return on equity, leverage, earning per share, and foreign ownership, and listing age (Vo 2015, Badruzaman 2020, Cosset, Somé, and Valéry 2016, Lee and Liu 2011, Naufa, Lantara, and Lau 2019). Size is defined as the natural logarithm of total assets. Return on equity is defined as the ratio of net profit after tax to equity. Leverage is defined as the ratio of total debt to total assets. Earnings per share (EPS) is the ratio of net profit to outstanding shares. Foreign ownership is the number of foreign shares divided by the total number of shares.

RESULTS AND DISCUSSION

Statistic Descriptive

According to table 1, the stock return volatility variable has a maximum value of 0.941 and a minimum value of 0.017, as indicated by the results of descriptive statistical analysis. The standard deviation is 0.163 and the average value is 0.265. The earning quality variable has a maximum value of 25.568, a minimum value of -84.53, an average value of 1.071, and a standard deviation of 7.338 according to the findings of descriptive statistical analysis. The corporate reputation variable’s descriptive statistical analysis findings have a maximum value of 1.00 and a minimum value of 0.00. Based on the year posted on the Indonesia Stock Exchange, the size has a maximum value of 32.402, a minimum value of 27.105, an average value of 29.428 and a standard deviation of 1.369, according to the findings of descriptive statistical analysis on the size variable. The return on equity variable, as determined by the year of listing on the Indonesia Stock Exchange, has a maximum value of 1.451, a minimum value of -0.689, an average value of 0.145, and a standard deviation of 0.305, according to the findings of a descriptive statistical analysis. Based on the year posted on the Indonesia Stock Exchange, leverage has a maximum value of 0.865, a minimum value of 0.007, an average value of 0.449, and a standard deviation of 0.204. These findings are based on descriptive statistical analysis conducted on the leverage variable. Based on the year posted on the Indonesia Stock Exchange, earning per share has a maximum value of 5655.147, a minimum value of -449.665, an average value of 264,715, and a standard deviation of 721,084, according to the findings of a descriptive statistical analysis on the earning per share variable. Based on the year posted on the Indonesia Stock
Exchange, foreign ownership has a maximum value of 94.508, a minimum value of 0.250, an average value of 39.293 and a standard deviation of 28.520, according to the findings of a descriptive statistical analysis on the foreign ownership variable.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Maximum</th>
<th>Minimum</th>
<th>Average</th>
<th>Deviation Standart</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock Return Volatility</td>
<td>0.941</td>
<td>0.017</td>
<td>0.265</td>
<td>0.163</td>
</tr>
<tr>
<td>Earning Quality</td>
<td>25.568</td>
<td>-84.53</td>
<td>1.071</td>
<td>7.338</td>
</tr>
<tr>
<td>Corporate Reputation</td>
<td>1.000</td>
<td>0.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Size</td>
<td>32,402</td>
<td>27.105</td>
<td>29.428</td>
<td>1.369</td>
</tr>
<tr>
<td>Return On Equity</td>
<td>1,451</td>
<td>-0.689</td>
<td>0.145</td>
<td>0.305</td>
</tr>
<tr>
<td>Leverage</td>
<td>0.865</td>
<td>0.007</td>
<td>0.449</td>
<td>0.204</td>
</tr>
<tr>
<td>Earning Per Share</td>
<td>5655,147</td>
<td>-449,665</td>
<td>264,715</td>
<td>721,084</td>
</tr>
<tr>
<td>Foreign Ownership</td>
<td>94,508</td>
<td>0.250</td>
<td>39,293</td>
<td>28,520</td>
</tr>
</tbody>
</table>

**Output Model**

Table 2 indicates that all fit models utilized in this investigation are satisfied, indicating the fit of this research model. APC = 0.126, ARS = 0.161, and AARS = 0.125 are the size of the fit model in this study model; all three are significant (APC P = 0.011, ARS P = 0.002, and AARS P = 0.011). It can be concluded that there are no issues with vertical collinearity (collinearity between exogenous or predictor variables) or lateral collinearity (collinearity between exogenous or predictor and endogenous or criterion variables) in this research model because the AVIF value of 1.158 and the AFVIF value of 1.142 are below the criterion acceptance limit of ≤5. Tenenhaus GoF value = 0.401 indicates that this research model’s predictive power falls into the large category because the value is above 0.25.

![Figure 1. Output Model](image-url)
According to earning quality measurement, stock has a negative impact on stock return volatility. These findings, which show that earning quality has a negative impact on stock return volatility. According to earning quality measurement, stock return volatility decreases as value increases. This research findings are consistent with research by Mitra (2016) and Rajgopal and Venkatachalam (2011) suggesting the volatility of stock returns is negatively impacted by earning quality. Earnings quality has various definitions in the literature, and there is no consensus on it (Khajavi & Nazemi, 2011). The definition of earnings quality in accounting can be seen from two perspectives, namely decision usefulness and economic based perspective. From the economic based perspective, Francis, Olsson, and Schipper (2006) indicate the degree of closeness of reported earnings to economic earnings, which is the same amount that can be consumed in one period by maintaining the company’s ability during that period. The meaning of the definition is that the quality of accounting earnings is indicated by “the relationship or correlation between accounting

### Table 3. R-Squared, Q-Squared and Effect

<table>
<thead>
<tr>
<th>Variabel</th>
<th>Path Coefficients</th>
<th>Keterangan</th>
<th>Rule of Thumb</th>
</tr>
</thead>
<tbody>
<tr>
<td>Earning Quality</td>
<td>0.025</td>
<td>Weak</td>
<td></td>
</tr>
<tr>
<td>Corporate Reputation</td>
<td>0.017</td>
<td>Very Weak</td>
<td></td>
</tr>
<tr>
<td>Size</td>
<td>0.005</td>
<td>Very Weak</td>
<td>&gt; 0.02 Weak</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>0.017</td>
<td>Very Weak</td>
<td>&gt; 0.15 Medium</td>
</tr>
<tr>
<td>Earning Per Share</td>
<td>0.006</td>
<td>Very Weak</td>
<td>&gt; 0.35 Large</td>
</tr>
<tr>
<td>Foreign Ownership</td>
<td>0.025</td>
<td>Very Weak</td>
<td></td>
</tr>
<tr>
<td>Leverage</td>
<td>0.077</td>
<td>Weak</td>
<td></td>
</tr>
</tbody>
</table>

According to table 3, the R-Squared result is 0.161, meaning that exogenous or independent variables (like corporate reputation and earning quality) as well as control variables like size, earnings per share, leverage, return on equity, and foreign ownership can account for 16.1% of the variation in endogenous or dependent variables (like stock return volatility). The remaining 83.9% of the variation is explained by variables not included in this research model. Because the Q-Squared result in this study has a value above 0.164, it suggests strong predictive validity.

**Hypothesis Test**

<table>
<thead>
<tr>
<th>Variabel</th>
<th>Path Coefficients</th>
<th>P-value</th>
<th>Rule of Thumb</th>
</tr>
</thead>
<tbody>
<tr>
<td>Earning Quality</td>
<td>-0.169</td>
<td>0.003</td>
<td>P &lt; 0.1</td>
</tr>
<tr>
<td>Corporate Reputation</td>
<td>-0.098</td>
<td>0.057</td>
<td>P &lt; 0.1</td>
</tr>
<tr>
<td>Size</td>
<td>-0.058</td>
<td>0.173</td>
<td></td>
</tr>
<tr>
<td>Return on Equity</td>
<td>-0.119</td>
<td>0.027</td>
<td></td>
</tr>
<tr>
<td>Earning per Share</td>
<td>0.047</td>
<td>0.221</td>
<td></td>
</tr>
<tr>
<td>Foreign Ownership</td>
<td>-0.115</td>
<td>0.032</td>
<td></td>
</tr>
<tr>
<td>Leverage</td>
<td>0.275</td>
<td>&lt;0.001</td>
<td></td>
</tr>
</tbody>
</table>

The path coefficient of the earning quality variable is -0.169 and significant with P = 0.003, indicating that H1 is accepted based on table 4 results; the path coefficient of the corporate reputation variable is -0.098 and significant with P = 0.057, indicating that H2 is accepted.

**Earning Quality and Stock Return Volatility**

The earning quality variable’s path coefficient, as determined by testing the first hypothesis, is -0.169, indicating a negative value and a significant p value with P = 0.003, where the value is less than 0.1. The first hypothesis is supported by these findings, which show that earning quality has a negative impact on stock return volatility. According to earning quality measurement, stock return volatility decreases as value increases.
earnings and economic earnings”. In the perspective of decision usefulness, if earnings figures can be used to make decisions, then earnings are said to be of high quality. From this point of view, various users of financial statements define earnings quality in different ways. For example, Dechow and Schrand (2004) tend to focus on performance, which is a good way to evaluate firm value and a good summary measure for future operating performance. In financial analysis, “sustainable earnings” is the term used to describe the stated high quality of earnings (Penman & Zhang, 1999).

Sustainable earnings are a sign of high-quality earnings, as determined by accounting methods. Gissel, Giacomino, and Akers (2005) describe earnings quality as the capacity of profits to properly depict business results in order to assist anticipate future earnings while taking into account earnings stability and persistence. Earnings information is used by analysts using various ratio analyses to determine the company’s previous, current and future capabilities. Earnings information disclosed by the company will affect investors’ investment decisions (Aboody et al., 2005). Because the final profits are more than or equal to the projected earnings, high earnings quality signals that the company’s financial performance is strong and that earnings can properly predict future earnings continuity. Mitra (2016) states that high earning quality will be able to reduce stock mispricing by restraining irrational trading by noise traders and consequently making the stock market more efficient, which will reduce and stabilise stock return volatility. Research conducted by Rajgopal and Venkatachalam (2011) found that high earning quality will cause low stock return volatility. This is because the company is considered to be able to disclose information about earnings quality where earnings quality can reflect good future cash flow so that investors will assume that the shares can be used for long-term investment as a result of which the issuer’s stock volatility will tend to be low.

**Corporate Reputation and Stock Return Volatility**

The corporate reputation variable’s path coefficient, as determined by testing the second hypothesis, is -0.098, indicating a negative value and a significant p value with P = 0.057, where the p-value is less than 0.1. The second hypothesis is supported by these findings, which show that corporate reputation has a negative impact on stock return volatility. According to corporate reputation measurement, stock return volatility decreases as value increases. This research findings are consistent with research by Bravo (2016) suggesting the volatility of stock returns is negatively impacted by corporate reputation.

Corporate reputation is a broad characteristic of an organization that indicates how highly stakeholders, both internal and external, regard the company. (Roberts & Dowling, 2002). According to Dalton and Croft (2003), reputation is the total evaluation of a company’s stakeholder characteristics based on their perceptions and interpretations of the company’s continuously communicated image. Walsh et al. (2009) state that customers’ overall assessment of a company is determined by how they react to its goods and services, how it communicates with them, and how they engage with it or one of its representatives (such as managers or workers). Gotsi and Wilson (2001) state that corporate reputation is the long-term appraisal of all the company’s stakeholders.

Evaluations are based on stakeholder experiences, which provide information about the company’s actions and how they compare to competitors. Reputation is also one of the key drivers of sustainable performance (Tischer & Hildebrandt, 2014). An excellent company image has a positive influence on many stakeholder groups (Tischer & Hildebrandt, 2014). Herbig, Milewicz, and Golden (1994) state that a company’s competence and its superiority to other competing businesses are indicators of corporate reputation. A corporation can profit from a favourable corporate reputation in various ways, including influencing consumers’ product selections, reducing competitors’ potential competition, and ensuring social standing within an industry (Hall Jr. & Lee, 2014). As a result of all of these benefits, organizations tend to have higher profitability, market performance, and a stronger competitive edge, which might influence stock return volatility.

Investor confidence in a firm is predicted to rise when it has a strong corporate reputation, which is a measure of the management’s perceived excellence (Hammond & Slocum, 1996), this assumption is based on investors’ psychological reactions to a company’s reputation. Higher corporate reputation trading volume activity could be more believable.
to investors and have a bigger impact. On the one hand, it is evident that social and psychological factors may also influence investor behaviour, and business reputation may positively influence an individual investor’s emotional inclinations (Helm, 2007). Corporate image may be viewed as an intangible aspect that influences investor loyalty and trust since capital market players may view corporations with a better reputation as more stable businesses. Given that irrational investor mood can potentially be reflected in stock return volatility (Rajgopal & Venkatachalam, 2011), the reputation of the company might be used to gauge this volatility. The role of a company’s reputation in shaping expectations for risk and return is being studied. Investors frequently believe that reputable businesses, particularly those with high reputation ratings, offer excellent investment prospects (Shefrin & Belotti, 2001). The majority of market participants are very worried about a company’s reputation because they believe that those with a more positive image may sustain higher profit margins over an extended period of time (Roberts and Dowling 2002). Helm (2007) in his research states that investors expect high returns from companies with high reputation. This is in line with research conducted by Fernández-Gámez, Gil-Corral, and Galán-Valdivieso (2016) who discovered that corporate reputation can increase stock prices which then this increase will cause high issuer stock return volatility. Bravo (2016) states that a company’s reputation can help to reduce the volatility of stock returns, but it can also lead to psychological bias among investors who believe that firms with a strong reputation would be more dependable and stable.

These results are in line with signalling theory in the accounting perspective that signal theory describes the relationship in providing information by companies to investor responses that can affect investment decisions (Rajgopal & Venkatachalam, 2011). If an information contains positive value, it can also be predicted that the market will react positively, but if the information contains negative value, it can also be predicted that the market will react negatively. These results are in line with Bravo (2016) research which shows that corporate reputation can reduce stock return volatility.

CONCLUSION

Based on the test results of earning quality variables and corporate reputation on stock return volatility using Partial Least Squares (PLS) analysis - Structural Equation Modelling (SEM), the conclusions obtained include (1) Earning quality has a negative effect on stock return volatility and (2) Corporate reputation has a negative effect on stock return volatility. This research is expected to be useful for investors when investing in the stock market, besides that it is also expected to be useful for companies to be more careful in carrying out company operations as it is related to the provision of capital by investors and it is hoped that companies can improve their corporate reputation in terms of quality, performance, responsibility, and attractiveness which can reduce the volatility of their returns. This research is limited to non-cyclical consumer companies and within a span of 5 years so that further research is expected to increase the observation period and sample of companies and add moderating variables such as good corporate governance and exchange rate.


Reducing Return Volatility:...


