EXAMINING THE LONGITUDINAL RELATIONSHIP BETWEEN ORGANIZATIONAL PRESTIGE AND CORPORATE FINANCIAL PERFORMANCE USING STRUCTURAL EQUATION MODELING

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ABSTRACT

I use structural equation modeling (SEM) and data of 167 Fortune 500 companies, which were ranked as the America’s Most Admired Companies from 2001 to 2006, to examine the longitudinal relationship between organizational prestige and corporate financial performance (CFP). The results demonstrate that organizational prestige has a reciprocal longitudinal relationship with CFP. However, it is noteworthy that the effect sizes in the longitudinal relationship decrease as the length of time lags increases.

KEYWORDS: organizational prestige, CFP, SEM

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The concept of prestige has become popular in organizational research (e.g., Dutton, Dukerich, and Harquail 1994; Carter and Dukerich 1998; Fryxell and Wang 1994). In general, it refers to reputation arising from success, or a favorable and publicly recognized name or standing for merit achievements (Shenkar and Yuchtman-Yaar 1997). The concept of prestige is equated with several other concepts such as standing and reputation used in different disciplines (Shenkar and Yuchtman-Yaar 1997; Deephouse and Carter 2005). Specifically, organizational prestige concerns the degree to which an organization is well regarded or how the status and image of an organization is judged by outsiders or observers (Mael and Ashforth 1992; Clark and Montgomery 1998). It can be generally considered as the relative esteem in which an organization has in an “ordered total system of differentiated evaluation” (Parsons 1951: 132), or as a perceptual representation of an organization’s past actions and future prospects that describe the organization’s overall appeal to all its key constituents when compared to other leading rivals (Fombrun 1996; Roberts and Dowling 2002).

Earlier sociological literature suggests a functional structural model of organizational prestige. Subsequently, some scholars argue that association, affiliation with other organizations, ownership, seniority, accreditation, technological development, and so forth strengthen organizational prestige (Mack 1954; Babchuk, Marsey, and Gordon 1960; Edwards 1969; Young and Larson 1965; Weizsacker 1980; Abbott 1974; Heyderbrand 1973). Sociologists often take the broadest approach and measure prestige during various time points, thereby providing insights embedded in a longitudinal perspective (Shenkar and Yuchtman-Yaar 1997).

Economists consider organizational prestige an information good that requires economies of scale (Weizsacker 1980). Strong organizational prestige serves as a valuable, rare, inimitable, and non-substitutable intangible resource that provides sustainable competitive advantages (Hall 1993; Barney 1991; Inglis, Morley, and Sammut 2006; Weigelt and Camerer 1988). Hence, organizations with strong prestige usually have superior financial performance (Barney 1991).

However, whether prior organizational prestige provides underpinnings for subsequent strategic advantages of organizations or vice versa splits the pundits: some scholars argue that organizational prestige influence corporate financial performance (CFP) (Porter 1980; Barney 1991; Roberts and Dowling 2002; Rose and Thomsen 2004; Fombrun 1996); some argue that CFP affect organizational prestige (Podolny and Phillips 1996; Fombrun and Shanley 1990; Stanwick and Stanwick 1998; McGuire, Schneeweis, and Branch 1990); and others suggest no longitudinal relationship between organizational prestige and CFP (Inglis et al. 2006). Based on these findings, I speculate a reciprocal longitudinal relationship between organizational prestige and CFP. Yet a dearth of research on this issue has employed alternative approaches other than econometric modeling; more longitudinal studies with varied advanced approaches and especially those that are able to capture measurement errors are desired. In addition, the vast majority of the previous research used data (especially Fortune data) of the 1980s and/or 1990s; little research used data of the 2000s. As the business environment evolves dramatically in the 21st century and becomes quite dissimilar from before, it is important to empirically test, and if necessary, update the theories with most recent data. Accordingly, I use structural equation modeling (SEM) and data of the 2000s to assess the longitudinal relationship between organizational prestige and CFP.

Next, I review the literature on the relationship between organizational prestige and CFP. Then I test different hypothesized structural equation panel models (Finkel 1995; Marsh and Yeung 1997; Campbell and Kenny 1999) in order to identify the longitudinal relationship
patterns, using the annual data (from 2001 to 2006) collected from the archival databases of the *Fortune America’s Most Admired Companies*, *Fortune 500*, and companies. The paper concludes by summarizing the findings and discussing their important implications for research.

**THEORETICAL BACKGROUND AND HYPOTHESES**

Organizational prestige is an intangible resource, representing an overall assessment of an organization’s current assets, position and expected future performance (Teece, Pisano, and Shuen 1997: 521). As a core resource, organizational prestige can be a major factor in gaining a competitive advantage and fortifying a financial position because it is difficult for the competitors to match the prestige (Shrum and Wuthnow 1988; Fombrun 1996; Fombrun and Shanley 1990; Benjamin and Podolny 1999). Nonetheless, how organizational prestige generates financial benefits and what the longitudinal relationship pattern between organizational prestige and CFP is (Inglis et al. 2006) remain moot questions. I speculate a reciprocal longitudinal relationship between them. The history of CFP and previous efforts affect current organizational prestige (Roberts and Dowling 2002; Podolny and Phillips 1996; Hammond and Slocum 1996); past CFP influences the outsiders’ perceptions of the value of an organization’s current outputs, attributes, members’ socioeconomic status, structure, and so forth (Perrow 1961; Young and Larson 1965; Shrum and Wuthnow 1988; Minnis 1953). Previous research (e.g., Roberts and Dowling 2002; Brown and Perry 1994) demonstrates that CFP accounts for 15 to 59 percent of the variance in organizational prestige. Hence, organizational prestige is a key indicator of an organization’s prior performance, including effectiveness, efficiency, and internal relationships (Sabate and Puente 2003; Perrow 1961; Fombrun and Shanley 1990).

On the other hand, organizational prestige, once acquired, can be converted into other resources (Shenkar and Yuchtman-Yaar 1997). Strong prestige brings an organization favorable situations, including generating excess returns by inhibiting the mobility of its rivals in industries, enhancing its customers’ buying intentions, charging premium prices to its customers with positive attitudes toward its products or/and services, creating better images in capital markets and to its investors, ability to survive crises, and so forth (Perrow 1961; Young and Larson 1965; Shrum and Wuthnow 1988; Minnis 1953). Previous research (e.g., Roberts and Dowling 2002; Brown and Perry 1994) demonstrates that CFP accounts for 15 to 59 percent of the variance in organizational prestige. Hence, organizational prestige is a key indicator of an organization’s prior performance, including effectiveness, efficiency, and internal relationships (Sabate and Puente 2003; Perrow 1961; Fombrun and Shanley 1990).

However, the empirical findings of the relationship between organizational prestige and CFP have not been in agreement. Rose and Thomsen (2004), for instance, provided evidence against the conventional wisdom that organizational prestige improves CFP, using market to book value of equity (MBV), but CFP was found to sway future organizational prestige.
Fombrun and Shanley (1990) found that prior organizational prestige is strongly associated with subsequent organizational profitability. McGuire, Sundgren, and Schneeweiss (1988) demonstrated that accounting-based measures, and particularly return on assets (ROA), serve an important signaling function when organizational reputation rankings are constructed. Podolny (1993) identified the inverse relationship between organizational prestige and costs, wherein prestigious organizations had lower costs that encouraged those organizations to further enhance their prestige. Some scholars found that CFP serves as a crucial or even overwhelming determinant of organizational prestige (Deephouse and Carter 2005; Fombrun and Shanley 1990). However, Inglis et al. (2006) found that organizational prestige did not affect CFP or vice versa. Therefore, how organizational prestige and CFP are related in a longitudinal manner remains an open issue. Accordingly, for the empirical investigation in this research, I propose four competing hypotheses about the longitudinal relationship between organizational prestige and CFP.

Hypothesis 1. Organizational prestige has no longitudinal relationship with CFP.
Hypothesis 2. Prior organizational prestige influences subsequent CFP but not vice versa.
Hypothesis 3. Prior CFP influences subsequent organizational prestige but not vice versa.
Hypothesis 4. Organizational prestige has a reciprocal longitudinal relationship with CFP.

**METHOD**

**Sample**

I considered 176 Fortune 500 companies ranked as the America’s Most Admired Companies from 2001 (published in 2002) to 2006 (published in 2007) (inclusive) because they had no missing data of the America’s Most Admired Companies for the consecutive six years. Some companies did not come out on the list of Fortune 500 for a year or two and therefore their Fortune archival data of net incomes and assets were not available, but I found their data in their annual reports posted on their corporate websites. After the data screening, 9 observations were identified as outliers and were excluded from the subsequent analyses (Kline 2005).

Accordingly, the final sample included 167 Fortune 500 organizations.

**Variables**

Organizational prestige was measured as the overall score obtained in the annual Fortune surveys (cf. Roberts and Dowling 2002: 1093 for detailed description of the methodology employed for collecting the Fortune reputation data). Ratings were made on a Likert-type scale of 0 (poor) to 10 (excellent). The score met the multiple consistency ecological model view of organizational effectiveness (Landgraf and Riahi-Belhaoui 2003). Despite the skepticism regarding the Fortune data (Preston and Sapienza 1990; McGuire et al. 1990; Brown and Perry 1994; Fombrun 1996; Fombrun and Shanley 1990), numerous studies have used this rating in their studies (Roberts and Dowling 2002; Hammond and Slocum 1996; Gatewood, Gowan, and Lautenschlager 1993; Fombrun and Shanley 1990; McGuire et al. 1988; Carmeli and Tishler 2005). Fryxell and Wang (1994) specifically did confirmatory factor analysis (CFA) within the LISREL program and suggested that the Fortune data may be appropriate for studies focusing on the financial goals of organizations (Brown and Perry 1994). I used the overall scores of annual organizational prestige (cf. Fryxell and Wang 1994 for the CFA results; Fombrun and Shanley
Since the raw data were not normally distributed, I normalized them to meet the normality assumption of SEM.

To measure CFP, I used return on assets (ROA). Accounting-based profitability measures are often used to assess CFP; the data are available and many previous studies have used the measures (Cowen et al. 1987; Huselid 1995; Nickerson and Silverman 2003; Grant 1987). Among those accounting measures, ROA is one of the most widely used indicators of CFP in organizational research (Robert and Dowling 2002; Inglis et al. 2006; Landgraff and Riahi-Belkaoui 2003). It is generally considered as one operational measure of an organization’s efficiency a propos the profitable use of its total asset base (Ansoff 1965; Bourgeois 1980; Gale 1972; Capar and Koyabe 2003; Roberts and Dowling 2002; Dess and Robinson 1984). Reinhardt (2001) referred to ROA as one of the most meaningful yardsticks for cross-industry comparisons and a “commonly and widely accepted yardstick for measuring business success” (Ansoff, 1965: 42). The data of annual net income and assets were both collected from the Fortune 500 website. The data not available on the Fortune website were obtained from the annual reports on the corporate websites, and the data consistency between the two sources was checked as well. The raw ROA data clustered toward zero and were not normally distributed; in addition, the magnitudes of their variances and covariances were too small to show numbers greatly different from zero. Therefore, I multiplied the data by 100 and then normalized them.

**Analytic Strategy**

The analytic strategy of structural equation modeling, using the LISREL 8.51 program (Jöreskog and Sörbom 1993), involved four stages in this research. First, I split the total sample into halves based on the years, one for model testing (2001-2003) and the other for model cross-validation (2004-2006) (Hoyle 1995). Second, I generated, identified, and evaluated the competing hypothesized panel models with the time lag of 1 year (Robert and Dowling 2002; Inglis et al. 2006; Rose and Thomsen 2004) that tested the competing hypotheses, using the data of 2001-2003. Specifically, Model 1 to Model 4 (see Figure 1) tested the competing H1 to H4 respectively (Hoyle 1995). I focused on multiple fit indices (cf. Kline 2005; Jöreskog and Sörbom 1993), including minimum fit function $\chi^2$, RMSEA with its 90% confidence interval and $p$ value for the test of close fit (RMSEA<.05), standardized RMR (SRMR), GFI, AGFI, CFI, and Critical N (CN). Third, I compared the competing models, selected the best fit one, and if necessary, tried to improve it in a theoretically meaningful manner until all the above fit indices were best possible (Steiger, Shapiro, and Browne 1985; Lee and Hershberger 1990; Stelzl 1986; MacCallum, Wegener, Uchino, and Fabrigar 1993). Finally, I cross-validated the selected best fit model with the data of 2004-2006.

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**RESULTS**

**Evaluation of Competing Hypothesized Models**

The means, standard deviations and correlations are shown in Table 1. The majority of the variables strongly correlate with each other. For the longitudinal relationship between organizational prestige and CFP (see Table 2), Model 4 had the better fit indices than Model 1, Model 2, and Model 3. Its $\chi^2(df=4)=8.17$ ($p=.09$), RMSEA=.09 with its 90% confidence interval (.01, .17), $p(RMSEA<.05)=.13$, SRMR=.03, GFI=.98, AGFI=.91, CFI=.97, and CN=270.83.
**Improvement of the Selected Best Fit Model**

Though the selected best fit hypothesized model Model 4 was better than its competing hypothesized models, its RMSEA and 90% confidence interval of RMSEA were not very desirable. Therefore, I tried to see whether it could be improved in a theoretically meaningful manner until all of its fit indices turned out best possible (Steiger et al. 1985; Lee and Hershberger 1990; Stelzl 1986; MacCallum et al. 1993). Since organizational prestige in 2001 might also influence CFP in 2003 and so might CFP in 2001 to organizational prestige in 2003 (Fombrun and Shanley 1990), I added these two causal relationships in Model 4 and thus produced Model 5. It turned out that the added relationships improved the model considerably.

Figure 2 shows Model 5. Its $\chi^2 (df=2)=4.07$ ($p=.13$), RMSEA=.08 with 90% confidence interval (.00, .20), $p$(RMSEA<.05)=.22, SRMR=.02, GFI=.99, AGFI=.91, CFI=.98, and $CN=376.34$. The total effect (i.e., direct effect plus indirect effects through two variables in 2002) and indirect effect of organizational prestige in 2001 on CFP in 2003 are -.06 (s.d.=.38, $p>$.10) and .82 (s.d.=.40, $p<.05$) respectively, whereas those of CFP in 2001 on organizational prestige in 2003 are both .04 (s.d.=.01, $p<.01$).

**Cross-Validation of the Improved Model**

I used the data of 2004-2006 to cross validate Model 5 (Model 5’ cross-validated Model 5). Model 5’ fit even better than Model 5 (see Figure 2). Its $\chi^2 (df=2)=3.38$ ($p=.19$), RMSEA=.07 with 90% confidence interval (.00, .18), $p$(RMSEA<.05)=.29, SRMR=.02, GFI=.99, AGFI=.93, CFI=.99, and $CN=453.49$. The total effect and indirect effect of organizational prestige in 2004 on CFP in 2006 are .08 (s.d.=.40, $p>.10$) and .66 (s.d.=.43, $p>.10$) respectively, whereas those of CFP in 2004 on organizational prestige in 2006 are .01 (s.d.=.01, $p>.10$) and .06 (s.d.=.02, $p<.001$) respectively. All the above weak total effects remind us to consider the length of time lags here, since the effect size diminishes as the length of time lag between a cause and the time for which its effect is assessed increases (Gollob and Reichardt 1987, 1991). Model 5 was replicated and thus it supports H4, which states that organizational prestige has a reciprocal longitudinal relationship with CFP. Finally, take note of the autoregressive effects in Model 5 and Model 5’. In two consecutive years, organizational prestige was positively related ($Bs>.60$, $ps<.001$) and so was CFP ($Bs>.70$, $ps<.001$).

**DISCUSSION**

The purpose of this research is to test the longitudinal relationship of organizational prestige with CFP, using SEM and data of the 2000s, thus assessing, and if necessary, updating the theories with most recent data. The structural equation models have provided an informative representation of the longitudinal relationship patterns. The results show that, consistent with my speculation, organizational prestige and CFP do have a reciprocal longitudinal relationship. Nevertheless, the longitudinal relationship concerns the issue of time lags, as its effect size decreases as the length of time lags increases. Little research on this issue has discussed the length of time lags in terms of the effect sizes (Cohen 1990), but it may explain why prior research has generated inconsistent results. Additionally, the autoregressive effects suggest that more prestigious organizations will be more prestigious and more profitable organizations more profitable. To conclude, (1) more prestigious organizations will gain stronger prestige over time...
and profit more in the short run; and (2) organizations with better CFP will have better CFP over time and stronger prestige in the short run.

**Implications for Research**

The results in this research, at odds with some previous findings based on data of the 1980s and/or 1990s (Rose and Thomsen 2004; Inglis et al. 2006) but consistent with many other studies (Barney 1991; Roberts and Dowling 2002; Podolny 1993; Stanwick and Stanwick 1998; Landgraf and Raihi-Belkaoui 2003; Fombrun and Shanley 1990; Deephouse and Carter 2005; Fombrun and Shanley 1990), have important implications for research.

First, the financial attributes of the *Fortune* reputation index tended to have greater impact on organizational prestige; this finding is in agreement with Roberts and Dowling’s (2002), Fombrun and Shanley’s (1990), Landgraf and Riahi-Belkaoui’s (2003), and Fryxell and Wang’s (1994) findings. The respondents of the *Fortune* reputation surveys could simply track previous CFP, and accordingly, the reputation scores were highly correlated with CFP (Roberts and Dowling 2002); this means that the influence of organizational prestige and CFP on each other might be inflated. Nonetheless, the reciprocal relationship of organizational prestige and CFP reveals that the majority of modern for-profit organizations attend to the hand-in-hand development of organizational prestige and CFP such that the organizations can sustain their longevity, long-term effectiveness, and competitive advantages (Fombrun and Shanley 1990; Hall 1993; Barney 1991; Inglis et al. 2006; Weigelt and Camerer 1988). As Petrick, Scherer, Brodzinski, Quinn, and Ainina (1999: 60) noted, organizational prestige, “whether or not it is embodied in a trademark, should receive constant leadership attention”. The findings in this research corroborate that the increase of organizational prestige or CFP serves as a fuel for their mutual growth. Yet it deserves observations and scrutiny how such a reciprocal relationship will change as time elapses and external environment evolves in the 21st century.

Second, Fombrun and Shanley (1990) suggested that organizations that develop prestige for attending to employee welfare may find themselves in a good bargaining position in labor markets, attract better applicants, and achieve lower costs (Stigler 1962), but few empirical studies have virtually demonstrated these effects. This may be because acquired organizational prestige affects organizational performance only marginally, or because the research did not consider time lags in terms of the effect sizes. The findings in this research favor the second reason: organizational prestige and CFP have a strong reciprocal longitudinal relationship, but the effect size decreases as the length of time lag increases. This is consistent with Roberts and Dowling’s (2002) argument that organizations with superior CFP and good prestige find themselves with an advantage that is durable in the short run, when the prestige is maximally relevant; however, the same prestige may become less relevant over time, and may even hurt CFP in the long run. Hence, time lags deserve more examination in the future.

Third, Hall (1993) considered organizational prestige an intangible resource providing a positional capability differential. It needs to be leveraged to generate above-average profits as a self-reinforcing dynamic (Roberts and Dowling 2002). This research has not well explicated how prestige is presently operationalized by organizations in the 21st century. Such leverage is a missing intermediary or intervening factor between organizational prestige and CFP (Inglis et al. 2006). Having organizational prestige is inadequate; it needs to be managed well and converted into competitive advantages (Bromley 1993; Weiss, Anderson, and MacInnis 1999). Fombrun and Shanley (1990) deemed it a formidable but rewarding research challenge to identify the
effect of organizational prestige on organizational performance. Future research ought to specify how organizations manage their prestige and convert it into competitive advantages.

Fourth, organizational prestige is perceived as a “fragile resource” (Hall, 1993: 616) that changes over time (Ching, Holsapple, and Whinston 1992) but still enjoys relative stability (Barney 1997). This reflects the cumulative investments of organizational prestige (Fombrun and Shanley 1990). In general, organizational prestige increases over time (Podolny 1993), as the results have demonstrated, but such increase does not apply to every individual organization; some organizations may have more fluctuating prestige whereas the others more stably changing prestige. A few scholars consider the cross-organizational differences of organizational prestige as relatively stable over time (Barney 2001; Henderson and Cockburn 1994). Future research should spell out what kinds of organizations under what circumstances have more fluctuating or stably changing prestige.

Last but not least, using SEM in organizational research is ever-increasing (James and James 1989; Medsker, Williams, and Holahan 1994; Hulland, Chow, and Lam 1996). The structural equation panel models in this research have showed an informative depiction of the longitudinal relationship patterns in the 2000s, though the fundamental reality is that no true model exists (Browne and Cudeck 1993; Cudeck and Henly 1991) and the best one can hope for is to identify a parsimonious and substantively meaningful model that fits observed data adequately well. For panel data, covariance modeling of time dependent data by autoregressive models is well established (Cook and Campbell 1979; Jöreskog 1979; McArdle and Aber 1990). Structural equation panel models utilize the inherent time ordered nature of panel data to address causal ordering problems. The model is estimated in a single step rather than a series of separate regressions (Farrell 1994; Kline 2005), thereby yielding a global likelihood for the model and a full range of tests with standard model fit indices (Bollen 1989). Future research may combine SEM and qualitative approaches to examine an array of organizational problems.
REFERENCES


Table 1. Means, Standard Deviations, and Correlations of Variables

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<th>Prestige05</th>
<th>Prestige04</th>
<th>Prestige03</th>
<th>Prestige02</th>
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Note: N = 167. Prestige denotes organizational prestige; and CFP denotes corporate financial performance.
† p<.10
* p<.05
** p<.01
*** p<.001 (two-tailed tests)

Table 2. Major Fit Indices for Structural Equation Models

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<th>Years</th>
<th>Hypothesis Tested</th>
<th>χ²</th>
<th>df</th>
<th>p (χ²)</th>
<th>RMSEA</th>
<th>90% Conf. Int. (RMSEA)</th>
<th>p (RMSEA&lt;.05)</th>
<th>SRMR</th>
<th>GFI</th>
<th>AGFI</th>
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<td>2001-2003</td>
<td>H1</td>
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<td>.004</td>
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<td>8.17</td>
<td>.09</td>
<td>.09</td>
<td>(.01, .17)</td>
<td>.13</td>
<td>.03</td>
<td>.98</td>
<td>.91</td>
<td>.97</td>
<td>270.83</td>
</tr>
<tr>
<td>Model 5</td>
<td>2001-2003</td>
<td>H4</td>
<td>4.07</td>
<td>.13</td>
<td>.08</td>
<td>(.00, .20)</td>
<td>.22</td>
<td>.02</td>
<td>.99</td>
<td>.91</td>
<td>.98</td>
<td>376.34</td>
</tr>
<tr>
<td>Model 5'</td>
<td>2004-2006</td>
<td>H4</td>
<td>3.38</td>
<td>.19</td>
<td>.07</td>
<td>(.00, .18)</td>
<td>.29</td>
<td>.02</td>
<td>.99</td>
<td>.93</td>
<td>.99</td>
<td>453.49</td>
</tr>
</tbody>
</table>

Note: N = 167. The χ² in the table is the minimum fit function chi-square.
Model 5': the improved model of a reciprocal longitudinal relationship between organizational prestige and CFP (2004-2006).
Figure 1. Model Structures

*Model 1*

Organizational Prestige 2001 ($X_1$) → $\gamma_{11}$ → Organizational Prestige 2002 ($Y_1$) → $\beta_{31}$ → Organizational Prestige 2003 ($Y_3$)

CFP 2001 ($X_2$) → $\gamma_{22}$ → CFP 2002 ($Y_2$) → $\beta_{42}$ → CFP 2003 ($Y_4$)

*Model 2*

Organizational Prestige 2001 ($X_1$) → $\gamma_{11}$ → Organizational Prestige 2002 ($Y_1$) → $\beta_{31}$ → Organizational Prestige 2003 ($Y_3$)

CFP 2001 ($X_2$) → $\gamma_{22}$ → CFP 2002 ($Y_2$) → $\beta_{41}$ → CFP 2003 ($Y_4$)
**Figure 1.** Model Structures (Continued)

*Model 3*

![Diagram of Model 3]

*Model 4*

![Diagram of Model 4]
Figure 2. Path Diagrams (Standardized Solution)

Model 5

Note: \(N=167\).  \(\dagger p<.10\)  * \(p<.05\)  ** \(p<.01\)  *** \(p<.001\) (two-tailed tests).