The impact of "naming and shaming" on business reputations An empirical study in the field of financial regulation[1]

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Summary
It has been widely established that reputation is a powerful social control device. But what happens when regulators try to make use of this strength by transforming reputational sanctioning into an instrument of public policy? Regulatory disclosure, or naming and shaming, is becoming more and more popular among regulators. This paper aims to explore the effects of this regulatory strategy through a case study of the Dutch financial supervising authority, the Authority for Financial Markets (AFM). It first adresses the implementation of the publication policy by AFM. Although informing consumers was the primary purpose of disclosure as meant by the legislator; the purpose in practice has shifted to informing companies about AFM enforcement policy. Second, this paper explores the actual effects of publication on companies' reputations, measured through media coverage and reactions of clients, business partners, and personal relations. It concludes that publication of warnings, fines and penalties generally does *not* have strong effects in terms of damage to business reputations in the field of financial regulation. For the most part, reactions from clients and business partners were absent or mild, sometimes even supportive. Occasionaly though, publication has destroyed reputations. This study has shown that to the extent that publications have had impact, these impacts are unevenly distributed among companies. Naming and shaming as it is implemented in the field of financial regulation seems to be a messy instrument, with unpredictable effects.

1. Introduction

The modern debate on regulation is characterized by contradictory demands. On the one hand, classic "command and control" regulation is under attack. It asks for a lot of enforcement capacity; interferes too much in markets; and offers the wrong incentives. The high costs for both government and markets are no longer considered acceptable. In recent Dutch public debates, public enforcement is being referred to as constituting "seven plagues"; a clew of institutional spaghetti (due to the amount and complexity of enforcement organizations); selfraising flour; or even a horror movie: for every organization that is abolished, three others grow out of the institutional monster[2]. As an answer to criticism of command and control regulation, regulators turn to alternative regulatory instruments that are more congruent to existing mechanisms of social control and self-regulation. In line with approaches as "responsive regulation" (Ayres and Braithwaite, 1992) or "smart regulation" (Gunningham and Grabosky, 1998) a mix of regulatory instruments is being employed.

On the other hand, major fraud cases such as Enron and in the Netherlands Ahold and the construction fraud have led to a decline in trust in corporate self regulation and compliance. This decline in trust has led to an increasing demand for supervision and control and a more punitive approach, and also to a call for more transparancy and self-cleaning capacity of corporations (Van Erp et al, 2008).

[1] This research was funded by the Dutch Council for Scientific Research.
[2] See Willemsen, Leeuw and Leeuw (2008) for an overview of this debate.

Public disclosure of corporate violations or *naming and shaming* corporate offenders is an approach that seems to offer an answer to all of these contradictory demands. It fits in deregulation strategies because it shifts power from the regulator to the consumer, and empowers consumers to influence company behavior. Thus, regulatory disclosure is argued to contribute to transparancy and to reinforce trust in markets. At the same time, it is perceived as a strong punitive stick that can destroy corporate reputations. In this respect, reputational sanctions are considered to be more *effective* than traditional sanctions in deterring regulatory crime or stimulating regulatory compliance. A clear cut example of this argument is found in the *Macrory Review on effective sanctions*, the report of Better Regulation Executive professor Richard Macrory to the British Government (2006). “A company’s reputation and prestige is an important and valuable asset”, professor Macrory argues. “The consequences of damaging a firm’s reputation can potentially exceed the effect of a maximum fine that a court could impose. A company that loses its reputation even for a short time can suffer significant damages to consumer confidence, market share and equity value. (…) The threat of this type of sanction may encourage firms contemplating not complying with regulatory objectives to re-consider, even if the noncompliance would generate significant financial benefit” (Macrory, 2006, p.83). Last, naming and shaming can contribute to the visibility and authoritativeness of an enforcement agency. It provides regulators with the powerful image they need in order to legitimize their costliness with the public (Parker, 2006). For example, in the Dutch policy program ”Towards a practical legal order”, it is argued that the external pressure of stakeholders will leave public regulation with less costs and regulatory burden, and a larger effectiveness and public acceptance of enforcement and sanctioning (TK 29279, no.9, p.20-21).

Because of these perceived advantages, it is not surprising that regulatory disclosure is an instrument of increasing popularity in the regulatory toolbox. In many European countries, regulators experiment with public disclosure of violations or sanctions, also referred to as naming and shaming. Of course, press releases or public notices following incidents have been the practice long since. What is new is the systematic and detailed character of the information that is published, as with the disclosure of all names and offences of violating companies in a public register or on a black list. In the Netherlands, the most well-established example of naming and shaming by a public regulatory authority can be found in the field of financial regulation. Whereas other Dutch enforcement agencies are still in the experimenting stage, the Authority for Financial Markets (AFM) has been issueing varied types of detailed publications on regulatory offenders for over a year now. The AFM is also the first supervisor in the Netherlands that publishes offenders’ names on a legal basis, and this legal basis was recently reinforced by a court decision supporting the AFM’s publication procedures.

Aim of this paper

Reputational mechanisms have been widely studied in commercial relations, by social scientists from various fields (Macaulay, 1963, Posner, 2000, Bernstein, 2001, Charny, 1990; Ellickson, 2002, Van Erp 2008). These studies show that reputational sanctions can be so effective in providing social control that they render legal sanctions redundant. Even in markets that are very vulnerable to conflict, such as diamond trade, legal enforcement is consciously put aside in favor of reputational regulation (Richman, 2006, Siegel, 2002). Reputational mechanisms are even able to succesfully regulate criminal markets, where the illegal nature of the activities makes it impossible to resort to legal conflict resolution (Van de Bunt, 2008, Van de Bunt en Kleemans, 2007).

In the field of regulation and governance, research has shown that reputation is a key motive for corporate compliance (Fisse and Braithwaite, 1983; Gunningham, Thornton and Kagan, 2004). A good reputation pays out in terms of confidence of business partners and investors, consumer trust, and goodwill and support of the community and the political and bureaucratic environment. It constitutes a companies’ “social license”, which, much more than its legal license or economic assets, provides continuity and growth of a company (Gunningham, Kagan and Thornton, 2004).

It has thus been widely established that reputation is a powerful social control device. But what happens when regulators try to make use of this strength by transforming reputational sanctioning into an instrument of public policy? Little empirical research has been performed into the *instrumental* use of reputational mechanisms by public regulators or in criminal law.

However, there are several questions that empirical research should answer (Kahan and Posner, 1999, Pawson, 2002). Are regulators able to effectively influence reputations and predict and control the effects? Or are reputational effects in practice inconsistent and disproportional? Does shaming effectively deter corporate crime or does it have little effect or even encourage criminal behavior? And is there evidence that shaming changes people's views about the harmfulness of criminal behavior?

This paper aims to explore the effects of systematic disclosure as part of a regulatory strategy. It adresses regulatory disclosure in the field of financial regulation by the Dutch financial supervising authority, the Authority for Financial Markets (AFM). The AFM issues public warnings and publishes sanctions with names and adresses of the offenders, both on websites and through newspaper advertisements. In this paper, I will adress both the implementation of the publication policy by AFM and choices it makes concerning balancing consumers' and company interest, and the actual effects of publication on companies' reputations. I will distinguish between public warnings, and publications of fines and penalties, and between companies that are financial intermediairies and investment companies.
The two main questions are:
1. What is the position of naming and shaming in the AFM's regulatory strategy?
2. What are the actual effects of naming and shaming on business reputations?

The results of this study not only benefit theory development: in the interviews that were conducted for this research project, the AFM staff have indicated that their publication policy is still under construction, and that they for one thing do not know the effects of publication on reputations of companies. Knowledge about these effects would enable them to evaluate the impact, as well as the proportionality and justness of their publication policy.

2. Measuring effects of naming and shaming: research design and methods

Measuring effects of naming and shaming
In exploring the effects of naming and shaming on business reputations, I will distinguish between *reactions from clients* and *reactions from business partners*. The client perspective is dominant in the literature on transparancy (Hood, 2006). In this body of literature, regulatory disclosure is often presented as a relatively neutral instrument to improve the information position of consumers, who are considered to have a right of access to the same information as the supervisor has. Information will enable them to make a better informed choice. It is expected that better informed consumers will contribute to the realization of public policy goals, without the need of direct govermental interventions. In this paper, we will explore to what extent clients end, or refrain from starting, relations with companies that offend financial regulations.

Whereas the client/consumer perspective is predominant in the literature on transparancy, scholars in criminology and law and economics have focused on reputational mechanisms operating through professional and personal relationships. In the field of corporate crime, John Braithwaite and others (e.g. Braithwaite, 1989; Braithwaite and Drahos, 2002, Parker, 2006) have studied reputational mechanisms from the perspective of shaming: moral disapproval by respected peers. "Shaming means all social processes of expressing disapproval which have the intention or effect of invoking remorse in the person being shamed and/or condemnation by others who become aware of the shaming" (Braithwaite, 1989, p. 100). Braithwaite states that it is not the severity of the sanction in financial terms, but the amount of public shame that it invokes, which is the most important motivator of compliance. In other words: "the nub of deterrence is not the severity of the sanction but its social embeddedness" (Braithwaite, 1989, p.55). However, Braithwaite argues that white collar criminals are usually rather invulnerable to effective shaming, because they have strong neutralizing powers. " (..) when a child steals persistently, there is a good chance that this will eventually become known to her parents and/or teachers; she will not be able to escape their disapproval. When a senior company executive persistently pollutes, however, there is little prospect of her family finding out about this moral failure" (Braithwaite and Drahos, 2002).
In the field of law and economics, reputational mechanisms are studied in the context of models of cooperation. Reputational sanctions are considered the most powerful mechanisms of enforcing cooperative agreements. When a person has defected on a cooperative

agreement, he will be avoided because he has proven to be less trustful, but also because cooperating with him runs the risk of being interpreted as a form of support for the offending behavior. In other words, people will avoid cheaters because they are cheaters, but also because they fear being avoided *themselves* if they fail to distantiate themselves from the cheater (Posner, 2000, p. 90).
These perspectives can be combined when we realize that there are two types of reasons for parties to value their reputation. One arises out of self-interest: the expectation that a good reputation will pay in terms of utilities; the other comes from moral obligation (Misztal, p.127-8). The strongest reputational effects occur of course when these reasons occur *at the same time.* In this paper, I will explore whether any of the effects I identified (reactions from clients, reactions from business partners, or feelings of moral failure) occur in reality by investigating the reactions of business and personal relations of offenders on the publication of their name by the AFM.

Before the reactions of clients and business relations can be identified, we need to know whether information about offenders actually reaches the relevant public. The effects of shaming are partly dependent on the question whether the public is aware of and values the publications of the AFM and whether they plays a role in consumer decisionmaking about financial products. The communicative quality of the publications determines whether the message will actually reach the public and contribute to its risk awareness (Pawson, 2002). The AFM publishes its decisions on their website, but the public outreach could be expanded if the AFM's press reports were taken over by other news reporters. There is then more of a chance that the consumers who do not actively approach the AFM website for advice will also receive updates and be informed. Therefore, I will explore the media attention for AFM decisions in written media.

This paper is limited to the effects of naming and shaming on business reputations, although it is recognized that naming and shaming can also contribute to general deterrence within markets. For example, naming an shaming could contribute to the legitimacy and trust in the supervisor, when it becomes apparent that bad apples are being sanctioned. Naming and shaming can thus serve as a reminder and reassurance mechanism for companies that are already compliant (Gunningham, Kagan and Thornton, 2004). At the same time, naming and shaming can deter potential offenders because of the risk of reputational damage on top of the risk of a fine (Braithwaite, 1989). These aspects will be subject of future parts of this research project.

Research methods
This paper presents preliminary results of an ongoing research project on regulatory disclosure. The results in this paper are based on four main sources.

1. A document study of legal and parlementary documents, jurisprudence, internet sources, annual reports, and the press releases of the AFM.

2. Interviews with regulators, supervisors and intermediary organisations in the financial market. Uptil now, 13 interviews have been conducted with staff members of the AFM (5 separate interviews) Dutch Ministry of Finance (2 respondents), Association of Financial Advisors (2 respondents), Dutch Consumer Association (2 respondents), Association of Insurance Companies (2 respondents), Dutch Banking Association, and KFD, a certifying company, Dutch Investors Association VEB (all 1 respondent), and a private banker (anonymous). In these organisations, we approached the staff member that was most expert on the issue, in most cases a senior advisor on supervision. Interviews were conducted on the basis of a topic list that was tailored to the expertise and market segment of each respondent. Also, respondents were asked to comment on examples of AFM press releases. They interviews were taped; tapes were destroyed after transcription. The interviews took 1 to 1,5 hour.
Respondents were generally very open, especially those in public organizations (AFM/ministry of Finance). They were all eager to cooperate and interested in the novel topic of the research. The novelty of the subject however, also resulted in respondents not being able to provide a clear answer to all of my questions. On several occasions, a question

resulted in a long silence, followed by “that’s a good question”.. An AFM staff member even reversed roles and started asking the opinion of the researcher on their publication policy! AFM employees all indicated that their publication policy is under construction and that they are learning from first experiences. They used the interviews to reflect on these experiences. The interviews can therefore be characterized as exploratory. Also, they were used to inventorize some ideas for further empirical measurement of reputational effects.

3. Telephone interviews with sanctioned companies on effects of publication on their reputation. For this research project, all 33 companies whose names have been published in 2007 have been approached, first through a letter explaining the aim of the research, and then by phone. Up til now, we conducted interviews with 13 company owners. From 11 companies, the adresses and telephone numbers that AFM had disclosed no longer were in use of had never existed, and no other adresses could be found. Six other companies could not be contacted. Three respondents have put us on hold until their procedure is finished. Uptil now, we have received only one refusal to participate, the reason being serious illness of the respondent. A few company owners contacted us spontaneously after the initial explanatory letter. This first round will be followed by a second one in which we approach companies that have been sanctioned in the first months of 2008. The companies against which the AFM has issued public warnings have not been contacted because of expected nonresponse : they are all foreign companies, mostly located in the Far East.
The interviews adressed the activities, size and volume of business of the company, penalty procedure and status of payment, current status of the company, and most importantly, consequences of publication in terms of reactions of clients, business partners and social relations. The companies we interviewed were all relatively small financial service providers or financial planners that have been imposed a fine or penalty. Although the names of the companies that are fined are public, the interview data are not, of course. Because of the small size of the group of respondents, identification has to be avoided. This has sometimes resulted in making less detailed descriptions than the data would permit.

4. An analysis of media coverage of AFM press releases on warnings and sanctions through Lexis Nexis. In this analysis, we included national and regional newspapers, and excluded press agencies (because their messages are not directly targeted to the public).

In later stages of this research, these strategies will be followed by questionnaires measuring the impact of regulatory disclosure on consumers and companies in general.

3. Introduction to the Netherlands Authority for the Financial Markets (AFM)

The AFM is entrusted with the role of supervising market conduct[3] in financial markets (which includes the supervision of the admission of businesses into this market). Supervision of market conduct aims to ensure orderly and transparent financial market processes, immaculate relations between parties and scrupulous treatment of clients/customers (art. 1.8 Financial Supervision Act). Supervision of market conduct entails the supervision of the distribution of information by and amongst financial services; the supervision of the reliability and professionalism of the financial establishments and the supervision over integrity within the financial markets, e.g. the prevention of unfair trade practices or insider trading.
Till recently, financial supervision was a part of a self regulatory agency for supervision of stock exchanges. It was the financial vulnerability of millions of citizens that eventually led to the requirement of more public regulation and supervision in this area. The need for supervision arises, in the first place, due to certain specific characteristics of the financial products that result in information backlogs for the consumers in the financial market. Financial products are complex and heterogeneous, and they are acquired infrequently. This results in few opportunities for learning and reputational effects in markets. Moreover, quality , measured in terms of profits, is not realised immediately but rather over a period of time (explanatory statement to the law, p 313).

[3] As opposed to prudential supervision on solvability of banks, performed by DNB (National Bank)

In 2002, the Authority for Financial Markets was set up in order to expand supervisory jurisdiction beyond the stock exchange to include investment, savings, lending and insurance[4]. The AFM exercises supervision over 10,000 such establishments: securities and investment establishments, brokers, advisors, banking and credit institutions, accountancy firms, insurance companies and pension funds, stock exchanges and markets as well as investors.

The Financial Supervision Act forbids companies to operate on the financial market without a license, that is issued by the AFM. The Financial Supervision Act entrusts the AFM with several powers to enforce the license requirements, examples of which would be the power to impose fines or penalty, to withdraw a permit or the power to appoint a trustee. An important instrument in the supervision of market conduct is also *the publication of the names of unreliable investment agencies.* This publication policy has been indicated as one of the focal aspects of financial supervision; it is considered to be a "necessary and important" aspect of supervision of market conduct. The AFM (on the grounds of article 1:78 WFT) has the responsibility to issue public warnings against the investment agencies suspected of a breach as well as the obligation to publish the fines and penalties imposed on them, before any judgment has been passed. In the remainder of this article, we distinguish between these two instruments: the public warning, and publication of penalties[5] and fines. Warnings will be appropriate when a company is offering financial products without license. Penalties or fines are last resorts in the enforcement of license obligations, such as the duty to perform a self-assessment of to adequately and timely inform the supervisor on request.

The primary goal of publication as stated in the law is warning the public against unreliable investment companies or financial products. The legislator explicitly characterizes the public warning as a preventive instrument. The public warning can be issued before punitive enforcement actions have been decided upon. By shaping the publication in the form of a public warning, publication in an early stage is made possible. When necessary, the supervisor can impose a sanction in a later stage. Publication of sanctions also has the goal of warning the public, not of punishing the company. The law makes no difference between the purposes of the public warning and the publication of sanctions. The legislator considers a warning message appropriate in the light of the seriousness of offenses that a fine of penalty is imposed for.

Although the legislator acknowledges that disclosure can be experienced as a sanction, it states that publication both should not be considered as a sanction and does not operate as a sanction. "The principle of the publication is neither punitive nor deterrent, neither is there question of retaliation. The power to disclose is solely meant to protect parties at financial markets". The same goes for publication of fines and penalties.

Although consumer warning is the primary goal, the legislator also refers to deterrence, be it implicitly. There is mentioning of "norm education". Publication of fines and penalties aims to enhance the visibility of enforcement actions. Publication has as a side effect that parties on financial markets experience that the regulator acts upon violations (explanatory note to the law, p. 301).

4. Disclosure in practice: the interests of the public versus the interests of the supervising agency

4.1 Public warnings

The AFM publishes its public warnings on the consumer pages of their website in a "warning list". Also, a press release is issued that is published on the news pages of the website. The first four news items are visible on the AFM's homepage. AFM does not publish advertisements concerning its public warnings. The public warnings are reported to the european supervisor.

[4] In 2007, an extensive revision of the law came about, causing a large number of existing laws to be merged into the Wet Financiele Toezicht which came into force on 1 January 2007.

[5] A penalty is a sum of money, imposed on a daily or weekly basis in case of non-compliance.

Currently (half april 2008), the public warning list consists of 40 warnings. In 2007, the AFM published ten warnings; in 2006, 21 were published. Public warnings are eliminated from the warning list after 3 years. The text of the warning generally resembles the following example:

"The Authority for Financial Markets (AFM) warns consumers not to throw in their lot with offers of financial services by Okamura Asset Management. The AFM is of the opinion that Okamura Asset Management offers financial services in the Netherlands without having the appropriate license. The AFM has received reports from consumers that they have been approached by Okamura Asset Management (…)"

The warning message also states adress, mail adresses and aliases the company operates with. Besides it contains a general advise to consumers to check whether a provider is licensed by the AFM or appears on the warning list. The AFM does not place advertisements for public warnings as it does for fines, because they view the warning list as clear enough and they feel that their warnings attract enough publicity by itself. However, this strategy is under consideration. The AFM press reports are also reflected on several other official public sites for consumers and financial institutions such as vragenoverlening.nl (a money lenders website) and geldwaardering.nl.

The dilemma between adequate warning consumers or legal cautionousness
The publication of warnings is a discretionary power. The Financial Supervision Act obliges the AFM to assess the interest of warning the public against potential negative effects for the financial institution. This brings about a dilemma for the AFM between warning the public as soon as a suspicion arises on the one hand, and legal carefullness and adequate legal protection for the company on the other hand. Concerning this dilemma, the AFM has uptil now given priority to the interest of legal protection. It has reserved the publication of warnings for situations or companies that are breaking the law beyond doubt, in other words, that are clearly offering financial products without license. Apparently, this has been the case in only 10 cases in 2007. In many other situations, there are doubts about either the type of service of product provided (does it require a license) or about the reliabililty of the company. Although the AFM has the power to issue a warning against dubious companies, it has exercised restraint in these situations. In all cases where companies are not noncompliant beyond any doubt, the AFM has not issued a warning but started an investigation that may eventually lead to a penalty or fine, or reports the case for criminal prosecution. For example, in 2007, the AFM filed 5 declarations for illegal financial activities with the prosecutor[6]. In these cases, the public receives no information at all about the potential risk of investing with this company. Also, AFM issued several public penalties to companies that are suspected of offering financial products without a license (behavior that would qualify for a public warning). However, a public penalty is imposed after a time lag of almost half a year, during which new clients could be acquired. Also, the public penalty may not attract the same level of attention as the public warning. Finally, no (separate) warnings are issued once companies are penalized or fined, because the fine is already public.
As reasons for these restraints, AFM staff mention the importance of legal precision and carefulness that is necessary in relation to the high impact they perceive the public warning to have. Once a warning has been issued, it can never be repaired. The AFM respondents perceive the public warning to be a severe measure (more severe than the penalty or fine). The passing on of the information to the European Supervising Authority adds up to this perception. Constitutional demands of carefulness oblige the AFM first to thoroughly research the case and can prove evidence of an offence, before a public warning can be issued. The fear for claims or reputational damage for AFM is another aspect of this argument. In xxxx, AFM lost a highly publicized lawsuit for two bankers that had too easily been accused of trading with foreknowledge. Within the AFM and other organisations that were interviewed for this research, the question is asked whether the public warning should not be used more actively. Several respondents state that the law protects companies better than consumers. The result is that relatively little (10 to 20 per year) warnings are published while it is hard to imagine that the market consists of only so little scams.

4.2 Publication of penalties and fines

[6] AFM Annual report 2007

In contrast to the public warning, the AFM has no discretionary powers in relation to penalties and fines. All penalties and fines have to be published, although publication is suspended during court procedures. In 2007, the AFM published 31 penalties and two fines. Three more penalties that were issued in 2007 were published in January 2008. Publication of a penalty is automatic when the penalty is forfeited, which in most cases happens when a company does not respond promptly and adequately to the demands of the AFM to supply information. In 13 (out of 31) cases, the penalty was issued because licensed companies did not adequately file their obligatory periodic self-assessment[7]. The other penalties were issued because the AFM suspects the companies of illegal activities (operating without a license) and the companies under suspicion did not respond to the AFM's information requests. Two fines were published for trading in securities without prospectus, these fines were issued in earlier years but had been subject to lawsuits delaying their publication.

Penalties and fines are published under the 'current news' section of the AFM website. Everyone who visits their website can see the most recent penalties on the home page, and older ones in the news archive. The AFM press reports are also reflected on several other official public sites for consumers and financial institutions such as vragenoverlening.nl (a money lenders website) and geldwaardering.nl. Besides, the AFM places 2 standard advertisements in national or regional newspapers. There is no separate list of penalties and fines, such as is the case with warnings.

The dilemma between adequate warning consumers and market deterrence

The Financial Services Act states the warning function as primary goal of the publication of penalties and fines. In this respect, the publication of sanctions does not differ from the public warning. However, as often is the case, regulatory practice shows a different reality than the law intends. In the daily operation of AFM supervision, the public warning function is not prominent. As interview results show, the prevailing function of publication is that of communication with market parties. The publication of sanctions is almost entirely directed towards market parties (companies or potential offenders). Respondents mention several potential effects of publication of sanctions: transparancy and accountability of the AFM, signaling the market that the AFM acts against offending companies, clarification or interpreting broad legal norms, deterring potential offenders and/or reassuring “good apples” that bad apples are being sanctioned.

From the sanctions that were published, the warning function towards consumers does not always seem relevant. In the opinion of most respondents from the interviews, it is not the purpose of the publication that consumers react to the penalty by refraining from business with the offending company. A penalty is considered a rather light sanction, and it is not meant as a signal for unreliability of the company.

The fine for the Belgian Bank KBC for manipulating the market that was recently published, gives an example. In its press release (14-3-2008), the AFM elaborates on the method of stock price manipulation. This is meant to inform other stock brokers on the demarcation line between legal and illegal trade practices. The press release is meant to adress a target group of compliance officers in banks and other specialist parties, but it is not meant to adress consumers. The withdrawal of consumers from KBC Bank it is neither a likely, nor a desirable outcome.

4.3 Conclusion: disclosure in the AFM's regulatory strategy

To conclude with, in the implementation of public warnings, the AFM faces a dilemma between timely warning consumers for the risk of investing with particular companies, and legal protection of companies from the negative impact of a public warning. Because a lack of cautiousness would provide risks for the legitimacy of the supervision policy, the AFM has been rather reserved with issuing public warnings. Although the public warning was meant as a light, preventive measure, in the daily supervision practice it is perceived as a strong measure that needs extensive research before imposing it. This does not serve consumer information provision at its best.

[7] The market consists of 10187 intermediaries and 1036 providers of financial products (1-1-2008). Out of these 11223 licensed companies, 125 were threatened with a penalty for not adequately or timely filing their self-assessment. In 13 of these 125 cases, the penalty was forfeited and published.

At the moment, fines and penalties are more actively publicized than public warnings, and publications are targeted more towards market parties (companies) than to consumers. Signaling companies about the interpretation of regulations and the enforcement is the primary purpose of publication fines and penalties. Informing consumers is a side effect, and it is not always clear what actions consumers are desired to take.
Generally speaking, the relationship between the AFM and market parties (businesses) seems to be more important in AFM's disclosure policy than the relationship between the AFM and consumers. Although informing consumers was the primary purpose of disclosure as meant by the legislator; the purpose in practice has shifted to informing companies about AFM enforcement policy.

In deciding whether to issue a public warning, the issue of reputational damage for the company is a prominent factor. Also, the AFM has indicated that it does not know the effects of their publications on companies' reputations. What are these effects in reality? Is there a difference between reputational effects of public warnings and penalties? In the next paragraph, I will discuss research findings on the effects of various publications on business reputations.

5 Effects of publications on consumers and on business reputations

5.1 Effects of public warnings

The purpose of the public warnings is to prevent consumers from entering business with a provider. A consumer questionnaire of the AFM shows that 6% of consumers is well aware of the AFM activities. Therefore, only a small part of consumers can be expected to be aware of the public warnings. Moreover, not all of them will actually consult the warnings or act accordingly. The AFM staff that were interviewed themselves were rather sceptical about the awareness of consumers of the public warnings. They do not expect consumers to actually consult the warning list on their own initiative. In their view, a more likely route towards effectivity is entered when consumers search for information about a specific company on the internet through google or other search machines. Also, warnings can raise the general awareness of the public on risks of investments. In this respect, it can be remarked that the publication format of the warning list gives an impression of exhaustive supervision. The emphatic and detailed publication of information sends out the unintended impression that all other companies not mentioned in this list are reliable. Thus, the AFM publication strategy could evoke too high expectations of government supervision (Meijer, 2004, p. 36) and even lead to moral hazardous behavior.
The cautionary character of the publication will probably gain more force if the emphasis was not so much on the publication of the names of the small group who are explicitly being considered as offenders, but instead if the publication occurred within the context of a message that contributes to the consciousness of the consumer in general[8].

All AFM press releases on public warnings were adopted in some sort in various media. However, the amount of publicity varies considerably. Of the 10 warnings that have been issued in 2007, 9 were mentioned in short, factual news messages. The main financial journals, Financieel Dagblad and de Telegraaf, published 7 and 2 of these messages respectively. One warning was mentioned in 5 journals, four warnings were only published in one journal (but not all of them in the same journal). To sum up, in 2007, consumers that wished to inform themselves about all public warnings had to read three different journals.
Only one public warning resulted in more elaborate media coverage. Bordeaux Advisory BV was the subject of 40 publications. Ten of these were short messages in regional newspapers; 1 in a national newspaper; 22 were longer articles (25—1055 words) in regional

[8] An example of this would be the manner in which the Dutch telecom supervisor OPTA deals with this issue. The OPTA also publishes the fines imposed, a recent example where Euro 55,000 were imposed for spreading out spam through unprotected wireless networks of innocent internet users. The first sentence of this press release was "Protect your wireless internet connection". Besides information on the fine imposed as well as the nature of the offence, the press release warns consumers to be very conscious of the dangers of the Internet. The press report thus puts the information of this fine in context of a warning against the dangers of unprotected Internet connection.

newspapers[9]; 7 were longer articles in national newspapers. On the question of why these companies received more extensive coverage, we can speculate that the nature of the scam (expensive Bordeaux was mixed with cheap wines) contributed to the media interest. It could well be possible that the size of the scam, degree of financial risk, or necessity to warn consumers is not the first reason for the media to decide on coverage.

The best indicator of reputational damage as a result of public warnings would be the possibility of acquiring new clients for financial companies that have received a public warning. If they would still able to acquire new investors in the Netherlands after the AFM has issued a public warning, the reputational mechanism would not work as it is meant to do. However, it is not known whether the businesses that are warned against have exited the market. The AFM reports not having encountered signals of continuing business activity. The AFM however is well aware of the possibility that they continue their business under a different name or legal entity. It considers it as an inevitable fact that they can never completely clear the market of unreliable businesses.

5.2 Effects of public sanctions

Newspaper and television media coverage of publication of sanctions
Of the 30 companies that received a fine or penalty, 23 were mentioned in some form in various media. Most (18) of these companies were mentioned in countrywide, as well as regional newspapers. 7 companies were not mentioned in any printed press at all.
In most cases, only a short message was displayed. In 8 cases, longer articles were published: 6 articles appeared in regional newspapers; two in the leading nationwide financial daily newspaper, two in other large newspapers. 3 companies were covered in major television consumer magazines on consumer rights or scams.
Just as with public warnings, the risk that a company forms for consumers appears not always to be the most important criterion for coverage in newspapers. Of the four nationwide newspaper articles, for example, one is devoted to the penalty of a a seventy eight year old real estate agent who was unable to react to the information request made by the AFM due to the fact that he and his wife had been hospitalised. The Volkskrant (a Dutch daily) read: "The powerful AFM hunts an aging property dealer.", and insinuated that in this case the AFM has sought to crack a nut with a sledgehammer. Real Estate Agency Siefkens posed no real risk for the purposes of supervision of market conduct, while other penalties, related to much riskier performers, received more media attention. Another national paper reports about an investment company in French holiday resorts that has received a fine for not offering investors a prospectus, and not having a license.

Reactions from clients
A direct reputation effect of publication of a fine or penalty would be that existing clients end their relations with the company or potential new clients do not throw their lot. To what extent does this reaction take place?
From the interviews, it appears that offending companies have experienced very different reactions from their clients. Of the twelve companies that we have interviewed on this subject, eight have hardly had any reactions from their clients. One entrepreneur was not even aware of the fact that his name was published, and became very angry when the researcher revealed this to him in the telephone interview. One company received many questions and reactions from clients, but since this was a small company whose clients were all personal acquaintances, the owner managed to convince these clients from staying with him. Two companies have lost 50 (out of 400) and 100 (out of 800) clients respectively after the penalty was published. However, these companies have also attracted new clients.
In one remarkable case, a company is actively and agressively approaching new clients to invest in a tropical resort. This company has already be criminally convicted for tax fraud, and has been issued a penalty of 80.000 euro by the AFM. Besides, its director is convicted to imprisonment on probation (2008). One of the victims of this company made an appeal on the internet to initiate an interest group to reclaim their money in a civil lawsuit. At the moment of this appeal, this person had not not been aware that the company had been issued a penalty just a couple of weeks before, as appeared when the researcher took up contact for an

[9] These are the same articles because regional newspapers share the same editor.

interview. In the months after the penalty, both existing and potential new clients have mentioned the AFM penalty in their contacts with the company. The contact person denies this and says it is a different company, as appears from emails that have been forwarded to the researcher. Even today, it is possible to contact this company and to invest money in a tropical scam.

From these findings, a first conclusion is that clients generally have not reacted very strongly to publications of offenses of their financial service provider. These findings contradict the suggestion that naming and shaming can lead to extreme and adverse reactions from the public, for example confusion, wrong interpretations, or even panic (Pawson, 2002, Meijer, 2004). In the field of financial regulation, none of these extreme reactions have taken place. Instead, the main reaction from the side of clients has been silence.

To the extent that a reaction *has* taken place, these results support the view that the importance of a reputation, and thus the impact of a reputational sanction, varies among companies (Posner, 2000; Gunningham, Thornton, Kagan 2004). Companies that have long term, personal relations to their clients (as is common in the field of financial services) will have more reputational capital, and suffer less from a negative publication made by a distant regulatory authority, while larger companies with a more varied customer population have experienced loss of clients. However, small companies with long term personal relations to their clients, are considered to have a higher risk profile, because they are generally not able to keep up with the current professional standards and developments on financial markets. Also, it seems that impudent and aggressive companies may find ways to overcome negative publicity and convince credulous clients to invest, in spite of a public penalty. Communication of public authorities can never surpass the boldness and persuasiveness of entrepreneurs with criminal intents. Both findings suggest that the strongest effects of naming and shaming do not affect the companies that form the highest risk.

Reactions from business relations

In the financial markets, in which trust and reputation are of crucial importance, we would expect large banks and insurance companies to terminate relations with financial intermediaries or investment companies that are not complying to legal obligations. For this study, we asked offending financial companies whether they have received reactions from banks and insurance companies. It should be remarked that the law does not require providers to end relations with a company that has received a penalty, but it does forbid them to deal with intermediaries without a license. Since many penalties have been issued for suspicion of operating without a license, we would at least expect a bank or insurance company to contact the intermediary to ask whether this is the case.

From the interviews, it appears that the companies that are sanctioned encounter very *different* reactions from business partners. In two cases, companies report difficulties with attracting new business partners that are necessary for continuing their activities, that they did not have before publication of the sanction. "As soon as the characters "AFM" appear before your name, you are done with", one businessman complains. In these cases, the strongest type of reputational sanction takes place. The negative reactions from business partners do not seem to originate from distrust in the company as such, but mainly from the fear that cooperation will damage the reputation of the cooperator. In other words, business partners seem to be afraid that they will be contaminated by the bad reputation of the offender (Posner, 2000).

These strong reactions are exceptions, however. On the whole group of interviewed companies, only two large insurance companies appear to consistently terminate relations with financial intermediaries whose names have been published. On the opposite, there are also several large insurance companies that have not contacted any of the offending companies and still cooperate with them. And there are even companies who report receiving sympathetic and supportive reactions from insurance companies, who in one case are reported to have referred to the AFM as "idiots".

It is not possible to elaborate in more detail on the relation between the type of sanction or behavior and the reaction of business partners, because this would jeopardize the confidentiality of the research. However, we can conclude that different financial institutions attach different value to the same type of penalties. In other words, companies that maintain business relations with different financial instutions have encountered both adverse and positive reactions to the same sanction. Apparently, the norms in the Financial Regulations Act are not very strong *social norms*. Infractions of this Act are not valued as a signal of untrustworthiness, or a signal that an offender is a bad apple. Instead, offending the act leaves many professional parties indifferent. This may be due to the novelty of the law and/or to the fact that supervision by the AFM is generally regarded upon as a regulatory burden. The offenses that the AFM publishes are all violations of information duties to the AFM; therefore, it is possible that these offenses are not considered very serious. Shaming of noncompliant businesses can only be succesful when there is consensus about the moral reprehensability of noncompliance (Braithwaite, 1989). “There is no technique, style, or approach the regulator can utilize to improve compliance where the meaning of compliance is contested” (Parker, 2006).

Several authors have mentioned the possibility that naming and shaming will result in the stigmatized persons gowing underground (Pawson, 2002, Posner, 2000, Braithwaite, 1989). Indeed, one of the companies reports being approached by investors who want to operate as straw men in exchange for 10% of the investment sum. Where legal partners withdrew their support, the company seems attractive to parties offering illegal financial contructions.

Last, we asked the question whether the entrepreneurs felt shamed or stigmatized by the AFM’s publications themselves or the reactions of clients, business partners, or personal relations. Of the 13 companies that we have interviewed on this question, four have indicated that they didn’t mind, and that they understand that it’s the law. They have not experienced negative effects of publications. One company owner states that no-one knows about the sanction, only his wife, “but she does not understand what the AFM is”.
Two companies are mildly negative, and seven are of the opinion that publication goes way too far and that they are being portraied as near criminals. Several of them report having had many negative reactions from friends and family, and having experienced “who your real friends are in times of trouble”. They have been subject of village gossip and one of them even reports to have been summoned by the town administration and having been asked to move out of town. The reactions of these company owners show no signs of shame, though; instead, they can be characterized as reactant and extremely hostile towards the AFM and the Dutch legal system in general. Remarkably however, only one of the sanctioned companies started a legal procedure against the sanction decision, which he won.

6. Conclusion and discussion

Effects of naming and shaming on business reputations
Naming and shaming is a relatively new policy instrument that is increasingly being used in public enforcement. Black lists, offenders’ indexes, performance reporting systems or systematic press releases with offenders names and details of the offense are becoming more and more common. Public regulators embrace disclosure policies for reasons of transparancy, consumer empowerment or market deterrence. Whatever reasons they may express, however, they all see great advantages of reputation sanctions in comparison to financial sanctions. Reputation sanctions are regarded as strong, powerful weapons, whose normative blows can both educate the market about right and wrong and and deter potential offenders. Where doubts are expressed, these mostly concern the risk of the effects being too strong, causing unrepairable damage when the supervisor proves wrong (Doorenbos, 2006, Yeung, 2005).

This study gives reason to soften both the high expectations *and* the serious doubts. In the field of financial regulation, publication of warnings, fines and penalties generally does *not* have strong effects in terms of damage to business interests. For the most part, reactions from clients and business partners were absent or mild, sometimes even supportive; questioning the behavior of the regulator. In the professional and consumer market, most AFM publications have not given a loud bang, but only a weak signal. From these findings, the question arises whether disclosure is a a suitable instrument in the regulation of markets where the level of consumer attention and consumer interest is low. Apparently, it is very difficult for public regulators to influence markets through communication.

This does not mean that the publications of the AFM have not had any effects. This study has shown that to the extent that publications have had impact, these impacts are unevenly distributed among companies. When we take a closer look at reactions in individual cases, we observe great variation in media attention, the reactions of clients, and reaction of business partners.

The *media* have appeared to be quite selective in what they report. They have not reported all of the offenses, and seem to attach more news value to the nature of the scam than to the height of the risk to consumers. As to the reactions of *clients*, some companies have lost a significant part of their clients, but have managed to attract new clients at the same time. Others have not had any reactions from clients. Generally speaking, clients appear to attach more value to personal communication of the offending company than to the general message of the regulator. The persuasive communication techniques that are employed by risky investment companies cannot be equalled by the regulator's standardized press releases. These findings suggest that the strongest effects of naming and shaming do not affect the companies that form the highest risk.

Reactions from business partners also show quite some variation. First, different financial institutions attach different value to the same type of penalties. Second, some companies have had their reputation destroyed by the publication, while others have not had any reactions, or even supportive reactions. Also, some offenders have experienced disproportionally negative reactions in their personal life, while others have not.

The conclusion is that reputational effects of naming and shaming in financial regulation are unbalanced and uneven. These findings support Posners qualification of naming and shaming as a messy instrument (Posner, 2000, p.95/106). The effects of naming and shaming are arbitrary and unpredictable. Government cannot control the level of reputational damage caused by media attention, consumer reactions and reactions of business partners. Naming and shaming is sometimes too weak, but in other cases it is too powerful, and it cannot be predicted when this will occur. On the basis of these first results, serious doubts can be expressed as to the proportionality and legitimacy of naming and shaming as a policy instrument.

Naming and shaming in the regulatory pyramid

In terms of regulatory strategy, the AFM combines educating the public, educating the market, and enforcement. The regulatory pyramid (Ayres and Braithwaite, 1992) is the basis of its regulatory strategy, that is aimed to stimulate consumer empowerment and voluntary compliance, with enforcement as a last step. Naming and shaming is meant to to empower and educate the public, to prevent them from investing with unreliable companies. In practice, however, the aim of consumer empowerment has to be balanced with company interests. The AFM considers its main instrument in consumer empowerment, the public warning, to be so stigmatizing and damaging that they exercise much restraint in using it, for fear of being wrong and/orcausing unjust reputational damage. It can be expected that the instrument of public warning as it is used by the AFM will only marginally contribute to consumer awareness. A much larger contribution can be expected by other initiatives that aim to enhance consumer awareness of financial risks, such as Centiq and geldwaardering.nl.

In practice, the instrument of naming and shaming is mainly being employed to educate the market (companies) about right and wrong, by publishing the names of companies that have received a penalty or fine. This use of naming and shaming is one level up in the regulatory pyramid: publication of sanctions in the context of moral education, to deter potential offenders and to reinforce and reassure voluntary compliant companies in their behavior (Braithwaite, 1989). From the interviews I performed so far, my first impression is that this strategy is very effective. This has to be further established with different research methods than I have employed uptil now. However, the question is whether the goals of deterrence and reassurance demand the publication of names of offending companies. Is it necessary to publish the names of offending companies to reach the purpose of "moral education" of the market? And if it is, does this purpose justify the uneven and unbalanced reputational effects of publication?

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