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Do features that associate managers with a message magnify investors' reactions to narrative disclosures?☆

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ABSTRACT

We test whether investors react more strongly to narrative disclosures when the CEO's presence or association with the message is more salient in the disclosure, holding all other information constant. In our first experiment, we manipulate whether a CEO uses more personal pronouns (e.g., "I" and "our" rather than "the company" and "its") in an assertion about whether the firm is "likely" or "unlikely" to win a lawsuit. We find investors' beliefs about the outcome of the lawsuit align more closely with the CEO's assertion when the disclosure contains more personal pronouns. Experiments 2 and 3 manipulate the extent of the CEO's association with the message and whether the disclosure contains good or bad news. In the second experiment, we manipulate whether a disclosure uses more personal pronouns. In the third experiment, we manipulate whether a disclosure does or does not contain a photo of the CEO. Both manipulations of association with the message lead to stronger reactions from investors in between-subjects tests. That is, when news is good (bad), including either more personal pronouns or the CEO's photo leads to more positive (negative) assessments of firm value. We also find that, within-subjects, both manipulations are perceived as indicating greater association with the message, but participants do *not* expect an effect on investment evaluations. In a fourth experiment, we provide additional evidence that personal pronoun usage affects investor reactions by increasing the perceived credibility of the disclosure.

1. Introduction

Managers play a key role in communicating firm performance, and the disclosures they provide can vary in the extent to which the manager's presence is salient in the disclosure (hereafter, managers' "association with the message"). Managers' association with the message is a broad, multi-dimensional construct. For example, some types of disclosures (e.g., conference calls, letters to shareholders, etc.) might associate managers more closely with the message than other types of disclosures (e.g., press releases, 10-Ks, etc.), and firms are increasingly using disclosure mediums that could more closely associate managers with the information in their disclosures (e.g., online video disclosures as in Elliott, Hodge, & Sedor, 2012 or social media disclosures as in Cade, 2017). Even within these different types of disclosures, there is variation in the extent to which disclosure choices associate managers with the message they are communicating. In this paper, we examine how two such disclosure choices – a manager's use of personal pronouns and the inclusion of the manager's photo in the disclosure – affect investors' reactions to the information in the disclosure.

Drawing on prior work in communications and psycholinguistics (Cohn, Mehl, and Pennebaker 2004; Hyland, 2005a,b; Pennebaker, 2011), we predict that these disclosure choices signal to investors that managers believe the information in the disclosure and, as a result, magnify investors' reactions to that information. Understanding these effects is important for several reasons. First, there is a great deal of variation in practice in the use of personal pronouns and photos. For example, recent work in the accounting literature documents significant variation in managers' use of personal pronouns within firm disclosures (Brochet, Miller, Naranjo, & Yu, 2016; Gow, Kaplan, Larcker, & Zakolyukina, 2015). Similarly, the Letters to Shareholders in the 2015 annual reports of Procter and Gamble, Walmart, and Target include photos of their respective CEOs, whereas the corresponding reports for Ford, Apple, and Kroger do not. Second, the literature has suggested a variety of reasons for this variation, including deception, self-serving

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attribution bias, and manager traits such as overconfidence and narcissism. Each of these explanations suggests that personal pronouns and photos may be signals of negative managerial traits. The theory that we rely on instead focuses on investors' *reactions* to these disclosure choices, and suggests that they may magnify investors' positive or negative reactions to news. Third, prior archival work indicates that personal pronoun and photo usage may be related to firm performance (Chatterjee & Hambrick, 2007; Chen & Loftus, 2017), which suggests the possibility of strategic use. Users would benefit from knowing about the possible effects of these strategies on their investment evaluations, especially given that psychology research suggests that they may be unaware of these effects (Pennebaker, 2011). Finally, the effects of personal pronouns are of particular interest given that the SEC describes them as one of the components of plain English disclosures (SEC, 1998). The SEC requires firms to use Plain English in some disclosures and encourages firms to use Plain English in all disclosures.[1] Our study examines whether doing so may have an effect on users that the SEC has not considered.

We test our predictions using a series of four experiments. In Experiment 1, participants read a short disclosure in which the CEO of a hypothetical firm makes a single assertion about the future outcome of a lawsuit. Using a 2 × 2 between-subjects design, we manipulate (1) whether the CEO asserts the company is likely or unlikely to win the lawsuit and (2) whether the CEO refers to the company in first or third person (e.g., "we" vs. "the company"), and test their effects on the extent to which participants' believe the CEO's assertion. Consistent with our predictions, we find that greater use of personal pronouns magnifies participants' reactions to the CEO's assertion. Specifically, when the CEO asserts the company is *likely* to win the lawsuit, participants assess a *higher* likelihood of winning if the CEO refers to the company using a first-person pronoun. In contrast, when the CEO asserts the company is *unlikely* to win the lawsuit, participants assess a *lower* likelihood of winning if the CEO refers to the company using a first-person pronoun.

Our second and third experiments examine how these effects may impact assessments of firm value. In Experiment 2, we examine whether personal pronoun usage within a more typical and detailed disclosure about past performance and future expectations affects perceptions of firm value. Within an abbreviated letter to shareholders, we manipulate (1) whether the disclosure contains good or bad news and (2) whether the CEO refers to the company in first or third person in the final sentence of the disclosure when discussing future performance expectations (e.g., "I" and "our" vs. "the company" and "its"). We isolate our manipulation to the final sentence in order to provide a test of our theory without changing other characteristics of the disclosure. Consistent with our predictions, we find that participants' reactions to the disclosure are stronger when the disclosure contains more first-person personal pronouns. That is, the use of first-person personal pronouns in the final sentence of the disclosure results in higher valuation judgments when news is good but lower valuation judgments when news is bad. Within-participant analyses indicate that participants *do* believe that personal pronouns increase managers' association with the message, but do *not* anticipate an effect on valuation judgments, which suggests that participants may be unaware of the effects of the personal pronouns in our between-subjects test (Kahneman & Tversky, 1996; Libby, Bloomfield, and Nelson 2002).

In Experiment 3, we provide convergent evidence by using a different disclosure choice to manipulate the extent to which managers associate themselves with the message within the same abbreviated letter to shareholders. We use a 2 × 2 between-subjects design and manipulate (1) whether the disclosure contains good or bad news and (2) whether the CEO's photo is present in the disclosure. Again, consistent with our predictions, we find that participants' reactions to the disclosure are stronger when the CEO's photo is included. That is, participants' responses are more positive when a photo of the CEO is included in a good-news disclosure and more negative when a photo of the CEO is included in a bad-news disclosure. As in Experiment 2, within-participants analyses indicate that participants believe that the photo increases the managers' association with the message but do not anticipate an effect on valuation judgments, suggesting that participants may be unaware of the effects of the photo in our between-subjects test.

While we find that investors' valuation judgments are affected by our manipulations in both Experiments 2 and 3, we do not find evidence that these reactions are explained by post-experimental measures of the extent to which participants are willing to rely on the disclosure or the extent to which they think management believes the information in the disclosure, both of which may be thought of as proxies for *disclosure* credibility. Similarly, we do not find evidence that these reactions are explained by measures of management's trustworthiness or competence, two dimensions of *management* credibility (Mercer, 2004). We conduct a fourth experiment to provide additional evidence regarding the process underlying our results. In Experiment 4, we use a 2 × 2 between-subjects design similar to that of Experiment 2. Specifically, we manipulate (1) whether the disclosure contains good or bad news and (2) whether the CEO refers to the company in the first or third person. In order to increase our ability to shed light on the underlying process, we use a shorter disclosure, manipulate the usage of personal pronouns throughout the disclosure (rather than in only the final sentence), and increase our sample size. We also collect additional measures to capture alternative processes that might explain our results (psychological distance, perceived management control, and involvement). Results from Experiment 4 indicate that personal pronouns increase the extent to which participants felt like they could rely on the information in the disclosure, the extent to which participants felt like management believed the information in the disclosure, and perceptions of management trustworthiness. These measures, in turn, led to more positive reactions to good news and more negative reactions to bad news. In contrast, the alternative process measures do not explain our results. These findings provide additional support for the idea that disclosure choices that associate managers with the message increase the credibility of the disclosure and magnify investors' reactions to the information contained therein.

Our findings complement related accounting research that examines disclosure attributes that magnify investor reactions through perceptions of either disclosure credibility or management credibility (Jennings, 1987; Mercer, 2004). Our findings suggest that managers can enhance the credibility of their disclosures by increasing their personal salience or prominence in the disclosure. These findings have potentially important implications for preparers and users of disclosures, as managers might seek to influence investors' reactions to firm communications by selectively adopting disclosure choices that more closely associate themselves with, or distance themselves from, the information in disclosures. Consistent with this idea, recent archival evidence suggests that the use of personal pronouns and CEO photos are related to firm performance (e.g., Chatterjee & Hambrick, 2007; Chen & Loftus, 2017). Managers might also opt for disclosure media that influence their association with the information in their disclosures and make other choices within a disclosure medium to associate themselves or distance themselves from the message. For example, the advent of new media could increase variation in the extent to which managers associate themselves with a message. Firms increasingly use media like Twitter or Facebook to engage with investors and, within these settings, disclosures may be provided on behalf of the firm, or instead may appear to come personally from the CEO. To the extent that these characteristics influence the salience of management in conveying the message, our results suggest that this may have downstream effects on

[1] See, for example, SEC Rule 421(d), Rules 13a-20 and 15d-20, and SEC Releases No. 33–8998 and 34–38164. As stated in Release No. 34–38164 "[The SEC's] ultimate goal is to have all disclosure documents written in plain English."