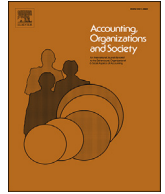




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Commentary

Unpacking the disclosure package: Using experiments to investigate investor reactions to narrative disclosures

Marlys Gascho Lipe

University of South Carolina, 1014 Green St., Columbia, SC, 29208, United States

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ABSTRACT

In this commentary on “Do features that associate managers with a message magnify investor’s reactions to narrative disclosures?” by Asay, Libby, and Rennekamp (2018), I discuss issues regarding the experimental methods commonly used to study the effects of narrative financial disclosures. First, I suggest a broader view of the complementarity of experimental and archival research. Second, experimental methods provide an opportunity to design materials that use minimal representations of phenomena of interest or to use a broader, 360°, approach in depicting the phenomena; I argue the latter approach is a valid option. Third, I note concerns about the ubiquitous “process” or mediation testing in many financial accounting experiments. Fourth, I argue that the use of online participant population can be improved through better screening, to parallel the screening we use with student participant groups. Fifth, I summarize comments by conference participants that questioned the source of corporate disclosure style choices and investor style expectations. The paper concludes with a call for a framework to organize and understand the myriad of financial disclosure style choices made by firm management.

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1. Introduction

Francis, Schipper and Vincent (2002) describe company disclosures as a “package of information.” Asay, Libby, and Rennekamp (2018) note that two important elements of this disclosure package are information content and style. While information content studies have formed the nucleus of archival financial accounting research for decades (Ball & Brown, 1968; Dhaliwal, Kaplan, Laux, & Weisbrod, 2013; Kothari, 2001), there has been a recent archival interest in management choice of and market reaction to disclosure style (Baginski, Demers, Kausar, & Yu, 2018; Davis & Tama-Sweet, 2012; Davis, Piger, & Sedor, 2012; Li, 2008, 2010), including dimensions such as readability, length, and tone. Experimental researchers have also studied effects of disclosure style, including readability (Rennekamp, 2012), concreteness (Elliott, Rennekamp, & White, 2015), and vividness of language (Hales, Kuang, & Venkataraman, 2011). Asay et al. extend the study of style to the use of personal pronouns and photos.

Experimental researchers, with their ability to create and control all aspects of their disclosure stimuli, have the opportunity to unpack the disclosure “package of information” to investigate the

effect of specific parts or aspects of the disclosure. In this commentary I discuss several ways experimentalists can use their comparative advantage for unpacking (and re-packing) disclosures to contribute to our understanding of the impact of these disclosures. First, experimental and archival methods can investigate complementary questions regarding company disclosures. Archival methods and experimental methods have differing strengths, and the two methods can illuminate different aspects of the information package. In addition, the two research approaches can be used to triangulate results (Bloomfield, Nelson, & Soltes, 2016), adding confidence to conclusions derived from either approach alone. Second, the experimentalist’s ability to control study stimuli can be used in (at least) two ways – to operationalize theoretical concepts with a *minimalist* approach wherein manipulations are chosen to differ as little as possible, or to use a more representative approach wherein theoretical concepts are operationalized in a more naturalistic way, encompassing *multiple aspects of the conceptual variable* in the study’s manipulation.

Following this discussion of the use of experimental control, I discuss some concerns regarding current experimental research that investigates narrative disclosures. Specifically, how informative is the ubiquitous process-testing we see in experimental investigations, are we including appropriate populations in the experimental investigations, and how well do experimental

E-mail address: marlys.lipe@moore.sc.edu.

operationalizations capture actual disclosure phenomena and match investor expectations of disclosure choices. I conclude with a brief discussion of the need for a framework to organize and understand experimental research regarding the disclosure package.

2. Archival and experimental method complementarities and triangulation

Asay et al. posit that a manager's association with a message in a corporate communication increases the impact of that message. Because Asay et al. use an experimental approach to test this hypothesis, they must operationalize the conceptual variable "manager association with the message" and they do so in two ways. Experiments 1, 2, and 4 manipulate the relative amount of CEO personal pronoun use in the message to vary CEO association with the message, while experiment 3 includes or excludes a photo of the CEO with the communication to vary this association.

Interestingly, archival researchers used the same measures of personal pronoun usage and inclusion/prominence of CEO photo in earlier studies but considered these measures as operationalizations of the rather negatively-viewed factors of CEO narcissism (Chatterjee & Hambrick, 2007, 2011; Olsen, Dworkin, & Young, 2014; Buchholz, Lopatta, & Maas, 2014; Zhu & Chen, 2015) and/or overconfidence or hubris (Devlin & Lucey, 2016; Schrand & Zechman, 2012) rather than the more neutral factor of manager association with message. While Asay et al. note that these operational variables have been used differently in archival studies, they do not take advantage of the groundwork performed by the archival researchers. Even though the prior archival work did not report how market participants reacted to pronoun or photo use specifically, and, thus, did not test Asay et al.'s particular hypothesis, this does not mean the prior work is uninformative or irrelevant for Asay et al.'s study. Experimental and archival work should be synergistic; while this is understood when researchers in the two areas have obviously complementary research questions (Bloomfield et al., 2016), it is less appreciated in cases where the connections are more mundane – such as here where a similar operationalization or measure (e.g., inclusion of CEO photo) is used in both types of research. Although CEO pronoun and photo use are measured and used archivally as proxies for narcissism and overconfidence, those studies are not designed to, and cannot, determine whether market participants perceive these variables as indicating the factors for which they proxy (and some research indicates, for example, that narcissism is not related to increased use of personal pronouns; Carey et al., 2015). Experimental researchers, however, have the tools to gather data on participants' opinions regarding the fit of the proxy and the conceptual variable; in the Asay et al. study, the researchers could have asked participants to evaluate CEO narcissism and confidence levels. In this way, the archival and experimental research would be complementary even though neither is testing the specific hypothesis of the other.

The complementarity I note above is different from the multi-method approach used in a contemporaneous study of CEO personal pronoun use by Chen and Loftus (2018). Chen and Loftus investigate investor reaction to the use of singular personal pronouns (I, my) vs. plural personal pronouns (we, our) and self-exclusive language (the firm, it). Chen and Loftus' study includes both archival and experimental methods but both investigate the same research question – does CEO use of singular personal pronouns (rather than plural personal pronouns or self-exclusive language) in discussing company performance signal to investors that the CEO has control over performance, leading to more positive reactions to the CEO's earnings report even when current performance is negative. Testing the hypothesis both archivally and experimentally lends significant strength and believability to Chen

and Loftus' convergent results (Bloomfield et al., 2016). In their experiment, Chen and Loftus are able to solicit data to test how well their background theory or story fits using intermediate and overall judgments made by participants (generally impossible archivally) and the archival method allows them to test how well these findings generalize to firms across industries, performance levels, and size, as well as across a myriad of different CEO and disclosure styles. As argued by Chen and Loftus, this multi-method approach increases the combination of internal and external validity of their study.

While increased validity is a worthy goal, this multi-method approach still does not take advantage of the opportunity to ask different but related research questions when using different methods. Chen and Loftus, like Asay et al., do not take the opportunity to gather data regarding the fit of the (personal pronoun) proxy and conceptual variable (e.g., narcissism) used in prior archival work. This means that, despite evidence coming from two interesting experimental studies (Asay et al., and Chen and Loftus), archival researchers are likely to continue to use pronoun type (and photo inclusion) as proxies for narcissism and overconfidence. An opportunity has been missed here and I encourage experimental researchers to think broadly about the complementarity of methods. How can we gather data that will help build the foundation for further work in the area, where that future research will likely utilize varying methods?

3. Two approaches to operationalizing conceptual variables

When experimental researchers use their ability to create research stimuli, they are free to operationalize independent and dependent variables as they wish. Considering the conceptual (i.e., theoretical) independent variables, experimental researchers can take (1) a minimalist approach or (2) a representative "360°" approach in operationalizing the variable. In the minimalist approach, the researcher very carefully ensures that stimuli representing different levels of the variable (e.g., high and low levels of CEO association with a message) differ in the smallest possible way (e.g., changing only the pronoun used in the final sentence of a message). In contrast, the more representative approach (that I am labeling the "360°" approach) utilizes an array of cues that are dimensions or attributes of the theoretical independent variable – attributes that are commonly present together because they are part (i.e., dimensions) of the same variable. This is related to the Brunswikian notion that cues are associated in the environment (i.e., they happen together – sometimes because they are all caused by an underlying factor) and that presenting study participants with one of these cues in isolation does not signal or represent the presence of the underlying factor to people who have experience with this rich environment.¹ Essentially, the 360° approach to manipulating an independent variable in a financial disclosure unpacks the disclosure into its constituent parts and the experimentalist chooses those parts that represent dimensions of the *theoretical concept* of interest. These are then used together (i.e., re-packed) to mirror their environmental co-occurrence, thereby strengthening the operationalization of the conceptual variable.²

¹ Note, this is only one aspect of a Brunswikian approach to research. For a good introduction to Brunswikian notions, see Hammond & Stewart, 2001.

² I want to be clear that I am not advocating varying multiple variables simultaneously *in order to mimic* the real world – studying multiple variables like this is the archivalists' comparative advantage rather than the experimentalists' – rather, I am suggesting the experimentalist include multiple dimensions of a single theoretical variable to *better capture and represent the conceptual variable* to knowledgeable experimental participants.

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