

A Further Examination of the Impact of Corporate Social Responsibility and Governance on Investment Decisions

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Abstract The value relevance of corporate social responsibility (CSR) performance disclosures for financial markets participants remains uncertain despite advances in the literature and the recent proliferation of CSR disclosures around the world. Using an experimental approach involving MBA students at universities in the United States and Lebanon, we study the value relevance of CSR disclosures by testing whether they affect participants' personal portfolio management investment decisions. We also examine whether the degree to which the CSR disclosures affect these decisions is influenced by corporate governance quality. To examine these issues, we examine the effect of environmental performance on investment decisions in Experiment 1, and the effect of labor performance on investment decisions in Experiment 2. Results from both experiments show that investment decisions are affected by CSR performance. Analysis shows that governance strength exerts a marginal effect on the investment decision only when CSR performance is strong. Lebanese participants appear to be more sensitive to weak performance (both CSR and governance) than U.S. participants. Overall, our findings extend the CSR disclosures literature by documenting the value relevance of CSR performance for financial markets participants' decision making. These findings also extend the governance literature by

documenting that consistent with attribution theory, the effects of governance quality are contingent upon the information and decision context, and that efforts to decontextualize governance may be counterproductive.

Keywords Investment judgments · Corporate social responsibility · Environmental disclosures · Labor practices disclosures · Corporate governance · Attribution theory

Introduction

The corporate disclosure environment features a marked increase in the supply of and demand for non-financial information over the last decade (Chua 2006).¹ One area of dramatic growth involves corporate social responsibility (CSR) disclosures. Cecil (2010) shows that the number of firms issuing CSR reports in the U.S. increased from two in 1991, to 154 in 2001, and to 230 in 2006 based on the Corporate Register online directory for CSR reports. More recently, PricewaterhouseCoopers (2010) shows that 81 percent (40 percent) of European (Canada and U.S.) firms listed on five S&P indexes in Europe issued CSR reports.

Prior research suggests that CSR disclosures shed light on multiple aspects of a firm's value proposition. For instance, Lindgreen et al. (2009b) note that managers perceive that CSR activities improve firm performance.

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¹ Coram et al. (2009) document that non-financial information on the balanced scorecard affects investor estimates of the trends of future share price. PricewaterhouseCoopers (2002) report that a majority of top executives around the world consider non-financial information to be more valuable than financial information in assessing a firm's long-term prospects. Narayanan et al. (2000) argue that the disclosures of non-financial information provide investors with better information about the substantive performance of managers and their companies.

Wang et al. (2009) demonstrate that social and environmental performance disclosures influence the credibility of financial disclosures and affect investors' share price judgment. Bird et al. (2007) show that CSR activities affect firm value and their impact varies based on the CSR category. Meta-analysis documents a positive but small association between CSR and financial/economic performance (Margolis et al. 2011; Orlitzky et al. 2003). Malik (Malik 2014, p. 2), in reviewing the literature, argues that "firms align their social goals with corporate goals where CSR is used as a strategic tool to maximize firm value, and those firms with strong CSR performance have greater potential to increase shareholder value as well as the value of other stakeholders." In the accounting literature, this relationship has also been documented by Dhaliwal et al. (2012) who found that there is a link between CSR and cost of capital, and by Casey and Grenier (2015) who found a link between CSR assurance and lower analyst forecast errors.

While CSR is understood to be generally linked to firm value, there is limited prior research exploring the ways in which CSR information affects financial market decisions. This study builds on Elliott et al. (2014) who found that in a context of positive CSR performance investors pay attention to overall CSR performance when it is presented along with other information when making valuation decisions, but that the effect is diminished when potential investors are asked to explicitly consider the CSR information. Elliott et al. (2014) argue that when investors are given CSR information but are not asked to explicitly assess CSR they use their affective reactions to CSR when making investment judgments. Elliott et al. state (2014, p. 294), "...[B]ecause there is limited support for our primary prediction and the related theoretical arguments in the negative CSR performance condition, future research could be valuable in offering additional insight as to whether our results will generally hold only for cases of positive CSR performance, or are likely to hold for both cases of positive and negative CSR performance." We extend that study by looking at two components of CSR; labor and environmental performance, and by varying the governance structure, a factor that may influence the reliability of the CSR information (Cohen and Simnett 2015; Peters and Romi 2015), and we explicitly model both positive and negative CSR performance in our experiments. Moreover, we explore how potential differences in cultural values may affect investment decision making in a CSR context. Prior research suggests that it is important to study multiple dimensions of CSR as CSR does not simply comprise a firm's environmental performance (Adams et al. 2011). Cohen and Simnett (2015) suggest that one reason environmental issues are studied more than labor issues is that environmental impact may be easier to

measure. Further, there is an explicit assurance standard for greenhouse gas emissions (IAASB 2012) but there is no explicit standard for labor practices. Thus, since there is a paucity of research on the effects of labor-related disclosures in CSR, we investigate the effect of disclosure of both labor and environmental performance.

Cheng et al. (2015) examine how strategic factors influence the use of CSR information by investors by manipulating whether disclosure of the environmental component of CSR was consistent with the strategic direction of the firm. They found that nonprofessional investors are more willing to invest in companies engaged in CSR activities if those activities are linked to a company's strategy and if the information received assurance. Their results suggest that if CSR information is perceived as both relevant and reliable, then investors will use that information in their decision making. In this study, we also build on Cheng et al. (2015) by incorporating measurements of participant perception of the relevance and reliability of the provided information within our empirical models.

Using a large longitudinal sample, Ho and Harjoto (2011) found that firms with stronger corporate governance tend to engage in more CSR activities than a matched sample of weaker governance firms. They also found that overall, Tobin's Q, a measure of firm's value, is positively associated with CSR activities. Although the results of this research on the relationship between CSR and firm value suggest that CSR information should be used by investors, the matter is complicated by reliability problems, or perceived reliability problems, for these disclosures (Simnett et al. 2009; KPMG 2011; Cohen and Simnett 2015). There is little, if any, regulatory oversight over the production and reporting of this information (Moroney et al. 2012). Mercer (2004) argues that attribution theory is useful for explaining how investors may assess the usefulness of disclosures. For example, she argues that investors may discount overly positive news as being provided to bolster the attractiveness of a company. In fact, CSR disclosures also have been found to serve as vehicles for impression management (Malsch 2013; Merkl-Davies and Brennan 2007). Moreover, Coram et al. (2009) found in a balanced scorecard-related task that investors paid attention to positive information only when they received some assurance of the reliability of the information through an assurance report. Enhancing the reliability of the CSR information by having the information receive assurance has been documented to increase the value of the CSR disclosures to investors especially when the CSR information is positive (Brown-Liburd and Zamora 2015). In addition to studying governance because governance affects the reliability of the information (Cohen and Simnett 2015), governance has also been found to affect both the influence of CSR (Kim

2015) and whether the CSR information receives assurance (Peters and Romi 2015; Zhou et al. 2015).

Accordingly, in this study, we also examine how another factor that has been documented to affect disclosure reliability; corporate governance (Cohen et al. 2004), may affect the influence of CSR information on investment decisions. We examine this from a moderating perspective evaluating whether the effect of governance is contingent on the context that we are studying. Specifically, we examine whether the effect of governance information is contingent on whether the CSR disclosure is positive or negative and whether the governance is positive and negative. Finally, prior research (Jamali and Sidani 2008; Wang et al. 2010) suggests that cultural factors may affect the importance of CSR in investment decisions. Thus, in an exploratory manner we also examine the investment decisions of participants from both the US and Lebanon; as those two countries differ on important cultural variables such as individualism/collectivism (Cohen et al. 1993; Hofstede 2015).

We use an experimental approach to investigate whether participants' investment decisions for personal portfolio management purposes are affected by CSR disclosures about labor and environmental matters (Bird et al. 2007). We conduct two experiments, one for labor and one for environmental performance, to test the effect of "stronger" reported CSR performance against the effect of "weaker" reported CSR performance. We test whether a common proxy for disclosure quality, corporate governance, moderates the association between CSR disclosures and investment decisions (Eng and Mak 2003; Cohen et al. 2004; Holder-Webb et al. 2008) by evaluating the differential effects of "strong" and "weak" governance on the investment decision. A distinguishing feature of our study is that the investment decision involves multiple dimensions of CSR performance, and that corporate governance quality likewise involves multiple dimensions.

Experimental results involving MBA students enrolled in a Financial Statement Analysis course at a U.S. university and at a Lebanese university document that participants are sensitive to the strength of reported CSR performance in both environmental and labor settings. In both experiments, participants are more likely to invest for personal portfolio management purposes when firms report stronger CSR performance. Findings further document a differential influence of corporate governance upon the relationship between CSR performance and investment decisions only when CSR performance is strong, and not when it is weak. Lebanese participant appear to be more sensitive to the weak experimental conditions than the U.S. participants, for all but governance in the labor experiment.

In the next section, we present a review of the literature upon which our hypotheses are based. We then discuss the

research method and provide information about the experiment, the participants, and the models. We present our results, and conclude with a discussion of our conclusions and the limitations of this study.

Literature Review and Hypothesis Development

Corporate social responsibility is an area of intense and increasing interest for both accounting and finance practice and within academia in general (Casey and Grenier 2015; Cohen and Simnett 2015; Malik 2014; Lindgreen et al. 2009a). The Social Investment Forum (2009) reports that socially responsible investment products increased from \$639 billion in 1995 to around three trillion dollars in 2009. One potential explanation for this increase in CSR investment products is that CSR activity may be a risk factor for the firm (Lindgreen et al. 2009b). A company with poor social responsibility practices may suffer from adverse publicity and decrease in sales resulting in decline in firm value, while a company that successfully conveys a positive image and legitimizes its action to the public may reap the benefit of increased customer loyalty (Cho and Patten 2007; Merkl-Davies and Brennan 2007; Adams 2004; Deegan 2002).

CSR and Firm Value

Prior research documents a positive association between CSR investments, firm performance, and shareholders' wealth. For instance, Barnea et al. (2009) show how a firm's CSR performance affects the equilibrium stock price of the firm when there are sufficient investors motivated by altruism. Using an archival approach and using the KLD database, Ioannou and Serafeim (2010) found an association between favorable CSR performance and favorable analyst recommendations. Wang et al. (2009) document that CSR performance affects student assessments of the credibility of management, bias in earnings reports, and ultimately, affects their estimates of market prices. The authors conclude that CSR performance may serve as a halo effect for the reputation of management. Eccles et al. (2012) document that firms adopting CSR policies early outperformed their counterparts in both stock market and accounting performance. Further, in these companies, the executive incentive compensation promotes positive CSR activity. Waddock and Graves (1997) demonstrate that a firm's current social performance is associated with its future financial performance. Bird et al. (2007) show that KLD ratings are positively related to stock returns for employment, diversity, and environmental concerns, but that returns are negatively associated with strength in environmental performance. Bird et al. (2007) explain

these results by appealing to an enlightened shareholder interest model where the market rewards firms that meet minimal standards, yet punishes firms that go beyond the minimum efforts.²

Several factors limit the usefulness of prior research. The first involves the source of the data. Most studies rely on archival data that is compiled by a third party, KLD. Although archival studies have yielded some valuable insights and advanced the field of understanding, they do not control for the information presented to investors, nor do they permit direct evaluation of investors' choices pursuant to different types of disclosures. An additional complication with the use of KLD ratings is that the degree to which the firm has a public profile affects the volume of information available in the market prior to the announcement of the ratings. The second factor is that share price data used may have been affected by existing public information pertaining to a variety of CSR activities and non-CSR-related information. This makes it difficult to have confidence in attributing observed behavior to one input or the other. The last factor is that the existing literature focuses on firm valuation rather than investment/divestment decisions made by financial market participants.

Behavioral research in the CSR area has not been as widespread as archival work (Cohen and Simnett 2015). One exception to this literature is a recent paper by Elliott et al. (2014), who find that CSR information does affect investor's decisions, but when individuals are asked to first make an explicit assessment of the CSR performance their subsequent investment decisions are not affected. Elliot et al. (2014) first asked participants to give estimates of fundamental value, which may have created an anchoring effect and influenced subsequent judgments. Cheng et al. (2015) found that investors pay more attention to CSR information if the CSR information fits in with the strategic direction of the firm. In general, prior research appears to focus mainly on environmental CSR, despite the wide range of topics that are regarded as constituting CSR activity (Chua 2006; Holder-Webb et al. 2009; Cohen and Simnett 2015).

We study CSR disclosures for both environmental and labor performance. This is important as the GRI G4 Guidelines (2013) organize-Specific Standard Disclosures

into three Categories—Economic, Environmental, and Social. The Social Category is further divided into four sub-Categories, which are Labor Practices and Decent Work, Human Rights, Society, and Product Responsibility. Thus, by failing to consider labor issues, the literature ignores one of the most important components of CSR reporting. Further, as Cohen and Simnett (2015) argue, there is a paucity of research in CSR other than in environmental issues. In fact, Cohen and Simnett (2015, p. 59) posit that labor is an integral part of the Triple Bottom Line reports that have been the cornerstone of integrated reporting. Cohen and Simnett (2015) posit that environmental issues are primarily looked at in CSR research because they are easier to measure and there is an assurance standard that explicitly deals with greenhouse gas emissions. (IAASB 2012). In contrast, labor issues are more complicated, as there is less universal agreement on what constitutes good labor practices. Thus, we examine the manner in which investors are affected by CSR disclosures related to the environment as well as CSR disclosures related to labor.

The observed association in prior research between CSR activity and firm value leads to our first hypothesis that investors are more likely to invest in firms with stronger CSR performance than in firms with weaker CSR performance. The desire to expand the literature's focus from concentrating primarily on environmental performance to other areas of CSR engagement leads to two forms of Hypothesis 1:

H1a Investors are more likely to invest in firms with stronger CSR performance in the environmental area.

H1b Investors are more likely to invest in firms with stronger CSR performance in the labor practice area.

Differential Effects of Governance

The value relevance of CSR performance indicators for financial market participants is likely to depend on its credibility and freedom from reporting bias.³ Investors are likely to attribute more (less) weight to CSR performance indicators in firms having more (less) credible disclosures. Prior research primarily suggests that the credibility of financial and non-financial disclosures may be a function of a firm's corporate governance quality (Cohen et al. 2004; Carcello et al. 2011b). Studies have demonstrated a link between governance quality and financial reporting quality (Klein 2002; Cohen et al. 2004; Dhaliwal et al. 2010),

² Bird et al. (2007) also find that the market appears not to value most CSR activity during their later period of 1997–2003; this may, however, be reflective of the significant economic uncertainty and society-level upheavals that took place globally during this period (i.e., the inception of significant wars, the rise of global terrorist activity, and multiple economic downturns). To the extent that CSR activity consumes resources, one would expect to see less of it, and to have such activity that is provided by less rewarded, during periods of scarcity in resources or increased uncertainty about the future.

³ For instance, Holder-Webb et al. (2009) found evidence supporting the existence of a positive reporting bias consistent with impression management. Cohen et al. (2012) found a tendency for managers of U.S. companies to disclose more positive than negative non-financial information.

restatements (Carcello et al. 2011a), reporting transparency (Eng and Mak 2003; Holder-Webb et al. 2009) and frauds (Agrawal and Chadha 2005). Ho and Harjoto (2011) found that firms with a stronger governance structure are more likely to adopt CSR activities, and that these firms are also likely to enjoy higher firm value. Similarly, Malik (2014) in a review of articles in the management disciplines including those published in accounting and finance journals suggests that there is an association between superior CSR performance and superior corporate governance.

It is unclear whether individual nonprofessional investors will incorporate the differential strength of governance, as Holder-Webb and Sharma (2010) find that professional lenders' perceptions of reporting reliability do not appear to be influenced by governance strength, while Larcker et al. (2007) are unable to substantiate a consistent or persistent relationship between governance, performance, and accounting.

It is possible that the influence of governance quality is contingent upon the context. Elliot et al. (2014) report that the effects of CSR disclosures may be contingent on whether the CSR information is positive or negative. Brown-Liburd and Zamora (2015) document a differential effect for assurance on one area of governance: CSR-related compensation. Their finding that assurance affects decisions only when CSR reporting is positive suggests that investors are looking for signals that the CSR information is reliable. Thus, if governance does indeed affect the reliability of the disclosure of CSR information (Cohen et al. 2004), the effect may be contingent on whether the CSR reporting is positive. Attribution theory (Mercer 2004) suggests that unless the disclosure information is reliable, investors may discount positive information. Coram et al. (2009) supported this relationship between reliability and content, finding that positive information carried more weight to investors if the information received an assurance service. Since corporate governance strength affects financial reporting quality (Cohen et al. 2004), we expect that the strength of corporate governance will affect the extent to which CSR disclosures will influence investment decisions. This is examined in the following hypothesis:

H₂ Governance quality will affect the relationship between CSR strength and investment behavior more when CSR performance is strong than when it is weak.

International Differences

We also explore international differences in investor behavior under the different conditions. We examine the behavior of both Lebanese participants and those from the U.S. The Lebanese context is unique for the several

reasons. First, Lebanon is located in an economic region of the world where corporate social responsibility and corporate governance are relatively new concepts that have gained significant momentum only recently.⁴ Second, the perception of CSR activities in Lebanon may not be comparable to that in more economically developed countries like the U.S. Jamali and Sidani (2008) document that a large percentage of executives in Lebanon still embrace the classical perspective on social responsibility where they view CSR as an additional cost that reduces competitiveness. Moreover, investors in Lebanon are not likely to be as sophisticated and exposed as those in the U.S. given that the Lebanese equity market is still considered a pre-emerging market in terms of size, number of listed firms, and the economic sectors reflected on the Beirut Stock Exchange by international standards (Shachmurove 2003). In fact, capital markets were regulated by a department within the Central Bank under the supervision of the Banking Control Commission until it enacted the Capital Markets Law in 2011. Moreover, according to Hofstede's (2015) national dimensions, Lebanese have a relatively small propensity to save for the future, focus on achieving quick results, and have a tendency to cynicism and pessimism. Third, Wang et al. (2010) document that cultural background affects investment behavior, finding that Lebanese participants have greater loss aversion, risking more money to avoid a definite loss even when this results in a greater loss, and exhibiting greater concern for avoiding extremely unlikely events with a very negative outcome.

Given the above, our research contributes to the literature by testing whether the aforementioned differences have significant implications on investment and divestment decisions.

RQ: Are the investment decisions of Lebanese and U.S. investors affected differently by CSR performance and governance strength?

Research Method

Participants

We administered two experiments to 154 Master of Business Administration (MBA) students who were enrolled in or had completed the master's level Financial Statement Analysis course at two schools: a U.S. university and an

⁴ For instance, the number of companies from this region that are members of the UN Global Compact—a strategic policy initiative for businesses committed to align their operations and strategies with 10 principles in the areas of human rights, labor, the environment, and anticorruption—has increased from three in 2003 to 262 by the end of 2012 (Booz and Company 2013).

English-language university in Lebanon.⁵ According to Elliott et al. (2007), MBA students are reasonable proxies for nonprofessional investors for experimental tasks and Elliot et al. (2007, p. 166) argue that MBA students who are taking financial statement analysis “are a good proxy for both tasks that are high and low in integrative complexity.” Experiment 1 asked the participants to make a hypothetical investment decision given information about the company’s environmental practices. Experiment 2 asked the participants to make the same hypothetical investment decision given information about the company’s labor practices. Each participant took part in one experiment only.

Independent Variables

We test our hypotheses using two experiments with a 2×2 fully crossed between-participant factorial experimental design for CSR performance and corporate governance (GOV) structure quality. The two experiments used CSR disclosures and incorporate two different types of activities shown by Bird et al. (2007) to be relevant for financial markets: labor policies and environmental policies. Each participant received information pertaining to either environmental policies or to labor policies. Each participant was exposed to either a Strong or Weak CSR condition. The Strong conditions for both types of policies include reports of a detailed record of accomplishment on corporate social responsibility and a commitment to leadership in that area; the Weak conditions for both policies disclose no details, minimal compliance with relevant regulations, and express an unwillingness to sacrifice economic performance to exceed minimal relevant regulatory requirements.⁶ Corporate governance disclosures incorporate information pertaining to the board of directors, its committees, in addition to the presence or absence of institutional investors. Each participant was exposed to a Strong or a Weak governance condition. The Strong condition included a disclosure of the presence of independent board and board committees, as well as the presence of institutional blockholders; the Weak condition reported the presence of a non-independent board and an absence of institutional blockholders.⁷

⁵ Hofstede (1980, 2001) and Salter et al. (2015) suggest that national culture may affect an individual’s decision making. Although Lebanon and the U.S. differ on important cultural variables such as Individualism and Power Distance (Hofstede 2015) we did not find any significance to including country of origin as a covariate. Thus, for all statistical analysis, we used the combined aggregate sample. Note, that we did not collect individual data from participants on their cultural score.

⁶ These descriptions are adapted from Holder-Webb et al. (2009) examination of disclosure of CSR activities.

All subjects were first given general background about a company. The described company was a publicly traded global manufacturer and retail distributor of children’s clothing that had expanded its manufacturing facilities overseas, primarily in Southeast Asia. After viewing this information, participants viewed information about CSR information and governance strength. This was followed by questions related to the investment judgments and then they were asked manipulation check questions. Finally, we elicited demographic information from the participants. Appendix A presents the manipulations used for each experiment.

Dependent Variable

Participants were asked to answer several questions following a short introduction to the hypothetical company including CSR disclosures and corporate governance information. Participants had to answer each question using a 7-point Likert scale anchored on 1 (“much less likely”) and 7 (“much more likely”). The hypothetical investment decision for long-term gains was measured through the participant response to the question “How much more or less likely would you be to invest in [the Company] for the next year, given the [environmental or labor] disclosure information?” The dependent variable thus assumes a value between 1 and 7 for each participant, with higher values indicating greater interest in investing.⁸

Manipulation Checks

The instrument included manipulation checks asking participants to rate the CSR performance and governance structure quality of the firm on 7-point Likert scales anchored by 1 (“not strong”) and 7 (“very strong”). Participants who received an instrument containing a Strong condition, but who rated the condition as “not strong” and vice versa were removed from further analysis.

Of the original 154 participants, 20 observations failed the manipulation checks.⁹ The remaining 134 participants assessed CSR performance and governance strength in a way that matches the experimental conditions. The final

⁷ These descriptions are adapted from factors that may affect the corporate governance mosaic (Cohen et al. 2004).

⁸ We also asked participants on whether they would divest in this company. Specifically, participants were asked “How much more or less likely would you be to divest from [the Company] for the next year, given the [environmental or labor] disclosure information?” Results for the divestment judgment and the investment judgment were qualitatively similar. Thus, all results reported in the paper are for the investment judgment only.

⁹ Analysis did not reveal any obvious trends with respect to experiment number, or experimental condition, with respect to the participants that failed the manipulation checks.

samples consist of 71 participants in Experiment 1 (environmental performance) and 63 participants in Experiment 2 (labor performance). There were no significant differences in the demographics or participant characteristics between the two experimental pools. Seventy percent of the participants were male and 60 % were U.S. residents. Thirty-six percent of the participants reported buying or selling individual investment products (stocks or bonds, not mutual funds) in the last five years, with an average (median) experience of 2.92 (3.00) years of experience buying and selling individual investment products.¹⁰

The mean (standard deviation) CSR performance perceived by participants in the Strong CSR condition is 5.03 (1.043) for Experiment 1, and 5.10 (1.193) for Experiment 2. The mean (SD) CSR performance perceived by participants in the Weak CSR condition is 3.39 (1.128) for Experiment 1, and 3.38 (1.100) in Experiment 2. The mean (SD) governance strength perceived by participants in the Strong GOV condition is 5.31 (1.091) for Experiment 1, and 5.58 (0.958) in Experiment 2. The mean (SD) governance strength perceived by participants in the Weak GOV condition is 2.40 (0.976) for Experiment 1, and 2.19 (0.821) in Experiment 2.¹¹

Models

As mentioned above, the dependent variable is the participant's ranking of intent to invest based on a 7-point Likert scale. It is inappropriate to employ least-squares or ANOVA techniques on data of this type due to the bounded nature of the variable. Likewise, general linear models are also inappropriate for ordinal (rather than interval) data. In this situation, Kennedy (2008) recommends the use of an Ordered Logit model (a generalized linear model rather than a general linear model) to yield robust estimates. This multivariate estimation technique explicitly models the implied threshold parameters that cause a respondent to move from a rating of "1" to a rating of "2" and so forth. Intercept terms are typically not included in an Ordered Logit. The maximum likelihood estimation process normalizes the error terms to have a mean of zero and a variance of one. Because of this process, the parameter estimates cannot be interpreted in the same way as the estimates from a least-squares regression (where a one-unit change in βx leads to a Y-unit change in the dependent variable); therefore, the discussion of the results here

¹⁰ Consistent with Elliott et al. (2007) we conclude that these types of students have both a relevant informational and knowledge background, and relevant investing experience.

¹¹ Cross-experiment, within-condition differences in means are not significant.

focuses on statistical significance rather than on economic significance. We test H_1 through CSR, which represents the Strong/Weak CSR experimental condition, and H_2 through an interaction between CSR and GOV.¹² We control for participant's rating of the relevance of the information provided (Financial Accounting Standards Board 2010) with RELEV. We also explore the potential effect of culture by first testing and then controlling for a participant's country of residence.

$$INVEST = \beta_0 + \beta_1 CSR + \beta_2 GOV + \beta_3 CSR * GOV + \beta_4 RELEV + \beta_5 USRESID (Model 1)$$

CSR and GOV assume a value of 0 for the Weak condition, and a value of 1 for the Strong Condition. RELEV is the participant's rating of the relevance of the information provided, based on a 7-point Likert scale anchored on 1 ("not relevant") and 7 ("very relevant"). USRESID assumes a value of 0 for non-US residents, and a value of 1 otherwise.

Results

Table 1 reports descriptive statistics and univariate tests for INVEST and the two primary independent variables of interest: CSR and GOV. Consistent with hypothesis H_1 , Panel A shows that the investment decision is significantly associated with CSR strength (at $p < 0.01$) for both Experiments 1 and 2. Respondents are more likely to invest in firms having stronger CSR performance. Panel B of Table 1 presents a main effect for governance and finds that the mean difference in INVEST contingent on GOV strength is significant ($p < .05$) only for Experiment 2 (labor performance). Panel C provides means, sample sizes, medians, and standard deviations for the entire experimental matrix for Experiment 1 (environmental performance). Univariate tests for H_2 suggest that corporate governance strength moderates the association between investment decision and CSR strength only for the Strong CSR condition in Experiment 1. Panel D provides the experimental matrix for Experiment 2 (labor performance). As with Experiment 1, governance strength appears to matter only within the Strong CSR condition. Thus, using only Univariate statistics it appears that

¹² As indicated in the development of H_2 , the assessment of the reliability of the firm's communications may be a function of the perceptions of the strength of the firm's governance. This is the case with our experimental participants: the subjective assessment of the reliability of the disclosures is highly correlated with the subjective assessment of the strength of the governance (Pearson correlation = .650, $p = .000$). Thus, we conclude that the governance measure is also impounding beliefs about reliability, and in order to avoid econometric problems arising from collinearity in these variables, we include only the governance variable.

Table 1 Descriptive statistics and univariate tests

Experiment	Strong condition (<i>n</i> = 66)			Weak condition (<i>n</i> = 68)			Mean diff. (<i>t</i> stat; <i>p</i> value)	
	Mean	Median	SD	Mean	Median	SD		
Panel A: INVEST by CSR strength*								
Environmental performance	5.31	6.00	1.510	3.06	3.00	1.530	2.259 (6.261; <i>p</i> = .000)	
Labor performance	5.10	5.00	1.758	3.19	3.00	1.674	1.909 (4.416; <i>l</i> = .000)	
Experiment	Strong condition (<i>n</i> = 67)			Weak condition (<i>n</i> = 67)			Mean diff. (<i>t</i> stat; <i>p</i> value)	
	Mean	Median	SD	Mean	Median	SD		
Panel B. INVEST by governance strength*								
Environmental performance	4.33	4.00	1.789	4.00	5.00	2.00	0.333 (0.741; <i>p</i> = .461)	
Labor performance	4.71	5.00	1.847	3.56	4.00	1.917	1.147 (2.418; <i>p</i> = .019)	
Governance	Corporate social responsibility							
	Strong condition				Weak condition			
	<i>N</i>	Mean	Median	SD	<i>N</i>	Mean	Median	SD
Panel C: INVEST by CSR strength and governance strength: environmental performance*								
Strong condition	17	5.76	6.00	1.091	19	3.05	3.00	1.224
Weak condition	18	4.89	5.00	1.745	17	3.06	3.00	1.853
Mean diff. (<i>t</i> stat; <i>p</i> value)	<i>t</i> = 1.768; <i>p</i> = .086				<i>t</i> = 0.012; <i>p</i> = .991			
Governance	Corporate social responsibility							
	Strong condition				Weak condition			
	<i>N</i>	Mean	Median	SD	<i>N</i>	Mean	Median	SD
Panel D: INVEST by CSR strength and governance strength: labor performance*								
Strong condition	17	5.71	6.00	1.490	14	3.50	3.50	1.506
Weak condition	14	4.36	5.00	1.823	18	2.94	2.50	1.798
Mean diff. (<i>t</i> stat; <i>p</i> value)	<i>t</i> = 2.268; <i>p</i> = .031				<i>t</i> = 0.929; <i>p</i> = .360			

*INVEST is the response to a 7-point Likert scale anchored on 1 “Much less likely to invest” and 7 “Much more likely to invest”

participants are most likely to invest in companies with both a strong CSR as well as a strong governance structure.

Multivariate Analysis

The results of the Ordered Logit estimations for Model 1 are presented in Table 2. The reference group for the CSR, GOV, and CSR*GOV conditions is the group exposed to a Weak condition. Panel A displays the parameter estimates and two-tailed significance tests for Experiment 1, and reveals that the CSR strength is a significant element of the decision to INVEST ($p < .001$). GOV is significant at $p < .10$. The negative coefficients on both variables indicate that participants exposed to the Weak condition are significantly less likely to invest. The interaction term is not significant, suggesting that the effect of CSR strength is independent of the effect of GOV strength. The perceived

relevance of the information is significant at $p < .05$, while it appears also that non-US-residents (the reference group for USRESID) are more sensitive to this information than U.S. residents at a weak significance level of $p < .10$. The overall model is significant at $p < .001$.¹³

Panel B of Table 2 presents the results of the model estimation for Experiment 2. As with Experiment 1, the CSR strength is a significant determinant of the INVEST decision ($p < .001$), as is the GOV strength ($p < .05$). As with Experiment 1, the interaction term is not significant, and the perceived relevance and national residence of the respondent are clearly not significant. The overall model is

¹³ Ordered logits do not yield measures of explained variance that are comparable to the R^2 provided by least-squares techniques. Thus, we present the Likelihood Ratio Chi-Square, which tests the null model that no variable in the model is significant.

Table 2 Ordered logit estimation of model 1, effect of CSR and governance strength on investment decision

Variable*	Parameter estimate	SE	Wald chi-square	<i>p</i> value (one-tailed)
Panel A: environmental performance				
CSR**	−3.308	0.7318	20.435	.000
GOV**	−0.982	0.6955	1.993	.079
CSRxGOV**	1.005	0.9368	1.150	.142
RELEV	0.277	0.1599	3.009	.042
USRESID**	0.775	0.4646	2.783	.095
Likelihood ratio chi-square		39.109 (<i>p</i> = .000)		
Variable*	Parameter estimate	SE	Wald chi-square	<i>p</i> value (one-tailed)
Panel B: labor performance				
CSR**	−2.700	0.7451	13.128	.000
GOV**	−1.640	0.7450	4.843	.014
CSRxGOV**	1.181	0.9574	1.521	.109
RELEV	0.111	0.1462	0.572	.225
USRESID**	0.267	0.4888	0.298	.293
Likelihood ratio chi-square		26.822 (<i>p</i> = .000)		

* CSR and GOV are the experimental manipulations and are coded as “0” (Weak condition) and “1” (Strong condition); RELEV is the participant perception of the relevance of the CSR disclosures as coded on a 7-point Likert scale anchored on “1” (not relevant) and “7” (very relevant); AGE is a continuous variable expressing the participant’s age in years; USRESID is an indicator variable assuming a value of “0” for Non-US Residents and “1” for US Residents

** Reference values for GOV and CSR are “Weak” condition. Reference value for USRESID is “Non-US Resident”. Reference values for CSR*GOV is the “Weak” condition for both

also significant at $p < .001$. The results shown in Table 2 support H1 and document a main effect for governance, but this multivariate analysis does not provide clearly significant support for H2.¹⁴

The results from the main multivariate analysis can be explained by the proposition that stronger (weaker) CSR performance has positive (negative) implications on firm reputation and image that may result in intangible returns (costs) through stronger goodwill (“ill will”) (Merkl-Davies and Brennan 2007). The lack of a significant interaction effect for governance strength corroborates the finding by Holder-Webb and Sharma (2010) that governance quality as conceptualized through board independence and external blockholders does not significantly affect investor perceptions of CSR information value with regard to resource allocations. It also suggests that the effect of governance on behavioral decisions may be more

complicated than results suggested in the archival area (Cohen et al. 2004; Cohen et al. 2008).

The Role of Governance Strength

Interpretation of logistic regressions of any type is complicated in that the models are only linear within the context of logits, a measure that does not offer an intuitively appealing interpretation (Kennedy 2008). The easier way is to interpret them through probabilities, but when this is done, the model’s surface becomes completely nonlinear in the dimensions of X and Y.¹⁵ A one-unit change in X does not imply a β change in the probability of Y as might be thought from the naïve standpoint (Mitchell and Chen 2005). This creates certain problems with respect to the understanding of dummy variable interaction terms. The basic problem is that when there are continuous variables in the model, as there are in ours, the accumulation of the predicted probabilities of Y may increase faster across one dummy variable depending on the setting of the other dummy variable. That is, the value of the continuous variables exerts a potentially strong effect on the

¹⁴ The results are comparable after controlling for the prior investment experience of participants. The parameter estimate for prior investment experience is insignificant for both investment/divestment decisions ($p > 0.10$). Results are also not affected qualitatively or quantitatively by including a vector of demographic controls (each is statistically insignificant). Demographic variables consisted of gender, age, education level, field of undergraduate and/or graduate study.

¹⁵ This is why we our hypothesis testing is based on the statistical significance of coefficients, rather than the interpretation of their economic significance.

accumulation of probabilities at various settings of the interaction term components. Hypothesis 2, and the univariate results shown in Table 1 suggest such an asymmetric effect with respect governance strength is possible. This is not a factor that can be controlled for effectively through a reconfiguration of our model; therefore, in order to explore the matter further, we performed some additional univariate tests. The results are shown in Table 3. The analyses underlying the results in Panels A and B of Table 3 hold the CSR conditions constant, and evaluate the effect of governance strength on the decision to invest, contingent upon CSR strength. Both experiments have been pooled into a single set of observations for purposes of this analysis. Panel A of Table 3 represents results for the weak CSR condition, and suggests that when CSR performance is weak, the strength of governance has no effect on the decision to invest ($p > .10$). Panel B of Table 3 represents results for the strong CSR condition, and suggests that when CSR performance is strong, governance strength exerts an incremental effect on the decision to invest ($p < .01$).

Another way of investigating this potential interaction is analysis of the simple main effects. A test of simple effects explores the degree to which one factor has different effects at different settings of another factor; in our case, whether GOV has different effects for different levels of CSR performance. The statistical analysis of the simple effects supports the results shown in Panels A and B: governance only affects the decision to invest when CSR is strong, and that H2 is supported conditional upon the existence of a strong CSR condition. This result is somewhat analogous to research on the effect of assurance services on CSR disclosures in which the effect of

assurance is most pronounced when CSR disclosures are positive in nature (Cohen and Simnett 2015). Thus, investors may be skeptical of positive CSR information as potential public relations unless there are corresponding signals that suggest that the disclosures are reliable.

Additional Analyses

As another test of the robustness of our main results, we consider a different formulation of the primary variables. The results in Table 2 rely upon the encoding of the primary independent variables, CSR and GOV, as dichotomous indicators based on the experimental manipulations (Strong Versus Weak) rather than participants’ subjective evaluation of CSR and GOV strength. We test the validity of the results by replicating our multivariate analysis using participants’ subjective ratings of the strength of CSR policies and Governance structures.

$$INVEST = \beta_0 + \beta_1CSR_RAT + \beta_2GOV_RAT + \beta_3RELEV + \beta_4USRESIDUS (Model 2)$$

INVEST, RELEV, and USRESID are measured as in Model 1. CSR_RAT and GOV_RAT are the participant’s ratings on a 7-point Likert scale anchored on 1 (“not strong”) and 7 (“very strong”) of the strength of the company’s CSR performance and GOV strength. Results of this estimation appear in Table 4. Panel A presents the results for Experiment 1 (environmental performance), and yields the information that the participant ratings of CSR performance is a significant ($p < .0001$) determinant of the INVEST decision, and that participants who perceive the CSR performance as being stronger are more willing to invest. Participant rating of GOV strength is not

Table 3 Additional testing of the interaction between CSR and GOV

GOV condition	N	Mean of INVEST	SD	t	p value (two-tailed)	
Panel A: effect of GOV when CSR is low (0)						
Strong	33	3.24	1.347	0.626	.533	
Weak	35	3.00	1.799			
GOV condition	N	Mean of INVEST	SD	t	p value (two-tailed)	
Panel B: effect of GOV when CSR is high (1)						
Strong	34	5.74	1.286	2.844	.006	
Weak	32	4.66	1.771			
CSR condition		Sum of squares	Df	Mean square	F	p value (two-tailed)
Panel C: analysis of simple effects of GOV based on estimated marginal means of CSR						
Weak	Contrast	0.998	1	0.998	0.406	.525
	Error	319.897	130	2.461		
Strong	Contrast	19.194	1	19.194	7.800	.006
	Error	319.897	130	2.461		

Table 4 Ordered logit estimation of model 1, effect of CSR and governance ratings on investment decision

Variable*	Parameter estimate	SE	Wald chi-square	<i>p</i> value (one-tailed)
Panel A: environmental performance				
CSR_RAT**	0.719	0.1882	14.619	.000
GOV_RAT**	−0.194	0.1519	1.639	.100
RELEV	0.389	0.1546	6.318	.006
USRESID**	0.609	0.4755	1.640	.200
Likelihood ratio chi-square		25.730 (<i>p</i> = .000)		
Variable*	Parameter estimate	SE	Wald chi-square	<i>p</i> value (one-tailed)
Panel B. Labor Performance				
CSR_RAT**	0.589	0.1894	9.667	.001
GOV_RAT**	0.159	0.1382	1.317	.126
RELEV	0.150	0.1418	1.126	.145
USRESID**	0.495	0.4827	1.051	.153
LIKELIHOOD RATIO chi-square		18.739 (<i>p</i> = .001)		

* CSR_RAT and GOV_RAT are the participant's ratings of CSR and Governance strength, respectively, on a 7-point Likert scale anchored on "1" (not strong) and "7" (strong); RELEV is the participant perception of the relevance of the CSR disclosures as coded on a 7-point Likert scale anchored on "1" (not relevant) and "7" (very relevant)

** Reference value for USRESID is "Non-US Resident"

statistically significant, but the participant rating of the information's relevance and the participant's residence outside of the US is (with the same directional results shown in Panel A of Table 2).¹⁶ Results presented in Panel B suggest that when the CSR activity is couched in terms of labor performance, the only significant indicator is the participant's perception of the CSR strength, and that GOV strength, relevance, and the national residence of the participant do not affect the INVEST decision.¹⁷

International Differences

Table 5 presents the results of univariate analysis of investment decisions between Lebanese and U.S. participants. Panel A shows the results of a *t* test evaluating whether INVEST is influenced by CSR strength for the pooled experiments (labor and environmental together). Results suggest that the Lebanese participants are significantly less likely to invest if the CSR performance is weak than U.S. participants are ($t = -5.682, p < .01$). Panel B shows the results for governance strength for the pooled experiments. Lebanese participants are less likely to invest

if the governance is weak than U. S. participants ($t = -3.353, p < .01$). Panels C and D examine the effect by experiment type, and show that the risk aversion suggested by the relative disinclination to invest under the "weak" CSR condition is evident for both environmental and labor performance with respect to CSR, while the risk aversion seems to be localized to environmental performance when it comes to responsiveness to governance strength. The general picture seen from Table 5 is that there are significant differences between the two populations with respect to investment behavior under weak conditions, but not under strong conditions. This is generally consistent with the risk aversion noted by Wang et al. (2010).

Collectively, these findings document the following. First, investment judgments appear to be related to CSR performance, where participants are more (less) likely to invest in firms having stronger (weaker) CSR performance. Second, corporate governance structure quality appears to influence investment judgments, with participants being more (less) likely to invest in firms having strong (weak) corporate governance structure. Finally, corporate governance only appears to be relevant for situations in which CSR performance is strong.

Discussion and Conclusion

We extend the line of inquiry of whether CSR performance matters (Casey and Grenier 2015; Elliott et al. 2014; Dhaliwal et al. 2012; Ioannou and Serafeim 2010; Holder-

¹⁶ This contrasting result between the manipulation and the perceptions of participants could be a function of governance being perceived as comprising multiple dimensions not described in the instrument, but which are components of what Cohen et al. (2004) denote as the "corporate governance mosaic".

¹⁷ Including an interaction term comprised the participant ratings of governance and CSR does not alter the results of the model qualitatively. The term is not significant in and of itself, and so has been omitted from the further analysis for reasons of parsimony.

Table 5 International differences

Experimental condition	Nationality	<i>N</i>	Mean intent to invest	<i>t</i> stat	<i>p</i> val	
Panel A: mean difference in intent to invest by CSR strength, pooled experiment						
Weak CSR	Lebanon	27	2.07	−5.682	.000	
	US	41	3.80			
Strong CSR	Lebanon	28	5.32	0.433	.190	
	US	38	5.13			
Experimental condition	Nationality	<i>N</i>	Mean intent to invest	<i>t</i> stat	<i>p</i> val	
Panel B: mean difference in intent to invest by governance strength, pooled experiment						
Weak GOV	Lebanon	28	2.86	−3.353	.002	
	US	39	4.46			
Strong GOV	Lebanon	27	4.63	0.451	.654	
	US	40	4.43			
Experiment	Experimental condition	Nationality	<i>N</i>	Mean intent to invest	<i>t</i> stat	<i>p</i> val
Panel C: mean difference in intent to invest by CSR strength, by experiment						
Environmental	Weak CSR	Lebanon	14	1.93	−4.860	.000
		US	22	3.77		
	Strong CSR	Lebanon	15	5.27	−0.159	.874
		US	20	5.35		
Labor	Weak CSR	Lebanon	13	2.23	−2.999	.005
		US	19	3.84		
	Strong CSR	Lebanon	13	5.38	0.709	.448
		US	18	4.89		
Experiment	Experimental condition	Nationality	<i>N</i>	Mean intent to invest	<i>t</i> stat	<i>p</i> val
Panel D: mean difference in intent to invest by governance strength, by experiment						
Environmental	Weak GOV	Lebanon	15	2.87	−3.069	.002
		US	20	4.85		
	Strong GOV	Lebanon	14	4.50	0.418	.273
		US	22	4.23		
Labor	Weak GOV	Lebanon	13	2.85	−1.670	.112
		US	19	4.05		
	Strong GOV	Lebanon	13	4.77	0.150	.103
		US	18	4.67		

Webb et al. 2009; Bird et al. 2007; Waddock and Graves 1997) by conducting two experiments (environmental and labor) manipulating the level of CSR performance (stronger or weaker) and corporate governance quality (stronger or weaker). The experiments examine participants' investment decisions for personal portfolio management. We first document that participants' investment decisions are directly related to CSR performance. This holds for both CSR information related to the environment as well as for labor policies. This finding suggests that investors may be paying more attention to CSR performance as the disclosure of this type of information becomes more widespread and receives more coverage in the press (Cohen and Simnett 2015; Simnett et al. 2009; Holder-Webb et al. 2009).

We further show that participants' investment decisions are affected by corporate governance strength. However, we find that governance strength only appears to matter when CSR performance is strong. This finding is somewhat analogous to the effect found for assurance services on CSR performance where assurance mattered only in the positive context (Brown-Liburd and Zamora 2015) and for what Coram et al. (2009) found in a balanced scorecard context. This lends supports to an attribution theory explanation in that positive news about a company is discounted unless an investor has some sense that the disclosure is reliable (Mercer 2004). This suggests that without some signal of the reliability of information, investors may be wary of the veracity of positive CSR disclosures. One implication of this finding is that the value

of governance is contingent upon the decision and information context, a matter that is inadequately addressed within the extant literature. The regulatory emphasis on governance, as well as considerable resources dedicated among organizations to “good” governance, suggest that this is a matter of primary importance for academic research to address. The question arises as to whether there would be value to companies in appointing CSR experts on their boards to monitor CSR activity, in a manner similar to the addition of financial experts to monitor the financial reporting process (Cohen et al. 2004, 2008). We also recognize that corporate governance can be operationalized in a number of ways. This study took a risk-based focus, which could have led to demand effects in driving the participants’ judgments. This suggests future research opportunities to evaluate the effect of governance on CSR-related judgments from the multiple perspectives suggested by the corporate governance mosaic outlined by Cohen et al. (2004).

An open question that remains is whether this information would become more influential under a reporting regime wherein the information was required to be disclosed by firms, or under an attestation regime wherein attestation or auditing services were available to provide third party verification of the disclosed non-financial information (Cheng et al. 2015; Malsch 2013; Adams et al. 2011; Coram et al. 2009). At present, attestation services for this type of information are available in several countries; although it is not widespread in either country providing participants to this study (Simnett et al. 2009). A study designed to take advantage of these structural differences in the attestation environment could shed useful light on whether investors will use this information more heavily if there is assurance than they do when it has not received assurance. Further, research could explore if the investors’ assessment of CSR as an initial step still attenuate the effect of CSR on valuation decisions as Elliott et al. (2014) had found if the attestation services are provided in an integrated reporting mechanism (Adams et al. 2011). Another question arises with respect to investor beliefs about managers’ motivations in providing this information in the unregulated environment: would investors be more inclined to use this information if it was required than they are at present, where the information may be provided as part of an impression management plan? In this study, we chose the operationalization of the manipulations after discussion with colleagues specializing in CSR research and consulting and by examining the review of CSR disclosures in Holder-Webb et al. (2009). However, the information was not taken directly from a CSR report. A future study could evaluate if the results would differ using the actual language from a CSR report as opposed to choosing a manipulation that would

accentuate the experimental condition. Moreover, we manipulated the CSR and governance to be either positive or negative. A future study could add a neutral condition to establish a baseline to compare against differential manipulations of the strength of CSR and/or governance. Further, an individual’s affect towards environmental issues could influence the impact of CSR information. This could be explored in future research by measuring sustainability preferences and the extent to which individuals held shares of CSR friendly stocks. Finally, we found some difference in investment decisions between the US and Lebanese participants. Specifically, Lebanese participants appear to be more sensitive to weak performance (both CSR and governance) than U.S. participants. A future study could examine if investors in countries, such as those in the EU, that already have a long history of using CSR information (Simnett et al. 2009) may be more sophisticated in their use of CSR information compared to the two countries providing experimental participants, neither of which involve a reporting environment that has widespread use of attestation services for this type of information (Casey and Grenier 2015). All in all, this study extends recent CSR-related investing research (Elliott et al. 2014) by examining the influence of CSR performance on investment decisions in the context of labor as well as the already widely studied environmental area (Cohen and Simnett 2015) and by exploring whether the quality of the governance structure may moderate the effect of CSR performance on investment judgments and decisions (Carcello et al. 2011b; Holder-Webb and Sharma 2010; Cohen et al. 2004).

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Appendix 1: Manipulations for CSR Performance and Governance Strength

Experiment 1: Environmental Performance

Strong CSR Condition Environment

As part of the risk management process, the board reviews the company’s environmental record. In response to questions from the board about environmental issues, management reports that after discussions with the board they will disclose on their website the following items related to environmental performance: (1) management has met with the board to discuss environmental performance, (2) the company is retrofitting all of their facilities to minimize the environmental impact of their production activities; (3) the

company reduced emissions of CO₂ by 20 % over the prior year, (4) the company has made it a priority to support environmental initiatives in the host communities where their facilities are located, and (5) not only is the company in compliance with all applicable environmental regulation, it will go beyond minimum regulation standards to ensure that its environmental practices will be the leader in its industry.

Weak CSR Condition Environment

As part of the risk management process, the board reviews the company's environmental record. In response to questions from the board about environmental issues, management reports that after discussions with the board they will disclose on their website the following items related to environmental performance: (1) management has met with the board to discuss environmental performance; (2) the company is in compliance with all applicable U.S. environmental regulations; and (3) the company, however, will not sacrifice the "bottom line" to go beyond the minimum legal requirements in establishing and enforcing environmental practices.

Experiment 2: Labor Performance

Strong CSR Condition Labor

As part of the risk management process, the board reviews the company's record of employment policies in overseas manufacturing facilities. In response to questions from the board about human rights and child labor issues, management reports that after discussions with the board they will disclose on their website the following items related to employment policies: (1) management has met with the board to discuss human rights and child labor policies, (2) the company has completed on-site inspections to ensure that human rights and child labor policies are enforced; (3) the company is in the process of drafting a living wage policy for employees of the manufacturing operations located overseas; (4) the company has made it a priority to support educational initiatives in the host communities where their facilities are located, and (5) not only is the company in compliance with all applicable U.S. wage and employment regulation it will go beyond minimum regulation standards to ensure that its internal labor practices will be the leader in its industry.

Weak CSR Condition Labor

As part of the risk management process, the board reviews the company's record of employment policies in overseas manufacturing facilities. In response to questions from the

board about human rights issues, management reports that after discussions with the board they will disclose on their website the following items related to employment policies: (1) management has met with the board to discuss human rights and employment policies; (2) the company is in compliance with all applicable U.S. wage and employment regulations; and (3) the company, however, will not sacrifice the "bottom line" to go beyond the minimum legal requirements in establishing and enforcing internal labor practices.

Manipulation of Corporate Governance Quality

Strong Governance Condition

The company has a tradition of having a majority of outside (non-employee) board of directors that oversees management's activities closely. The Chair of the Board is an independent outsider and the Board has the primary power to conduct independent investigations of unethical behavior. There are large institutional holdings of the company's stock and these groups actively participate in the governance of the firm. The company is in compliance with all of the stock exchange listing requirements concerning the independence and qualifications of the audit committee.

Weak Governance Condition

Although the company has a majority of outside members on the board of directors, the directors are appointed to the Board primarily because of their prior business dealings with the company and social connections with the top management. The CEO also serves as the Chair of the Board and has the primary power to conduct independent investigations of unethical behavior. Although there are a large number of shareholders, they are geographically dispersed and no group of investors wields any significant influence. The company is in compliance with all of the stock exchange listing requirements concerning the independence and qualifications of the audit committee.

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