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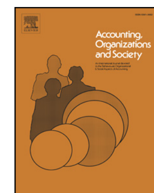

Corporate social media: How two-way disclosure channels influence investors☆

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A B S T R A C T

I examine how firm-investor communications on social media affect investors' perceptions of the firm. I focus on a case in which a Twitter user criticizes a discretionary accrual adjustment and management chooses whether and how to respond. I collect data using multiple experiments in which I vary the perceived validity of a criticism via the number of retweets it receives and/or the firm's response. Results suggest that the influence the criticism has on nonprofessional investors' perceptions depends on the number of times it has been retweeted. Results also suggest that following a criticism perceived to be valid, there are benefits of addressing the criticism directly *or* of redirecting attention to a positive highlight from the firm disclosure (relative to not responding). The findings advance our understanding of how a firm can effectively manage investors' perceptions by participating in, rather than abstaining from, conversations about the firm on social media.

1. Introduction

Social media is characterized by the dynamic two-way exchange of user-generated content (Kaplan & Haenlein, 2010). As such, social media offer those capital market participants who have no direct line to management the ability to publicly voice questions and interact in ways that give managers incentives to take action (Elliott, Grant, & Hobson, 2018). In 2014, the Securities and Exchange Commission (SEC) approved firms' use of social media to release and discuss financial information (SEC, 2013; 2014). Because it remains unclear whether and how firms should interact with constituents who voice their concerns on social media, more firms are experimenting with social media in an effort to develop best practices (Joyce, 2013). In this paper, I investigate how firm-investor communications on social media affect investors' evaluations of the firm as an investment and the firm's reputation.

Examining how investors judge communications on social media is important for several reasons. First, social media differ from traditional media—such as press releases and company websites—in that social media promote public *two*-way interactions in which firm managers do not have complete control over what is said about their firms (Miller & Skinner, 2015). Thus, what we know about investors' reactions to corporate disclosures from existing research may not generalize to investors' reactions in today's evolving information environment. Second, recent archival research has demonstrated the relevance of social media activity for security prices (Curtis, Richardson, & Schmardebeck, 2016; Lee, Hutton, & Shu, 2015), for returns (Chen, De, Hu, & Hwang, 2014), and for information asymmetry (Blankespoor, Miller, & White, 2014). As individuals continue to increase their reliance on social media for firm-level news and investment advice, firms that fail to participate in the conversation are likely to be noticed for their silence (e.g., Apple, Facebook, and Google (PR Newswire, 2015)). Third, public relations agencies have expressed concerns about the risk that social media pose to corporate reputations (e.g., Accenture, 2014) and empirical evidence links reputational capital to firm value (e.g., Chakravarthy, deHaan, & Rajgopal, 2014). Because many companies are not yet confident or

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adept at using social media (Investis, 2015), managers and investors could benefit from a better understanding of the consequences of various social media strategies.

To examine my research question, I collect data using multiple experiments in which I measure nonprofessional investors' reactions to the activity around an earnings announcement on Twitter.com, a social media platform that allows users to broadcast short, text-based posts called *tweets* (Appendix A provides an example). Although all participants view the same firm-directed criticism, I manipulate between participants a signal of the validity of this criticism as well as the firm's reaction—namely, whether the firm (1) abstains from the conversation, (2) publicly provides an explanation for why the criticism is undeserved, or (3) attempts to redirect investors' attention to a positive highlight from its original disclosure.

The experimental method is desirable in examining my research question. For example, as opposed to attempting to identify specific perceptions using observed stock price changes, an experiment allows me to measure these perceptions directly and independently. I can also hold constant factors such as disclosure characteristics, which prior research demonstrates influence these perceptions. Further, in the real world, the quality of the criticism and the signal of its validity are likely endogenous, making it difficult to disentangle investors' reliance on one versus the other. By taking an experimental approach, I isolate the effect of this signal on investors' perceptions of a criticism's quality, independent of the *actual* quality of the criticism.

To develop my theoretical framework, I apply the *Persuasion Knowledge Model* (Friestad & Wright, 1994) from the field of consumer behavior. This model outlines how consumers use their knowledge of persuasion motives and tactics to interpret, evaluate, and react to marketers' influence attempts. As consumers of corporate disclosures, I expect investors to use their understanding of firms' and of other investors' motives, information sharing strategies, and persuasion tactics to decide how much to rely on a given criticism when evaluating the firm.

First, because investors are motivated to accurately assess the validity of the criticism, they should be receptive to information that helps them achieve this goal (Friestad & Wright, 1994). For example, if the criticism does not come from a trusted source, investors—sensitive to the critic's motive to persuade—will seek out other cues regarding the criticism's validity. Given prior research demonstrating individuals' tendency to use consensus as a cue for correctness (Axsom, Yates, & Chaiken, 1987), I propose that one such cue nonprofessional investors may use is the number of times the criticism has been reposted and forwarded to additional users. On Twitter, the reposting of someone else's tweet is called *retweeting*. As a result, the influence a firm-focused criticism has on these investors' evaluations of the firm should increase with the number of times the criticism has been retweeted.

Next, because an explanation provides additional, relevant information for assessing the criticism, management could have some success in mitigating the criticism's damage by providing a reasonable explanation for why it is undeserved. In contrast, repeating a positive highlight from the firm's disclosure does not directly inform investors about the validity of the criticism. Instead, investors may interpret this type of response either as a negative signal about the criticized act (e.g., the firm has no acceptable explanation) or as a positive signal about the criticized act (e.g., that the criticism is not worthy of an explanation). While the former interpretation would exacerbate the criticism's damage, the latter would have a mitigating effect.

My primary experiment uses a 2 × 3 (number of retweets: few or many × firm response strategy: no response, explanation, or redirection) + 1 (control: no criticism, no firm response) between-participants design. Participants take the role of a current investor in a firm and follow the related Twitter activity for the firm's current quarter earnings announcement. Results suggest that (i) simply viewing a criticism can harm nonprofessional investors' perceptions of a firm as an investment as well as their perceptions of the firm's reputation, and (ii) when the firm remains silent after a criticism, the damage caused increases in the number of times the critical tweet has been retweeted. Results also suggest that *either* providing an explanation *or* attempting to redirect attention after a criticism gains traction helps to mitigate, but does not fully eliminate, the criticism's negative effect on nonprofessional investors' evaluations of the firm.

Analysis of post-experimental measures suggests that although both explaining and redirecting might appear comparable on some dimensions, participants do report being more likely to *like* and more likely to *retweet* a firm's explanation than its redirection tweet. Further, when participants are given a chance to evaluate all three strategies side-by-side, they report a strong preference first for the explanation, followed by the redirection, and then no response. This rank-ordering is consistent with the between-participants results for the key dependent measures, which suggests that participants are aware that they value both active responses more than they value the choice to remain silent (Kahneman & Tversky, 1996; Libby, Bloomfield, & Nelson, 2002).

Altogether, results suggest that although nonprofessional investors may prefer an explanation if one is known to be available, a redirection can still mitigate damage both when viewed in isolation and when investors explicitly consider not responding as an alternative strategy. To further explore this favorable reaction to the redirection strategy, I conduct additional experimentation in which participants take the role of *prospective*, instead of *current*, investor. I find that prospective investor-participants continue to favor a firm's redirection over no response, suggesting that motivated reasoning (Kunda, 1990)—an unconscious bias—cannot fully explain the original finding. I also find that the positive signal investors take from the redirection is at least partially determined by its source, not merely its content, as participants do *not* appear to favor the redirection over no response if the redirection comes from an unfamiliar source instead of from the firm.

My study makes several contributions. First, I extend the voluntary disclosure literature, which has dealt primarily with firms' unidirectional disclosure practices. In contrast to the extant literature, I investigate investors' perceptions of *bi*directional firm-investor communications.[1] Indeed, the uncontrolled and public nature of social media has moved firms closer to a truer two-way model of communication in which firm managers feel additional pressure to publicly engage with all types of constituents. I provide evidence that firms can benefit by participating in, rather than abstaining from, conversations about the firm on social media. My results also suggest that capital market benefits exist even if a manager does not *directly* respond to a specific grievance, but instead responds by redirecting attention to something positive. It will be important for researchers to take these benefits into consideration as we adapt the voluntary disclosure literature to incorporate recent changes to the information environment (Miller & Skinner, 2015).

Second, my study complements and extends the small but growing literature exploring the importance of new media for capital market participants' perceptions and behavior. Most closely related to my study, Lee et al. (2015) use archival data to document (i) an association between the frequency of outsider tweets around a product recall announcement and the related negative stock price reaction, and (ii) an association between the frequency of tweets from the firm and the attenuation of this negative reaction. My study complements Lee et al. (2015) in that I experimentally manipulate a firm's response strategy to draw inferences about the effects of *how* a firm chooses to handle

[1] Research on the question and answer portion of earnings conference calls provides one exception in the extant literature. However, the social media setting and the conference call setting are fundamentally different due to the expectations and incentives of the communicators involved. For example, whereas firm managers can exert some influence over professional analysts' behavior (Feng & McVay, 2010) and can have some success in filtering the questions that are asked during these calls (Mayew, 2008), managers are unlikely to have the same influence over the non-affiliated analysts and investors who interact and provide financial advice online for public consumption.

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