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Citation

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THE EFFECTS OF CORPORATE REPUTATION AND COMPENSATION DISCLOSURE ON INVESTOR JUDGMENTS

ABSTRACT

Regulators have increased the disclosure requirements of top executives as part of corporate governance reform. This study examines how trust arising from a firm's corporate reputation will interact with top executive compensation disclosure to influence investor judgments. This study used a 2 X 2 between subjects experimental design, with corporate reputation (good versus bad) and pay ratio (high versus low) as independent variables to test the hypotheses. The key findings show that if the firm with a good corporate reputation discloses a high pay ratio, participants punished the good reputation firm more than the bad reputation firm, demonstrating a negative violation of expectations. On the other hand, if the firm with a bad corporate reputation discloses a low pay ratio, participants rewarded the bad reputation firm more than the good reputation firm, demonstrating a positive violation of expectations. The results of this study may be limited by its particular circumstances of corporate reputation and compensation disclosure, making generalizations of the findings to other settings difficult.

Keywords: corporate reputation, executive compensation disclosure, investor judgments

1. Introduction

A key aspect of compensation disclosure relates to top executive compensation. Regulators have increased the disclosure requirements of top executives as part of corporate governance reform. In 2015, the U.S. Securities and Exchange Commission (SEC) announced a final rule that requires a public company to disclose the ratio of the compensation of its chief executive officer (CEO) to the median compensation of its employees with effect from January 2017 (SEC 2015). As required by the Dodd-Frank Act, the rule require companies to disclose the median of the annual total compensation of all its employees, except the CEO; the annual total compensation of its CEO; and the ratio of those two amounts (SEC 2015). In U.K., the government passed The Companies (Miscellaneous Reporting) Regulations 2018, which requires additional disclosures on CEO pay ratios to be made in listed companies' annual reports for financial years starting on or after January 1, 2019 (U.K. National Archive 2018). Affected firms will be required to publish the ratio of their CEO's total remuneration to the median, 25th and 75th percentile total remuneration of their employees.

Perceived excess top executive compensation has attracted much criticism from the public. The public viewed top executive compensation as out of control and an unfair allocation of resources (Hill 2016). U.K. Prime Minister Theresa May championed for "responsible capitalism" and cited "runaway executive pay as creating an irrational, unhealthy and growing gap between what these companies pay their workers and what they pay their bosses" (Parker 2016). Trust is an important component of social capital and has always played an important role in capital markets (Levitt, 1998; Williamson 1993). This study examines how trust arising from a firm's corporate reputation will interact with executive compensation disclosure to influence investor judgments.

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This study used a 2 X 2 between subjects experimental design, with corporate reputation (good versus bad) and pay ratio (high versus low) as independent variables to test the hypotheses. The findings show that investor judgements of a firm were more positive when the firm has a good corporate reputation than when it has a bad corporate reputation. Participants also react more positively to the disclosure of low than high pay ratio. This study also examined the joint effects of corporate reputation and pay ratio on investor judgments. The findings show that if the firm with a good corporate reputation discloses a high pay ratio, participants punished the good reputation firm more than the bad reputation firm. On the other hand, if the firm with a bad corporate reputation discloses a low pay ratio, participants rewarded the bad reputation firm more than the good reputation firm.

There is evidence of substantial differences in the readability of disclosures related to top executive pay made by firms. Thus, a supplementary experiment was conducted to examine the generalizability of the main experiment's results to a situation where the readability of pay ratio disclosure is lower. The results show that the effects of pay ratio disclosure is diminished when readability is lower (as is the case in the supplementary condition) than when it is higher (as is the case in the main experiment).

This study contributes to the literature on corporate reputation. Prior studies have generally documented positive effects associated with corporate reputation. Herremans et al. (1993) find that good corporate social responsibility reputation leads to better economic performance. Hirst et al. (1999) also document positive effects of management credibility on investor judgments in evaluating earnings forecasts. While Ciani and Kaplan (2010) similarly document how CEO reputation can positively influence investor judgment about a firm's future performance, they also note that trust arising from reputational effects are malleable and sensitive to context. We extend

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the literature by highlighting how trust arising from corporate reputation can interact with compensation disclosure to influence investor judgments. Our disclosure setting is especially pertinent given that top executive compensation has been an area of contention in recent years and could potentially undermine trust more easily than other forms of disclosure (Hoskisson et al. 2009). Hill (2016) argued that "excessive pay is the biggest obstacle to restoration of trust in business."

The remainder of this paper is organized as follows. The next section reviews relevant literature and develops the hypotheses. The subsequent sections describe the research method and present the results. The final section discusses the implications, limitations and opportunities for future research.

2. Background and Hypotheses

2.1 Corporate reputation

Barnett et al. (2006) define corporate reputation as "observers' collective judgment of a corporation based on assessments of the financial, social, and environmental impacts attributed to the corporation over time". One stream of research focuses on how corporate reputation influences stakeholder trust, which relates to their perceptions of the reliability, honesty, and benevolence of companies, and how it can influence their judgments. In general, research in this area finds that people inherently trust good reputation firms more than bad reputation firms (Berens and Van Riels 2004).

It is possible that when investors trust a firm more, they will rely more heavily on the disclosures that it makes. Consistent with this, Pevzner et al. (2015) find that investor reactions to earnings news is stronger in more trusting than less trusting countries because such news is

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perceived to be more credible. To the extent that this applies to our setting, it is likely that investors will trust the disclosures of a good reputation firm more than a bad reputation firm and consequently put more weight on the disclosures of the good reputation firm than that of the bad reputation firm.

A sense of trust towards a firm can function as a cue in making heuristic judgments which people use to cope with complexity and to reduce cognitive effort across a wide range of decision making tasks (Tversky and Kahneman 1974). Research in the accounting literature provides evidence that the trust heuristic is used in various contexts, including when audit supervisors review their subordinates' work (Kadous et al. 2013; Tan and Jamal 2001) and when investors make investment judgments following the announcement of restatements (Elliott et al. 2012).

Accordingly, it is hypothesized that investors would judge the firm more positively when the firm has a good corporate reputation than when it has a bad corporate reputation.

H1: Investor judgements of a firm will be more positive when the firm has a good corporate reputation than when it has a bad corporate reputation.

2.2 Pay ratio

Equity theory compares the ratio of contributions and benefits for each employee and advocates a fair balance to be struck (Adams 1963). Employees judge the overall "fairness" of a relationship by comparing their contributions and benefits with an internally derived standard. They value fair treatment, which causes them to be motivated to keep the fairness maintained within the firm. Perceived unfair treatment would result in negative outcomes.

Prior studies have shown that perceptions of the "fairness" of top executive compensation affects the company's investment potential (Gopalan 2007; Kelly and Seow 2016). Gopalan (2007)

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argued that shame sanctions would curb excessive CEO compensation. Investors perceived the company's investment potential negatively if their perception of the CEO compensation was excessive and unfair. Kelly and Seow (2016) found that a higher-than-industry pay ratio between a CEO's pay and median employee pay prompted participants in an experiment to deem a CEO's pay unfair, resulting in negative effects on their perceptions about the company. Due to the negative perceptions of unfairness, participants were less likely to invest in the company.

Accordingly, it is hypothesized that investors would judge the firm more positively when the firm discloses a low pay ratio than when it discloses a high pay ratio.

H2:   The improvement (deterioration) in investor judgements of a firm will be larger (smaller) after it discloses a low pay ratio than a high pay ratio.

2.3 Joint effects of corporate reputation and pay ratio

The expectancy violations theory in the communication literature assumes that people form expectations based on the communications that they receive (Burgoon and Burgoon 2001). People expect their predictions to come true, based on the beliefs that they have formed. When the predictions do not come true, an expectancy violation has occurred. The theory predicts that negative violation would result in undesirable results, while positive violation can produce desirable results.

Prior studies based on expectancy violations theory suggest that expectations can affect how users interpret a firm's accounting choices and judge the investment potential (Clor-Proell 2009; Fleming 2009). Clor-Proell (2009) found that users' investment decisions are more extreme when a mismatch occurs between actual and expected accounting choices than when a match occurs. Participants invested significantly more or less when they receive a mismatch than when

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they receive a match. Fleming (2009) found that negative violations adversely affect investment-screening judgments. Venture capitalists will view new ventures as less favourable when proposals violate their expectations about the precision of the forecast estimates.

Accordingly, it is hypothesized that a firm with a good corporate reputation is expected to disclose a low pay ratio than a firm with a bad corporate reputation. Thus, if a firm with a good corporate reputation discloses a high pay ratio, there is a negative violation of expectations and the good reputation firm would be punished more harshly than a bad reputation firm by investors. On the other hand, a firm with a bad corporate reputation is expected to disclose a high pay ratio than a firm with a good corporate reputation. Thus, if a firm with a bad corporate reputation discloses a low pay ratio, there is a positive violation of expectations and the bad reputation firm would be rewarded more than a good reputation firm.

H3: After a firm discloses a high pay ratio, the improvement (deterioration) in investor judgments will be larger (smaller) if the firm has a bad corporate reputation than if it has a good corporate reputation.

H4: After a firm discloses a low pay ratio, the improvement (deterioration) in investor judgments will be larger (smaller) if the firm has a bad corporate reputation than if it has a good corporate reputation.

3. Research Method

3.1 Participants

We conducted our experiment with 244 participants recruited from Amazon's Mechanical Turk (AMT) platform.[1] This pool of participants represents suitable proxies for non-professional

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[1] Prior approval for the experiment was obtained from our university's Institutional Review Board.

investors. In particular, AMT has been used in prior accounting studies (e.g. Koonce et al. 2015; Rennekamp 2012), and has been demonstrated to replicate results obtained in existing accounting studies (Krische 2015). The extent literature shows that participants recruited on the AMT platform often exert just as much effort as other student participants commonly used in such studies (Paolacci et al. 2010). As such, recruiting from the AMT platform allows us to use participants who possess sufficient knowledge to perform the experiment but at the same time do not represent subjects who are more sophisticated than necessary (Libby et al. 2002). Consistent with this, Blankespoor et al. (2017), who use AMT participants in their study, find that participants' perceptions correlate highly with market valuations of their focal firm while Farrell et al. (2017) find that AMT participants exert equal or more effort than other participant populations in completing accounting-research related tasks as proxies for non-professional investors.

Hauser and Schwarz (2016) suggest that including attention check questions in experimental studies using AMT subjects are an effective way to determine if participants pay sufficient attention when completing experiments. Accordingly, we included two attention check questions in our experiment. Overall, 100.0% of participants answered at least one attention check question correctly and 82.0% of participants answered both attention check question correctly.

3.2 Design and procedure

We used a 2 X 2 between subjects design for our experiment, with corporate reputation (good versus bad) and pay ratio (high versus low) as independent variables to test our hypotheses. In the experiment, participants were randomly assigned to one of four online experimental conditions. In all conditions, participants were told to assume the role of a potential investor of Great Meals Corporation, a fictitious US-based restaurant operator. They were also provided with background information, including the most recent quarterly financial results, about the company.

Next, to operationalize the corporate reputation manipulation, participants were told that the Reputation Institute (RI), an independent organization, conducts an annual study to measure the corporate reputation of the world's largest firms. As part of its methodology, RI measures a company's ability to deliver on stakeholders' expectations across the following seven key dimensions of corporate reputation: (i) product and services, (ii) innovation, (iii) workplace, (iv) governance, (v) citizenship, (vi) leadership, and (vii) performance. Participants were told that RI rates companies across these seven dimensions and places each company in one of the following five corporate reputation categories: (i) excellent, (ii) strong, (iii) average, (iv) weak, and (v) poor.[2] Following this, participants were told that Great Meals had been included in RI's 2017 study, and participants assigned to the good corporate reputation conditions were told that Great Meals had achieved an "excellent" corporate reputation rating while participants assigned to the bad corporate reputation conditions were told that Great Meals had achieved a "poor" corporate reputation rating. After viewing this information, all participants made their initial investment judgments about Great Meals.[3]

To operationalize our pay ratio manipulation, we then told all participants that Great Meals had also recently disclosed information about the compensation of its employees in its proxy statement. Next, participants were provided with an extract from Great Meals' proxy statement discussing its CEO's pay ratio. All participants were told that the mean CEO-to-median employee pay ratio of a group of seventeen publicly-listed companies in the restaurant industry that Great Meals competes with for executive talent was 55 to 1. Further, participants assigned to the high

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[2] The methodology for measuring corporate reputation is adapted from the methodology applied by the Reputation Institute (2017) in developing the 2017 Global RepTrak 100, a ranking of the 100 most reputable companies globally in 2017.
[3] In providing their initial and final investment judgments, participants responded to the question "To what extent do you agree that Great Meals is a good investment?" on a 15 point scale, with -7 corresponding to "Strongly Disagree" and +7 corresponding to "Strongly Agree."

pay ratio condition were provided with a version of the extract which stated that the CEO-to-median employee pay ratio for Great Meals was 428 to 1 while participants assigned to the low pay ratio condition were provided with a version of the extract which stated that the CEO-to-median employee pay ratio for Great Meals was 57 to 1. There is evidence to suggest that the pay ratios that we use in our experiment and our provision to all participants of the mean CEO-to-median employee pay ratio of a peer group are consistent with industry disclosure norms. For example, a recent report by ISS Corporate Services, a consultant in corporate governance, compensation, and sustainability issues, documents that the median pay ratio across 23 industries ranges from about 23 to 1 to 150 to 1 (Kimball, 2013) while another report by Willis Tower Watson (2018), a HR consultant, documents significant variability in the pay ratios reported by companies within industries (up to a maximum of 5,000 to 1). Further, another article published by Willis Tower Watson (2017) recommends that in making pay ratio disclosures, companies should contrast their disclosures with those of their peers and companies in other industries.

After viewing the CEO-to-median employee pay ratio information, participants then made their final investment judgments about Great Meals. They also provided their responses to a range of other questions relating to the case (including attention and manipulation checks and demographic information).

4. Results

4.1 Manipulation checks

Participants' ratings of the extent to which they agreed that Great Meals enjoys a good corporate reputation was significantly higher in the good corporate reputation condition (mean =

4.21) than in the bad corporate reputation condition (mean = -0.63, t = 9.98, p<0.01).[4] Hence, our manipulation of corporate reputation was successful. In addition, 58.6% (χ^2 = 7.23, p<0.01) of participants correctly identified whether Great Meals' CEO's annual total compensation presented to them was much higher than other CEOs in the company's comparison group (as is the case in the high pay ratio condition) or was about the same as other CEOs in the company's comparison group (as is the case in the low pay ratio condition), at a rate that is greater than chance. Our manipulation of CEO pay ratio was successful.

4.2 Effects of corporate reputation on investor judgments

H1 predicts that investor judgements of a firm will be more positive when the firm has a good corporate reputation than when it has a bad corporate reputation. We use two dependent variables to test this hypothesis. The first dependent variable is participants' initial investment judgments of Great Meals (pre_investment) which was made immediately after participants viewed the corporate reputation manipulation while the second dependent variable is participants' final investment judgments of Great Meals (post_investment) which was made after participants viewed the pay ratio manipulation.

Panel A of Table 1 presents descriptive statistics for pre_investment, panel B presents the conventional analysis of variance (ANOVA), and panel C presents simple main effects tests. As shown in panel B, the effect of corporate reputation on pre_investment is significant (F = 146.05, p<0.01). Panel C shows that the effect of good versus bad corporate reputation on pre_investment is significant both when pay ratio is both high (F = 63.48, p<0.01) and low (F = 84.33, P<0.01). In addition, mean participant ratings in the good corporate reputation/high pay ratio condition (mean

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[4] Participants made their ratings on a fifteen point scale, with -7 corresponding to "Strongly Disagree" and +7 corresponding to "Strongly Agree." Two-tailed tests are presented unless stated otherwise.

= 5.27) are higher than in the bad corporate reputation/high pay ratio condition (mean = 0.00, t = 7.97, p<0.01). Participant ratings are also higher in the good corporate reputation/low pay ratio condition (mean = 4.65) than in the bad corporate reputation/low pay ratio condition (mean = -0.98, t = 9.18, p<0.01). These results indicate that participants' initial investment judgments are more positive when the firm has a good corporate reputation than when it has a bad corporate reputation.

Insert Table 1 here

Panel A of Table 2 presents descriptive statistics for post_investment, panel B presents the conventional analysis of variance (ANOVA), and panel C presents simple main effects tests. As shown in panel B, the effect of corporate reputation on post_investment is significant (F = 93.37, p<0.01). Panel C shows that the effect of good versus bad corporate reputation on post_investment is significant both when pay ratio is both high (F = 32.18, p<0.01) and low (F = 69.70, P<0.01). In addition, participant ratings in the good corporate reputation/high pay ratio condition (mean = 3.46) are higher than in the bad corporate reputation/high pay ratio condition (mean = -0.60, t = 5.67, p<0.01). Participant ratings are also higher in the good corporate reputation/low pay ratio condition (mean = 4.05) than in the bad corporate reputation/low pay ratio condition (mean = -0.80, t = 8.35, p<0.01). These results indicate that participants' final investment judgments, made after they have been provided with information related to pay ratio, continue to be more positive when the firm has a good corporate reputation than when it has a bad corporate reputation. Overall these findings provide support for H1, and are consistent with participants reacting more positively to a firm with a good than bad corporate reputation.

Insert Table 2 here

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4.3 Effects of pay ratio on investor judgments

H2 predicts that the improvement (deterioration) in investor judgements of a firm will be larger (smaller) after it discloses a low pay ratio than a high pay ratio. We examine this hypothesis using the change in participants' investment judgment (change_investment) as the dependent variable. Change_investment is computed by subtracting participants' final investment judgments from their initial investment judgments (change_investment = post_investment – pre_investment).

Panel A of Table 3 presents descriptive statistics for change_investment, panel B presents the conventional analysis of variance (ANOVA), and panel C presents simple main effects tests. The results in panel B indicate that the effect of pay ratio on change_investment is significant (F = 14.85, p<0.01). Further, when corporate reputation is good, the deterioration in change_investment in the low pay ratio condition (mean = -0.59) is smaller than in the high pay ratio condition (mean = -1.80, t = 3.34, p<0.01). When corporate reputation is bad, there is an improvement in participants' investment judgments in the low pay ratio condition and a deterioration in their investment judgments in the high pay ratio condition. Change_investment is significantly larger in the bad corporate reputation/low pay ratio condition (mean = 0.18) than in the bad corporate reputation/high pay ratio condition (mean = -0.60, t = 2.14, p = 0.04). Overall, these support H2, and are consistent with participants reacting more positively/less negatively to the disclosure of low than high pay ratio.

Insert Table 3 here

4.4 Joint effects of corporate reputation and pay ratio on investor judgments

H3 predicts that after a firm discloses a high pay ratio, the improvement (deterioration) in investor judgments will be larger (smaller) if the firm has a bad corporate reputation than if it has

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a good corporate reputation. H4 predicts that after a firm discloses a low pay ratio, the improvement (deterioration) in investor judgments will be larger (smaller) if the firm has a bad corporate reputation than if it has a good corporate reputation. We examine these hypotheses using change_investment as the dependent variable.

Panel A of Table 3 shows that the effects of both corporate reputation ($F = 29.62$, $p<0.01$) and pay ratio ($F = 14.85$, $p<0.01$) on change_investment are significant. Simple effects tests presented in Panel C of Table 3 also shows that the effects of good reputation versus bad reputation is significant both when pay ratio is high ($F = 7.34$, $p = 0.01$) and when it is low ($F = 8.67$, $p<0.01$).

In the high pay ratio condition, the deterioration in participants' investment judgments is larger in the good corporate reputation condition (mean = -1.80) than in the bad corporate reputation condition (mean = -0.60, $t = 2.71$, $p = 0.01$). This supports H3, and is consistent with a good reputation firm being punished more harshly than a bad reputation firm upon the disclosure of a high pay ratio. In the low pay ratio condition there is a deterioration in participants' investment judgments in the good corporate reputation condition and an improvement in participants' investment judgments in the bad corporate reputation condition. Change_investment is significantly larger in the bad corporate reputation/low pay ratio condition (mean = 0.18) than in the good corporate reputation/low pay ratio condition (mean = -0.60, $t=2.14$, $p=0.02$). This supports H4, and is consistent with a good reputation firm being punished and a bad reputation firm being rewarded upon the disclosure of a low pay ratio.

4.5 Supplementary analysis

Prior studies have suggested that managers can manipulate the readability of financial disclosure to strategically obfuscate bad news (e.g. Rennekamp 2012). Consistent with this, there

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is evidence of substantial differences in the readability of disclosures related to CEO pay made by firms. For example, prior studies have found that the higher a CEO's excessive pay, the less readable the related compensation disclosure becomes (Laksmana et al. 2012). At the outset, it is unclear if the readability of CEO pay ratio disclosure influences investor judgments. On one hand, prior studies suggest that the readability of disclosures can function as heuristic cues that influence investors' processing of information and subsequently impact their judgments (e.g. Rennekamp 2012). On the other hand, it is possible that investors view CEO pay ratio information as an important piece of information in making investment judgments and, as a result, process such information systematically, regardless of readability.

Accordingly, we conduct a supplementary experiment to examine the generalizability of the results in our main experiment to a situation where the readability of CEO pay ratio disclosure is lower. In particular, we conduct a 2 X 2 between subjects experiment with corporate reputation (good versus bad) and pay ratio (high versus low) as independent variables. The supplementary experiment was conducted on 240 participants recruited from the AMT platform at the same time as the main experiment. All aspects of the supplementary experiment are identical to the main experiment other than for the lower readability of the CEO pay ratio disclosure presented to participants. We used the Bog index to measure readability in our study. The Bog index is a standard comprehensive measure of readability developed by Stylewriter software engineers based on plain English writing principles (Bonsall IV et al. 2017). Prior studies have examined the Bog index and concluded that it captures financial reporting readability attributes highlighted by the SEC (Bonsall IV et al. 2017). In the main experiment, the CEO pay ratio disclosure used had a Bog index of 64 in both the high and low pay ratio conditions. In the supplementary experiment, the CEO pay ratio disclosure used had a Bog index of 118 in both the high and low pay ratio

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conditions. A Bog index of 64 corresponds to a readability rating of "fair" while a Bog index of 118 corresponds to a readability rating of "bad" on the Stylewriter software.

4.6 Results of supplementary analysis

Panels A, B, and C of Table 4 present the descriptive statistics, conventional analysis of variance (ANOVA), and simple main effects tests for pre_investment respectively. Panels A, B, and C of Table 5 present the equivalent results for post_investment. As shown in panel B of Tables 4 and 5, the effect of corporate reputation is significant on both pre_investment ($F = 78.57$, p<0.00) and post_investment ($F = 44.71$, p<0.00). Panel C of Table 4 shows that the effect of good versus bad corporate reputation on pre_investment is significant when pay ratio is both high ($F = 27.71$, p<0.00) and low ($F = 54.56$, p<0.00). Similarly, panel C of Table 5 shows that the effect of good versus bad corporate reputation on post_investment is significant when pay ratio is both high ($F = 13.73$, p<0.00) and low ($F = 35.54$, p<0.00). We also find that pre_investment is significantly higher in the good (mean=4.86) than bad (mean=-0.53, t=8.85, p<0.01) corporate reputation condition and that post_investment is significantly higher in the good (mean=3.82) than bad (mean=-0.51, t=6.77, p<0.01) corporate reputation condition. Overall, these results indicate that participants in the supplementary experiment, as in the main experiment, continue to react more positively to firms with good than bad corporate reputation.

Insert Tables 4 and 5 here

Panels A, B, and C of Table 6 present the descriptive statistics, conventional analysis of variance (ANOVA), and simple main effects tests for change_investment respectively. Panel B shows that the effect of pay ratio is significant on change_investment ($F = 4.10$, p=0.04). However, change_investment is not significantly different across the high (mean = -0.96) and low

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(mean = -0.32) pay ratio condition (t = -0.91, p=0.14). In addition, change_investment is also no different across the good corporate reputation/high pay ratio (mean = -1.29) and good corporate reputation/low pay ratio (mean = -0.83, t = -1.40, p=0.17) conditions and across the bad corporate reputation/high pay ratio (mean = -0.24) and bad corporate reputation/low pay ratio (mean = -0.25, t = -1.47, p=0.14) conditions.

Insert Tables 6 here

Overall, this set of results suggest that the readability of CEO pay ratio disclosure can influence investor judgments. In particular, we find that the effects of CEO pay ratio disclosure is diminished when readability is lower (as is the case in the supplementary condition) than when it is higher (as is the case in the main experiment). This suggests that managers may indeed benefit by obfuscating bad news by manipulating the readability of financial disclosure (consistent with Li's (2008) claim).

5. Conclusion

This study examines how trust arising from a firm's corporate reputation will interact with executive compensation disclosure to influence investor judgments. Regulators have increased the disclosure requirements of top executives as part of corporate governance reform. Top executive compensation has been an area of contention in recent years and could potentially undermine trust more easily than other forms of disclosure.

The findings show that investor judgements of a firm were more positive when the firm has a good corporate reputation than when it has a bad corporate reputation. Participants also react more positively to the disclosure of low than high pay ratio. The findings also show that if a firm with a good corporate reputation discloses a high pay ratio, there is negative violation of

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expectations and the good reputation firm would be punished more than a bad reputation firm. On the other hand, if a firm with a bad corporate reputation discloses a low pay ratio, there is a positive violation of expectations and the bad reputation firm would be rewarded more than a good reputation firm. Overall, the results suggest that trust plays an important role for the effect of compensation disclosure on investor judgments. It is important for companies not to violate the trust build up by their corporate reputation.

The results of the supplementary experiment show that the effects of pay ratio disclosure is diminished when readability is lower (as is the case in the supplementary condition) than when it is higher (as is the case in the main experiment). This suggests that managers may indeed benefit by obfuscating bad news by manipulating the readability of compensation disclosure.

There are limitations for this study. A limitation relates to external validity associated with the experimental method adopted for this study. The results of this study may be limited by its particular circumstances of corporate reputation and compensation disclosure, making generalizations of the findings to other settings difficult. Future research could examine other settings and consider other target audiences, besides investors for this study.

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Table 1:
Participants' initial investment judgments of Great Means[a]

Panel A: Descriptive Statistics - Mean (Standard Deviation) [Sample Size]

	Corporate Reputation	
Pay Ratio	Good	Bad
High	5.27 (1.52) [56]	0.00 (4.74) [65]
Low	4.65 (2.04) [74]	-0.98 (4.65) [49]

Panel B: Conventional ANOVA Tests of Between-Subjects Effects

Source	Sum of Squares	df	Mean Square	F	p-value
Intercept	1189.17	1	1189.17	48.71	0.00
Corporate Reputation	1767.70	1	1767.70	146.05	0.00
Pay Ratio	38.06	1	38.06	3.14	0.08
Corporate Reputation*Pay Ratio	1.93	1	1.93	0.16	0.69
Error	2904.83	240	12.10		

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Panel C: Follow Up Simple Effects Tests

Simple Effects	Sum of Squares	df	Mean Square	F	p-value (two-tailed)
Effect of good versus bad corporate reputation when pay ratio is high	834.80	1	834.80	63.48	0.00
Effect of good versus bad corporate reputation when pay ratio is low	933.83	1	933.83	84.33	0.00

[a] Table 1 presents statistical results related to participants' initial investment judgments of Great Meals (*pre_investment*). Panel A presents descriptive statistics for *pre_investment*, panel B presents the conventional analysis of variance (ANOVA), and panel C presents follow-up simple main effects tests.

Table 2:
Participants' final investment judgments of Great Means[a]

Panel A: Descriptive Statistics - Mean (Standard Deviation) [Sample Size]

	Corporate Reputation	
Pay Ratio	Good	Bad
High	3.46 (2.66) [56]	-0.60 (2.28) [65]
Low	4.05 (2.24) [74]	-0.80 (4.19) [49]

Panel B: Conventional ANOVA Tests of Between-Subjects Effects

Source	Sum of Squares	df	Mean Square	F	p-value
Intercept	588.10	1	588.10	44.04	0.00
Corporate Reputation	1183.14	1	1183.14	93.37	0.00
Pay Ratio	2.31	1	2.31	0.18	0.67
Corporate Reputation*Pay Ratio	9.19	1	9.19	0.73	0.40
Error	3041.27	240	12.67		

Panel C: Follow Up Simple Effects Tests

Simple Effects	Sum of Squares	df	Mean Square	F	p-value (two-tailed)
Effect of good versus bad corporate reputation when pay ratio is high	496.92	1	496.92	32.18	0.00
Effect of good versus bad corporate reputation when pay ratio is low	693.43	1	693.43	69.70	0.00

[a] Table 2 presents statistical results related to participants' final investment judgments of Great Meals (*post_investment*). Panel A presents descriptive statistics for *post_investment*, panel B presents the conventional analysis of variance (ANOVA), and panel C presents follow-up simple main effects tests.

Panel A: Descriptive Statistics - Mean (Standard Deviation) [Sample Size]

Pay Ratio	Corporate Reputation	
	Good	Bad
High	-1.80 (2.61) [56]	-0.60 (2.28) [65]
Low	-0.59 (1.48) [74]	0.18 (1.36) [49]

Panel B: Conventional ANOVA Tests of Between-Subjects Effects

Source	Sum of Squares	df	Mean Square	F	p-value
Intercept	117.94	3	35.96	9.03	0.00
Corporate Reputation	58.48	1	117.94	29.62	0.00
Pay Ratio	59.12	1	59.12	14.85	0.00
Corporate Reputation*Pay Ratio	2.69	1	2.69	0.68	0.41
Error	955.62	240	3.98		

Panel C: Follow Up Simple Effects Tests

Simple Effects	Sum of Squares	df	Mean Square	F	p-value (two-tailed)
Effect of good versus bad corporate reputation when pay ratio is high	43.58	1	43.58	7.34	0.01
Effect of good versus bad corporate reputation when pay ratio is low	17.86	1	17.86	8.67	0.00

[a] Table 3 presents statistical results related to participants' change in investment judgments of Great Meals (*change_investment*). Panel A presents descriptive statistics for *change_investment*, panel B presents the conventional analysis of variance (ANOVA), and panel C presents follow-up simple main effects tests.

Panel A: Descriptive Statistics - Mean (Standard Deviation) [Sample Size]

	Corporate Reputation	
Pay Ratio	Good	Bad
High	4.75 (1.82) [51]	0.91 (4.95) [70]
Low	4.95 (2.05) [63]	0.05 (4.80) [56]

Panel B: Conventional ANOVA Tests of Between-Subjects Effects

Source	Sum of Squares	df	Mean Square	F	p-value
Intercept	1682.09	1	1682.09	117.28	0.00
Corporate Reputation	1126.92	1	1126.92	78.57	0.00
Pay Ratio	6.31	1	6.31	0.44	0.51
Corporate Reputation*Pay Ratio	16.87	1	16.87	1.18	0.28
Error	3384.87	236	14.34		

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Panel C: Follow Up Simple Effects Tests

Simple Effects	Sum of Squares	df	Mean Square	F	p-value (two-tailed)
Effect of good versus bad corporate reputation when pay ratio is high	432.98	1	432.98	27.71	0.00
Effect of good versus bad corporate reputation when pay ratio is low	711.48	1	711.48	54.56	0.00

[a] Table 4 presents statistical results related to participants' initial investment judgments of Great Meals (*pre_investment*) in the supplementary experiment where the readability of CEO pay ratio disclosure is low. Panel A presents descriptive statistics for *pre_investment*, panel B presents the conventional analysis of variance (ANOVA), and panel C presents follow-up simple main effects tests.

Table 5:
Participants' final investment judgments of Great Means[a]

Panel A: Descriptive Statistics - Mean (Standard Deviation) [Sample Size]

| Pay Ratio | Corporate Reputation | |
	Good	Bad
High	3.45 (2.72) [51]	0.67 (4.82) [70]
Low	4.13 (2.39) [63]	0.30 (4.42) [56]

Panel B: Conventional ANOVA Tests of Between-Subjects Effects

Source	Sum of Squares	df	Mean Square	F	p-value
Intercept	1081.77	1	1081.77	75.02	0.00
Corporate Reputation	644.73	1	644.73	44.71	0.00
Pay Ratio	1.40	1	1.40	0.10	0.76
Corporate Reputation*Pay Ratio	16.11	1	16.11	1.12	0.29
Error	3402.89	236	14.42		

Panel C: Follow Up Simple Effects Tests

Simple Effects	Sum of Squares	df	Mean Square	F	p-value (two-tailed)
Effect of good versus bad corporate reputation when pay ratio is high	227.95	1	227.95	13.73	0.00
Effect of good versus bad corporate reputation when pay ratio is low	433.40	1	433.40	35.54	0.00

[a] Table 5 presents statistical results related to participants' final investment judgments of Great Meals (*post_investment*) in the supplementary experiment where the readability of CEO pay ratio disclosure is low. Panel A presents descriptive statistics for *post_investment*, panel B presents the conventional analysis of variance (ANOVA), and panel C presents follow-up simple main effects tests.

Panel A: Descriptive Statistics - Mean (Standard Deviation) [Sample Size]

	Corporate Reputation	
Pay Ratio	Good	Bad
High	-1.29 (1.97) [51]	-0.24 (1.65) [70]
Low	-0.83 (1.61) [63]	0.25 (2.11) [56]

Panel B: Conventional ANOVA Tests of Between-Subjects Effects

Source	Sum of Squares	df	Mean Square	F	p-value
Intercept	65.98	1	65.98	19.79	0.00
Corporate Reputation	66.88	1	66.88	20.05	0.00
Pay Ratio	13.67	1	13.67	4.10	0.04
Corporate Reputation*Pay Ratio	0.01	1	0.01	0.00	0.96
Error	787.04	236	3.34		

Panel C: Follow Up Simple Effects Tests

Simple Effects	Sum of Squares	df	Mean Square	F	p-value (two-tailed)
Effect of good versus bad corporate reputation when pay ratio is high	32.61	1	32.61	10.17	0.00
Effect of good versus bad corporate reputation when pay ratio is low	34.29	1	34.29	9.89	0.00

[a] Table 6 presents statistical results related to participants' change in investment judgments of Great Meals (*change_investment*) in the supplementary experiment where the readability of CEO pay ratio disclosure is low. Panel A presents descriptive statistics for *change_investment*, panel B presents the conventional analysis of variance (ANOVA), and panel C presents follow-up simple main effects tests.