# CSiR Karma: The Stock Market Reaction to a "Bad" Firm When an Irresponsible Issue Arises

A corporate social irresponsible event harms social welfare or stakeholders (Lin-Hi & Müller, 2013; Windsor, 2013), and it can be attributed to a firm's internal characteristics, intentionality, or controllability (King, Felin, & Whetten, 2010; Mishina, Block, & Mannor, 2012). Interestingly, the stock market reactions to the irresponsible event are not always the same. When Toyota announced a series of product recalls in 2010, Toyota's stock price dropped 17 percent over a month. On the other hand, Ford also recalled 6.7 million vehicles in 2006, the second-largest product recall in U.S. history. However, Ford's cumulative abnormal returns for three days around the recall announcements were only -0.013 in the 2006 case. Although both product recalls of Toyota and Ford were salient issues, it seems that the stock market reacted differently. What is the factor that explains different stock market reactions? One of Toyota's and Ford's differences is that Toyota was known for its good product quality management, but Ford was less known for it.

Existing studies establish both theoretically and empirically that a firm's prior corporate social responsibility (CSR) provides an insurance effect for financial performance when an irresponsible event occurs (Godfrey, 2005; Godfrey, Merrill, & Hansen, 2009; Peloza, 2006; Shiu & Yang, 2017). CSR activities can provide goodwill, which initiates doubt on whether the company intentionally committed bad behavior. However, existing studies have limitations to understand the dynamics of CSR and CSiR fully. First, only a few studies have discovered the boundaries of CSR's insurance effect (Godfrey et al., 2009; Shiu & Yang, 2017). As this study described from the product recalls of Toyota and Ford, the market reaction may vary depending on how investors have perceived the company as "good" or "bad" and how they assess a product recall. Second, existing studies focus less on the role of CSiR (Greenwood, 2007; Lin-Hi & Müller, 2013). Some studies include CSiR as a control variable (Godfrey et al., 2009) or aggregate CSR and CSiR to measure net CSR by subtracting CSiR from CSR (Griffin & Mahon, 1997; Mattingly & Berman, 2006; Price & Sun, 2017).

However, historical CSiR itself may affect the stock market reaction, and it may concern the influence of historical CSR on the stock market reaction. First, stakeholders may punish a firm with high historical CSiR because of the increasing marginal effects of the negative information (Haack, Pfarrer, & Scherer, 2014; Rozin & Royzman, 2001; Zavyalova, Pfarrer, & Reger, 2017). Second, the insurance effect from historical CSR may be limited when stakeholders take into account historical CSiR. When both positive and negative information coexist, negative cues might be more potent than positive signals (Baumeister et al., 2001; Kanouse & Hanson, 1972; Rozin & Royzman, 2001). Thus, historical CSiR can be an essential informational cue in understanding the stock market reaction to an irresponsible event, but existing discussions have been limited to historical CSR.

Thus, the purpose of this study is to analyze the influence of historical overall CSiR and product domain-specific CSR and CSiR on the stock market reaction when an irresponsible event occurs. First, this study explores the relationship between a firm's historical CSiR on the stock market reaction. If it is negative, it is called the punishment effect. Second, it aims to examine how the punishment effect from overall CSiR varies depending on a firm's product domain-specific CSR/CSiR.

Various theoretical lenses predict the impact of overall CSiR on the stock market reaction differently. First of all, the literature on the insurance effect suggests the punishment effect of overall CSiR could be weakened when firms build goodwill from product-specific CSR. Second, the literature on increasing marginal negativity argues that the punishment effect of overall CSiR can be strengthened for firms with product domain-specific CSiR. The additional negative information from an irresponsible event can have a substantial impact on the stock market reaction. On the other hand, expectancy violation theory contends a more severe reaction in product domain-specific CSR and less severe response in the case of product domain-specific CSiR. Expectancy refers to cognitions about an enduring pattern of anticipated behavior (Burgoon, 1993; Burgoon & LePoire, 1993). Stakeholders may predict the actions of firms based on the firm's past CSR and CSiR activities. Expectancy violation theory has contended that unexpected behaviors lead evaluators to scrutinize more thoroughly and react more strongly (Burgoon & Hale, 1988; Burgoon & LaPoire, 1993; Love & Kraatz, 2017). Consequently, the punishment effect from overall historical CSiR may be strengthened when shareholders' expectation is incongruent for "good" product quality firms, but be lessened when shareholders' expectation is congruent for "bad" product quality firms.

This article uses the hand-collected 271 product-related irresponsible events of S&P 500 firms from 2003 to 2018 to test the hypotheses. This study analyzes the relationship between a firm's overall historical CSiR performance and the stock market reaction. This study further explores whether a firm's previous CSR or CSiR on product domain moderates the primary relationships between historical CSiR and the stock market reaction via subsample analyses. Regression results conclude that overall historical CSR may not always ensure a firm, but overall historical CSiR may punish the firm when a product-related irresponsible event occurs. Results suggest that a firm's strength in the product domain may weaken the influence of overall historical CSiR on the stock market reaction. A firm's concern in the product domain also may mitigate the punishment effect of overall historical CSiR in different mechanisms.

This study contributes to the CSR literature in several ways. First, this study clarifies the boundary condition of the insurance effect from CSR. This study suggests that the positive relationship between CSR and the stock market reaction (overall historical CSR's insurance effect) is not statistically significant when overall historical CSiR is considered simultaneously. We fail to conclude CSR's insurance effect when a product-related irresponsible event occurs to a firm. Second, this study sheds light on the importance of overall historical CSiR. This study implies that overall historical CSiR not only limits the benefit of CSR but also punishes a firm. Thus, it infers the theoretical importance of CSiR for scholars in the CSR literature, and it also provides practical implications for practitioners. Implementing CSR without avoiding CSiR may not be beneficial to a firm when an irresponsible event happens. Finally, this study explores the dynamics between overall CSiR and domain-specific CSR/CSiR. Product domain-specific CSR could provide the insurance effect by weakening the punishment effect of overall CSiR. When stakeholders perceive a firm as "good" because of the firm's CSR activities in the product domain specifically, the firm may benefit from the doubt based on moral capital from CSR activities. This study also points out the role of low expectancy violation. When stakeholders perceive a firm as "bad" because of the firm's CSiR activities in the product domain, specifically, an additional product-related irresponsible event is not surprising enough to grab stakeholders' attention. Thus, the additional irresponsible event's stock market reaction was less adverse to the "bad" firm. It corresponds with the shareholders' expectations based on its historical CSiR activities. To sum up, this study contributes to the CSR literature by exploring the influence of overall historical CSiR on the stock market reactions when an irresponsible event occurs. It also suggests the insurance effect from product domain CSR and low expectancy violation from product domain CSiR mitigate the influence of overall CSiR.