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What Causes Sin Stock Aversion?
Social Preference or Probability Bias?
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Abstract
Some businesses tout their virtues, e.g. in terms of CSR. Others may be seen as sinful from adverse media coverage. Does the perception of morality in business affect investor’s choice of its stocks? While it has been reported that some investors avoid investing in sin stocks while exhibiting a preference to invest in virtue stocks, one cannot conclude that perceived morality alone affects stock choice since sin stocks/virtue stocks may differ from the stocks of other companies in additional dimensions such as firm size, performance, and volatility. This paper experimentally investigates the determinants of sin stock aversion and virtue stock affinity in the literature: trust/trustworthiness elicited from a trust game (Riedl and Smeets, 2017), altruism elicited from a dictator game, and wishful thinking based on a Karmic investment hypothesis resulting in a probability bias favoring perceived virtue and against perceived sin (Risen, and Carter, 2012). Our measure based on Chew and Sagi’s (2008) definition of source preference disentangles moral aversion-affinity from the stock's underlying market performance. This enables us to identify and discriminate between social preference (proxied by trust/trustworthiness in trust game and altruism in the dictator game) and wishful thinking resulting in a probability bias as determinants of moral aversion-affinity. We find that sin stock aversion/virtue stock affinity is linked to altruistic giving in the dictator game along with both Trust and Trustworthiness in the trust game. When betting on whether the last digit of the chosen stock is odd or even, about 37% of sin stock aversion is due to trust/trustworthiness, while about 13% is due to wishful thinking. When betting on up, about 27% of sin stock aversion is due to trust/trustworthiness, 22% is due to wishful thinking, and 29% are due to both factors. While social preference and wishful thinking both contribute to moral aversion-affinity, the effect of the former predominates. Interestingly, the observed moral aversion-affinity to stocks is not associated with ambiguity aversion, the number of years of investment experience, and share of wealth invested in the stock market.

Keywords: Corporate Social Responsibility, Social Preference, Behavioral Finance
JEL Classification: G02 (Behavioral Finance), C91 (Laboratory)

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