Research Issues in Accounting for Cross-Border Organizations

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Levels of Analyses

• Economy
  – National,
  – Regional,
  – International
• Organization
• Agent
Figure 1

Resource Flows in Private-Good Organization

Employees

Managers

Government

Shareholders

Creditors

Customers

Vendors

Skills
Compensation

Residual Rights
Equity Capital

Interest Loan
Capital

Cash
Cash

Goods and Services

Public Goods
Taxes
Factor and Product Markets

• Labor
  – Managerial (skills vs. compensation)
  – Other (skills vs. wages)

• Financial Capital
  – Equity (capital vs. returns, risk, residual)
  – Loan (capital vs. interest, risk)

• Physical Capital (Private products and services (cash vs. contribution)

• Public services (tax vs. services)
Accounting and Control

- Viewed as a mechanism to define, implement, enforce and renegotiate contracts for labor, capital, products and services
- Forms of contracts, and details of accounting and control depend on the conditions in markets for these resources
- Cross-border organizations must simultaneously deal with markets with different conditions on two sides of the border
Cross-Border Market Comparisons

- Markets do not always exist
- Even when they do, they may be in different states of development, and operate with different conventions and expectations
- Novel challenges for accounting in cross-border organizations
- Consider a few examples
Labor Markets

• Seniority wage and job security
• Performance-based compensation and flexible workforce
• Cost of switching jobs (search, retirement benefits, moving)
• Language, education
• Market-linked compensation
• Expectations of others’ behavior
Employee Risk Bearing

• Direct ownership of equity and options
• Unfunded pension plans
• Links between employee compensation and profitability of the firm
  – Adjustment of compensation and working conditions for business conditions
  – Bonus plans
Research Questions

• What are the links between labor market conditions, performance measurement and compensation methods?
• What can/do cross-border organizations do to deal with the differences among labor markets?
• How can measured performance be made robust when compensation is linked to performance?
• Alignment of expectations (culture shock!)
• Consequences of employee risk-bearing for performance measurement and control
Markets for Financial Capital

- Cross-border differences in equity, bond, bank loan and mortgage markets
- Compare bank loan markets in U.S. and Japan
- More emphasis on financial reporting in U.S.
Credit Markets in U.S.

- Arms-length relationships
- Borrowers shop for best rates
- Low compensating balances
- Need-based borrowing
- Pre-payments of loans
Credit Markets in Japan

- Equity features of loans
- Longer term commitments between banks and borrowers
- Few term loans
- High compensating balances
- Banks hold equity and often serve on boards
- Changes in Bank of Japan policy in 1976
- Switch to U.S. style consolidation criteria in financial reporting
Research Questions

• How well do the financial reports in various countries serve their markets for financial capital?

• Is the demand for change motivated by filling the deficiencies (catching up) or is it prospective (to prepare for the future)?
Industrial Organization

• In U.S., equity ownership is the key feature of corporate relationships and accounting
• In Japan, ex-zaibatsu and keiretsu groups have more extensive relationships
• Equity-based consolidation used in U.S. yields non-comparable results when applied in Japanese economy (Kajiwara, 1999)
• What can accountants do to write accounting rules that yield meaningful comparisons across economies with structural differences?
To Summarize

- Firm, its contracts and accounting depend on factor and product market conditions
- A comparison of market conditions is a good starting point for study of cross-border differences
- Neither markets nor accounting are static
- How do we make sure that adjustments to changing conditions are appropriate?
Regulatory Competition as a Guiding Principle

• Markets can help guide committees, boards and legislative bodies
• Allow competition between two sets of standards in each jurisdiction (e.g., local and international)
• Let each firm choose one set and clearly label its financial reports accordingly
Consequences of Regulatory Competition

• Firms will tend to choose the standards that will lower their cost of capital which is observable
  – If they don’t, market for corporate control can remove the management

• Standard setters will compete for corporate following, and tend to develop efficient standards
  – If they don’t, they will go out of business
Research Question

- This system of dual standards will introduce best practices at suitable speed to local economies
- It will also help the cross-border organizations by giving them a choice of following local or imported practices
- My final research question is: Why Have we always depended on regulatory monopolies in accounting? Will competition at a global scale work?
Text and Slides of This Presentation

• Available for download from
• http://www.som.yale.edu/faculty/sunder/research/
• A related paper by Dye and Sunder is available at
• http://www.som.yale.edu/faculty/sunder/research/
• http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=160390