



Connected Stakeholder Coordination and Accounting

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China Accounting Review Inaugural Spring Conference
Chongqing 2022

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Outline



- Why institutions matter?
- Institutions and connected stakeholder approach
- Effects of the approach on accounting
 - 7 examples
- What next?





Why institutions matter?

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Accounting does not exist in a vacuum

- Accounting is used for mitigating organization costs and contracting costs (even relational contracts)
- Fundamental institutional factors shape markets, firm ownership, corporate governance and accounting
 - Political economy
 - Law
 - Culture and social norms



Do we still need to care about institutions?

- Will China and other countries eventually converge into the US-style governance and accounting system? Unlikely
- Saying China is different does not mean that all aspects of China's accounting is different from the US?
 - Some will converge and some will not. That's why institutional research is necessary.

Specificity vs. generalizability



- The research is generalizable by using universal theories
 - property rights, institutional economies, agency theory, political science, and sociology.
- The China specificity is not in the use of basic theories, but in the constraints and conditions.
 - Political economy + social norms → Connected stakeholders → Continental Europe and East Asia
 - Relational contracts → U.S. startups

What can we do with the institutional perspective?



- Ask the right questions
 - find first-order effects and not barking on the wrong tree
- Help to evaluate the effectiveness of policies and design policies
- Avoid spurious correlations or correlated omitted variable problems.



Institutions and connected stakeholder approach

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Social norms and political economy



- Role of social norms
 - Culture and norms. Chinese culture's stronger preference for permanent relationships (*guanxi*). Shape the way we do business.
- Role of political economy: *local* government controls key resources such as capital (state banks, equity market), labor (*hukou* system), land, licensing and many other SOEs. This will further increase the importance of network.
 - Local government control + *guanxi* that is locality specific → strong local networks → transaction and governance

Connected stakeholder approach vs. shareholder approach



- Firms work closely with connected stakeholders: e.g., provincial and city leaders (bank loans, subsidies, hukou, licensing, industrial policies, land, regulations), connected stakeholders such as suppliers and customers.
- Firms do have arm's length stakeholders e.g., minority shareholders and customers.



Effects on accounting – a few examples

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Agency conflicts

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Agency conflicts



- Not shareholders vs. managers
- But large shareholders vs. minority shareholders, and more generally
- Network-induced agency problem: connected stakeholders vs. arm's length stakeholders (Gao, Wong, Xia and Yu, 2021)
- Accounting? Not just to limit managers' opportunism.



Information intermediaries

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Role of information intermediaries

- A big part of their role is to understand firms' and their connected stakeholders' network relationships.
- Without that, it is hard to evaluate the contracts and the ways they handle contingencies.
- The concept of embedded intermediaries for analysts (Li, Wong and Yu, 2020) and auditors (DeFond, Li, Wong and Wu, 2022).



Accounting and disclosure

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Accounting and disclosure



- Not necessarily to use transparency to reduce cost of capital or emphasize earnings as a measure of performance (monitoring managers)
- Accounting and disclosure are used as a communication device to all stakeholders (connected and arm's length) to signal stability in firms' relationships (Lu, Shin and Zhang, 2021)



Firms' relationships matters

Networks and information



- Financial analysts focus on quantifying soft information about firms' relationships in textual form
 - Examine Chinese analysts' research methods (Wong, Wong, Zhang and Zhang, 2022).
- Firms' network connections with government officials shape firm pairs' share price co-movement
 - Use big data and textual analysis to map out firms' network relationships (Piotroski, Wong and Zhang, 2021)



Online media platforms

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Online media platforms as information intermediary for retail investors



- Equity market with less developed institutional investor market. Weak law to protect investors' voting rights.
- Retail investors have free-rider problems.
- Social media with the features of visibility of users' communication and coordination of users' actions can tackle this problem (Wong, Yu, Zhang and Zhang, 2022).
- Example of filling institutional voids
 - Retail market – Taobao + Alipay resolve the trust issue in retail market.



Tax

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Tax avoidance?



- Not a lot of US-style tax avoidance (叶康涛, 侯唯珠 and 黄铮, 2018)
 - China universities do not offer large master's degree in taxation.
- Tax rules are not decentralized to the court.
 - Decentralization to court ruling is more market and arm's length
- Firms rely on their relationships to negotiate the tax rates with the local government.
 - Tax collector is a connected stakeholder



ESG

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ESG from a connected stakeholder perspective



- Environment – an externality issue
- Sustainability – LT vs. ST horizon, commitment of connected stakeholders vs. arm's length shareholders
- The Chinese government can play a big role in coordinating the connected stakeholders.
 - How do Chinese firms approach ESG differently from those of their US counterparts?



What next?

Exciting time



- Methods are important:
 - Quasi-experiment and field experiments.
 - Case studies, survey/field data and interacting with practitioners and firms
- Generalizability with more theoretical clarity
- Focus on institutions and theoretical framework suitable for China.
- Train students to understand China's institutions and theories.
 - Not necessarily doing institutional research but pay attention to institutions.



Thank you