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INFORMATION DISCLOSURE AND THE MULTINATIONAL CORPORATION

with
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Preface

'European management faces an explosion of proposed legislation on corporate information disclosure. International bodies like the ILO (International Labour Organization), the UN (United Nations), the OECD (Organization for Economic Cooperation and Development) and the EEC (European Economic Community), indeed governments everywhere, are scrambling on to the disclosure bandwagon as fast as the legislation procedures will allow'.[1]

In general terms this 'explosion', referred to by Jack Peel, a former Director of Industrial Relations of the European Commission, is the result of a gradual building up of three sources of pressure. The first is an economic pressure. European companies are having to face rapid technological change in the face of US and Japanese competition, as well as new, bitter competition from the newly industrializing countries (NICs). Decisions resulting from these new structural developments are having to be taken within the context of the world's worst recession since the 1930s. Such restructuring decisions have an immediate effect on the future employment prospects of thousands of employees and for future employers it becomes increasingly difficult to deny the right of these employees to have their interests taken into account by management, to have an opportunity to receive full information about these decisions and also to be involved in the decision-making process itself.

A second pressure for information disclosure is the trade unions who have strengthened their power to the point where they are able to launch an assault on what for so long had been considered management prerogatives. Trade unions have been helped by legislation which, in many European countries, has given workers a role in the running of their companies. Moreover, allowing workers greater participation on the supervisory boards of all companies in the European Community has been on the legislative agenda since 1972.

Finally, new concepts of the role of employees do not just stem from economic change or the development of trade union power, they are also derived from social changes, which have taken place since the war. These are, especially, higher standards of living, increasing educational opportunities and social mobility. This has provoked a questioning of unaccountable power, an erosion of deferential attitudes and has given birth to demands for a more transparent society. Pressure for companies to disclose more information has therefore been produced as a result of these three changes.[2]

However, employees have not been the only groups wishing more information. Governments and investors have also joined in this chorus. Their desire is not only for more information but for more usable information, focusing their attention on the need to improve the comparability of financial and general data.

As a result, the OECD, EEC and the UN have been for many years attempting to standardize accounting methods. These attempts have run into protracted difficulties. However, the EEC, in 1983, did pass the seventh directive on group accounts which by 1990 will oblige companies to obey general EEC standards as opposed to national laws.

Undoubtedly, demands for more data and more comparable data have worried MNCS. However, it has been pointed out that these trends may work to their advantage.[3] The sharing of more information with their employees helps blunt the frictions that inevitably occur over the implementation of hard, but necessary decisions. Also, maximum norms of information disclosure in comparable formats can help employers compare their own performance against competitors, while disarming critics and reducing the hostility with which multinational companies are often perceived in developing as well as European countries.

The purpose of Professor Gray's book is to provide a review of the major issues, problems and trends relating to this process of information disclosure and the multinationals. His book discusses the evolution of accountability and information disclosure, the arguments for and against more disclosure from the viewpoints of all the actors and reviews information disclosure developments in practice on a world-wide basis.

IRM sponsored this work because it considered it an important issue concerning the nature of the multinationals. Through this promotion of serious and independent academic work, of which Professor Gray's work is a good example, IRM hopes to better inform trades unionists, managers, international civil servants and politicians involved in policy discussions on multinationals.

References

1. Jack Peel, *The Real Power Game*. (London: McGraw-Hill Book Company, 1979), p. 122.
2. See chapter 3. *Report of the Committee of Inquiry on Industrial Democracy*, Chairman Lord Bullock, Her Majesty's Stationery Office, 1977.
3. 'Multinationals become focus of moves to standardize company data'. Brij Khindaria. *International Herald Tribune*, November 28, 1983.

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The Institute for Research and Information on Multinationals (IRM) promotes and finances independent academic research on multinational companies and their impact on society. This research is undertaken by academics of various disciplines from all over the world. The findings are made available to the widest possible audience through the publication of books, reports and bulletins, through the media, and through the organization of conferences, seminars and other activities.

Contents

1

Introduction

The power of multinational corporations (MNCs)[1] to control and move resources internationally[2]—sometimes to the apparent disadvantage of national interests—has recently given rise to demands, especially from governments and trade unions, for extensions in accountability and information disclosure.[3]

At the international inter-governmental level, the involvement of The United Nations (UN), the Organization for Economic Co-operation and Development (OECD), and the European Economic Community (EEC) in the development of accounting standards, with special reference to MNCs, confirms the politically sensitive nature of MNC operations and impact.[4] Apparently, the global reach of the MNC is to be countered only by global/regional regulation.

Pressures on MNCs are evident not just from inter-governmental organizations. A broad array of interest groups are demanding that MNCs improve the quantity and comparability of information disclosed. Deficiencies in current disclosure and measurement practices are perceived by international organizations of trade unions[5] and investment analysts[6] alike—albeit with some differences consistent with their own special concerns. The accounting profession, in the form of the International Accounting Standards Committee (IASC) is also striving to attain some measure of harmonization of accounting standards worldwide.[7] MNCs themselves would tend to support some degree of international harmonization, as a result of their concern with the multiplicity of national financial reporting requirements, while viewing with alarm the growing number and variety of international standard-setting agencies and their demands for extensions in information disclosure.[8]

The development of accounting and information disclosure by MNCs is thus taking place in a complex, multi-dimensional, and dynamic environment involving many participants, including governments, trade unions, investors, bankers, accountants, and managers.

1.1 PURPOSE AND SCOPE

The purpose of this book is to provide a review of major issues, problems, and trends relating to information disclosure and the MNC. This is an area of considerable controversy, and it is hoped that politicians, government officials, trade unionists, investors, managers, and other interested parties will be thereby better informed about the issues involved and recent developments. The discussion is also likely to be of particular interest to financial managers and accountants, though the analysis of specific accounting and reporting practices is limited to an overview of selected areas of significance to MNCs.

The main focus of the study is on information disclosure by MNCs in the context of corporate annual reports, comprising financial statements/accounts and additional financial and non-financial information. These reports are usually referred to as general-purpose reports, i.e. they include information which may be used by a number of user groups for a variety of purposes. General-purpose reports may be contrasted with special reports designed for specific user groups, such as employees, and issued separately either on a confidential or publicly available basis.

While it is recognized that there is growing interest in the provision of special reports and that this is likely to be an important area for future development, given the diversity of users and information needs, the thrust of the current controversy is concerned with the content of general-purpose corporate reports. Indeed, much of the pressure to expand the content of such reports is aimed at accommodating the information needs of a wider range of users than hitherto envisaged. Thus the expansion of this type of report, with sections of special interest to specific groups, may be but a prelude to a widespread decentralization of corporate reporting.

It must also be appreciated that information is often disclosed to interested parties by means other than corporate annual reports, whether they be general-purpose or special reports. Financial and non-financial information is regularly, or occasionally, supplied to governments, bankers, works councils, trade unions, investment analysts, and others in a wide variety of contexts, formal and informal, on a confidential or publicly available basis. Thus corporate annual reports are not the only, nor necessarily the most important, source of information about MNC operations and impact. Nevertheless, it is widely recognized by governments, trade unions and the financial community in many countries that corporate annual reports are an important instrument of accountability, a public record, and a reliable source of information which may not be readily available elsewhere.

International inter-governmental organizations such as the UN, OECD, and EEC have recognized the significance of information disclosure in MNC annual reports, as have international organizations of trade unions, investment analysts, and accountants. Hence there would appear to be ample justification to focus our study accordingly while remaining aware of the limitations involved.

1.2 OUTLINE

The book begins with a historical review of the evolution of accountability and information disclosure, including a discussion of accountability in relation to MNCs with special emphasis on the differences between MNCs and domestic or uninational corporations (UNCs) which have given rise to recent pressures for more accountability and information disclosure.

Secondly, the demand for information from the major participants concerned is analysed with special reference to governments, trade unions and employees, and the financial community.

Thirdly, managerial perspectives concerning the supply of information are considered with some discussion of the likely costs and benefits that must necessarily be evaluated in decisions regarding disclosure, whether it be on a voluntary or regulatory basis.

Fourthly, the extent of regulation and information disclosure in practice is reviewed on a world-wide basis in respect to selected issues of significance to MNCs: consolidated financial statements, funds statements, segmental information, transfer pricing and related party transactions, accounting for inflation, foreign currency translation, and non-financial reporting, including value added statements and business forecasts. Problems and prospects for developments in each of these areas are briefly discussed.

Finally, an overview of the discussion is presented and some conclusions offered for consideration and debate.

2

The Evolution of Accountability and Information Disclosure

Accountability and Information disclosure[1] by corporations in the national context is influenced by a variety of economic, social, and political factors. The political system and type of economy, the stage of economic development, the social climate, the legal system, the management and ownership structure of corporations, the accounting profession, the tax system, and the nature and stage of development of the capital market, are all important environmental factors which determine both the accounting systems used and the extent to which information is publicly disclosed.[2]

The influence of these factors is likely to vary both between and within countries over time. Moreover, it would seem that there is an evolutionary process of some complexity at work with special reference to the growing number of cross-cultural and regional influences such as those arising from the activities of MNCs and international intergovernmental organizations such as the UN, the OECD and EEC. In the European context, the EEC is an especially significant influence in that any agreement on the harmonization of information disclosure becomes legally enforceable throughout the EEC countries. In figure 2.1 one attempt to formulate a model of the evolutionary factors involved is presented.[3]

While there are many differences in national environments, with corresponding differential effects on accounting systems, there are also many similarities. Attempts to classify countries, and identify clusters or groupings, are still very much at the early stages, but such efforts would seem to be useful in gaining a better understanding of factors influencing the development of accounting systems with consequent benefit in terms of predicting likely changes and their impact. Accounting systems in centrally planned economies such as the USSR are, of course, quite different from those developed in market economies such as in the USA and the EEC countries. So far as public reporting in

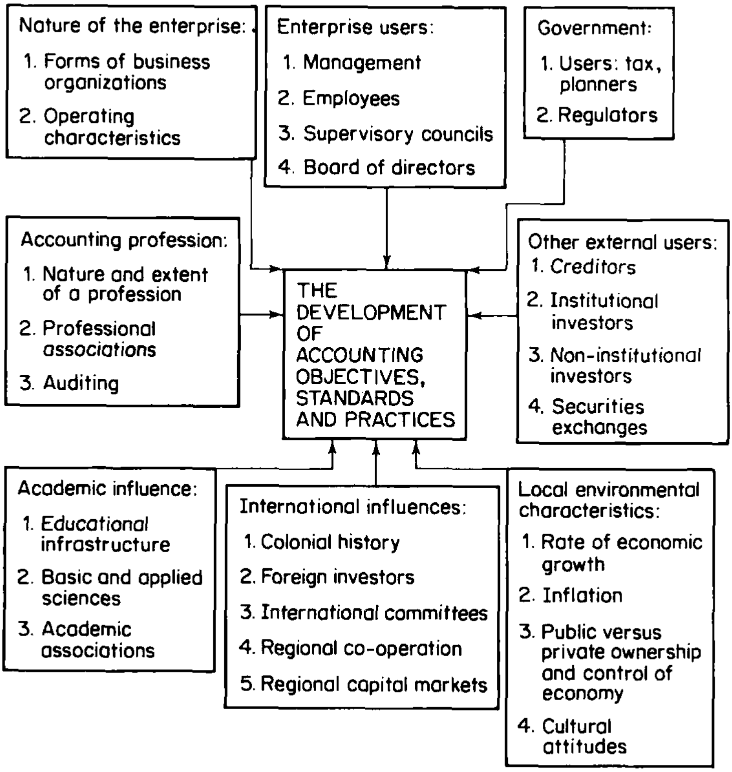

Figure 2.1. The evolution of accounting and reporting practices. Source: *Lee H.Radebaugh, 'Environmental Factors Influencing the Development of Accounting Objectives, Standards and Practices in Peru',* International Journal of Accounting *(Fall, 1975)*

market economies is concerned, a number of empirical studies point towards the identification of four basic models, viz. British Commonwealth, Latin American, continental European, and United States.[4] There have also been attempts to classify national systems on a more judgemental basis as in figure 2.2 which is an example of a biological approach to systems classification.[5]

In all of these studies it would seem to be much more difficult to discern clear patterns relating to information disclosure as compared to asset and profit measurement practices which have perhaps been more stable over time.

Given the change factors at work it is not likely to be an easy task to predict future evolution. The current situation is highly dynamic in the context of the activities of a wide range of national and international organizations, as well as the changing nature of business and especially multinational operations. It may well be that new models or patterns

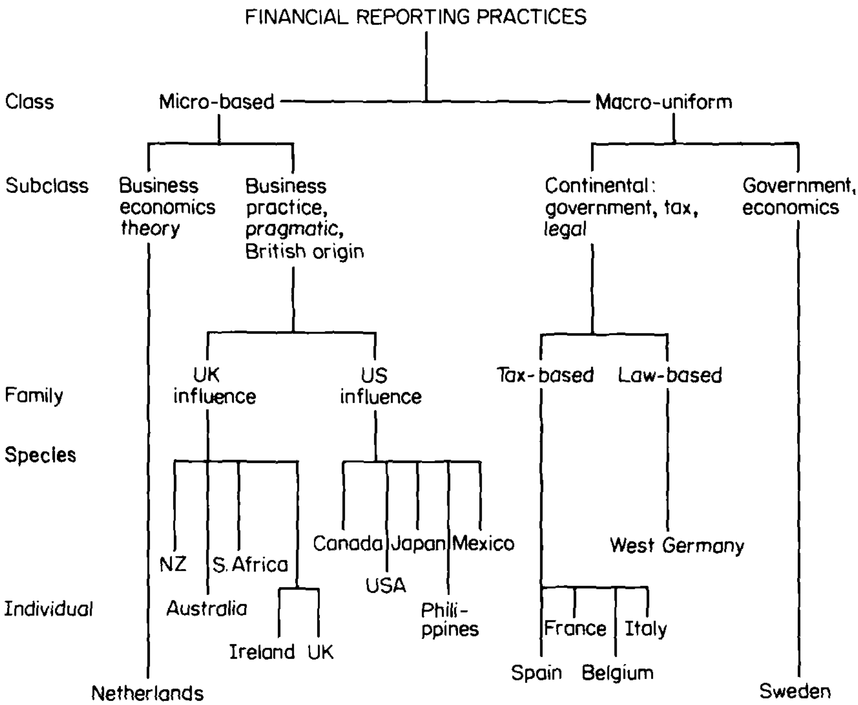

Figure 2.2. The classification of national accounting systems. Source: *C. W. Nobes and R. H. Parker (Editors),* Comparative International Accounting *(Philip Allan, 1981)*

of reporting are in the process of being formed, e.g. the UK and continental European models are in the process of co-ordination and some fusion following EEC developments in accounting harmonization.

Consider now some of the more influential factors in the development of information disclosure by corporations.

2.1 DEVELOPMENTAL FACTORS

A major factor influencing the development of information disclosure in the USA, UK, and other market economies was the recognition of corporations as legal entities with the public ownership of shares and the right of limited liability.[6] Two characteristics of these early corporations necessitated disclosure for the protection of two groups in particular. First, as a consequence of limited liability the resources available to creditors in the event of the corporation's liquidation were limited to those of the corporation itself. The liability of the shareholders being limited to their investment, disclosure was seen as a means of regulation. Information disclosure or 'transparency' would assist creditors in determining the extent to which they were prepared to commit resources to the company and the use of resources they had committed. The second major reason for the close relationship between limited liability and disclosure was the protection of shareholders. The emerging entrepreneurs often came from backgrounds which did not give them easy access to the capital necessary to launch and expand individual projects. The introduction of limited liability removed a major disability. Those who owned capital were often unwilling to become involved in what were frequently risky projects as they stood to lose not only their investment but the rest of their personal wealth as well. Limited liability restricted the potential loss to the investment in the corporation. As many of these investors were not directly involved in the running of the business, it was essential for their protection that they should have access to information on a regular basis.

Information disclosure to those with a direct financial relationship with corporations has been influenced by two additional developments—the growth of professional management and the emergence of stock exchanges.

Much has been written about the so-called separation of ownership and control which is supposed to have resulted from the emergence of professional management composed of individuals whose positions of power within corporations stemmed from their possession of administrative and/or technical skills rather than ownership of the corporation's capital.[7] The growth in size and increasing complexity of business is the basis for this growth of the managerial class. Whether, and to what extent, the separation of ownership from management and the division of the corporation into two essentially distinct groups results in corporation behaviour different from that of a corporation owned and controlled by the same persons is a matter of considerable controversy.[8] Whatever the general position may be, the fear of such deviance and the experience of individual cases were further reasons for maintaining and expanding disclosure as a means of checking that management was not behaving in a manner to the detriment of the owner's interests.

Corresponding to the growth in the number, size, and complexity of corporations was the demand for finance in the form of shares, or what is termed as equity investment, as well as loans. This gave rise to the development of capital markets where the raising of finance could be facilitated. A major factor influencing the disclosure of information was the emergence of stock exchanges which have their origins in the desire of shareholders to trade their investments without liquidating the company and the need for a mechanism for raising new finance in an efficient manner. The former reason, the exchangeability of shares, is that which preoccupies the major portion of the market's time and energy, especially in countries such as the USA and UK.[9]

The growth of stock exchanges necessitated the expansion of information availability to a wider audience, viz. potential investors interested in buying and selling shares. As most private shareholders were not capable of comprehensively analysing the financial disclosures of corporations, they tended to rely on specialist advisers/financial analysts.

It is these analysts who now act as interpreters of corporate reports for many investors, current and potential. It is in this way that the information needs of investors, and financial analysts in particular, have acted as a constant pressure on corporations to increase both the quality and the quantity of their disclosures. Thus the emergence of stock exchanges has served to both deepen and broaden disclosure.

The importance of information usage by potential investors and comments by financial analysts has meant that the financial disclosures of public corporations whose shares may be traded have become publicly accessible.[10] The availability of corporate reports to groups other than investors and creditors is not, therefore, a consequence of any pressure directly exerted by them but is a result of the necessity of public availability for unidentifiable potential investors.

The predominant influence of stock exchanges in determining the quality and quantity of publicly available information in corporate reports is indicated by the strong correlation between well-developed markets and the extent of financial disclosure in corporate reports. Countries with active and well-developed markets, e.g. the USA and UK, generally have a greater extent of public financial disclosure than those with relatively inactive ones, e.g. West Germany, France, Italy, Belgium.[11]

While the basis for this difference lies to some extent in national attitudes it is mainly due to the lower demand in some countries for public information disclosure. This is in turn a function of differences in environmental factors including especially the political system and role of government, the type of economy, the ownership of business, and the nature and stage of development of capital markets.

Why is it that stock exchanges appear to have been the predominant force in the emergence of *public* corporate disclosure? It has already been argued that the existence of an active market necessitates the publication of financial information for share-trading decisions by shareholders and potential investors. What distinguishes shareholders from other finance providers is that most shareholders are 'outsiders'. Despite being nominally owners of the corporation they have perhaps the least