AN EXPLORATORY INVESTIGATION OF SOCIO-ECONOMIC PHENOMENA
THAT MAY INFLUENCE ACCOUNTING DIFFERENCES
IN THREE DIVERSE COUNTRIES

DISSERTATION

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By

Lawrence R. Hudack, B.B.A., M.B.A.
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This dissertation attempts to provide an exploratory structure to respond to, and tries to resolve, an existing void in international accounting research. The void is a lack of coherently structured, nation-specific, descriptive research to investigate socio-economic phenomena which may influence financial accounting.

This dissertation's salient features include a political economy theory, an exploratory, sociological method, and a case study format. The political economy of accounting, introduced by Tinker [1980] and refined by Cooper and Sherer [1984], emphasizes a persuasive social relations dimension. This theory motivates selection of three countries (the United States, France, and Japan) that appear to have divergent socio-cultural environments. An exploratory and analytical approach of modified (enlarged) exogenism, developed by Smith [1973, 1976] and adapted to accounting by McKinnon [1986], provides an analytic structure for this exploratory investigation. Modified exogenism focuses upon an open, dynamic social system (the process of financial accounting), and provides analysis
reflecting four major areas (the environment, intrusive events, intra-system activity, and trans-system activity). After examining the nation-specific financial accounting (socio-economic) structures for each country, an analysis of selected financial disclosures attempts to gain a better understanding of how socio-economic factors have influenced the development of financial accounting.

My primary objective is to attempt to provide some insight about how diverse socio-political factors have impacted the development of financial accounting in three countries.

Library research of nation-specific literature attempts to extract a relatively accurate picture of social, political, and economic institutions and policies, and relates such findings to financial accounting processes for each nation.

This dissertation attempts to provide a necessary foundation for future theoretical international accounting harmonization studies.
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CHAPTER I

INTRODUCTION

International accounting research offers a relatively new frontier for pioneers to explore. A challenge exists that necessitates basic research involving descriptive studies at a nation-specific level. Specifically, an understanding of how socio-economic factors impact nation-specific financial accounting processes is a necessary condition for meaningful harmonization studies. This dissertation responds to the challenge through an exploratory (socio-economic) framework that analyzes financial accounting differences in Japan and France with respect to the United States. Chapter one states the dissertation's primary objective, discusses fundamental research issues, and offers a brief overview of the upcoming chapters.

Objective of Dissertation

The primary objective of this dissertation is to provide some insight about how diverse socio-economic factors have impacted the development of financial accounting in Japan and France in comparison to the United States. The study employs a political economy theory and a
modified (enlarged) exogenist method.

The political economy of accounting, introduced by Tinker [1980] and refined by Cooper and Sherer [1984], emphasizes a persuasive social relations dimension. The theory motivates the selection of countries in this study. Japan and France appear to have divergent socio-economic environments from the United States and use accounting for different purposes.

Modified exogenism, developed by Smith [1973, 1976] and adapted to accounting by McKinnon [1986], provides the analytic structure for this investigation. I initially identify and examine financial accounting (socio-economic) structures using an exploratory, modified exogenist approach. After illustrating these institutional structures, I then analyze selected financial disclosures to determine how the socio-economic factors impact the development of financial accounting. This study does not attempt to show causation but rather associations that may lead to a more realistic foundation for future theoretical international accounting harmonization studies.

Research Perceptions

A researcher’s perceptions are instrumental in formulating research questions, and analyzing data and results. Burrell and Morgan [1979] classify research
strategies along an objective/subjective continuum.¹

Burrell and Morgan label the objective dimension, the functionalist research paradigm.² A functionalist views data to be external to one's mind (i.e., "it's out there"), perceives knowledge to be hard, real and tangible, and adheres to 'pure' scientific observation by an independent observer. The functionalist paradigm tends to favor microscopic, narrowly defined research (e.g., to examine a leaf of a tree from a forest).

In contrast, Burrell and Morgan label the subjective dimension, the interpretive research paradigm. An interpretivist views data to be internal to one's cognition, perceives knowledge to be a socially conditioned reality that is based upon personal experience and insight, and supports first hand experience and logical analysis. The interpretive paradigm tends to favor panoramic, broadly defined research (e.g., to look at the whole forest).

Burrell and Morgan conclude that social science researchers frequently adopt a functionalist perspective.

¹Refer to Burrell and Morgan [1979] for complete coverage of their two dimensional social science research taxonomy which identifies four separate paradigms. The other dimension is radical change - regulation. These two paradigms are radical structuralist and radical humanist; neither has yet to be very popular in western thought.

²The objective and subjective dimensions are the extremes of a continuum.
Chua (1986) argues that mainstream accounting research is no exception. Overcoming this functional bias may provide many opportunities for future researchers, if complementary alternative paradigms are adopted. An interpretive framework should allow researchers to address different research questions and result in different analyses, expanding and complementing traditional microscopic studies.

Chua (1986) classifies accounting research, based upon its underlying philosophical assumptions, into three categories: a dominant functionalist mainstream, an interpretive, and a critical. Table one provides a recap of the three accounting research paradigms, their underlying philosophical assumptions and derived accounting research perspectives.

Chua recognizes a major strength of the mainstream functionalist approach to be an insistence upon clarity and rigor. But, she favors expanding the accounting research agenda. Chua (1986, p.602) contends that functionalist research restricts: "the range of problems studied, the use of research methods, and the possible research insights that could be obtained." Specific limitations include scope restrictions that exclude evaluating (and possibly changing)

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3Chua adapts her functionalist and interpretive perspectives from Burrell and Morgan (1979), and adds a critical perspective based upon human nature.
institutional structures,* and lack awareness of controversial issues such as questioning realism and the empirical testability of theories. Evaluating institutional structures requires a wider analysis than is possible under nomothetic research. Functionalism's underlying assumptions, with respect to accounting, are not universal truths and need to be complemented. Acceptance of additional accounting research perspectives should help compensate for any deficiencies attributed to a singular perspective.** This dissertation adopts an interpretive framework as an alternative to the functionalist model.6

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*Institutional structures include societal organizations that prescribe existing systems of property rights or distribution of wealth and wealth-creating opportunities (e.g., owners' utility maximization assumptions that may be advocated by authoritative participants in a nation's financial accounting process).

**Chua is not alone in advocating expansion of accounting research perspectives: Tinker, Merino, and Neimark [1982], Tomkins and Groves [1983], Cooper and Sherer [1984], Schrueder and Ramanathan [1984], and Arrington [1986, 1987], among others, recognize alternative perspectives to mainstream accounting research.

6The critical alternative offers still other insights, but is beyond the scope of this paper which is to establish a basic understanding through association. Once such an understanding is derived, future research with a critical approach may be attempted. For further discussion and illustration of a critical analytical stance, refer to Tinker, Merino, and Neimark [1982].
Chua [1986] demonstrates that the interpretive viewpoint primarily emphasizes obtaining an understanding in social science. Similarly, to provide a basic understanding of three countries' financial accounting processes is a primary goal of this dissertation.

To provide a basic understanding requires a research perspective that transcends the prescribed narrow boundaries of a purely "scientific," objective based, verification oriented approach. A more cosmopolitan view, flexible enough to recognize varying socio-political and economic structures, is necessary.

Chua [1986] describes an interpretive perspective's underlying assumptions to include acceptance of a socially constructed reality and an understanding through logic.\(^7\) The phenomenon under study is an emergent, intersubjective social reality where continuous human interaction legitimizes meanings and norms.

An interpretist maintains that knowledge should be logically consistent, subjectively interpreted, and generally agreed upon. Logical consistency requires a high degree of clarity and distinctness, and must be compatible with the principles of logic. Subjective interpretation refers to seeking the actors' meaning for an action (i.e., a

\(^7\)Chua's description is based upon Schutz [1962, 1964, 1966, 1967].
plausible or common sense meaning). General agreement pertains to the adequacy of a theory by assessing via the extent to which the actors concur with the explanation of their intentions; it is a form of verification through consensus.

This dissertation depicts the financial accounting process as a socially constructed reality. The authority of participants and related mechanisms flow from human interaction. Financial accounting is a continuous socio-economic process.

Kaplan (1963) specifies two potentially interchangeable methods that provide understanding: the pattern model and the deductive model. According to Kaplan, the pattern model attempts to relate a phenomenon under study to a set of other elements that together constitute a unified system. In other words, an identification of a phenomenon to be a specific part in an organized whole should promote an improved understanding of this phenomenon. The pattern model's salient features include focusing upon relationships and stressing some notion of closure (i.e., wholeness, unity, or integration). Whereas, the deductive model attempts to apply general laws, or known regularities, to an observed, isolated phenomenon. In other words, if a phenomenon is observed to be in accordance with expected regularities, then a conclusion may be drawn which subsumes
the isolated phenomenon under the general laws. The deductive model's primary strength is its insistence upon precision or exactness.

Kaplan contends that neither model is superior to the other; some situations may lend themselves more readily to one model and some to the other. For instance, the pattern model is more suitable than the deductive model for early stages of inquiry or to study human behavior when there are few or no general laws. Both methods may serve useful methodological purposes.

Berlin [1966] suggests that natural science's functionalist and history's interpretive studies seek different goals, thereby requiring different methodological approaches. According to Berlin, natural science tends to emphasize specialization and attempts to respond to severely delimited questions that are intentionally established with a bias toward objectively quantifiable answers. This precision requires a microscopic focus upon isolated strands of experience or some meticulously selected ingredient. Accordingly, natural science's purpose encourages a

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9Refer to figure one. A relationship between basic and applied research is presented.

9Refer to Potter [1973] and Danziger [1985] for additional support in favor of a complementary expansion of research methods beyond nomothetic to include ideographic.
scientist to abstract and dissociate normally associated phenomena. Meanwhile, history emphasizes a wider, more general perception which includes subjective, qualitative characteristics. Such breadth requires a relatively panoramic view of interwoven strands of a texture or a whole compound. Accordingly, historical methodology encourages a historian to integrate and associate interactive phenomena with their environment. In sum, different purposes promote different methods to achieve certain prescribed goals.

Berlin, like Kaplan, recognizes a need for more than one type of methodology. Historical methodology is akin to Kaplan's encompassing pattern model; it is ideographic, focusing not on regularities but on culturally specific phenomena. Whereas, natural science aligns itself with Kaplan's precision-oriented deductive model.

Chua (1986) contends that an interpretive perspective and its related ideographic method (e.g., case studies) provide valuable opportunities for future accounting research. Major strengths include an ability to recognize diverse definitions and assumptions, a relatively encompassing awareness of societal relations, and an insistence upon representative faithfulness (e.g., an accurate description).

An emergent social reality, such as a nation-specific financial accounting process, favors recognizing guidelines
established by changing socio-political, economic, and historical contexts. For instance, the study of a financial accounting process necessitates recognition of a relative reality influenced by its changing socio-economic environment. To gain a basic understanding of an emergent socially constructed reality necessitates familiarity with the process's societal relations through identification and examination of the process's authoritative goal-setting structures. Finally, representative faithfulness seeks to understand the actors' definitions of situations, and analyzes how such concepts are woven into a wider social structure. Actors are participants within a process that is under study (e.g., the regulators, facilitaters, preparers, and users of financial reports).

This dissertation adopts an interpretive perspective to enhance an understanding of how socio-economic factors impact the development of accounting in three countries.\(^\text{10}\) I examine the financial accounting processes in Japan, France, and the United States to highlight the interactive nature of accounting processes. This study adopts Kaplan's pattern model. Kaplan argues that the pattern model is most appropriate when one is at an early stage of exploratory

\(^{10}\)Recent descriptive studies in accounting include Hoskin and Macve [1988], Skousen and Yang [1988], Zhou [1988], Miller and O'Leary [1987], and Puxty, Willmott, Cooper, and Lowe [1987], among others.
inquiry (e.g., international accounting research).

Overview of Upcoming Chapters

Six chapters follow this introductory chapter. Chapter two discusses the theory and analytical framework for this study. The theory is "the political economy of accounting," introduced by Tinker (1980) and refined by Cooper and Sherer (1984). The analytical framework is a modified (enlarged) exogenist approach that is adapted from Smith (1973, 1976). Chapter three provides an overview of international accounting and sets up a nation-specific case study format. Chapters four and five describe and analyze financial accounting in Japan and France. Relying upon a two dimensional political economy theory and an exploratory modified exogenist approach, I examine both countries' financial accounting (socio-economic) structures and analyze select financial accounting practices / disclosures to determine how socio-economic factors impact the development of financial accounting.

This dissertation relies primarily upon a synthesis of secondary sources related to each country. Secondary sources include nation-specific financial accounting, finance, economic, political, and sociological literature. Orsini, McAllister, and Parikh (1987), Choi and Bavishi (1983), and Fitzgerald, Stickler, and Watt (1979) provide data for selection and analysis of specific financial
accounting practices/disclosures.

Chapter six provides a comparative analysis of the U.S. financial accounting (socio-economic) structures and selected financial accounting practices/disclosures with respect to the Japanese and French scenarios. Chapter seven summarizes the Japanese, French, and U.S. Political Economies of Accounting and discusses future research possibilities.
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CHAPTER II

THEORY AND METHOD

An Introduction to the Political Economy of Accounting

Tinker (1980) introduces a classical political economy theoretical foundation to financial accounting. Tinker's political economy perspective recognizes two interrelated dimensions of capital that shape social and economic life. The two concepts of capital are the social relations of production and the economic forces of production. Their interrelationship is observable in particular institutional forms and arrangements. Figures two and three depict "the two concepts of capital and their relationship," and "political economy: a two dimensional approach," respectively.

In contrast, traditional neoclassical economic thought recognizes only the "economic forces of production" dimension. The addition of a second dimension (social relations of production) is essentially a re-birth of Ricardian economic thought. In the early nineteenth century, Ricardo emphasized a residual theory of distribution, where profit is simply a return to the capitalist. Ricardian political economic thought is an expanded conceptualization that recognizes all participants.
in the socio-economic process.

Tinker adopts Ricardo's encompassing directive and stresses the need to consider all the participants in the financial accounting process. He does not assume that a select elite (e.g., stockholders) should be the focal point of the reporting process. 

The social relations of production is an integral dimension of Tinker's political economy. This dimension does more than enlarge neoclassical economic theory, it recognizes the social relations that enable us to understand the economic forces of production. Such relations determine the type of economy within a country. Tinker [1981, p.19] offers the following example: "social relations involving private property owners and 'free' labor produce a competitive market." Tinker [1980] argues that a private property norm promotes construction of mechanisms to enforce the interests of particular social institutions (e.g., the legal protection of property rights is a mechanism established by authoritative participants of a social system).

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1An exclusive stockholders' emphasis is not recognized in Japan nor France. While in the United States, the FASB may identify stockholders as prime users but may not always promulgate standards that benefit them.

2"Capitalism" and "individualism" are not necessarily interrelated.
Two of Tinker's articles [1980, 1981] discuss a specific case analysis involving a foreign subsidiary and its particular environment over time. Both articles provide a brief illustration of how political economy can be applied to a nation-specific setting. Tinker [1980] examines Japan's "disequilibrium policy" which permits the government to establish a low cost of capital so that investment and growth may be stimulated. Underlying this policy is an institutional cooperation among the Liberal Democratic Party's protectionist laws, the government bureaucracy's weak enforcement of monopoly laws, and a cooperative business leadership. Tinker identifies such social and political processes in Japan as the integral "social relations" which are indispensable for interpreting economic performance. In sum, Tinker argues that in order to understand the Japanese economic policy, researchers should examine the Japanese socio-economic environment and its institutional arrangements.  

Tinker provides a two dimensional approach that emphasizes the generally problematic nature of social relations. Social relations can be explicitly observed in institutional forms that are constructed to interact with

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3Chapter four examines Japanese institutions and related socio-economic environment within a financial accounting context. A similar examination is replicated for France in chapter five.
economic relations (i.e., the type of economy). He shows that a 'capitalist' economic structure does not require competition, cooperation is possible through his simple example, involving the spirit of institutional cooperation found in Japan. Political economy, by expanding the breadth of analysis, enables us to obtain a better understanding of various countries' socio-political and economic processes.

A Refinement to the Political Economy of Accounting

Cooper and Sherer (1984) provide constructive insight into the political economy of accounting, and offer indirect encouragement for applying the theory to an international financial accounting setting. The authors contend that a political economy of accounting framework is valuable for understanding and evaluating how financial accounting processes interact with their social, political, and economic environment.

Cooper and Sherer identify three key variables that impact financial accounting: recognition of power and conflict in society, an emphasis upon specific historical and institutional environment, and an emancipated view of human motivation. The first feature suggests that an assessment of the value of financial accounting reports is "likely to be contested as it is shaped in (and shapes) both the political and economic arenas" (Cooper and Sherer 1984,
In other words, social relations are interactive; social relations of power and conflict determine accounting's significance, and in turn, affect such relationships. Recognition of historical specificity encourages an examination of the process of financial accounting in the context of institutions (i.e., the social and political structures and cultural values of the society) in which they are historically located. An expanded (nondeterministic) view of motivation depicts financial accounting to be a dynamic process with a potential to change and reflect differing interests and concerns. In sum, financial accounting is both a product and process of society; it is socially determined and, in turn, determines societal structures.

Cooper and Sherer also provide three complementary imperatives for researchers: be explicitly normative, be descriptive, and be critically aware. The authors recommend that the researcher acknowledge his or her value judgments (be explicitly normative) about how society may be organized. Since value judgments may bias the researcher's perception of power and conflict, such views should be reported. "Descriptive research requires an accurate

"The next section identifies two distinct models (hierarchical and polyarchical) that this dissertation contends may exist in Japan, France, and the United States."
depiction of interactive phenomena and is consistent with historical methodology (e.g., to examine accounting in its socio-economic context). Critical awareness requires the researcher to adopt an attitude which extends beyond a familiar status quo. Such an attitude is necessary so as to be able to recognize different cultural interests and norms.

The political economy perspective directs attention to power relationships within a society and insists upon a close examination of the socio-economic conditioning environment. This approach requires identification of relevant societal structures and a concern for substance over form. Chapter three identifies key institutions (i.e., the relevant socio-economic structures).

**A Focus Upon Social Relations**

A political economy provides an excellent format for international accounting research because it emphasizes social relations among political and economic institutions. A recognition of social relations (e.g., power and conflict)

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5Political economy motivates the selection of the United States, France, and Japan because these nations are perceived to have divergent socio-economic environments.

6An institution is loosely defined to include organizations or identifiable groups of people with known objectives (e.g., government bureaucracies, corporations, corporate groups, professional organizations, labor unions, financial markets, banks, etc.).
enhances a basic understanding of underlying nation-specific financial accounting (socio-economic) structures.

Institutional power and conflict shapes and is shaped by social phenomena. Dahl [1967] defines power as the ability to impose one's will upon another and conflict as the existence of more than one interest. Special attention to and further elaboration upon social relations are necessary to make political economy of accounting a viable theory.

Dye [1986] furnishes an informative illustration regarding the institutional basis of power in America. According to Dye, a review of the literature on power reveals two distinct models: hierarchical and polyarchical. The hierarchical model is based upon "elitist" literature. The polyarchical is derived from "pluralist" writings. Social theory recognizes the merits of both and rejects neither.²

The hierarchical model implies that a cohesive "power elite" exercise authority in a wide variety of institutions. A power elite is a relatively small group of dominant, authoritative individuals or entities. Cohesiveness refers to a convergence of power at the top of a nation's institutional structure (e.g., the leaders in all sectors of society have similar backgrounds). A hierarchical or

²This dissertation contends that the two models may also be applicable to Japan and France.
elitist model assumes the form of a pyramid.®

The polyarchical model suggests that different groups of individuals or entities exercise power in various sectors of society. There is little or no overlap in leadership; authority is dispersed. "Specialists," who limit their participation to a narrow range of societal decisions, provide leadership in different sectors. These specialists come from various sources. A polyarchical or pluralist model resembles a circular pattern.™

Dye argues that both models focus upon elites (i.e., the authorities within institutions and across authoritative, institutional structures). The fundamental difference between the two models rests on assumptions about the degree of cohesiveness of leadership and institutional structures. Elitists attempt to demonstrate cohesiveness. Pluralists attempt to illustrate that many elites exist and that these plural, specialized, relatively independent elites frequently compete and occasionally conflict.


Elitist mechanisms that emphasize convergence over specialization include interlocking directorates, interlocking institutional experiences, similar social backgrounds, and private policy-planning organizations.

Interlocking directorates refer to directors sitting on the governing boards of more than one institution. This arrangement creates an elitist network linking various institutions. Multiple interlockers establish an inner group of institutional leadership (i.e., an "elite within an elite"), and thereby, provide sound rationale to an elitist model.

Institutional experiences refer to holding a number of leadership positions in various institutions over one's lifetime. For instance, a corporate director may resign his or her position to take a government position or vice versa. This migratory sequential interlocking tends to enhance cohesion among institutions.

Similar social backgrounds refer to shared upper- or upper-middle social class backgrounds, relatively uniform prestigious educational experiences, and numerous social, family, and business ties which intentionally encourage interaction and solidarity within the elite. Examples of family and social ties include intra-class marriage and exclusive social club memberships. Such interactions encourage general agreement on societal values, attitudes,
and beliefs. Participants usually attain a general consensus regarding goals and purposes. Disagreement, if any, is limited to specific means for achieving their (common) goals and purposes.

A limited number of powerful policy-planning organizations may represent significant institutions (e.g., the large corporations) to devise self-serving, 'national' policy agenda. Dye contends that the primary objective of policy-planning organizations is to reach a consensus on major policy directions for the nation before the "proximate policy makers" (e.g., the elected representatives) become directly involved. These select planning organizations attempt to establish the agenda of national decision making and direct research involving policy questions.

In contrast (from elitists), pluralists look for specialization over convergence. Pluralists contend that elitist mechanisms are nonexistent. Furthermore, if such mechanisms exist in form, then the pluralists argue that the (elitist) mechanisms are ineffective.

According to Dye, the institutional elite structure in the United States possesses evidence of both hierarchy and polyarchy. Theorists (i.e., European social theorists) posit a dual existence due to recognition of the need for both specialization and coordination in advanced societies. Specialization (division of labor) accompanies most
socio-economic development. Functional differentiation encourages and enhances this development. Separate institutions and their related roles of power develop in response to new complexities and often fuel future socio-economic development. In addition, society needs coordination, if it is to function as a whole. However, social theory does not uniformly prescribe how coordination of power is to be achieved, how much unity is required, or how much competition is to be permitted. Accordingly, the degree of coordination and mechanisms for coordination differ from one society to another. In sum, social theory suggests both convergence and differentiation among institutional elites.10

The preceding discussion supports consideration of both elitist and pluralist perspectives when focusing upon nation-specific social relations among the process of financial accounting participants. Participants include both internal component members and external neighboring social systems. Chapter three specifies these participants. The absence of conclusive support for either elitist or pluralist views requires nation-specific description that

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10See Dye [1986] pages 264-267 for support in favor of recognizing both elitist and pluralist perspectives.
recognizes both models.\textsuperscript{11}

\textbf{A Modified Exogenist Structure}

Smith [1973, 1976] discusses two analytical methods for social change and advocates a modified version of the exogenist approach. According to Smith [1973], endogenism has dominated Western thought; he suggests that the research agenda needs to be expanded to consider exogenism. Smith [1976] defines (social) change to be a modification or replacement of particular (social) patterns or units by other novel ones. He focuses on a dynamic social process, rather than on a static, isolated object.

Smith [1973] discusses the restrictions of a functionalist endogenist method and its evolutionist perspective. According to Smith, endogenism focuses on the systematic properties (regularities) of a society viewed as a self-generating process. The objective is to discover the "natural laws of succession" and no attempt is made to examine societal system/environment relations over time. Endogenism also depicts the environment as a reservoir which acts as a stimulus or catalyst, taken out of its context and

\textsuperscript{11}Recognition of both elitist and pluralist models is not foreign to accounting literature. Refer to Paton and Littleton's [1940] discussion of proprietary and entity theories for corporate (financial) accounting. Proprietary theory is consistent with an elitist model, while entity theory is congruent with a pluralist model.
injected into a system under study. Researchers do not examine or analyze external disturbances nor do they recognize chance or accident. The focus is on discovering regular patterns. This framework has a very narrow object-specific scope which is a serious limitation. Endogenist researchers do not observe the whole environment nor do they monitor societal system/environment relations. The environment is some mysterious source that sporadically intrudes upon society or the object under study.

To compensate for endogenism's restrictions, Smith evaluates the merits of an alternative, interpretive exogenist method and makes some modifications. According to Smith, exogenism is often associated with diffusion theory which is primarily concerned with tracing cultural importations (i.e., influence from neighboring societies). He identifies five sources of diffusion: migration, elite missionary activity abroad, invasion (including conquest and extermination), trade and technological exchange, and the spread of ideas and institutions.

Smith suggests that diffusion is merely one element in a complex set of variables that require analysis. He enlarges the exogenist approach to include examination of

12Chapter four discusses Japan's importation of financial reporting from western nations, particularly the United States.
three interrelated phenomena: (1) the process under investigation, (2) its neighboring systems, and (3) surrounding environment. According to Smith, the three areas are an interactive process, each influencing the other; and, an analysis of the interrelationships is necessary in order to obtain a basic understanding.

Smith [1976] also provides additional relevant insights regarding other factors (socio-economic, political, and cultural) that affect processual change. Socio-economic factors include patterns of resource allocation, production, and interests of various groups. The political structure consists of patterns of distribution of power and authority, formation of public policy, and institutionalization of power in organizations. Cultural heritage includes knowledge and technology, ideas and beliefs, and more generally artifacts and modes of customary behavior and rituals. These factors are important because they provide guidance for selection of appropriate neighboring systems and institutions which may interact with a phenomenon (process) under study in accordance with Tinker's [1980] political economy of accounting. The political economy of accounting contends that socio-economic institutions and the related environment impact the development of a financial accounting process.
To recap, Smith favors an enlarged, modified exogenist approach over traditional endogenism because the former is more open and recognizes both internal elements and external factors. His enlarged exogenism can accommodate the individual autonomy of a phenomenon (process) under study, and acknowledges cultural importation and neighboring institutional / surrounding environmental influences. The political economy of accounting, particularly its social relations dimension, supports an interactive contention.

An Adaptation to Accounting

McKinnon [1986] provided a major contribution to international accounting research through the introduction and adaptation of Smith’s exploratory, modified exogenist approach. Prior to her application, the discipline was in search of a suitable method for nation-specific studies. An application of Smith’s modified exogenist approach supplies a viable solution to the existing void.¹¹

McKinnon argues that functionalist premises have blinded contemporary international accounting research


¹⁴Refer to Violet [1983] for a discussion on accounting and cultural anthropology.
because such premises preclude the use of an appropriate research method capable of effectively studying historical development and environmental influences. She claims that functionalism's implicit acceptance of assumed nonproblematic, although often unrepresentative, social environmental and institutional structures frequently renders misleading and inaccurate interpretations. She further criticizes functionalist researchers for focusing almost exclusively upon quantitative (cardinal) measurement and statistical data analyses which may not be able to capture complex and dynamic attributes of social phenomena. All too often, cardinal quantitative analysis requires abstraction to a degree that squeezes out the very essence of the phenomenon that research should focus. In contrast, a modified exogenist, interpretive perspective requires explicit recognition of social environmental and institutional structures.

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16 Berlin [1966] and Kaplan [1963] support the contention that an extreme concern for quantification may eliminate the very essence of the phenomenon under investigation. International accounting research has many factor/cluster analyses that claim to address socio-economic factors. However, such factors lack depth (e.g., using language as the surrogate to capture culture).
McKinnon develops and uses an (enlarged) exogenist method to examine the Japanese system of corporate reporting regulation. She operationalizes the exogenist approach through identification of relevant institutions and "central response events." She depicts the process of regulation as an open, dynamic social system, then selects and examines relevant institutions. She bases her selection of relevant institutions upon existing sociological literature on Japan, guided by Smith's [1976] regions (i.e., socio-economic, political, and cultural). Analysis of the system focuses upon "central response events" (i.e., insight-stimulating examples). She selects system significant events from existing Japanese corporate regulation literature and personal interviews with experts.17

In accordance with Smith's blue prints, McKinnon depicts corporate reporting regulation to be an open, dynamic social system. She decomposes processual change into three phases (source, diffusion, and reaction) and analyzes four major areas (environment, intrusive events, intra-system activity, and trans-system activity). Figures four and five illustrate three of the four areas.

17McKinnon [1986] identifies five "central response events" with respect to Japan's development of corporate reporting regulation. The five are introduction of the commercial code, the years of depression and war, the allied occupation, the modification of audits, and the introduction of consolidated financial statements.
This dissertation adopts a different focal point, concentrating primarily upon exploring and illustrating socio-economic phenomena and how such phenomena may influence divergent financial accounting practices / disclosures in Japan, France, and the United States. The "process of financial accounting" replaces McKinnon's "process of regulation." The process of financial accounting is considered to be an open, dynamic social system.

I examine the four areas (environment, intrusive events, intra-system activity, and trans-systems activity) to derive an institutional structure to analyze financial accounting practices / disclosures. The environment consists of a set of existing socio-economic relationships and cultural conditions that constrain or facilitate the nation-specific, financial accounting process. Intrusive events activate changes in the existing financial accounting process\(^\text{1}\) and come from external sources (i.e., Smith's five types of diffusion). Intra-system activity involves relations among individuals and groups which comprise the structural elements of the financial accounting process (i.e., the authorities). Trans-systems activity involves

\(^1\)For instance, the American occupation of Japan during her reconstruction period after World War II did have an impact upon Japanese financial reporting through the Securities and Exchange Law.
relations between the financial accounting process and its neighboring social systems.

The four areas are used to derive a socio-economic (institutional) analytical framework. This (nation-specific) socio-economic framework is used to structurally analyze divergent financial accounting practices / disclosures.
CHAPTER REFERENCES


Development of an adequate socio-economic analytical structure for international accounting requires recognition of current trends occurring in socio-political and economic arenas. Technological innovations in communication and transportation make the world "smaller." Socio-political problems that involve "nonworld powers" have a worldwide impact (e.g., South Africa's apartheid and the Persian Gulf conflict). Similarly, these innovations promote a global economy that transcends the interests of individual states. For instance, the alleged Japanese "dumping" of automobiles and semiconductors on the world market creates a serious international economic problem (i.e., the huge trade imbalances). These preceding observations make the old cliche ("it's a small world") very relevant.

Internationalization impacts the accounting profession. Kanaga [1980] argues that because of significant foreign investment in the United States and the growing emphasis on expanding American exports, the transnational business developments cannot be ignored by the accounting profession. Daley and Mueller [1982] assert that accounting professionals must cultivate an international orientation in
order to meet the demands coming from users of financial statements and all other parties interested in CPA services (e.g., the regulators of multinational enterprises, financial analysts, bankers, labor unions, etc.). Choi and Bavishi [1983] recognize that an increasing number of companies are selling their securities on a worldwide basis. The consensus being that financial reporting must adopt an international perspective. In sum, the internationalization of business precludes the accounting profession from being indifferent to international developments. Ideographic research (e.g., indepth nation-specific case studies) is needed if we are to understand how financial accounting processes impact and are impacted by different socio-economic environments.

A Survey of International Accounting Literature

This section examines a representative sample of recent literature related to international accounting. The survey includes standard sources of Mueller [1967, 1968] and Oldham [1975], and the more recent works of Holzer et al. [1984], Arpan and Radebaugh [1985], Evans, Taylor, and Holzmann

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Footnote: For a more comprehensive look at the international accounting literature, an extensive bibliography appears in Appendix B. Also refer to Agami, A.M. and F.P. Kollaritsch, Annotated International Accounting Bibliography 1972-1981, the American Accounting Association (1983).
Mueller [1967] attempts to "identify, describe, and analyze" the major dimensions of international accounting. He observes and describes four comparative patterns of accounting development: (1) accounting within a macroeconomic framework, (2) the microeconomic approach to accounting, (3) accounting as an independent discipline, and (4) uniform accounting. Mueller presents these four patterns as normative constructs, based primarily on the economic or business environments at a conceptual level.

In a subsequent article, Mueller (1968) reports upon differences among various countries' economic and business environments, he posits that a close interrelationship exists between such environments and accounting, while emphasizing the interactive nature of financial reporting. Accounting reflects environmental conditions and influences them. In sum, if one assumes that accounting is both a product and a process of its environment, then the United States generally accepted accounting principles should not be forced arbitrarily on other countries.

Mueller's innovative works cannot be overestimated; his contributions to the initial phases of international accounting research offer guidance to current researchers. His recognition of an interactive relationship between a
country's financial accounting practices and its particular socio-economic environment are particularly useful. Although Mueller emphasizes this relationship, he does not follow through and provide any comprehensive descriptions of specified nations' underlying environments and related accounting frameworks. He provides only relatively sketchy, piecemeal illustrations and his four patterns, while useful, appear to be too simplistic.

Oldham [1975] modifies and applies Mueller's distinct patterns to major Western European countries. His modifications are minor; he maintains a relatively simplistic format of analysis. But, Oldham does provide valuable descriptions. He describes the accounting systems of the European Economic Community's (EEC) constituent members, plus Sweden and Switzerland, to provide additional understanding through a structured analysis.

Holzer et al. [1984], Arpan and Radebaugh [1985], and Evans, Taylor, and Holzmann [1985] are representative of contemporary international accounting books. Holzer et al. is a "readings book" consisting of twenty essay chapters, covering a wide range of relevant topics, written by twenty-three authors. The first two essays introduce the international dimension of accounting and report upon

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*The EEC members are Belgium, Denmark, France, West Germany, Holland, Italy, Luxembourg, and the United Kingdom.*
European accounting history. Other essays focus upon financial reporting in various countries, including the United States, France, and Japan.

Holzer et al. lacks a consistent and coherent structure; both technical and conceptual contents are uneven and vary in several respects which result in an inability to compare the various nations covered. A primary purpose of this dissertation is to alleviate, or at least attempt to minimize such inconsistencies through the use of a coherent structure of analysis.

Arpan and Radebaugh [1985] and Evans, Taylor, and Holzmann [1985] provide a more coherent, yet a much more restricted scope than Holzer et al. Their works include an informative overview of international accounting and international business, an emphasis upon the importance of environmental influences on accounting systems and practices, and discussions about specific financial accounting topics. Arpan and Radebaugh adapt Farmer and Richman's [1966] interpretive framework in order to highlight environmental influences on accounting. However,

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4The political economy of accounting theory drives an (enlarged) exogenist framework to describe and analyze financial accounting in Japan, France, and the United States.
Arpan and Radebaugh [1985, p.29] limit their analysis by stating: "it is well beyond the scope and length of this book to describe how differences affect all accounting standards and practices of all or even a few nations."

Arpan and Radebaugh also synthesize major international accounting harmonization studies. While such studies have been dominant in international accounting research, they tend to lack a theoretical foundation. Researchers use factor or cluster analysis to group countries with respect to certain environmental variables, or specific accounting practices and standards. But, selection of variables is ad hoc, no theoretical support is provided for selection of variables, practices and standards.

In sum, Holzer et al., Arpan and Radebaugh, and Evans, Taylor, and Holzmann provide an introduction to a relatively new topic: international accounting. Holzer et al. provides the most depth but least structure. Whereas, Arpan and Radebaugh and Evans, Taylor and Holzmann offer a much more consistent presentation, while condensing, and thus

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simplifying many of Holzer's separate essay chapters into one or two chapters. All three books provide useful information with respect to technical accounting issues of multinational corporations.

An examination of international accounting literature reveals a need for coherent, indepth description of nation-specific financial accounting (socio-economic) structures. This dissertation attempts to provide such a structure. While the scope of the immediate project is limited to examining a three countries, future research will be directed at incorporating additional countries, while using the same consistent (socio-economic) structural descriptive approach.

McKinnon [1986] provides substantial motivation for, and a vivid illustration of the need for thorough nation-specific studies. She argues that a methodological leap has occurred in international accounting research and that thorough descriptive studies must precede meaningful cluster type or harmonization studies. McKinnon adapts Smith's [1973, 1976] exploratory (sociological) approach to examine Japanese corporate reporting. Specifically, she

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traces the development of corporate reporting regulation, and determines the operational form of the current financial accounting regulatory system in Japan.

Orsini, McAllister, and Parikh [1987] provide country by country reference volumes containing current information on financial accounting and auditing practices, standards, and regulations. Directed primarily at financial executives, attorneys, and practicing accountants, this publication draws upon the extensive international experience of the accounting firm of Ernst & Whinney.

Orsini, McAllister, and Parikh's explicit purpose is to provide a thorough, comparative reference manual of technical financial accounting and auditing practices existing in various countries. The authors do not attempt to describe any underlying national socio-economic structures of accounting. Orsini, McAllister, and Parikh's study is used as a source manual to determine extant financial accounting disclosure practices for the United States, France, and Japan. This dissertation complements the latter study by developing an analytic framework to understand nation-specific financial reporting practices.

"Volumes one and two include France, Japan, and the United States.

"Appendix B contains a comprehensive list of contemporary international accounting literature."
Exploratory Financial Accounting Illustration

This study applies an interpretive, exploratory, modified exogenist approach to the process of financial accounting. Figure six depicts a nation-specific financial accounting framework. This framework specifies internal participants of the process, its neighboring social systems, and its related socio-economic environmental characteristics.

McKinnon [1986] identifies internal participants of the corporate reporting regulation process by examining the system's structure and preparing a structural outline of authorities. Authorities are the major participants within the system who formulate and administer the process.

Financial accounting authorities may include regulators, preparers, facilitators, and users of financial reports. Regulators may be public, private, or mixed entities. Preparers are corporate management, including corporate accountants, who use capital. Public accountants serve as facilitators who review financial report contents for acceptability. Users or "financial analysts" include both agents and actual principals who supply capital. Principals may include potential, current, and past investors, creditors, and employees of the corporation.

These major participants produce mechanisms that include an annual financial report, mandatory public filings
of financial information, and authoritative written sources about underlying financial accounting principles, standards or rules. Annual financial reports usually include an auditor's opinion, financial statements, footnote disclosures, and other messages from corporate management.

 Authorities use mechanisms such as mandatory public filings of financial information or related written guidelines to implement the process. Figure six shows that a financial reporting process is not completely independent, an awareness of potentially interactive neighboring social systems is important.

 Smith [1976] identifies three factors (social, political, and economic) that impact a social process. Capital funds, corporations, labor, and government may constitute the neighboring social systems for a financial reporting process. These systems are potentially interactive neighbors; each system may influence or be influenced by the financial accounting process. Therefore, each system has the potential to introduce process changes.

 Financial reports may attempt to facilitate the socio-economic process of matching the corporate demand for capital with the holders of capital funds and labor power. Large corporations are often in need of huge amounts of investment and credit funding and labor power for various enterprising endeavors. Meanwhile, vast sums of investment
and credit funds are often available in organized capital markets and developed banking systems for enterprises that appear to be able to provide attractive future returns. Annual corporate financial reports may be used to attempt to forecast an enterprise's future profit generating ability. In addition, labor usually desires its "fair share" for rendering the necessary labor power. Annual financial reports may help to expedite contract negotiations between corporations and labor organizations. Labor may be in the form of a political party, strong union membership, or both.

Government often relies upon macro economic indicators to establish fiscal and monetary policies. These macro economic indicators include production output or gross national product (GNP) figures, consumer and producer price levels, and various interest rates. All of these indicators are accumulated averages of financial accounting data, or are directly affected by such data. Government may attempt to directly influence reported financial data to promote its national economic goals.

Smith's three encompassing regions (social, political, and economic) provide a broad guideline for consideration of neighboring systems. Choi and Mueller [1978] and Arpan and Radebaugh [1985] provide more specificity with respect to identification of environmental variables that may effect
the process of financial accounting. Both elaborations are consistent with Smith's three regions. Choi and Mueller identify fifteen "relevant environmental circumstances" which may influence financial accounting. The fifteen may be classified into six social, four political, and five economic variables.

The six social variables include:

- a) nature of business ownership (e.g., widespread public ownership versus predominately family- or bank-owned corporate interests),
- b) size and complexity of business firms,
- c) social climate (i.e., conservative versus liberal),
- d) level of sophistication of business management and the financial community,
- e) status of professional education and organization, and
- f) general levels of education and technical facilitating processes.

The four political variables are:

- a) political system (i.e., centralized versus de-centralized),
- b) legal system (e.g., code law versus common law),
- c) degree of legislative business interference (e.g., antitrust regulation), and
- d) presence of specific accounting legislation.

Refer to Choi and Mueller [1976, pp.23-28] for further discussion and rationale for the fifteen environmental circumstances. Their selection is admittedly subjective.
The five economic variables are:

a) type of economy involved (e.g., agricultural versus industrial),

b) relative stability of the currency of account,

c) speed of business innovations (e.g., business combinations and leasing arrangements),

d) stage of economic development, and

e) growth of economy.

All fifteen variables fall within the encompassing setting of Smith's three regions, and provide additional detail to consider when attempting to describe a nation-specific environment that pertains to its financial accounting process.


According to Arpan and Radebaugh's [1985] adaptation to financial accounting, educational characteristics include:

a) degree of literacy level,

b) achieved levels of formal schooling,

c) educational system's orientation, and

d) the appropriateness of the educational system's output for the country's economic and societal needs.
The second group of cultural characteristics include:

a) degree of conservatism,
b) degree of secrecy, and
c) attitudes or beliefs toward business and accounting.
These attitudes may range from distrust and antagonism to wholehearted support and trust, and may determine accounting's credibility, purpose, and status.

The third group of legal and political factors include:

a) amount of legal codification, and
b) political persuasions (e.g., liberal or conservative).

The fourth group of economic factors include:

a) stage of economic development,
b) basic economic orientation including the degree of government involvement,
c) source of funds (e.g., existence of sophisticated capital markets),
d) price level impacts, and
e) degree of international activity including inter-country relationships.

In sum, socio-economic environmental characteristics may consider a nation's educational and legal processes, citizens' attitudes of business, political beliefs, and economic surroundings. Both Choi and Mueller, and Arpan and Radebaugh's elaborations offer guidance on environmental factors to consider during the search through nation-specific sociological, social anthropological,
political, and economic literature.

Figure six provides an illustration of a generic nation-specific financial accounting (socio-economic) framework. This illustration consists of a financial accounting social system, its neighboring social systems, and an awareness of related socio-economic environmental characteristics.

A nation-specific structural framework is used to understand national differences in financial accounting. The illustrated nation-specific financial accounting (socio-economic) structure is used to analyze divergent financial accounting disclosures. This analysis requires selection of certain insight-stimulating examples or "central response events." These insight-stimulating examples are the financial accounting practices/disclosures in Japan and France that are significantly different than those observed in the United States.

A political economy's emphasis upon social relations supports this dissertation's contention that certain authoritative institutional representatives, who possess special interests, often (directly or indirectly) influence the process of financial accounting. Furthermore, these authorities usually attempt to establish mandatory financial

\[10\] For further discussion about "central response events" refer to McKinnon [1986].
accounting disclosures that are congruent with their expectations or objectives. Given such contentions, the selected divergent financial accounting disclosures are reviewed in an attempt to determine if a particular institution's objectives (identified in the illustrated nation-specific structure) are dominant, or if there is evidence of compromise among the previously identified, interested institutions.

This dissertation uses prior research to select certain financial accounting disclosures for analysis. Insight-stimulating examples are selected from comparative financial accounting literature. Particularly, literature that contrasts Japanese and French financial accounting practices against those observed in the United States. Japan-USA and France-USA comparisons determine significant differences to analyze using nation-specific financial accounting (socio-economic) frameworks.

In sum, the structural case study analyses review certain divergent financial accounting practices/disclosures in order to attempt to identify particular (nation-specific) institutional participants' and socio-economic environmental influence. Anticipated findings may range from elitist domination, to pluralist compromise, to even pluralist anarchy. Clear-cut evidence of particular (nation-specific) institution's dominance, showing winners and losers, is
consistent with the elitist social relations. Whereas, evidence of either conflict and/or compromise is congruent with pluralist social relations. Prior (secondary) research determines the selection of divergent financial accounting disclosures.
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CHAPTER IV

JAPANESE POLITICAL ECONOMY OF ACCOUNTING

This case study focuses upon the process of financial accounting in Japan, illustrating Japanese financial accounting (socio-economic) structures and environmental characteristics.¹ A structural analysis reviews divergent financial accounting practices/disclosures to identify "central response events" in order to determine impacts or influences from socio-economic factors and particular institutional participants. The case study adapts Kaplan's [1963] pattern model. The objective of the research is to provide an exploratory description (i.e., to supply a basic understanding through association).²

Figure seven illustrates the Japanese financial accounting process, its neighboring social systems and its socio-economic environment.³ The illustration enhances an

¹McKinnon [1986] is partially replicated and extended; "the process of financial accounting" replaces "corporate reporting regulation" as the focal point.

²Refer to McKinnon [1986], she convincingly argues that international accounting research lacks adequate descriptive studies. Descriptive studies are necessary to attempt research involving explanations through causation.

³Refer to Appendix C for chapter references by section.
understanding of Japanese financial reporting, particularly with respect to divergent practices. Divergent refers to practices that differ from those observed in the United States. Since political economy posits that socio-economic factors and institutional authorities impact financial reporting practices, this study anticipates differences will exist. This chapter includes a synthesis of significant financial accounting differences and the Japanese financial accounting (socio-economic) framework.

This case study of Japan includes the following sections: the financial accounting process, neighboring social systems, environmental characteristics, mandated financial reporting, and financial accounting differences. Figure seven illustrates the first three sections. The financial accounting process has four authoritative groups (regulators, facilitatiers, preparers, and users). The neighboring social systems are capital funds and corporate sectors. Environmental characteristics consist of social, political, and economic traits. Financial accounting differences include: accounting for income taxes, legal reserves, foreign currency translation, and consolidations; and, the absence of a cash flow statement and earnings per share information.
The Financial Accounting Process

The Japanese financial accounting process includes regulators, facilitators, preparers, and users of financial reports. The government bureaucracy, particularly the Ministry of Finance (MOF), dominate the regulatory process. Facilitators refer to certified public accountants who are all required to belong to the Japanese Institute of Certified Public Accountants (JICPA). Preparers are corporate management; while institutional investors, interested in dividends and capital gains, constitute the dominant user group.

Regulators

A tripartite of laws, all legislated by the government bureaucracy, regulates financial accounting in Japan. This tripartite includes the Securities and Exchange Law (SEL), the Commercial Code, and the Corporate Income Tax Law along with regulations related to each law. The MOF administers both the SEL and taxation areas; the Ministry of Justice (MOJ) oversees the Commercial Code. The Commercial Code and the Corporate Income Tax Law apply to all corporations; while the SEL affects only publicly-held corporations (i.e., approximately 4,000 of Japan's largest corporations). The largest corporations prepare two sets of financial statements. Stockholders receive financial statements in
accordance with the code, while another set must be filed with the MOF to ensure SEL compliance. The only significant difference between the code and SEL statements is that the SEL requires more detailed disclosure.

Tax laws significantly impact financial reporting, since financial income must be identical to what is reported on the corporate income tax return. The SEL incorporates code requirements and also conforms with the tax laws. The MOF's Securities Bureau which controls the SEL's financial reporting requirements is the dominant authoritative regulator, especially for Japan's publicly-held corporations.

**MOF/BADC** -- The MOF's Securities Bureau promulgates financial accounting standards that are formulated by the Business Accounting Deliberation Council (BADC), an advisory body appointed by the Finance Minister. The MOF relies upon

"It seems ironic that the code-based financial statements are distributed to stockholders since traditionally the Commercial Code emphasizes protecting creditors' interests over investors. However, extensive efforts have been made through revisions to coordinate the code with the SEL.

Major revisions to both the code and SEL have alleviated most problems that existed with Japan's dual reporting. These problems were significant; and may be attributed to cultural importation. The code was modeled after German law, while the SEL was greatly influenced by American principles. Currently, both report the same net income and shareholders' equity."
the council's expert advice to establish generally accepted accounting principles (GAAP). The BADC members are part-time members that include academics, JICPA members, prominent businessmen, stock exchange representatives, and government officials. The MOF appoints BADC members and funds the BADC's budget. Despite the existence of an 'independent' BADC which creates the appearance that financial accounting and reporting requirements (particularly for its largest corporations) are established in the private sector, the MOF controls standard-setting.

The BADC is organized into four sections. Section one establishes financial accounting standards and is responsible for improving financial accounting systems. Section two promotes accounting education. Section three establishes auditing standards. Section four promulgates cost accounting standards.

The BADC issue their official recommendations through "Financial Accounting Standards for Business Enterprises".

Hirose [1987] reports that during July 1986 the BADC had 39 members: thirteen academics, nine businessmen, six JICPA members, three Tokyo Stock Exchange representatives, two Securities Analysts' Association members, two economic journalists, and one representative each from the Ministry of Justice, the Securities Dealers' Association, the Japan Federation of Tax Accountants Association, and the National Association of Small and Medium Enterprises. The thirteen academics consisted of nine from accounting, three from law, and one from tax. The nine businessmen include three from the Keidanren, two from banks, and four from non-banking corporations.
The MOF incorporates the FAS into the SEL regulations. SEL regulations are entitled "Regulations Concerning the Terminology, Forms and Preparation Methods of Financial Statements" (RFS). The RFS dictate the form and content of financial statements required under the SEL.

To recap, SEL financial statements are consistent with the Commercial Code and tax requirements. The SEL requires more disclosure, but the SEL law only applies to the largest corporations. SEL statements are filed with the Securities Bureau of the MOF. The BADC establishes financial statement form and content through issuing FAS. The MOF incorporates FAS into RFS. The MOF maintains actual control over the regulatory process by appointing BADC members and funding its operations. The BADC members are part-time appointees from various academic and business backgrounds.

Facilitators

Legislative action and delegation of responsibilities by the MOF cultivate an institutionalized public accounting profession in Japan. The CPA Law (1948) instituted requirements that are comparable with laws in other advanced countries (e.g., the United States). Rigorous qualifying

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"The FAS are also called FASBE and BAPs. BAPs refer to the "Statement of Business Accounting Principles." First issued in 1949 and revised in 1954, 1963, 1974, and 1982; they include three sections and are modeled after Sanders, Hatfield, and Moore (1938) "A Statement of Accounting Principles."
examinations, apprenticeship or experience requirements, and a strict code of professional conduct promote competency. A significant amendment to the CPA Law promotes formation of audit corporations to ensure proper audits of the largest corporations. The 1951 Securities and Exchange Law (SEL) requires that the largest corporations' financial statements be audited by certified public accountants; this legislation greatly increased demand for public accounting services in Japan. The MOF's legislation introduced and nurtured the profession, while delegating operational responsibility to the Japanese Institute of Certified Public Accountants (JICPA).

JI CPA -- The JICPA is a 'private' professional corporation, established in 1949 under the CPA Law, to exercise supervision and guidance over the public accounting profession. All Japanese CPAs must be members of Japan's only organization for CPAs. The institute administers qualifying examinations, establishes and maintains rules of conduct for members, provides representatives to the BADC for accounting and auditing standard-setting, promotes research, proposes reforms, sponsors training courses, and publishes and edits various accounting and auditing

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*The JICPA [1982] reports that prior to 1966, certified public accountants in Japan functioned exclusively as sole practitioners.*
literature.

The JICPA's primary function is to coordinate the public accounting profession in Japan. Mandatory membership and rules of conduct enable the JICPA to effectively organize and control all CPAs. The institute works closely with the BADC to formulate and implement financial accounting and auditing standards. Representation on the BADC ensures input into formulation of standards; control of the licensing process allows the JICPA to monitor compliance. The JICPA publications paraphrase and provide application guidelines with respect to promulgated standards. The Institute distributes these publications to all CPA members, thereby communicating generally accepted accounting principles to practitioners at the profession's grassroots level.

The Profession -- Japan's public accounting profession is relatively small compared to the profession in other developed countries. Small refers to both its membership and the size of its constituent public accounting firms. A

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9The lack of other CPA organizations in Japan apparently makes the JICPA an unequivocally important institution for Japanese CPAs. In contrast, American CPAs are administered by individual states and membership in the national and state societies are optional.

10The Japanese accounting profession is small compared to the French and is extremely small with respect to the United States.
mere 7,800 CPAs and another 1,500 Junior CPAs staff approximately 90 audit corporations. About 70 percent of CPAs conduct audits. Only 10 audit firms employ more than 50 CPAs, while the total number employed by all 10 firms is less than 700 CPAs. Another 12 medium-sized audit corporations employ 20 to 50 CPAs each or about 300 in total. Some audit corporations are affiliated with large foreign accounting firms, particularly from the United States and Britain. Most of the large Japanese audit corporations have offices in foreign countries (e.g., New York, Paris, etc.). Four foreign firms operate in Japan employing about 250 CPAs.\textsuperscript{11} Despite Japan's dynamic economic growth, the public accounting profession remains relatively small in Japan.

In sum, the MOF through legislative action introduced and nurtured a public accounting profession in Japan. The profession and JICPA are synonymous. The number of constituents (both firms and individuals) and CPA firm size are remarkably small.

\textbf{Preparers}

Corporate management is responsible for financial reporting. Management must prepare an annual financial

\textsuperscript{11}Refer to Yabuki [1987] for specific statistical data about the profession. Approximate numbers that are used above are as of December 1985.
report to meet its legal obligation. The Ministry of Finance (MOF), particularly the Securities and Exchange Law (SEL), requires annual corporate financial reports. SEL financial reporting should provide useful information to present and potential investors and creditors. A precarious objective given the preparers' attitude toward speculative investors.

**Corporate Management** -- Management appears to be indifferent toward stockholders seeking short-term profits and have a preference for avoiding conflict with labor. Management is particularly indifferent towards stockholders with portfolio investment motives (i.e., those who are primarily concerned with receiving dividends and realizing capital gains). Corporate cross-shareholdings (long-term ownership of other companies' common stock for cementing business relationships) enables managers to virtually ignore transient investors. Cross-shareholdings prevent 60 to 70 percent of a company's stock from being traded, thereby eliminating any outside take-over threat.

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12 Business relationships refer to suppliers, customers, banks, insurance companies, etc. A small percentage of ownership is a sign of commitment and loyalty.

13 In France and the United States, threats of corporate take-overs are prevalent; both nations perceive the threats to enhance management efficiency.
Similarly, management compensation benefits are not dependent upon profits; therefore, managers have little, if any, incentive to maximize reported short-term profits. Compensation is based upon seniority; bonuses are tied to industry norms rather than profit-sharing. Japanese managers generally place their employees’ well-being above stockholders’ interests to promote harmonious labor relationships. The Japanese management and labor are generally united in a common cause (i.e., the company’s success). Both parties feel an intense loyalty to their company, and perceive it as belonging to them rather than the stockholders.

Secrecy -- Management practices include advocating secrecy, while providing informal access to information for important corporate group members. Much information sharing takes place within a group; but, little or none is shared with outsiders without external pressure (e.g., the SEL legislative reporting regulations). Japanese managers and the MOF have a high regard for maintaining a competitive advantage rather than for competition, per se. This concept of competitive advantage precludes information sharing and promotes secrecy. Meanwhile, significant members of a corporate/financial group (i.e., Keiretsu) have virtually
unlimited access to information. Publicly issued financial reports may contain more form than substance, since group members have informal access to obtain the latter.

Long-Term Emphasis -- Managers prefer to develop a relatively long-term orientation; they stress increasing market share and improving productive efficiency. Corporations often increase market share through aggressive pricing to undercut competition and thereby attaining high volume. Short-term profits are sacrificed to acquire market prominence. Productive efficiency refers to minimizing production costs through technological improvements. Technological improvements require substantial capital commitments to research and development, perpetually updating plant and equipment facilities and retraining employees. Both long-term objectives and related strategies are not compatible with maximizing a company's annual income as prescribed by the SEL.

To recap, the MOF requires corporate management to prepare an annual financial report. But, management attitudes, practices, goals and strategies are not always

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1“Kajiura and Kosuga (1987) report that financial institutions (banks and insurance companies) have their own staff to gather financial information directly from the investee/debtor companies. Keiretsu and Zaibatsu refer to corporate groupings and are discussed in the corporate sector.”
congruent with the SEL's annual reporting requirements, particularly with respect to motivational and time frame perspectives. Corporate managers' attitudes and practices focus on long run goals; such strategies are usually not congruent with short-term SEL reports. Creditors do not rely on the SEL reports for their information, and nonrelated equity investors do not occupy a central role in financing Japanese industry.¹⁵

Users

Nonrelated Investors and Securities Firms -- The primary users of SEL financial statements are nonrelated institutional investors, primarily financial and corporate entities with portfolio investment motives, and securities corporations. Portfolio investors seek to maximize dividend income and capital gains through security trading to improve earnings (i.e., pursuing a zaitek activity). But, this practice is not widespread, only 40 percent of all institutional investors subscribe to a zaitek activity. Securities corporations provide brokerage and underwriting services. Brokers offer investment advice based upon financial statement analysis. Underwriters are expected to carefully review financial statements in a prospectus,

¹⁵McKinnon [1986] describes the SEL as a cultural importation of disclosure laws from the United States. This phenomenon is incongruent with the Japanese business environment, attitudes, etc.
otherwise they may be held liable for negligence. Both nonrelated institutional investors and securities corporations have their own securities analysts or specialists.

Creditors, related institutional investors, and individual investors are not primary users of SEL financial statements. Individual investors generally do not analyze annual financial reports; they rely upon a broker's advice, or newspapers and magazine articles. Creditors and institutional investors have dual roles (creditor/investor and investor/investee) that create complex interrelationships. Extensive cross-shareholding create these complex interrelationships. For example, major city

14Large corporations are characterized by low equity, high debt proportions to total capital. This high debt situation should put the creditor front and center, but does not.


18Cross-shareholding refers to suppliers, banks, customers, etc. owning small percentages of each others' common stock for long-term relationship purposes. Shibata [1988] reports that this practice is followed by about 60 percent of the financial institutional and corporate investors.
banks are significant sources of both credit and equity financing for large corporations. These same corporations typically have significant equity interests in the large banks; they also own and are owned by other large corporations. These financial/corporate groups are called the Keiretsu. Significant Keiretsu members have informal access to information including financial data that exceeds SEL financial report contents. The major banks employ financial research personnel and have informal access to comprehensive financial information. Therefore, the large corporations and major banks do not need to rely upon audited SEL financial reports.

To recap, the primary users of SEL financial statements are relatively sophisticated, securities analysts working for nonrelated institutional investors and securities corporations. These primary users are minor contributors with respect to capital formation within corporations. Major capital sources (i.e., individual investors, related institutional investors and creditors) do not rely upon the SEL financial statements. Related institutional investors and creditors rely upon informal sources to acquire information.

In sum, the Japanese financial accounting process includes regulators, facilitators, preparers, and users. Two authoritative groups appear to be prominent, while two
others are relatively passive. Regulators and preparers take active roles and may impact the process; they also do not have mutually exclusive interests. Facilitators adhere to and promote the process; but, their audits are generally perceived to be perfunctory and ceremonial. The actual users are a rather small minority, because anticipated significant users have informal access to financial information. Such access effectively subverts any strong demand for published financial information. Thus, the financial accounting process (Figure Seven) relegates SEL financial statements to a secondary role.

Neighboring Social Systems

The Japanese financial accounting process specifically interacts with two social systems: capital funds and corporate sectors. Two other groups, government and labor, seem to be integral components (i.e., authorities within capital funds and corporate systems).¹⁸ A social system is a functionally differentiated group, composed of interactive entities (i.e., the authorities).

¹⁸The process of financial accounting in Japan interacts with many social systems involving varying degrees of influence. A thorough picture of all systems that impact, or are influenced by, accounting is beyond the scope of this dissertation. Only salient features of prominent social systems are discussed.
The government influences financial accounting in a disseminated, yet direct fashion. The powerful ministries of the government bureaucracy are major authorities in the financial accounting process (MOF and MOJ), capital funding (MOF), and corporate (MITI) social systems.

Enterprise unions represent labor throughout the corporate sector. These powerful unions are quite effective in communicating and impacting company policy with respect to immediate labor concerns (e.g., job security, wages, working conditions, etc.). 'Organized' labor adheres to a cooperative, rather than antagonistic, attitude toward the corporate sector.

Capital Funds

An established banking system, a rapidly growing securities exchange, and an active Ministry of Finance (MOF) are the primary authoritative participants in generating new capital. The MOF directly regulates the banks and the stock exchange through its banking bureau and securities bureau, respectively. These MOF bureaus exercise enormous control in each of their areas.

Banking System

A modern banking system in Japan began when the Meiji government founded the Bank of Japan (established in 1882) as the central bank to issue a single gold-based currency.
and to service various city banks. During this same period, the Meiji government issued pension bonds to feudal lords in exchange for all taxation powers. These bonds were later sold to the city banks for cash, while the banks held the bonds as reserves.

This modern structure evolved into a well-developed banking system that the postwar government used to supply the corporate sector with tremendous amounts of capital funding investments deemed necessary for economic recovery. The Japanese corporations rely heavily upon (bank) debt financing for capital funding.

The contemporary banking structure includes the central bank, thirteen city banks, and three long-term credit banks.\(^\text{20}\) The Bank of Japan is the central bank and the dominant force that directs a pyramid shaped banking industry. The central bank serves as a guarantor for elite banks. This arrangement precludes financial failure and assures control of the money supply. The thirteen city banks include four descendants of powerful Zaibatsu banks, two former government banks, six relatively new city banks, and the Bank of Tokyo. The three long-term credit banks are former government financial institutions that

\(^{20}\)Kester [1986] reports that the banking system's premier players also include seven major trust banks, but they primarily service personal housing and consumer finance markets.
continue to enjoy very close ties with the government. The Industrial Bank of Japan plays a particularly prominent and dominant role in corporate financing while maintaining a close relationship with the Ministry of International Trade and Industry (MITI).

The Bank of Japan, in addition to controlling the money supply, uses three methods to control the flow of funds within the banking system: change the reserve requirement, change the basic bank rate (discount rate), or "moral suasion." Moral suasion is the use of discriminating influence to encourage attainment of a targeted goal; it relies upon strong government-banking ties and is quite effective. The reserve requirements and bank rates have been kept relatively low to ensure that sufficient funds are available for investment purposes.

The powerful elite banks significantly influence economic relationships and performance. Interrelated equity holdings create very close ties between major banks and corporations. The prevalent short-term loans by city banks strengthen the corporate sector's dependency upon the banking system. Some city banks concentrate on serving specific industrial groups which limits competition in the banking sector. Unencumbered by fears of financial failure, the elite banks facilitate funding in accordance with the national industrial policy.
The city banks play a major role in the Japanese capital funding system. These banks provide approximately 60 percent of a large corporation's credit; a large proportion of corporate debt is in the form of short-term promissory notes from banks that are continually rolled over. These short-term loans enhance an existing (bank) debt dependency by corporations. The former Zaibatsu banks (Sumitomo, Mitsui, Mitsubishi, and Fuji) extend between 20 and 30 percent of their loans to their interrelated industrial groups, and are closely coordinated with their clients. These four banks often provide important leadership to the modern Keiretsu. Eight other city banks maintain looser ties with distinct industry groups (i.e., less than 10 percent of their respective loan portfolios are concentrated in a specific industrial group).

All twelve banks are loyal to meeting and servicing the demands of large corporations that need tremendous amounts of debt capital. This loyalty is exhibited through "overloan" programs, cross-shareholding, and actively supporting major customers that encounter financial difficulties. An overloan program involves lending substantial amounts above what would normally be appropriate to certain customers. The Bank of Japan's guarantee against financial failure minimizes the risk that would normally be associated with such loans in a purely competitive
environment.

Cross-shareholding, the acquisition of a small percentage of a company's common stock to be held on a long-term basis, also facilitates a long-term relationship. Banks may acquire up to five percent of a client's common stock and are often expected to do so. This practice causes banks to assume a dual role of creditor and owner, while corporations reciprocate by owning its bank's common stock. Cross-shareholding promotes a mutual bonding that enhances loyalty. This bond protects corporations by ensuring that banks will provide additional loans, arrange a merger, or provide managerial assistance during periods of financial distress. Interlocking directorates allow the major city banks to maintain a close relationship with significant borrowers. Banks also participate in major corporate decisions, including rescue operations. For example, the Sumitomo Bank helped Toyo Kogyo, the maker of Mazda cars, to restructure its debt and avoid bankruptcy during the mid-1970s.

The Bank of Tokyo is not affiliated with any distinct industrial group and focuses on international finance. The bank was founded under a unique charter that included an exclusive right to engage in foreign exchange transactions. The Bank of Tokyo no longer has a monopoly on foreign exchange transactions due to recent deregulation, but the
original charter has established the bank as a dominant force in foreign exchange and a major participant in Japan's import/export economy.

The long-term credit banks provide long-term financing that carry a "de facto guarantee" of the government. These long-term loans are evidence of governmental favor; they are a corporate life insurance policy regardless of the loan's size. The long-term credit banks maintain a close relationship with government through financing, hiring, and advisory practices. These banks purchase a high-volume of government bonds, hire 'retired' senior ministry officials, and provide staff members to assist government bureaucrats in the preparation of monetary policies. The long-term banks maintain close client relations through interlocking directorates. These banks place their staff members on the (borrowing) corporations' boards of directors to cement relationships with the corporate sector (e.g., the Industrial Bank of Japan has a network of over one hundred fifty staff members on various corporate boards). The mature, heavy industries traditionally dominate the long-term banks' lending base.21

21Mature, heavy industries include electric power, steel, chemicals, oil refining, automobiles, and shipbuilding. Kester [1986] reports that such industries are the primary customers of the former Zaibatsu city banks.
A summary of the banking structure shows that the Bank of Japan controls the major city banks by adjusting and influencing the amount and distribution of funds, and by guaranteeing the banks against financial failure. Insulated against failure, the major city banks are the primary capital source for large corporations. The Bank of Tokyo, through special governmental permission, is an important cog with respect to foreign exchange transactions. Meanwhile, the long-term credit banks maintain a very close relationship with the government bureaucracy, and are an attractive source of capital funds, particularly for the mature, heavy industrial sectors. The major Japanese banks (both city and long-term), large corporate groups, and the government bureaucracy promote cooperative financing efforts that enhance a mutual interdependency.

The banking system in Japan continues to play a dominant role in financing corporate activities. Japanese corporations are highly leveraged by bank debt. Banks channel a smooth flow of personal household savings to the corporate sector. The Japanese people's long-established propensity to save provides banks with a large and stable capital base.\(^\text{12}\) The corporate sector's financing

\(^\text{12}\)Parente and Weintraub [1988] report that a high personal savings rate may be attributed to an inadequate social security system and a need for retirement savings. In addition, conservative savers prefer relatively risk-free bank or postal savings with fixed interest rates over the more speculative securities markets. Public confidence in
requirements range from daily operating needs to long-term capital improvements. During periods of extremely high economic growth (1950's and 1960's), banks usually provide "overloan" programs to meet excessive demands for capital expansion as well as funds for normal operations. The Bank of Japan directs the flow of capital with guidance from the government to priority industries even when credit appears to be excessive. During slow steady growth periods, the banks still provide vital working capital funds.

Japanese customs allow large manufacturers to be notoriously slow in paying their suppliers, normally taking about six months to pay. Large companies typically take about 90 days to acknowledge receipt of an order and then tender a 90 day promissory note. Suppliers regularly use these promissory notes as collateral to borrow from banks in order to remain in business. The banks ease a potentially tremendous burden on small suppliers due to the customary practice of slow payment. Slow payment enables the large entities to concentrate upon future growth rather than present obligations. The banks' revolving short-term credit

Japanese banks is extremely high; there has not been a bank failure in over 40 years in Japan.

Priority industries are those explicitly targeted by the national industrial policy.
policy is the lifeblood of the corporate sector, and facilitates the large companies' international competitiveness.

To recap, the Japanese banking system is well established and coordinates capital funding in accordance with government policy and the corporate sector's needs. Capital funding comes primarily from bank credit. The (banking dominant) financial system provides necessary funds (at a relatively low cost) to corporations, while influencing and being influenced by government. In addition, the banks own equity shares in major corporations and the same major corporations also own equity shares in the banks.

**Securities Exchange**

Japan is second only to the United States in stock market capitalization. Japan's stock market capitalization represents about 25 percent of the world's total. The Tokyo Stock Exchange (TSE) is Japan's premier exchange. The TSE consists of two sections. Companies listed on the first section are comparable to those appearing on the New York Stock Exchange. The second tier companies are similar to the American Exchange companies (i.e., smaller and more

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**Bellanger [1986] also reports that by comparison the United States accounts for about 50 percent of the total global stock market capitalization as of the mid 1980s.**
speculative).

The Japanese securities market's overall characteristics may be misleading, particularly with respect to responding to the corporate sector's demand for capital funds. Despite the market's magnitude and impressive list of constituents, the market has never supplied more than a token amount of funds to corporations. Equity issues represent a small, and shrinking, source of external funds.

The Japanese securities market, particularly the TSE, are perplexing to most foreign observers. Descriptions range from being inadequately developed to being a world leader. Such an anomalous scenario may be attributed to the government's initial lack of confidence in the reorganized securities exchange. The Exchange's unique practices and lingering criticisms of the market have been counteracted by the presence of very powerful brokerage houses, the market's phenomenal growth and vigor, and a 'revolutionary' emphasis upon efficient financial management.

Postwar Japan's rebuilding and subsequent economic recovery required huge amounts of capital investments. To provide the necessary funds, the Japanese government turned to an established, mature banking system rather than the reorganized securities exchange. The choice may have been de facto; a flood of new stock and bond issues after World War II would have required heavy purchases by the
government. The occupation forces forbid the Japanese government from making such investments. But, the occupying forces permitted the government to promote an expansionary monetary policy that ensured sufficient funds through borrowing at low interest rates to stimulate economic growth and recovery.

Practices such as preemptive par value issues, rigidly fixed dividends, ultraconservative individual 'investors' and cross-shareholding also hinder the market's development. During Japan's high economic growth period (1950s and 1960s), rigid enforcement of preemptive rights issued at par value made equity security issues a more expensive capital financing technique than bank debt. Underwriters, who continue to make public equity issues unattractive, enforce an extension of the old practice. These underwriters require that the difference between market price and par value of new equity issues be distributed to shareholders in the form of stock dividends over a five year period. Meanwhile, Japanese stockholders expect corporations to maintain fixed dividends per share which compounds an equity issue's cost, since any increase in dividends is expected to be maintained in the future.

Kester [1986] reports that Nihon Gakki, a musical instruments manufacturer offered the first equity issue at market prices through a public offering was in 1969.
In addition, ultraconservative individual 'investors,' who prefer stable, fixed interest securities, and cross-shareholding limit the growth of the securities market. Cross-shareholding removes large blocks of corporate stock from the market altogether. Only 30 to 40 percent of the outstanding common stock of large corporations is available for trade. In sum, the stock market is subordinate to bank financing in Japan. Securities' ownership is not widespread due to the attitudes of investors. The capital market is thin with less than one-third of the shares being publicly traded.

Finally, lingering criticisms revolve around suspected information asymmetries that may promote speculative and manipulative practices. Corporate and major bank shareholders (through long-term close relationships) have much greater access to financial information than (publicly) disclosed information. Small investors, who perceive such information asymmetries, must follow a trading rule based on following the actions of those believed to be informed, rather than using intrinsic analysis. Such practices make financial disclosure less important than normal. In addition, a general perception by individual investors exists that insider trading practices are not rigorously

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policing by the MOF's Securities Bureau (i.e., the stock market may not be a fair game).

The Japanese securities market is not moribund; four of the world's largest brokerage houses (Nomura, Daiwa, Nikko, and Yamaichi) are from Japan. These four powerful securities firms handle almost 60 percent of the trading volume on the TSE and earn tremendous profits. The four firms maintain a close relationship with the MOF's Securities Bureau, and their dominating role helps to stabilize the TSE.

The Japanese securities market has demonstrated phenomenal growth and vigor, and an extremely high volume of trading. This tremendous volume is remarkable, given cross-shareholding practices that eliminate about two-thirds of the outstanding securities from being traded. The recent plunge and next day recovery during October 1987 illustrates the market's vigor, and the stability factor that the four

BUSINESS WEEK [July 13, 1987] reports that the four firms are also rapidly becoming international giants, particularly impacting the United States and European securities markets. Their international strategy is similar to the Japanese automotive industry's aggressive concentration to acquire market share even to the extent of forgoing profits abroad.
giant brokerage firms have over the market. 

In recent years the Japanese have experienced a relatively stagnant economy and have responded with a 'revolutionary' emphasis upon financial management. 

Recently, many Japanese corporations are becoming active institutional investors, attempting to bolster overall reported profits through trading in the securities market (i.e., zaitek). Corporations are using their surplus funds to purchase securities rather than to acquire productive capital assets. Corporations are selling and repurchasing long-term investments to realize capital gains, while preserving their cross-shareholdings. Zaitek is a revolutionary practice because the traditional cost effective production emphasis is now being equated with (or even replaced by) an efficient cash management and capital

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**BUSINESS WEEK** [November 16, 1987] reports that the TSE's crash was not as bad as the one experienced by the New York Stock Exchange. The TSE's next day rebound was not a complete recovery, but it was remarkable nonetheless.

**Yoshimura [1987]** reports that the Japanese economy's rapid economic growth has been adversely affected by the mid-1970s OPEC oil embargo and the mid-1980s strong yen. Both occurrences contributed to recessionary periods. Periods immediately following these recessions show modest economic growth.

**Shibata (1988) reports that this practice leads some to believe that cross-shareholding will eventually weaken and thereby free up more securities for trade.**
gains emphasis.\textsuperscript{31}

To recap, the Japanese securities market, while enormous, remains subordinant to the banking system in providing capital to industry.\textsuperscript{32} Governmental discrimination, preemptive par value issues, rigid fixed dividend expectations, ultraconservative individual 'investors', cross-shareholdings, and suspected information asymmetries limit the growth of equity markets. These factors relegate the TSE to a secondary role in capital markets. Nonetheless, the TSE has four very powerful brokerage houses, a remarkable performance record, and the potential to become a dominant force in the future.

MOF

The Ministry of Finance (MOF) exercises significant influence over the banking and securities market\textsuperscript{33} through its banking and securities bureaus. The MOF's significant

\textsuperscript{31}\textit{BUSINESS WEEK} [September 21, 1987] reports that a recent disastrous financial experience by Tateho Chemicals involving zaitek may cause many companies to return to concentrating upon efficient production, and thereby, forgo speculating in the financial markets.

\textsuperscript{32}Minami [1986] reports that the average proportion of shareholders' funds to total funds in Japanese corporations is significantly less than an average U.S. corporation.

\textsuperscript{33}Both financial institutions were virtually closed to foreigners until recent years. Deregulation (particularly allowing foreign participation) is occurring but very slowly.
influence stems from an effective one-two punch of "administrative guidance" and legislative regulation. Administrative guidance refers to informal government directives that are expected to be followed by private enterprises (e.g., the banks and brokerage houses). Administrative guidance is used more frequently to influence than legislative action. Strict regulations separate banks from brokerage houses, and restrict many functions within each area. These are effective because they provide plenty of cheap funds to banks and ensure healthy profits for brokers.

The MOF's banking bureau is responsible for Japan's monetary policy. The Japanese government relies upon monetary policy to influence economic performance. Monetary policy is an effective tool because of the corporate sector's dependence upon bank debt. The banking bureau operates directly via the Bank of Japan and indirectly through the three long-term credit banks to control the money supply. The Bank of Japan receives an implicit government guarantee against financial failure for adhering to the banking bureau's monetary goals. This guarantee is then passed on by the Bank of Japan to the long-term credit banks and major city banks in return for

3"Japanese fiscal policy is often relegated to play a supportive role."
their allegiance. In addition, the three long-term credit banks are former government institutions that maintain extremely close ties with the banking bureau through high-volume purchases of government bonds, hiring 'retired' bureaucrats, and providing staff members to assist bureaucratic planning (including monetary policy). These interchanges and the implicit government guarantee against failure establish a cooperative atmosphere between the banking bureau and the private banks within the banking system.

The MOF's securities bureau supervises and directs activities within the securities market. Japan's securities market is one of the most regulated in the world. For instance, one significant regulation requires brokers to match buyers with sellers before selling a security. Brokers also limit daily stock price decreases because rules determine how much a security can drop each day.

Brokerage houses, particularly the four dominant firms adhere to 'tight' regulation while maintaining close ties with the securities bureau to protect their enormous profits. Similar to banks, brokerage houses provide

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BUSINESS WEEK [November 11, 1987] reports that the matching regulation is not present in the New York Stock Exchange. Its intent is to prevent massive panic selling.

BUSINESS WEEK [September 7, 1987] reports that during 1986 the four largest Japanese firms earned well over double the profits of the United States' four largest, while
policy advice and employment opportunities to bureaucrats. In addition, promulgated regulation does not necessarily ensure compliance and enforcement (e.g., "insider trading" is illegal, but is not aggressively policed). This close relationship facilitates stability in a highly profitable securities market and allows for certain illegal activities to be conveniently overlooked.

To recap, the MOF exercises significant influence over the banking system and securities market (while being influenced itself). The MOF also maintains a close relationship with the dominant groups in each sector. Both private banks and securities firms accept informal government guidance. Meanwhile, the MOF is receptive to advice from the private financial sector in formulating such guidance. This close relationship results in cheap funds for banks, high profits for major securities firms, incurring only about 70 percent of the sales. This is attributed to the high commissions that are charged within the Japanese securities markets.

Insider trading scandals may be detrimental to brokerage firms' profits and be particularly devastating to any that may be implicated.

BUSINESS WEEK [November 16, 1987] reports that meetings between the big four brokerage firms and the MOF during an October 1987 financial crisis helped to soften a negative impact on the Tokyo Securities Exchange. These meetings instilled a public confidence in the securities market.
successful implementation of bureaucratic financial policies, and discretionary regulatory enforcement by the MOF.

Corporate Sector

The Japanese corporate sector displays a dual structure, involving a few giant enterprises and numerous small entities. The former dominate the latter. Fukutake [1981] reports that approximately two-tenths of one percent of all the corporate enterprises own about 65 percent of the total amounts capitalized. Generally, the three largest companies within each major industry control over half of the market shares. Some dominant companies span across into many industries. This concentrated power is further enhanced through harmonious labor relationships.

Zaibatsu / Keiretsu

Corporate elitism comes from Japan's traditional group consciousness at the corporate level and a "Japan Incorporated" phenomenon. Corporate groupings can be traced back to the early twentieth century Zaibatsu and continue through the present day Keiretsu.

Bellanger [1986] describes Japan Incorporated as a close, harmonious working relationship between the government bureaucracy and industry, particularly the relationship between the Keidanren and the Ministry of International Trade and Industry (MITI).
Ten major corporate groups, formed under the control of powerful Meiji families, made up the Zaibatsu. These corporate groups had a hierarchical structure. At the top, a family, through a holding company, maintained centralized control over a vast number of subsidiary companies. The Zaibatsu possessed monopolistic power over virtually all major industries. They were formally 'dissolved' during the American occupation when holding companies were banned and Zaibatsu families' shareholdings were sold to the public on a newly created stock exchange. However, the divestment policy did not change attitudes toward corporate organization. The grouping concept of corporations survived and the Keiretsu surfaced after American occupation ended.

The Keiretsu comprise sixteen corporate groups that possess a more pluralist-type structure than the Zaibatsu. Eight of the corporate groups operate in many industries and are descendants from the former Zaibatsu. The other eight are newer corporate groups that concentrate upon operations.

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McKinnon (1986) describes Zaibatsu as financial cliques that were originally formed during the late nineteenth century. The four largest were Mitsui, Mitsubishi, Sumitomo, and Yasuda.

McKinnon (1986) reports that some corporate groups even retain their old names (e.g., Mitsubishi, Mitsui, and Sumitomo). The remaining first category groups are Fuyo, DKB, Sanwa, Tokai, and Industrial Bank of Japan (IBJ).
within a particular industry. Since the internal structure of the Keiretsu are interdependent, they appear to be pluralistic. But, the larger corporate members dominate, and the "smaller" corporate members maintain a one-way dependency upon the larger firms. A vertical relationship with many small suppliers serving only one large manufacturing customer is a common characteristic.

Interlocking directorates and regular meetings of the presidents from premier corporations within a group help to facilitate group cohesion. The presidents' club (shacho-kai) is a group's (formal) policy coordinating body. Interlocking directorates, a product of cross-shareholdings by corporate members, remains a prevalent practice in Japan. Cross-shareholding occurs when a major corporation owns one to two percent of the outstanding common stock of as many as fifty companies on a long-term basis, while each of the interrelated companies reciprocate by owning one to two percent of its shares. Corporations do not engage in cross-shareholding for speculative, investment purposes, but rather to establish a long-term relationship to facilitate business transactions between the corporations involved.\(^3\)

\(^3\)McKinnon [1986] reports that the newer corporate groups are Nippon Steel, Hitachi, Nissan, Toyota, Matsushita, Toshiba-IHI, Tokyu, and Seibu.

\(^3\)Shibata [1988] reports that cross-shareholdings proved to be an effective defense mechanism to the 1971 revision to the Securities and Exchange Law. This revision
Commitment to long-term ownership shows a commitment of support for the welfare of the company. Major banks, insurance companies, suppliers, and customers participate in cross-shareholding. The practice prevents 60 to 70 percent of all outstanding common stock of major companies from being traded on the stock exchange. The major banks are significant forces within Keiretsu groups, assuming dual roles of creditors and owners. Meanwhile, reciprocity exists because the major banks are owned by the major corporations. The practice of cross-shareholding facilitates interlocking directorates, the same corporate directors serve on various corporate boards within a group. These interlocking directorates are an effective, informal policy coordinating mechanism to further enhance group cohesiveness.

In sum, the Keiretsu promote cross-shareholding which encourages participants to establish and maintain long-term group relationships at the major corporate level. This practice enables a relatively few elite groups to control Japan's major industries. Corporate elitism also is cultivated by large corporate lobbying organizations,¹⁴ allowed foreign take-overs. In response to this new threat, the practice of cross-shareholding became even more popular, particularly to the newer, post-war companies.

¹⁴Hrebenar [1986] reports that there are four major Japanese institutions that actively represent the corporate sector: the Kaidanren, Nikkeiren, Nissho, and Keizai
particularly the Japan Federation of Economic Organizations (i.e., the Keidanren).

Keidanren

The Keidanren, a large national federation, represents over 100 leading industrial, commercial, financial and trade associations, and approximately 800 of the largest individual enterprises. The Keidanren communicates the interests of the entire business community to the public and the government bureaucracy; its expressed purpose is to influence government policy. This federation operates through a number of standing committees that focus on issues involving foreign trade, economic cooperation, taxation, finance, banking, steel and mining. The standing committees have close working relationships with respective government bureaus and agencies.

The Keidanren maintains a particularly close (cooperative) association with two key government

Doyukai. Nikkeiren (Japan Federation of Employers' Associations) focuses upon management and labor relations. Nissho (Japan Chamber of Commerce and Industry) emphasizes small and medium business and regional industry development. Keizai Doyukai (Japan Committee for Economic Development) is composed of top executives from major corporations. All are strong political pressure groups, known collectively as the Zaikai. The Zaikai pressured the conservative parties to merge to form the Liberal Democratic Party (LDP) and is the LDP's only reliable source of political funds.

"Keidanren Hall is a fourteen story building located in the Tokyo business district."
ministries: the Ministry of International Trade and Industry (MITI) and the Ministry of Finance (MOF). The federation is an effective mechanism for establishing and communicating unified and coherent programs that reflect the needs of the (big) business community to MITI and MOF. The Keidanren's official policies provide valuable input for national economic policies (e.g., fiscal budget, taxation, and trade issues). MITI and MOF also use the Keidanren's network of big business representatives to communicate the government's policies and expectations to the business community. The Keidanren permits effective two-way policy consultations between big business and government ministries.

The Keidanren's size and diverse membership create coordination problems that are overcome by consensus building and compromise. The consultative process within the federation, and between the federation and government is complex. This complexity is due to opposing viewpoints of Keidanren members and the government's responsibilities to other interest groups outside of the business community. Consensus building and compromise alleviate both internal and external problems. Agreement within the federation enables the corporate lobbyist to communicate its policy to government. Agreement between the federation and government legitimizes policy and facilitates its implementation.
The Keidanren's sizable research staff and standing committees practice consensus building by thoroughly researching, discussing, and deliberating an issue before establishing an official policy. Consensus building attempts to minimize conflict by encouraging competing forces to become familiar with the other side. "Compromise may not always involve each side agreeing to equal concessions. However, it is often understood that the party which gives up more now, will be repaid by receiving more in the future when an opportunity arises. For instance, during the OPEC oil embargo MITI limited price rises on oil. This price freeze initially caused significant declines in Japanese oil company profits. But when the price of oil became cheaper, MITI allowed the higher prices to remain so that lost profits could be recovered by the oil companies.

In sum, the Keidanren represents the corporate sector by providing economic advice (favorable to corporations) to the government bureaucracy. "Advice that is well researched and through consensus building is representative

"Refer to McKinnon [1986] pages 109-110 for a discussion of consensus building within the Keidanren.

"The Keidanren's huge political donations to the controlling Liberal Democratic Party can not be overestimated. In contrast to U.S. law, Japanese corporations are permitted to make direct political contributions.
of big business in Japan. The federation also provides an effective communications network for government to suggest appropriate action for big business to follow (e.g., MITI's "administrative guidance").

MITI

The Ministry of International Trade and Industry (MITI) is the primary section of the government bureaucracy that regulates the corporate sector. MITI's effectiveness is attributed to its use of "administrative guidance" rather than promulgating legislative regulation. Administrative guidance refers to exercising influence through 'non-authoritative' and 'voluntary' means to achieve administrative goals. MITI institutes informal action to influence economic performance in the private sector (e.g., to promote mergers, control production, etc.). This informal pressure is often effective because government agencies (particularly MITI) possess formal legal power to

\[\text{When issues are controversial, top Keidanren officials avoid forcing policies, especially where opposition is strong. However, the business community often reaches a decision out of fear that if they fail to take action on an issue, MITI will get involved without being as sensitive to the business community.}\]
authorize, approve, and supervise industry." The Japanese prefer an informal over a formal approach because the informal allows the government greater flexibility when guiding activities in a dynamic environment.

MITI is composed of elite bureaucrats and organized along industry lines. A vast majority of the ministry's members are graduates of the University of Tokyo, Japan's best university. Many Tokyo graduates forgo higher salaries and benefits offered by private industry to work for this prestigious ministry. Normally bureaucrats remain with the ministry until about age fifty, then they 'retire' to enter politics or accept an executive position in private industry. MITI's organizational structure is according to industry lines and parallels that of the Keidanren and

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Generally, MITI's administrative guidance is well received. However, major exceptions do occur (e.g., Toyota's refusal to merge with Nissan, and Honda's entry into the automotive industry were directly opposite to MITI's advice).

Nakane [1970] reports that Tokyo graduates who do accept positions in private industry's best firms become important informal links to classmates in MITI.

Stockwin [1980] reports that this trend of 'retiring bureaucrats' entering politics or private industry strengthens an existing bond among the bureaucracy, politicians, and the business community.
Japan's powerful set of industrial associations. Such a structural arrangement facilitates communication between the government bureaucracy and the private corporate sector. The overlap involving Tokyo graduates, post-bureaucratic careers, and structural organization encourages a close cooperative relationship. Interdependency is prevalent between government and corporate sectors rather than independence.

The relationship between MITI and the business community resembles a love/hate arrangement. MITI makes and enforces difficult decisions that are deemed good for the overall business community. The ministry attempts to systematically line up support through consensus building practices, while possessing sufficient leverage (e.g., through licensing privileges or influencing bank loans) to make a decision stand. Sometimes specific business sectors may not agree with particular MITI decisions and may refer to MITI as an oppressive enemy. But, since Japanese businessmen recognize that MITI's goal is to safeguard the health of the whole corporate sector; dissenting sectors usually comply with governmental decisions. The ministry is

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32The industry associations embrace the major firms in each industry.

33The Keidanren apparently lacks sufficient leverage to be able to force an issue.
perceived as a prestigious, important, useful and meaningful branch of government.

MITI's self-defined role is to respond to, and try to overcome the market mechanism's inadequacies. According to MITI, a competitive market mechanism can not adequately resolve long-term structural problems (e.g., to establish and maintain international, productive competitiveness). To correct the market's flaws, MITI establishes industrial policies and offers administrative guidance.

MITI's industrial policies target certain industries for economic development. During the mid-1950s through the 1960s MITI emphasized the basic industries (e.g., shipbuilding, steel, automotive, and chemical). During the early 1970s, MITI switched to emphasize the "knowledge-intensive" industries (e.g., computers, aircraft, and robotics). The targeted growth industries receive preferential treatment, including bank financing at low interest rates, access to latest technology, sponsoring

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"According to Minami (1986), knowledge-intensive industries include computers, aircrafts, industrial robots, atomic power related industries, fine chemicals, large scaled integrated circuits, office communication equipment, pollution prevention machinery, high quality clothing and furniture, electronic musical instruments, information management services, information supplying services, computer software, system engineering, and consulting. A 1980 MITI report decisively down plays the role of heavy and chemical industries, while stressing a need to develop more reliable sources of energy to become less dependent on foreign oil imports."
research, and special accelerated depreciation tax
deductions, etc.

MITI offers administrative guidance to both growth and
decaying industries, and to individual firms within those
industries. Growth industries are encouraged to modernize
and expand productive facilities, declining industries are
persuaded to contract. MITI often encourages collusive
activity or cartelization as a means for making industries
more (productively) competitive internationally. The
Japanese Antimonopoly Law contains two exemptions that allow
special recession cartels and rationalization cartels. In
addition, MITI circumvented the Japan Fair Trade Commission
(JFTC) by sponsoring a number of special industry laws
permitting various kinds of cooperative industry behavior.
MITI may suggest specific production output levels, fix
prices, etc. in response to unusual situations (e.g., the
OPEC oil embargo). In sum, MITI plays an active role which
according to Vogel (1978) leads to a "guided free enterprise
system" in Japan.

To recap, the Japanese corporate sector is an elitist
society (or at best a very limited pluralist society),
involving the powerful Keiretsu, Keidanren, and MITI as
interrelated authoritative groups. The largest corporations

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Both types of cartels are subject to case by case
approval by the Japan Fair Trade Commission (JFTC).
from the Keiretsu are well represented in the Keidanren, which has a close working relationship with MITI. While MITI attempts to do what it perceives to be best for the nation in the long run, its continual interaction and exchange with the business community, particularly the Keidanren, influences MITI.

**Enterprise Unions**

A discussion about the corporate sector would not be complete without mentioning Japan's relatively harmonious relationship between corporate management and labor. At first glance, labor may appear to be dominated, but labor associations seem to function as a silent partner in major corporations.

Large corporations strive to maintain harmonious labor relations through enterprise unions, 'lifetime' employment, seniority wages and semiannual bonuses. Most large companies support an inhouse union that often includes all of its employees regardless of occupation. 'Lifetime' employment is a guarantee against recessionary layoffs.\(^5\) Seniority wages and semiannual bonuses reward long tenures and supplement wages to reduce employee turnover. These customs limit mobility and enhance union members' loyalty to the corporation.

\[^5\]Dore (1986) reports that lifetime employment traditionally means until the age of 55 years old.
Corporate management frequently attempts to avoid conflict with its enterprise union by establishing procedures for consultation with the union on all matters that involve important labor decisions. Such procedures permit the union to have input into the company's annual budget, particularly with respect to manpower budgets. Unions expect management to discuss all anticipated changes involving labor. An enterprise union usually negotiates wages, working conditions, promotions, etc., with the company. Industry based bonuses for managers do not necessarily encourage suppressing workers' compensation and benefits. The unions generally cooperate because they expect to share in gains from a corporation's success.

In sum, enterprise unions promote harmonious labor relations through cooperative efforts due to a perceived common goal. 'Lifetime' employment, seniority wages and semiannual bonuses help to cement this bond by stabilizing a company's workforce and its enterprise union membership.

[Koike (1987) reports that the largest companies within an industry normally establish an acceptable trend to follow.

In contrast, U.S. profit sharing bonuses for managers creates a zero sum game between management and labor. One side's benefit is at the expense of the other side.]
The Japanese Socio-Economic Environment

The Japanese socio-economic environment is extremely complex. This section attempts to provide an accurate description of dominant perceptions, but relies on interpretation of existing, at times relatively subjective, literature. The intent is to provide a background setting to investigate financial accounting practices/disclosures in Japan. Prominent social features include the concepts of group consciousness, relative ranking, and harmony. Salient political traits consist of centralization, tremendous costs, conservatism, and continuity. Major economic qualities include GNP-ism, investment led growth, foreign trade dependency, a dual capital structure, and a strong currency.

Social Features

Group consciousness (dantai ishiki), an extremely high emotional attachment to a set of individuals within a frame,

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This section draws upon the works of social scientists including sociologists, political scientists, and economists to provide an overview of social, political, and economic characteristics that appear to be dominant in contemporary Japan.
forms the basis for Japanese social organization. A frame refers to a relationship due to social context or situational location (e.g., students at the same university, or employees of the same company). Japanese tradition promotes frame based grouping. The threat of ostracism faces anyone who deviates from group norms.

Japanese group consciousness promotes interdependence, a continuum (location) mentality, psychological dependence, reciprocity of obligations and compassion, and requires complete commitment. The Japanese culture encourages interdependence within a frame by assigning work to groups and by popular slogans (e.g., the enterprise is the people, or the employer and its employees are bound as one by fate). A continuum (location) mentality classifies individuals into three social categories: inner, intermediate, and outer. Those within a particular frame view the world as us against them. The Japanese view self as an interactive self relative to others. This increases psychological dependence on the group which provides authority, approval, and security. Reciprocity requires individuals to subordinate

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60 Nakane [1970] reports that the Japanese "frame based" grouping is different from an "attribute based" group that is common in western societies. Attributes are acquired at birth or through achievement (e.g., kinship or occupation).

61 Refer to Nakane's [1970] discussion of the traditional Japanese household or "ie." Contemporary Japan effectively promulgates the image that one's place of employment is to be viewed as one's "ie."
their own identities to enhance their group's well being and to promote cooperative rather than competitive behavior. Reciprocity of obligations and compassion promote a strong emotional bond. All members have a voluntary duty to behave according to group norms (e.g., to diligently obey one's superior and to be sensitive to one's junior). One result is that the Japanese do not rely upon litigation since such behavior would be irrational and dysfunctional. The Japanese culture also fosters complete commitment to one's corporate employer. Employees often spend long hours after work 'socializing' at bars with one's superior to make affairs at the firm run more smoothly. A long tenure enables an employee to accumulate social capital (e.g., prestige) that is not transferable if one moves to another group or company.

Japanese behavior illustrates the importance of relative ranking. An informal, yet widely recognized ranking system, exists that creates hierarchies among groups and institutions such as corporations, universities, and government ministries. Institutional ranking is a carryover from traditional ranking of households within a village. At the individual level, a person's institutional affiliation, tenure with the group, educational background, and age are important criteria in determining one's relative position of rank vis-a-vis another. Rank may be broadly classified into
three categories: superior, subordinate, and peer. Very strong competition within the same rank leaves little, if any, emotional ties at the horizontal level. Emotional ties are vertical between superior and subordinate (e.g., a parent/child like relationship).

The Japanese language reflects the importance of the concept of relative ranking. Appropriate speech and behavior depend upon familiarity of another's rank. If one does not know another's rank, communication becomes virtually impossible, since the use of an improper referent that assumes an inappropriate rank is a great insult to either the sender or receiver. To overcome this problem, the Japanese exchange name cards that contain all vital information to determine rank. In sum, Japanese culture reflects a vertical social structure, but cooperation among groups prevents a complete adoption of a vertical society concept.

Harmony (wa) is a core value, an eminent value, based upon a Confucian social order.** Confucianism does not recognize a "good/bad" dichotomy; it stresses a balance of complementary forces. Subcharacteristics of harmony include conciliation, subtlety, and sensitivity. Conciliation emphasizes agreement (i.e., consensus is the top priority).

**Refer to McKinnon [1986] pages 89-90 for a discussion about wa.
A consensus comes from participative, consultative decisions, and a readiness to incorporate a genuine reconciliation of competing interests. Subtlety refers to exercising restraint or being reserved through an avoidance of direct confrontation, by not issuing strong opinions, and by sidestepping unequivocal choices. Sensitivity requires recognition of the concerns of all people, especially the weaker or lower ranks. In sum, harmonious practices in Japan favor consensus over winners and losers, and subtlety over clarity. The former encourages the avoidance of litigation, while the latter makes it difficult to develop (western-style) contractual relationships.

Political Traits

Stockwin [1980] uses a "fusion of powers" concept to describe the centralization of the political process in Japan. A "tripod" (i.e., three interlocking hierarchies: the Liberal Democratic Party, the government bureaucracy, and the corporate sector) governs Japan. These three hierarchies are interlocked by a network of mutually reinforcing ties (i.e., an interdependency exists). A passive electorate accepts this elitist combine, probably due to the nation's economic prosperity.

—an emphasis upon consensus may help to explain why MITI and the Keidanren are effective organizations.
The Liberal Democratic Party (LDP) controls the National Assembly (Diet). The LDP party consists of five major factions; its organization is a centralized, top-down power structure. The LDP party provides a vital component to the prominent pre-parliamentary procedure. Despite its internal competition among the party's factions, the LDP usually presents a united front in the Diet by voting along straight party lines. The Diet selects the Prime Minister and possesses formal legislative power. However, a pre-parliamentary process relegates the Diet's role to providing a formal process to approve legislative bills (i.e., to rubberstamp predetermined policy). The government bureaucrats often initiate and adjust pre-parliamentary policies which are then submitted to the LDP's Policy Affairs Research Council (PARC) for approval. The PARC deliberations are critical in Japanese politics; they provide a venue for negotiations among various interest groups and public officials who seek LDP approval. Failure to use and obtain PARC's approval results in stiff opposition from the LDP controlled Diet.

Corporate management and government bureaucrats covet the LDP's legislative support. Both groups have some leverage; the LDP is dependent upon the corporate sector for financial support and technical expertise, while the government bureaucrats supply valuable research and
formulate policy. In addition, the LDP and the corporate sector offer career opportunities to ambitious government bureaucrats.

Hrebenar [1986] reports that the corporate sector is very visible in Japanese politics; the financial world (Zaikai) assumes a particularly active role. Four major business organizations represent the Zaikai: the Japan Federation of Employers' Associations (Nikkeiren), the Japan Chamber of Commerce and Industry (Nissho), the Japan Committee for Economic Development (Keizai Doyukai), and the very powerful Federation of Economic Organizations (Keidanren). The Keidanren communicates big business's viewpoints to the government and the public. The Keidanren's widespread institutional support provides tremendous resources for lobbying activities; it seeks consensus in order to present a united business viewpoint. Generating consensus requires substantial research on particular matters due to the heterogeneity of associations and corporations represented.

"According to Hrebenar [1986], the Nikkeiren focuses upon labor policies and cooperation between labor and management. Nissho represents various cities' economic concerns throughout the nation. Keizai Doyukai is a large association of executives that focuses upon economic development. The Keidanren is a national federation of leading industrial, commercial, financial and trade associations and about 800 large, individual enterprises."
The government bureaucracy consists primarily of ministerial bureaus. The 12 ministries are each subdivided into particular bureaus, including the relatively powerful Ministry of Justice (MOJ), Ministry of Finance (MOF), and Ministry of International Trade and Industry (MITI).\textsuperscript{55} The Prime Minister appoints the 12 ministers to each department who serve at his pleasure. Their appointments also depend upon the results of frequently held elections.\textsuperscript{56} Vice-ministers and bureau directors are permanent civil servants who usually control the ministries. Due to their longer tenure, vice-ministers and bureau directors, accumulate high levels of technical and legal competence. Such skills are necessary to initiate and implement complex legislation which include financial and economic policy. The fusion of the LDP, corporate sector, and government bureaucracy provides Japan with a highly concentrated, very powerful political mechanism that is conspicuously


\textsuperscript{56}According to Tsuneishi [1966], the constitution provides the Prime Minister with the power to dissolve the House of Representatives (whose terms may last as long as four years), and thereby, create a general election. The newly elected Diet selects a Prime Minister, who then appoints bureaucratic ministers.
centralized.

To participate in the Japanese political process, an individual must possess or have access to enormous financial resources (i.e., to be elected to the Diet is very expensive). Money is the crucial ingredient for political success. Relatively frequent general elections cause politicians to concentrate primarily upon raising funds.

Efforts to curb excessive political campaign expenditures have been unsuccessful. The Japanese refer to the Political Funds Control Law (PFCL) as a "bamboo sieve." Politicians almost universally ignore the PFCL limitation; they falsify expenditure data to appear to be just below the legal limit when actual expenditures are much more than is allowable. The Keidanren publicly ignores the law; it establishes lofty fund raising goals for corporations to fund LDP candidates. Corporate political funds are responsible for the merger of two separate conservative parties (i.e., the Liberal and Democratic parties) to form the Liberal Democratic Party. The 1955 merger created a conservative party that apparently is too strong to be defeated by an assortment of autonomous progressive or socialist parties.

The LDP is conservative; the party resists fundamental changes, and emphasizes stability and order (but not a return to traditional values). The LDP is the party of big
business. The Japanese business sector views political stability as an essential condition for maintaining economic growth. Therefore, businessmen willingly donate substantial sums of money to support the LDP.

The LDP's control of the Diet for over 30 years provides a continuity in conservative leadership. The (corporate financed) LDP repays the corporate sector by supporting an accommodating economic policy (e.g., relaxed enforcement of antitrust laws, funding for leading companies that may encounter financial difficulties, etc.).

**Economic Qualities**

Japan's primary national goal (since 1955) is to increase its gross national product (GNP). Her strict adherence to this GNP-ism objective promotes economic growth. The Japanese economy is now second only to the United States among noncommunist countries. The Japanese emphasize production rather than distribution (i.e., making the pie larger has precedence over slicing up the pie). Thus, the Japanese government concentrates on expanding capacity rather than directing social welfare programs, or controlling environmental pollution, or providing an adequate social security program. In addition, the Japanese benefit from limits placed on their national defense expenditures by the allies after World War II. This limitation on defense spending allows the government to fund
more productive areas.

The Ministry of International Trade and Industry (MITI) is the primary section of the government bureaucracy that administers "industrial policies" to promote the growth of industry. MITI's guidance is important for Japan's economic success, but the real engine of growth is the formation of productive capital investment. The investment for Japanese economic growth is dependent primarily upon bank debt.

The Japanese strong propensity to save, particularly with banks, creates a large sum of capital funds for investment purposes. Meanwhile, reciprocal investments between the banks and corporations result in banks being willing to lend funds, even to financially troubled major companies during hard times. In return, the major corporations roll-over or even borrow funds, to help banks, when surplus money exists. In addition, the government (particularly the MOF through the Bank of Japan) maintains

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[68] Yoshimura [1987] contends that the bond between banks and corporations is currently growing weaker. Recently bank loans are being repaid while new capital funds are being provided from the securities market (i.e., "farewell to banks and good day to securities"). However, debt financing is still relatively high when comparing Japanese debt/equity ratios to those found in the United States.
low discount rates that result in extremely low interest rates for bank borrowing. The banks also perceive the MOF as a lender of last resort, ready to provide a bail-out should an important corporation be faced with bankruptcy.

Although Japanese economic growth may not be "export led," its economy is highly dependent upon foreign trade. Japan imports raw materials, particularly oil and natural gas, and exports value-added products such as electronics and automobiles. Japan has few natural resources; the country's major resource is a well educated, industrious work force. Japan imports relatively cheap, unrefined, raw materials and produces finished goods often for export. This import/export process has been so successful for the Japanese economy that pressure, particularly from the United States, is being applied for Japan to reduce its huge trade surplus.\footnote{External pressures to reduce the trade surplus have hurt the Japanese economy as evidenced by a 1986 recession, but signs of recovery, based upon domestic}

\footnote{Japanese responses include: MITI's "about face" which is now to encourage imports and to 'discourage' export dumping tactics, and establishing overseas production facilities. For instance, $5 billion dollars have recently been invested in Japanese automobile plants in the United States and an estimated $27 billion Japanese investments were made in the United States during 1986.}
demand, are appearing.  

Japan's dual capital structure refers to an existence of two distinct corporate sectors, based upon entity size. The larger enterprises, though few in number, possess a high degree of monopolistic control over capital (e.g., about two-tenths of one percent of all the enterprises own about 65 percent of the total book value capital). The three largest banks make about one-third of all loans; and, the three largest companies within each major industry usually control 50 percent or more of their respective market shares. These large enterprises possess modern technology, a high capital/labor ratio, and high labor productivity and wages. Vast numbers of small enterprises compose the other sector. The smaller companies face fierce competition and have limited access to financing.

The Japanese yen is a very strong currency; its value has doubled in comparison to the US dollar in the last few years. The yen's strength comes from Japan's huge trade surplus and its low inflation rate. The yen's strength increases Japanese purchasing power; Japanese producers and consumers can buy relatively cheap imports. Conversely, Japanese exports are now more expensive, resulting in a reduction of exports, particularly to the United States.

The decline in exports causes an unemployment rate of about three percent. While relatively low in comparison to most countries, the Japanese find three percent uncomfortably high.

Mandated Financial Reporting in Japan

Contemporary Japanese financial reporting requires a formal dual reporting process; yet, these requirements are without grassroots support. Dual reporting refers to Commercial Code and Securities and Exchange Law (SEL) based financial reports. A publicly owned company usually prepares two sets of financial statements. The SEL financial report is similar to the code, but contains more detail and is filed with the MOF's Securities Bureau. Shareholders receive the (condensed) code based report. The government bureaucracy receives both reports, the SEL by the MOF and the code by the Ministry of Justice (MOJ).

The government views financial reporting as part of Japan's 'modernization' process, a necessary step to compete with western economic powers. Modernization refers to the effort to become more like the western world in response to pressure from western nations, particularly the United States. Two historical events are symbolic of such pressure: Commodore Perry's "black ships" arrival and subsequent military intimidation to reverse Japan's
self-imposed isolation during the latter half of the nineteenth century and the American occupation after World War II.\(^7^1\)

Perry's visit forced Japan to interact (i.e., to trade) with western nations, and thereby, created a need to establish 'modern' political, legal, and corporate infrastructures. Failure to 'modernize' would have perpetuated Japan's exploitation by western nations through unequal treaties.\(^7^2\) Japan quickly adopted a western legal system (patterned after the Europeans) that was acceptable to western nations who then revised the unequal treaties. A prominent feature of 'modern' Japanese law was the Commercial Code (modeled after German law) that addresses external reporting requirements of corporations.\(^7^3\) 'Modern' Japanese law, including the Commercial Code's section that requires financial reporting, is a reaction to an intrusive

\(^7^1\)Refer to McKinnon [1986] chapters six and eight for a detailed discussion of these two intrusive events by the United States.

\(^7^2\)McKinnon [1986] described the treaties as unequal because they were based solely upon the law of the western nation concerned. Japan's traditional legal system included unwritten civil, criminal and commercial laws, and an 'unstructured' procedure for settling disputes that were beyond the militarily dominant western nations' comprehension and thereby unacceptable. Traditional Japanese law was perceived to be archaic by the west.

\(^7^3\)The code also provides the basis for the corporate form of business organization.
event (i.e., the oppressive western nations' trading policies).

The American occupation after World War II attempted to establish a democratic and economically sound nation.\(^7\) During occupation (1945 to 1952), the powerful Zaibatsu were 'dissolved' and a massive distribution of corporate shareholdings to the public took place to promote democracy.\(^7\) The Ministry of Finance (MOF) was selected to try to ensure an existence of a fair securities market and responded by promulgating the Securities and Exchange Law (1948). The Japanese patterned the SEL after the United States' Securities Act of 1934 and established the MOF's Securities Bureau to regulate the newly established stock exchanges' activities. The SEL requires publicly-held corporations to file annual audited financial statements with the Securities Bureau. Japan's 'modernization' was a reaction to an intrusive event (i.e., the presence of United States forces after the Japanese surrender).

Since, both the code and SEL based financial reports appear to have been direct responses to external (western)

\(^7\) Of course, demilitarization was also a top priority.

\(^7\) According to Hiramatsu [1987], individuals owned about 70 percent of the outstanding corporate stock in 1950 which has subsequently decreased to about 26 percent in 1989.
pressures (i.e., cultural importation), the financial reporting process is not central to Japanese business. Suppli
ers of capital do not demand financial statements. Banks generally do not rely upon audited financial statements; they frequently employ their own audit personnel to investigate a company's credit worthiness. Banks and related corporate investors (i.e., Keiretsu members that participate in cross-shareholdings for long-term business relationships rather than financial profits) have informal access to financial information. The most important (anticipated) financial statement users rely upon alternative means to acquire such information. The Japanese also tolerate information asymmetries among market participants.

Given the above scenario, management apparently responds to mandated financial reporting by emphasizing form rather than substance. Form refers to meeting the minimum required by government mandates, including financial statement audits which management regards as perfunctory and ceremonial. Substantial financial information is provided

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76Financial reporting apparently is not intrinsic to Japanese culture. This may create questionable compliance with respect to stated financial reporting objectives.

77According to Shibata (1988), cross-shareholding involves about 60 to 70 percent of all the large corporations' outstanding common stock.
to prominent parties through alternative means. Prominent users, who have access to alternative information, include major banks and other Keiretsu members.

Nonrelated institutional investors and securities firms are among the minority of (anticipated) users, who do rely upon published financial statements. Securities firms analyze financial statements to avoid charges of negligence with respect to financial information in a company's prospectus.

Financial Accounting Differences

Japanese financial accounting principles are generally similar to those found in the United States, although some significant differences exist. The strong similarity comes from the Securities and Exchange Law (SEL) which was promulgated during the U.S. occupation of Japan (1945-1952). The significant differences are due to prominent social, political, and economic characteristics, and structural arrangements. Structural arrangements refer to major participants or authorities within the financial accounting social system and its neighboring systems (i.e., the capital funds and corporate sectors).

According to the JICPA [1982], individual investors are generally not perceived to be users of financial statements.
The foundation for Japanese generally accepted accounting principles (GAAP) does not reflect traditional accounting practices, but, rather U.S. practices since Japanese GAAP was primarily transplanted from the United States. The Business Accounting Deliberation Council (BADC) issues official recommendations involving financial accounting matters through "Financial Accounting Standards for Business Enterprises" (FAS). The FAS establish Japanese GAAP. The FAS was originally patterned after Sanders, Hatfield, and Moore [1938], and include three sections: General Principles, Income Statement Principles, and Balance Sheet Principles. The stated financial reporting objectives and most financial accounting practices and disclosures continue to reflect those found in the United States.

A comparative review between Japanese and U.S. financial accounting practices and disclosures reveals that significant differences do exist with respect to accounting for income taxes, legal reserves, foreign

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*Refer to Fujita [1966] for an additional discussion about the FAS's composition being very similar to "A Statement of Accounting Principles" by Sanders, Hatfield, and Moore [1938].

*Differences are identified by Fitzgerald, Stickler, and Watts [1979], Choi and Bavishi [1983], and Orsini, McAllister, and Parikh [1987]. Orsini et al. assures contemporary coverage.
currency translation, and consolidations. Accounting for income taxes, legal reserves, and foreign currency translation all protect corporate resources from being excessively distributed through dividends. Income tax treatment and foreign currency translation also shield excessive distributions from taxation. All three reflect a group consciousness, are conservative, and promote capital accumulation for productive competitiveness. Consolidation requirements provide an example of cultural importation; the Japanese adapted the requirement to appear 'modern' (western) due to outside pressure (i.e., a reaction to foreign criticisms directed at archaic reporting practices). In addition, a statement of cash flows and earnings per share information are conspicuously missing from the Japanese financial report.

**Accounting for Income Taxes**

A significant difference between Japan and the United States occurs in accounting for income taxes. In Japan, tax laws practically dictate financial accounting since financial accounting income must be equal to taxable income. No expense is tax deductible unless it is first included in the income statement (i.e., there are no deferred taxes). This symmetry between financial and taxation reporting

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1 In Japan neither a statement of cash flows nor a statement of changes in financial position is required.
promotes the use of general and specific reserve and allowance accounts, discourages deferred and intangible assets, and tends to depress reported earnings.

The Corporation Tax Law and related regulations, promulgated by the MOF, permit a wide variety of tax deductible expenses to promote savings and investments by corporations. Tax deductions have both general and specific purposes. General purposes include allowances for bad debts, depreciation, amortization, inventory and security price fluctuations, and employee retirement.\textsuperscript{66} The general deductions are available to all companies. In addition, the government may allow specific purpose deductions to industries or activities targeted for growth. These specific tax incentives are renewable on an annual basis. Examples of special purpose deductions include additional amounts for overseas market development and export activities, and special (additional) depreciation deductions for certain productive assets. Both general and specific purpose deductions result in allowance or reserve accounts on the balance sheet; changes to such accounts are shown on the income statement. Tax regulations generally allow direct write-offs for deferred and intangible asset

\textsuperscript{66} Expenses allowed for taxes tend to be higher than what would normally be anticipated (e.g., higher bad debts expense than historically experienced, or accelerated depreciation and amortization expenses).
expenditures; if such costs are capitalized, they usually must be amortized within five years. Tax avoidance encourages Japanese companies to expense rather than capitalize expenditures. Tax compliance lowers reported income, and thereby, curbs amounts available for dividend distribution.

This relatively conservative approach used for accounting for income taxes primarily benefits corporations, banks, management, and employees. A corporation that minimizes its income tax expense also shields resources available for dividend distribution. Dividend amounts are determined based upon reported earnings. Resources retained within a corporation are available to maintain or expand future operations, and thereby, enhance a corporation's future productive competitiveness. Related banks and other Keiretsu members rely upon fellow corporations' future survival to maintain their corporate group. Banks perpetually lend to and collect funds from corporations. Other Keiretsu members regularly sell to and buy from the large corporations. Management and employees rely upon their corporation's existence so that their primary group affiliation remains intact and to fulfill their long-term oriented goals. Management usually strives to secure and expand a market share base. Employees expect a life-time employment opportunity.
Management has little, if any, motivation to report impressive short-term earnings, since their compensation is in the form of seniority wages and industry norm bonuses, and cross-shareholding eliminates any take-over threat.

Accounting for income taxes is consistent with prominent environmental characteristics, particularly group consciousness, conservatism, continuity, and investment led productive competitiveness. Keiretsu members through cross-shareholding perceive financially speculative investors to be outsiders. Management and employees are bonded together with respect to their company and have a relatively similar perception. Both groups (the Keiretsu and an individual corporation) have little or no concern for speculative investors' interests.

Accounting for income taxes tends to depress reported earnings and also provides management with an opportunity to smooth earnings. The former is conservative, while the latter permits a steady, nonvolatile financial picture to be drawn. Income smoothing is practiced through annual (subjective) revisions to allowance and reserve accounts that are created through tax laws. Subjective adjustments may increase or decrease annual earnings. Management prefers continuity over volatility because the former tends to promote confidence rather than suspicion, particularly with respect to key government bureaucracies (e.g., the MOF
and MITI). Investment led productive competitiveness requires capital accumulation for maintenance and expansion. The government bureaucracy promotes capital accumulation through generous tax deductions to minimize the corporate income tax burden. Consistency between tax and financial reporting prevents the government's objective from being subverted through excessive dividend disbursements.

**Legal Reserve**

Japan's dividend policy is conservative; a legal reserve account must be created prior to the computation of an amount available for dividends. Traditionally dividend payouts have been relatively low. A legal reserve account appropriates retained earnings at a rate of 10 percent of cash dividends declared until the reserve equals 25 percent of the capital stock account. Dividends are limited to the excess of net assets over the aggregate of stated capital, capital surplus, accumulated legal reserve including the current dividend, and excess deferred assets\(^3\) (if any). These dividend restrictions are consistent with, and compounded by, the previously mentioned corporate tax laws that encourage reporting suppressed earnings to avoid income tax expenses.

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\(^3\)Refer to Orsini, McAllister, and Parikh [1987], excess deferred assets refer to unamortized preoperating, and research and development costs over capital surplus and an updated, accumulated legal reserve account.
The legal reserve and its related conservative dividend policy benefit corporations, banks, management, and employees. A resource retention policy is better for a company's long-term existence rather than resource depletion. The aforementioned (accounting for income taxes) analysis which involves institutional authorities (particularly banks and management) and environmental characteristics is also appropriate with respect to accounting for a legal reserve and its related dividend restriction.

The presence of a legal reserve symbolizes group consciousness, conservative, and continuous norms; it also facilitates investment led productive competitiveness. A corporation demonstrates an investment priority by skimming off some economic profits (that have already been understated) prior to distribution. Short-term investors have no reason to support such actions, since reinvestment for future survival and growth tend to be contrary to short-term profit interests. Short-term investors' interests apparently are regarded by management to be those of an unrecognized outsider. Restrictive dividend practices contribute to relatively low dividend payouts. Low dividend payouts do not deplete a corporation of its necessary resources and are easy to maintain during recessionary
Resource retention is an effective technique to satisfy demand for capital funds so as to enhance productive competitiveness, particularly for a (long-term) profit motivated entity.

**Foreign Currency Translation**

Accounting for foreign currency translation is conservative when the Japanese yen is relatively strong. During the last decade, the yen has been a strong currency in comparison with major trading partners (e.g., the United States dollar). Proper accounting treatment requires foreign exchange translation differences to be accounted for as current period gains or losses on the income statement. Generally, translation losses result from re-stating a weaker currency into a stronger currency (e.g., United States dollars into Japanese Yen). Translation losses reduce both financial and taxable income and conserve corporate resources by depressing both dividend and taxation.

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**According to Stonehill et al. [1975] a continuous dividend flow is traditionally expected. A suspension of ceremonial dividends is regarded as an utmost embarrassment.**

**The BADC issued "Accounting Standards for Foreign Currency Translations, etc." on June 26, 1979.**

**Refer to Orsini, McAllister, and Parikh [1987] for specific exchange methods. The BADC [1979] recommends a modified monetary/nonmonetary translation method.**
The Japanese do not hedge to avoid financial reporting losses, since managers are indifferent with respect to short-term profits.

Foreign currency translation (like accounting for income taxes and legal reserves) benefits corporations, banks, management, and employees for the reasons discussed above. Table two summarizes the aforementioned discussion about divergent financial accounting practices and disclosures in Japan.

**Consolidated Reports**

The Securities and Exchange Law (SEL) requires preparation of consolidated financial statements, however some noteworthy loopholes do exist. A prominent loophole limits consolidations to include only significant subsidiaries. This materiality clause minimizes the number of subsidiaries included in consolidated statements.

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**An anomaly is possible should the yen weaken, and thereby, cause translation gains to be recognized. A situation that has not occurred since the BADC issued its pronouncement. In addition, the BADC's [1979] pronouncement is relevant for "ordinary exchange fluctuations" and explicitly leaves room for change should an 'unusual' situation occur.**

**A significant subsidiary is a subsidiary whose sales or total assets amount to at least ten percent of the combined total sales or total assets of the consolidated group. This practice eliminates all small and medium size companies owned by the larger corporations. Keiretsu groups may even exclude large corporations due to the group's tremendous size.**
and often eliminates the preparation of consolidated financial statements." Approximately half of the corporations with subsidiaries do not file consolidated financial statements with the MOF's Securities Bureau. Those that do file consolidated statements exclude over two-thirds of their subsidiaries.

The MOF's underlying purpose for 'mandating' consolidated financial statements is to improve the international status of Japanese financial statements. Westerners perceive Japan's parent-only reports to be archaic and manipulative. The MOF's consolidation requirement is an attempt toward 'modernization' through cultural importation. Once again, modernization refers to becoming more western-like, particularly in appearance. However, corporations through their powerful Keidanren's efforts received a major concession (i.e., inclusion of a materiality clause). Hence, although Japanese generally accepted accounting principles do require consolidated financial statements; in practice, an exception becomes the rule. The consolidation requirement provides a specific illustration of form over substance that often occurs.

\[\text{Referring to McKinnon [1986] chapter eleven for a thorough analysis and discussion about consolidations in Japan. She reports that over 70 percent of subsidiaries were excluded and 50 percent of the corporations with subsidiaries did not submit consolidated financial statements in 1979-1980 because of the materiality clause.}\]
through cultural imitation rather than domestic development.

Consolidated reporting symbolizes a political compromise between an elite government bureaucracy and a powerful corporate sector. The MOF, concerned with international perceptions of financial reporting in Japan, sought to require consolidations, however the powerful Keidanren believed that such reporting was not necessary. These two factions arrived at an acceptable compromise. Consolidated financial reports are formally required, but loopholes make the requirement substantially meaningless. This compromise is very symbolic of financial reporting in Japan.

Cash Flows Statement and E.P.S.

The absence of a cash flows statement and earnings per share (EPS) information in the Japanese financial report is consistent with a lack of concern for reporting short-term profits and the welfare of nonrelated investors. The Japanese emphasize long-term growth and a group consciousness. Investors, seeking dividends and immediate capital gains, usually desire such information, yet it is not presented. Management does not acknowledge any responsibility with respect to speculative investors.

\footnote{According to McKinnon [1986], Japanese financial reporting in general is a cultural importation, and is perceived by corporations to be an imposition.}
Management recognizes a responsibility to themselves, employees, bankers, and related (long-term) investors. EPS simply does not fit this group concept. A primary objective of a cash flows statement (formerly called statement of changes in financial position) is to help investors project future dividend paying ability. But, since the Japanese view dividends as resources taken from their group, management has little reason to provide cash flow statements or EPS. Incorporating both would benefit financially speculative investors, while having little or no effect upon the group members.

A cash flows statement also has alternative uses such as projecting debt paying ability. However, major related banks and suppliers have informal access to acquire any necessary information.
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CHAPTER V

FRENCH POLITICAL ECONOMY OF ACCOUNTING

This case study focuses upon the process of financial accounting in France, illustrating French financial accounting (socio-economic) structures and environmental characteristics. Figure eight illustrates the French financial accounting process, its neighboring social systems and its socio-economic environment. The illustration attempts to enhance an understanding of French financial reporting, particularly with respect to divergent practices and disclosures. Divergent refers to practices that differ from those observed in the United States. Financial accounting differences include: accounting for income taxes, legal reserves, foreign currency translation, leases, fixed assets, and a required social report.

1McKinnon [1986] is partially replicated and extended; "the process of financial accounting" replaces "corporate reporting regulation" as the focal point, while the environment is enlarged to consider social, political, and economic factors. France is featured in place of Japan.

2Secondary sources include books and articles by both French and other authors. In addition to published material, an unpublished documentary response by an international accounting firm's Paris office to an open-ended questionnaire about accounting in France is used. Refer to Appendix C for chapter five references by section.

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The Financial Accounting Process

The French financial accounting process includes regulators, facilitators, preparers, and users of financial reports. The government bureaucracy, particularly the Finance Ministry, dominates the regulatory process. Facilitators refer to registered accountants and auditors who are required to belong to their respective national organizations. Preparers are corporate management, while the prime user is the government bureaucracy. Bankers and institutional investors are secondary users of the financial report.

Regulators

Numerous laws, legislated by the government bureaucracy, regulate financial accounting in France. The Plan Comptable General (uniform chart of accounts) and Code General des Impots (tax law) are the most influential factors that shape the French financial accounting principles. Both the chart of accounts and the tax law are under the powerful Finance Ministry's jurisdiction. Virtually all companies must adhere to the Plan and corporate tax laws. Corporate tax law significantly impacts financial reporting, since financial statements must apply the same accounting methods that are used in the corporate
The tax return does require more detail (i.e., additional subclassifications of accounts) than does the financial report. In addition, the publicly-traded corporations (i.e., the largest and few in number) must also comply with the reporting requirements of the Commission des Operations de Bourse (COB).

Three consultative organizations significantly influence French financial reporting: the Conseil National de la Compatilite (CNC), the Commission des Operations de Bourse (COB), and the European Economic Community (EEC). The first two are substantially agencies of the Finance Ministry. The third extends beyond the realm of domestic authority.

CNC -- The Conseil National de la Compatilite is the official standard-setting body whose role is to assist the Finance Ministry with the regulation of financial accounting in France. The CNC is a consultative committee composed of professional and government representatives. The committee's president is a senior civil servant position.

A practice that is identical to Japan, but not the United States.

"The CNC is also called the National Council of Accountancy (NCA). According to Barrett and Roy [1976], the CNC is comparable to the Financial Accounting Standards Board (FASB) in the United States, except that the FASB has stronger ties with the accounting profession. The CNC appears to be very similar to Japan's BADC."
Five vice-presidents respectively represent: the Finance Ministry, government accounting, the Ordre des Experts Comptables et des Comptables Agréés (the leading professional institute of accountants), business firms, and higher education. Staff members include experts in accounting, law, economics, or finance.

The CNC's primary responsibilities include maintaining the Plan Comptable Général (national chart of accounts) and publishing interpretations and recommendations to encourage proper accounting practice. Pronouncements focus mainly upon accounting methods and constitute a major source of accepted accounting doctrine.

The Plan Comptable Général (established 1947) is the dominant force that directs French financial reporting. The Plan is a voluminous publication that contains terminology, detailed charts of accounts, and rules for calculating the elements of financial reports. Its most salient feature is a national chart of accounts that enables the government to collect uniform economic data from individual firms. The national chart of accounts consists of nine major account classifications, each with many sub-classifications. All of the classifications are numerically coded. The related (explicit) guidelines emphasize technical precision and quantitative accuracy. The plan forces financial data into a standardized format; even though, such a procedure may
cause a loss of informational content. All industrial and commercial businesses must comply with the uniform chart.

**COB** — The Commission des Operations de Bourse, a government agency, tries to ensure the regularity of the stock exchange operations. A six member executive council directs all COB activities, including a consultative role with respect to the regulation of financial accounting matters. The Council of Ministers appoints the executive council's top official, the Finance Ministry appoints four executives, and the sixth council member is a civil servant's position. The COB proposes amendments to legislation which relate to corporate reporting, and publishes a series of accounting recommendations and interpretations. Despite the COB's lack of legal authority, companies usually follow its pronouncements. While the COB's pronouncements have no legal authority, the COB can block new security listings by companies that fail to abide

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5Ernst & Whinney [1984] reports that the Code General des Impots (income tax law) mandates compliance effective January 1, 1984. However, according to Arpan and AlHashim [1984], most companies have already been in compliance.

6According to the AICPA [1975], the COB has duties and powers similar to those of the Securities and Exchange Commission (SEC) in the United States.

7According to Most [1984], the COB maintains very close ties with the powerful Finance Ministry.
by its recommendations.

**EEC** -- The European Economic Community directly impacts French financial reporting through its Fourth and Seventh Directives. The Fourth Directive calls for a "true and fair view" (image fidele). A (French) true and fair view essentially stresses reporting economic reality of the firm through increased footnote disclosure. Prior to the Fourth Directive, disclosure was not given a high priority in France. The Seventh Directive, requiring consolidations, is not nearly as drastic as the Fourth. The COB's major recommendation already requires the preparation of consolidated financial statements for companies listed on the securities exchange. The recent movement to try to unify Europe into an economic power has caused some cultural importation to occur in French financial reporting.

**Facilitators**

Two mutual organizations represent and direct a relatively small public accounting/auditing profession in France. The Ordre des Experts Comptables et des Comptables Agrees organizes and guides public accounting procedures that include consulting, accounting supervision, and bookkeeping services. The Compagnie Nationale des

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"According to Ernst & Whinney [1984], the COB's recommendation is not popular with many companies, particularly large holding companies."
Commissaires aux Comptes organizes and administers auditing procedures. The former emphasizes professional accountancy; the latter promotes compliance. Constituent members usually belong to both organizations and both are subject to direct government oversight.

The Ordre -- A government ordinance limits the privilege to practice public accounting to members of the Ordre des Experts Comptables et des Comptables Agrees. The Ordre monopolizes all public accounting work except for statutory audits. Membership is restricted to French citizens or EEC nationals that have satisfied examination and practical training requirements and are currently in public practice. According to Orsini, McAllister, and Parikh [1987], there are approximately 10,000 individual and 3,800 company or partnership members. The Ordre administers qualifying examinations, establishes and

9 Collins [1980] reports that financial accounting is under the Finance Ministry's jurisdiction. Auditing is regulated by the Ministry of Justice.

10 Orsini, McAllister, and Parikh [1987] report that a limited number of other foreign nationals (e.g., American CPAs) are permitted to practice, provided certain conditions are met.

11 Principals or partners of accounting firms must be individual members. In addition, Welchman [1983] reports that there are about 7,000 registered student (apprentice) members in practice.
maintains rules of conduct for members, represents the profession in the accounting standard-setting body (i.e., the CNC), and issues practical accounting and audit guidelines to all members to implement the official financial accounting legislation.

The Compaugnie -- A government ordinance limits the privilege of conducting statutory audits to members of the Compagnie Nationale des Commissaires aux Comptes. All stock companies (societes anonymes) and private limited companies (societes a responsabilite limitee) meeting certain size criteria must be audited by one or more statutory auditors (commissaire aux comptes). Membership is open to French citizens, EEC nationals, and nationals from countries that extend reciprocity to French nationals. The members must also satisfy examination and practical training requirements. There are approximately 9,000 individual and 300 company members. Most members of the Campagnie are also members of the Ordre. The Compagnie administers qualifying examinations, establishes and maintains rules of conduct for members, and issues practical guidelines to members with respect to desirable auditing and acceptable accounting procedures.

\[^{12}\text{According to Ernst & Whinney [1984], two auditors are required for companies listed on a stock exchange, or have capital in excess of five million francs.}\]
The Profession -- The two 'mutual' organizations enhance a centralized structure but not necessarily complete unification of the profession. Welchman [1983] reports that for many years relations between the two institutions have been a mixture of animosity and indifference.¹³ In addition, the Ordre's restrictions, particularly a rule that prohibits a member from employing more than ten accountants (excluding registered apprentices), discourage the growth of large accounting firms (e.g., firms comparable to those in the United States). The many small constituents are literally dependent on the state-sponsored national institutions.¹⁴

French accounting firms are generally very small but there are a few exceptions. Collins [1980] reports that there are approximately twenty 'sizeable' French accounting firms with multinational clients. Two firms have staffs in excess of 1,000 and a third is approaching that level. These exceptions exist primarily due to associations, including arrangements with other European or American institutions.

¹³Welchman [1983] reports that the negative attitudes have been replaced by an increasing degree of collaboration and shared representation since 1981.

¹⁴Welchman [1983] reports that a 1975 survey of the Ordre membership reveals that 80 percent of the accounting firms employed a staff fewer than ten accountants. Since membership is only about 10,000 that leaves very few to staff a limited number of large firms.
firms. Nationalistic tendencies make an associative structure preferable to an outright merger. Partnership groupings effectively circumvent the Ordre's rule that limits the number of professional accounting employees per firm. A partner is not considered an employee. Collins [1980] reports that government protected monopolies prevent foreign public accounting firms from directly practicing in France. The foreign accounting firms are limited to establishing an association with a French firm. Such an association ensures that the French have equal rights and voting powers on a joint executive committee.

In sum, the accounting profession includes less than 20,000 individuals working mostly in very small firms (less than ten accountants). Two national organizations, through centralized structures, control entry and membership behavior. Powerful international accounting firms are restrained through agreements that require equal authority be given to French partners.

Preparers

Corporate Management -- Corporate management is responsible for financial reporting. Management must prepare an annual financial report to meet its legal obligations. The Finance Ministry mandates uniform annual

1^Management's responsibility appears to be similar to both the United States and Japan.
reports to provide economic data that facilitates national economic planning, and to assist decision-making by investors, creditors, employees, and third parties. The (French) emphasis is on the former rather than the latter objective.

French managers' attitudes toward financial reporting are extremely conformist and moderately conservative. Managers respond to the letter of the law (i.e., to provide uniform financial statements), and tend to reduce reported profits. Such attitudes reflect the influence of French law and the country's socio-economic environment.

Conformist — French managers respond to the letter of the law rather than attempt to reflect a firm's actual economic performance. Management is obliged to provide an annual financial report to satisfy government's demand for data to plug into its macro-economic, regression-based planning model. The Plan Comptable General insists upon a uniform chart of accounts, and tends to emphasize accuracy and precision (i.e., compilation). The French bureaucracy apparently is better suited to control technical aspects, but may encounter much difficulty with respect to subjective
matters (e.g., value judgments). Informational quality of accounts and accountability are not effectively implemented into the annual report.

French management has little motive to publish financial information that reflects actual performance and prefers secrecy. Only a minority of capital funds are derived from the stock market. Approximately 80 percent of company funding is from re-invested profits and loans from nationalized banks in accordance with government credit allocations through 1986. Most French companies have a narrow private ownership base or are state-owned. Public (nationalized) enterprises and closely-held private entities have informal reporting methods. Government bureaucrats and top executives of state-owned enterprises maintain close ties and effective, informal lines of communication. Owners

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14Hamon [1979, p.95] argues that the implementation of a 'true and fair' concept will be difficult in France because "such a concept may run counter to a prevailing sense of obligation to conform with a system of rigid rules and standard format."

17Ernst & Whinney [1983] reports that, in France, 50 percent of company financing is generated internally, 30 percent is from nationalized bank loans, and 20 percent is from the stock market.

18The Economist [July 11, 1987] reports that government credit allocations were discontinued at the end of 1986 in favor of more conventional monetary practices. However, the state maintains ownership of most of the banking system in France.
usually actively participate in companies with a narrow ownership base. A preference for secrecy may be attributed to a desire to achieve or maintain a competitive advantage, and to preserve family privacy.

**Short-Term Profits** — French managers maintain a moderately profitable reporting emphasis. French laws and socio-economic circumstances restrict a short-term profit orientation; while tantiemes (executive bonuses), corporate take-over threats, a forceful ultimatum, and a strong U.S. influence support a short-term profit reporting orientation. French managers have a personal incentive to maximize short-term profits to receive annual profit-sharing bonuses (i.e., tantieme). The weak franc attracts foreign take-over bids. Companies that appear to be understating earnings are also prime targets for foreign take-overs. The threat of nationalization presents another threat to senior management. Poor economic performance by major

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19 Bickerstaffe [1983] reports that relatively high, progressive personal income taxes tend to de-motivate a profit-sharing pursuit.

20 Business Week [September 26, 1987] reports that European shareholders, particularly the French, are focusing on the bottom line and becoming responsive to corporate raiders who zero in on 'inefficient' management. The article states that foreign investors are lured by easier exchange controls, favorable economic policies, and relatively cheap stocks. Unfavorable earnings reports tend to depress corporate stock prices.
companies has frequently led to their nationalization. The managers of state-owned enterprises have been given an ultimatum by the Ministry of Industrial Redeployment (MIR), to be profitable or be fired.

The United States also has had a significant influence since World War II. An important condition of U.S. economic aid to France under the Marshall Plan was the requirement to train managers to be "economically knowledgeable" and "politically reliable." Economically knowledgeable essentially referred to learning and adopting capitalism. Politically reliable meant anti-communist. The United States government sponsored "productivity missions," inviting thousands of managers and top civil servants to the U.S., to facilitate both objectives. While in the United States, the French economic elite were indoctrinated with an American management philosophy that included a short-term profit orientation.

Conservative -- French law deters an emphasis on short-term profitability. Corporate officers may be held legally liable and even sent to jail for their firm's financial failure. Corporate income tax law essentially requires the financial report and tax return to be identical. Higher reported pre-tax profits cause a higher

\[\text{\#1 Refer to Boltanski [1987] for a detailed discussion.}\]
income tax expense. Both areas of the law encourage ultraconservative profit reporting practices. Understating profit prevents capital from being distributed through dividends or taxes. Excessive distributions may jeopardize a company's future existence.

Socio-economic circumstances, namely a strong social welfare sentiment, curtail managerial motivation to report short-term profits, despite profit-sharing bonuses. The greater its reported prosperity, the more a company has to contribute to social welfare programs. The poorer a company appears, the more it receives from a government that repeatedly has intervened to transfer wealth through high income taxes and social benefit costs. The government has frequently enacted programs to protect labor. A prime example is the mandatory profit sharing law that requires worker participation in profits. Recently, the Socialist government reduced the work week and extended annual vacations for all employees. Employers had to bear the cost of these benefits. Previous interventions included price controls and restrictions against employee layoffs. Meanwhile, the government has a selective credit policy, lending funds to industries facing troubled economic times (e.g., the steel and automotive industries), at subsidized rates. In sum, companies have little incentive to report high profits.
**Users**

The primary user of the uniform annual financial reports is the government, particularly the Finance Ministry. Banks and institutional investors also use the reports, but government is the most significant consumer.

**Government** -- The Finance Ministry requires corporate management to prepare a uniform annual financial report to obtain data for its macro-economic, regression-based planning model. This elaborate model relies upon national income accounts, compiled from companies' annual financial reports, to formulate national economic guidelines. Uniformity facilitates data compilations and performance comparisons within and across industries. Such comparisons are important for an interventionist government that supports select companies and industries. Comparative information helps to identify strengths and weaknesses, opportunities and bottlenecks, and the impacts of various industrial policies.

The Ministry of Industrial Redeployment (MIR), the country's most dominant stockholder, relies upon the uniform annual report to monitor economic performance of individual (industrial) enterprises. The MIR is responsible for appointing and replacing the presidents of the many nationalized companies, and evaluating performance with respect to three year planning contracts signed with the
state. Failure to comply with the contract terms or unsatisfactory profits may lead to MIR action that includes firing management. The MIR also might alleviate a firm's reported financial difficulties through special funding arrangements.

The Ministry of Labor recently waged a successful campaign to require the financial report to include a bilan social (effective 1984). A bilan social or social balance sheet is a quantitative, nonmonetary schedule that details a firm's labor related statistics. These labor statistics are vital for the Ministry of Labor to function effectively.\(^{\text{23}}\)

**Banks**-- Bankers rely upon annual financial reports to try to determine credit worthiness. Despite frequent nationalizations and a government allocated credit policy, bankers exhibit a strong preference for making short-term, risk adverse loans.\(^{\text{24}}\)

**Institutional Investors** -- Large insurance companies, financial institutions, and banks rely upon annual financial reports for investment decisions. The government promotes

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\(^{\text{22}}\)Planning contracts (i.e., contacts de plan) are discussed in the "Corporate Sector."

\(^{\text{23}}\)The bilan social is discussed in the "Financial Accounting Differences" section.

\(^{\text{24}}\)The banking system is discussed in greater detail in the "Capital Funds" section.
institutional investment in order to ensure stability, and to provide a counterbalance to corporate management's power. The huge privatization program includes a provision to place one fourth to one third of equity holdings of nationalized industrial giants with a "hard core" (noyau dur) of institutional investors. The noyau dur are long-term investors who are interested in the company's progress and representation on the board.²⁵

Privatization also has created a phenomenal growth in a new class of about five million small (household) shareholders. Quick profits (e.g., initial offerings have produced 20 to 30 percent profits) and employee participation schemes have attracted many small shareholders.²⁶ However, individual shareholders usually do not rely upon annual financial reports.

²⁵The WALL STREET JOURNAL [August 21, 1987] reports that financial management by corporations which seek short-term capital gains through high volume is not as popular in France as it is in the United States.

²⁶BUSINESS WEEK [May 25, 1987] reports the increase in individual household stockholders is attributed to profits that are "virtually guaranteed." The WALL STREET JOURNAL [January 19, 1988] discloses that about 5 percent of Matra's shares were sold by the government to employees at preferential rates and another 6 percent was retained for a future (free) stock distribution. The ECONOMIST [November 1, 1986] reports that 10 percent of Saint-Gobain stock was set aside for employee purchases at preferential rates by the government.
Capital Funds

An established, dominant banking system, expanding securities exchange, and aggressive Economic, Finance and Budget Ministry (Finance Ministry) supply new capital. The securities exchange is very small by world standards, and until the mid 1980s has not been a reliable source of domestic capital funds. The banking system and Finance Ministry cohabitate through a collusive interdependent partnership to generate capital funding for the corporate sector. This partnership is not always compatible. A common educational background and pantouflage unite elitist bankers and economic bureaucrats, but conflicting goals divide them. Pantouflage refers to personal links established when government bureaucrats 'retire' to pursue senior executive banking positions. Conflict occurs because bankers favor immediate profits, low risk, and short-term investments. Economic bureaucrats strive to ensure adequate long-term financing for targeted growth oriented enterprises.

French capital funding participants appear to be similar to those observed in Japan but, according to Hough [1982], are not as cohesive (both within and across institutions).

BUSINESS WEEK [July 20, 1987] reports that the Paris Bourse (i.e., securities exchange) generates only one twentieth of the New York Stock Exchange's trading volume. The bourse's volume is less than half of the London Exchange's trading activity.
with a relatively high degree of risk. Tight regulation of the banking system attempts to overcome these incongruent goals.

**Banking System**

A state 'controlled' banking system is the primary source of external capital funding for the corporate sector. The French propensity to save creates extremely large banks. The French prefer short-term liquidity and risk avoidance; numerous households maintain savings accounts, but very few own security portfolios. Given the population's strong propensity to save and apparent risk aversion, French banks have accumulated massive amounts of funds.

A handful of huge oligopolistic banks and a strong central bank facilitate a highly concentrated financial power base. The Banque de France (the central bank) controls the money supply through adjusting interest rates

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**Aujac (1986)** reports that many of the larger banks were nationalized after World War II, then in 1982, the rest of the banks were acquired by the state. Although recent privatizations of banks has occurred, private equity placements have ensured state control.
and reserve requirements. The governor of the Bank is appointed by the nation's President. The Banque Nationale de Paris (BNP), Credit Lyonnais, and Societe Generale are known as the "big three." The Economist [May 24, 1986] reports that the "big three" dominate the commercial deposit banks by controlling 60 percent of all domestic deposits, and by granting 50 percent of all domestic loans. The three are among the world's ten largest banks.

The Caisse de Depots et Consignations is a huge financial institution that, among other functions, channels funds from deposit banks to long-term credit institutions. Special (long-term) financial institutions direct the flow of credit to priority sectors. The most prominent is Credit National. Credit National provides long and medium-term loans drawn from the Caisse des Depots, the money market, and the Treasury. These loans are usually at subsidized interest rates, generally two to three percent below the

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Hough [1982] reports that the central bank was responsible for administering France's discriminatory credit allocation that ensured loans and lower interest charges to companies targeted by the National Plan. The Economist [July 11, 1987] reports that credit allocation ceased at the end of 1986 in favor of the more conventional interest rate and reserve adjustments.

Green [1986] reports that the French have not been nearly as effective in transferring household savings into industrial production as have the Japanese. The French government does not guarantee against financial failure of banks as do the Japanese.
market rate. The Credit National's officials advise the Treasury regarding all major financial rescue operations.

Despite heavy governmental regulation and even nationalization, the bankers maintain a remarkable amount of independence.\(^3\) This independence apparently exists because the banks control a highly concentrated financial power base. Ultraconservative bankers advocate "prudent banking" policies that often do not support entrepreneurial endeavors in accordance with the National Plan. Prudent banking stresses short-term loans with guaranteed returns and low risks.\(^3\) Green [1986] attributes the prevailing ultraconservatism to an institutionalized reaction from a series of nineteenth century bank failures. These failures were caused by bad debts from over investment in high risk industrial enterprises. In contrast, innovative entrepreneurs need long-term funding for relatively risky ventures with unknown returns. The conflict between the bankers and the entrepreneurs within a credit-based capital system contributed to France's relatively late industrialization. The French bankers literally bottleneck

\(^3\)Crozier [1982] describes France as traditionally an authoritarian state with independent subjects. There is a perpetual struggle between respect for authority and a pursuit of liberty.

\(^3\)Short-term loans may facilitate perpetual corporate dependency upon the banks.
the vast reservoir of savings account funds.\textsuperscript{38} 

\textbf{Finance Ministry}

The Economic, Finance and Budget Ministry (Finance Ministry) is a complex and powerful ministry. The Finance Ministry embraces the elite economic bureaucrats that join forces with top business executives to direct the French economy through a limited pluralism. The Finance Minister's regulatory authority over economic matters is virtually absolute, courtesy of the Fifth Republic's constitution.\textsuperscript{39} An elite group of officials from the Treasury Division and the Banque de France manage the financial sector. This elite group interacts daily. The deputy governor of the Banque de France meets with the two top monetary officials of the Treasury every month. The governor of the Bank, the director of the Treasury, and the Finance Ministry meet whenever necessary to resolve substantial matters. The Finance Ministry's regulatory powers ensure that it has a

\textsuperscript{38} In addition to a generally tight credit policy, the OECD [1987] reports that interest rates in France have been consistently higher than those in Japan and the United States. Higher interest charges not only discourage borrowing but also reduce profits that in turn reduce internally generated funds.

\textsuperscript{39} The Economist [December 12, 1987] reports that the constitution restricts the scope of oversight commissions and vests responsibility as far as possible in the executive branch (including appointed ministers). The French Finance Minister is heir to a long tradition of central control that goes back to Louis XIV's minister, Jean Baptiste Colbert.
prominent, authoritative status in the financial sector because French commercial law requires a law to be enacted before an activity is permissible. Code law facilitates a substantial involvement in financial affairs by the ministry. Regulation is so prevalent in France that the nationalization of banks and financial institutions has little effect upon their operations.

Aggressive government intervention was most evident after World War II when a number of large banks were nationalized and, more recently, when a Socialist government came into power (1982). The 1982 "reforms" placed virtually the whole banking system under state ownership. This enabled the Finance Ministry to assume the role of a controlling stockholder. As a controlling stockholder, the Finance Minister appoints presidents for each bank. These bank presidents are summoned to weekly meetings at the ministry.

Soon after the banking system was nationalized in 1982, the Finance Ministry ordered the banks to purchase over $850 million of direct equity shares in desperatelyp

\footnote{French deregulation apparently refers to more permissive laws rather than their repeal.}

\footnote{Aujac (1986) reports that contrary to the initial fears by bankers, the appointed presidents are well qualified and generally autonomous; but, selected by the ministry nonetheless.}
This forced transfer drew vehement protests from the bankers. The bankers complained that these forced investments violated their prudent banking concept. They claimed such actions would jeopardize their banks existence, and the banking system's strong international status.

Nationalizations have also subjected the banks to commit to "contracts de plan" (i.e., three year agreements with the Finance Ministry that incorporate the government's investment objectives and the financial needs of the corporations).

State ownership of banks significantly reduced, but did not destroy the autonomy of the bankers. Banks are expected to be profitable while serving the interests of the state (e.g., funding state-sponsored industries). Yet, investments on behalf of the state may not enhance bank profits and may even result in their losses.

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The forced transfer may have been attributed to the Socialist ideology to preserve jobs during a serious recession. A strategy that did not endure for more than a year or two, due to worsening economic conditions.

de Quillacq [1983] reports that the French international banking network is second only to that of the United States. Green [1986] attributes such a phenomenon to heavy, profit-restrictive regulation upon domestic banking in France.

Green [1986] argues that the bankers failure to support entrepreneurial spirit may also have been detrimental to the generation of profits, and gave the
1982 regulations have been modified by the termination of encadrement and privatization.

Encadrement refers to controlling the money supply through discriminatory credit rationing and restrictive banking. The Banque de France and the Caisse de Depots, directed by the Finance Ministry, allocated loans at various interest rates to corporate customers. Preferential treatment (e.g., receiving loans and lower interest rates) was given to corporations, targeted by the national economic plan. Corporations, not favored by the plan, did not have an opportunity to shop around among banks, since the banks were significantly, and later, totally under state control. Encadrement created tension between the Central Bank and the Treasury, until it was terminated at the end of 1986.

Prudent bankers frequently objected to granting loans to 'unworthy' debtors. This direct intrusion by the state has been replaced in 1987 by a more orthodox (indirect) method of adjusting interest rates and reserve requirements.

Privatization refers to selling the banks back to the private sector. To date, about half of the financial institutions have been sold by the state. This action has resulted in mixed (state/private) ownership of the banking system. As noted earlier, the Finance Ministry placed a government just cause to intervene to promote industrial growth.
significant block of shares (e.g., one fourth to one third) of the privatized banks' capital into a "hard core" of institutional investors (noyau dur). The ministry's selection of the institutional investors was compatible with its objective (i.e., to change ownership, but not control). However, the bankers have attained greater autonomy, due to the switch to private ownership.

'Deregulation' may also lead to a relatively novel role for the Paris Bourse; the Bourse may become a major source of capital funding. Yet, a shift from the banking system to the capital market does not necessarily guarantee that the role of government will be less prominent. The Finance Ministry, through the Commission des Operations de Bourse, regulates the Paris Bourse. In addition, the code law ensures regulatory involvement in the securities market, since a financial instrument cannot be sold unless a law has been enacted to make the instrument legal.

In sum, French capital funding is primarily credit generated; the corporate sector relies heavily upon bank debt. An underdeveloped capital market, a strong propensity for (risk adverse) savings, and government intervention force a reluctant banking system to assume a capital creating role. Aggressive government intervention is evident through nationalization and encadrement. State intervention may establish a banking structure with a
pretense of being an effective mechanism for funding state-sponsored capitalism, however appearances may be deceiving. Government ownership of banks does not guarantee control over the ultraconservative bankers.

**Securities Market**

A stockbrokers' association and a government agency jointly manage the Paris Bourse (stock exchange). Both must approve a company's application to list securities on the exchange. The Syndicat des Agents de Change\(^1\) is an organization of stockbrokers who (until recently) functioned as a government protected monopoly, protected since 1807, courtesy of Napoleon Bonaparte.\(^2\) The Commission des Operations de Bourse (COB) is a six member group, whose objective is to ensure the regularity of the stock exchange's operations.\(^3\) The COB, a regulatory agency, has audit powers, disclosure responsibilities, and authority to

\(^{1}\)The AICPA [1975] describes the Syndicat des Agents de Change as having similar functions to the Stock List Department of the New York Stock Exchange.

\(^{2}\)Business Week [July 20, 1987] reports that recent legislation, effective January 1988, allows banks to buy up to 30 percent of a broker and take full control by 1990.

\(^{3}\)Most [1984] describes the COB's (established in 1967) duties and powers as similar to those of the Securities and Exchange Commission (SEC) in the United States.
approve listings on the bourse. The Council of Ministers appoints its president, the Finance Minister appoints four members, and the sixth is a civil servant. Both organizations require compliance, involving similar sets of financial reporting requirements.

Prior to 1983, France's emphasis on national planning led to a smallish, underdeveloped Paris Bourse; but, recent deregulations contribute to its growth. The government's use of financial persuasion (i.e., control over funding) may have suppressed the French securities market. The government also nationalized the banking system and many significant industrial enterprises to facilitate cooperation with the National Plan. Nationalizations limit securities available for trade. The 1982 nationalizations eliminated 12 percent of the market's blue chip companies.

Deregulation refers to easing restrictions against foreign participation, privatization, and allowing more creative financing instruments. Relaxation of restrictions on foreign investment has led to an influx of capital funds from the United States, Britain, and West Germany. In 1986, privatization expanded the number of blue chip securities.

**Malvy [1986] reports that France's late industrialization necessitated state intervention which has resulted in a lack of public confidence in the private sector's ability to provide economic leadership. The French perceive this as a task better suited for the "powerful and knowledgeable" civil service.**
available and offered high returns. Recent offerings have attracted many small first time investors (i.e., a grassroots support base). Legislation that permits new financial instruments is very popular, and companies are beginning to bypass banks to borrow directly on money and security markets.

The 'bustling' Paris Bourse is relatively small, and the ongoing privatizations are too big for the current market to handle. Private security placements to employees and institutional investors are common; substantial amounts are sold on foreign exchanges. Examples include the recent sales of Saint-Gobain and Matra.

The Paris Bourse is too small to digest the massive privatization program. Selective placement of substantial blocks of shares ensures that some state control is maintained; allowing the state to relinquish ownership, but not necessarily control. The effects of this shift, from direct to indirect control by the state, may free up the

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"The WALL STREET JOURNAL [September 11, 1987] reports that the initial wave of privatization sales have yielded a new class of approximately five million small shareholders which represents ten percent of the population.

"BUSINESS WEEK [July 20, 1987] reports that French companies are raising money at a record rate through the capital market. During the first six months of 1987, the Paris market was tapped for new capital that approximates the annual total for 1986."
capital markets somewhat, but not totally.

Corporate Sector

Two authoritative participants (large corporations and the government bureaucracy) control the French corporate sector. National champions and the Patronat represent the big corporations, while the Ministry of Industry (MIR) represents the government. Weak labor unions present few obstacles, but pro-labor (socialist) legislation prevents complete dominance of labor by employers.

National Champions

The French corporate sector displays a dual structure. A few "national champions" dominate the numerous "petites et moyennes entreprises" (PMEs) and medium-sized entities. A national champion is a very large enterprise that functions as a monopoly or oligopoly within industrial

"Authoritative participants appear similar to those found in Japan. However, according to Franko and Behrman [1984], despite apparently stronger structural relationships in France (e.g., state-ownership), actual relationships between government and business are not as cohesive as the Japanese. In addition, Green [1986] describes the Patronat and MIR to be not as effective as their respective Japanese counterparts: the Keidanren and MITI.

Sjogren [1987] reports that PMEs are also called "fortyniners" because they intentionally maintain employment below 50 employees to avoid certain labor laws. The ECONOMIST (February 9, 1985) reports that approximately half of the French firms are PMEs, and as of 1983, they employ over half of the labor force.
divisions. French industry has one or two national
champions within each major industrial category. *9
President Pompidou proposed the concept of national
champions, to protect French industry against foreign
competition. France's entry into the European Economic
Community (EEC), via the Treaty of Rome (1957), required
phasing out protectionist legislation by the late 1960s.
Protectionism has a long tradition in France and was a major
reason for industry's relative backwardness (e.g., mostly
small, inefficient firms). *30 To counteract deregulation,
Pompidou supported the emergence of one or two large
enterprises in each major industry to protect the many small
and medium sized producers that would supply and purchase
from the national champions. National champions were
established through mergers.

During the late 1960s and early 1970s, the government
initiated a merger movement of vast proportions to establish
internationally competitive firms. Extraordinarily large
mergers created the giants that dominate each industry in

*9 Stoffaes [1986] identifies the dominant companies
within major industries.

*30 Vaughan et al., [1980] discuss the French preference
for small and medium-sized entities, because such firms
provide an important avenue of upward mobility. Workers and
employees are able to free themselves from a wage-earning
dependency and become proprietors. But, small firms lack an
economies of scale.

During the late 1970s and early 1980s, Pompidou fine-tuned his market dominance strategy, emphasizing expertise to capture particular market niches. He wanted to make French companies truly competitive in specific segments of world markets. The government initially served as an advisor, but subsequently became more active, and turned to nationalizations. Nationalizations facilitated concentration of a certain activity within a single company. Common state-ownership facilitated asset swapping and additional mergers. For example, Isinor and Sacilor merged to create a monopoly in the steel industry. Lagrange [1986] describes asset swapping, providing examples such as Thomson's trade with CGE involving telecommunications activities for electronics. In addition, Bull acquired information-technology subsidiaries, spun off from Thomson and CGE. Similarly, Elf-Aquitaine, Rhone-Poulenc, and

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Nausbaum (1985) reports that at the end of World War II France possessed very few of the world's largest corporations. Today 38 of the 500 largest corporations outside the United States are French, according to a recent FORTUNE listing. This list also includes 136 Japanese, 87 British, 58 German, and 33 Canadian companies.
Pechiney traded chemical, petroleum, and fertilizer operations; each company becoming more specialized. The market niches strategy centralized power within targeted industries.

The government not only established National Champions, it also generously supported them through subsidized loans and grants. Government support to industry is highly concentrated in the largest enterprises. For instance, THE ECONOMIST [February 9, 1985] reports that Usinor-Sacilor received half of the state's capital grants to nationalized firms in 1984. The government justifies this policy by arguing that the big recipients serve as conduits and support the smaller companies. A few (select) large industrial corporations have been the chief beneficiaries of industrial policy over the last twenty years.

Ownership of the National Champions is mixed between the public (state) and private sectors. Private ownership has been relatively restricted to the bourgeoisie. Marceau (1977) reports that approximately half of the 200 largest French industrial companies were family controlled during

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Aujac [1986] reports that French industrial policy (since 1965) has downplayed the importance of domestic competition. Government promoted mergers have essentially eliminated enforcement of existing antitrust laws. The Commission de la Concurrence's power to decide antitrust cases has been shifted to members of the cabinet (e.g., the Finance Minister). The French antitrust law is a victim of a policy of industrial concentration.
the early 1970s. Single families controlled six of the 20 largest companies. Post World War II and 1982 nationalizations placed approximately half of the industrial output of the large enterprises under state control. Prior to 1982, public (national champion) enterprises dominated the transportation, communications, energy, banking, and insurance industries. After 1982, the public sector owned approximately 60 percent of the basic and high-technology industries, and a major share (approximately 30 percent) of the capital goods industries. Basic industry refers to metallurgy and chemicals. High-technology industries include aerospace, electrical equipment, telecommunications, electronics, computers, and pharmaceuticals. Capital goods industries include automobiles and mechanical equipment.

Recent developments (since 1986) indicate that some of the nationalized entities are being returned back to the private sector. Privatization plans also include

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BUSINESS WEEK [September 28, 1987] reports that Michelin, the tire company with sales well in excess of $6 billion in 1986, is controlled by the Michelin family.

Aujac [1986] reports that during February 1982, some of France's largest industrial enterprises were nationalized. These enterprises include CGE, Pechiney, Rhone-Poulenc, Saint-Gobain, Thomson, Usinor-Saillor, Bull, Dassault, Matra, and the Compagnie Generale de Constructions Telephoniques (CGCT).

Various articles in BUSINESS WEEK and the WALL STREET JOURNAL report that privatizations have included Saint-Gobain, CGE (France's second largest industrial
selective placement of a significant amount (approximately 20 to 30 percent) of ownership with stable, institutional investors. Meanwhile, placements with employees and initial sales have expanded the base of small, individual investors.\(^5\)

**Patronat**

The Comité National du Patronat Français (Patronat) is an 'umbrella' organization for the collective interests of the French employers.\(^5\)\(^7\) The Patronat (established in 1946; reorganized in 1969) is a coalition of trade associations and large scale enterprises. An executive council, dominated by the leaders of major industrial trade associations, governs this coalition. The major industries (e.g., automotive, petroleum, chemical, and textile) provide most of the funding, and receive preferential representation. The stronger industrial trade associations

group), and Matra. Rhone-Poulenc, Pechiney, and Thomson were scheduled for privatization, but have been delayed due to the world-wide stock market crash in October 1987.

\(^5\)\(^6\)The *WALL STREET JOURNAL* (September 11, 1987) reports that privatization has increased the number of small shareholders to approximately five million (i.e., about double the previous level).

\(^5\)\(^7\)The Comité National du Patronat Français is also called the CNPF. Nausbaum (1985) reports that approximately 90 percent of French business enterprises are affiliated with the Patronat.
and larger entities overshadow the weaker associations and smaller firms. Nonetheless, the Patronat has widespread authority and legitimacy throughout the business circles.

The Patronat representatives, the business sector's most visible interest group, consult regularly with government bureaucrats. The Patronat openly opposes nationalizations, restrictive labor laws, price controls, high corporate income taxes, and social security increases during the 1980s. Its efforts contribute to recent privatizations, repeal of labor laws, removal of price controls, lowering of corporate income taxes, and an increase in employee social security contributions. The Patronat's efforts also help to solicit generous government subsidies to big business.

The Patronat is not the sole lobbying group for business interests; individual trade associations also are quite active. The Patronat and strong trade associations unify and communicate business interests to government and the general public. The communication of agreement with government policy by these interest groups serves to legitimate the government's plans. Numerous trade associations exist in France to provide individual firms extra leverage with government. These trade associations maintain close ties with related government departments.
interactions between business and government. Trade associations maintain divisions that correspond to divisions within the government bureaucracy; these associations often hire top civil servants who leave the government to fill their highest positions.

In addition to the high profile lobbyists, the Association Francaise des Enterprise Privees (AFEP) is an efficient and effective big business interest group. The AFEP prefers to work behind the scenes and maintains a supposedly secret membership that includes about 40 chairmen of large private companies. The AFEP maintains fancy offices close to the Elysee Palace, home of the President, and regularly wines and dines top government officials.

MIR

The Ministry of Industrial Redeployment is an important authoritative participant in the corporate sector. The MIR's prominence increased because of the nationalization of French industry. As a result of these nationalizations, the MIR has equity interests that control approximately half of France's industrial output from national champions. The MIR's responsibilities include appointing chief executive

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Bickerstaffe [1984] reports that the chairmen represent companies with a total turnover of $54 billion. AFEP is directed by Ambroise Roux, a former chairman of CGE, who has close ties with President Mitterrand.
officers for all the public industrial enterprises, and
establishing and monitoring industrial policy."

Similar educational backgrounds and pantouflage
establish a strong bond between the MIR's highest
bureaucrats and the executives of national champions. The
elite government bureaucrats and top business executives are
recruited primarily from two prominent educational
institutions: the Ecole Polytechnique and the Ecole Normal
d'Administration (ENA). This elite training creates a
fraternity of like-minded leaders in government and
business. Many top business executives usually begin
their careers in the civil service. The civil service is a
prestigious place to begin an ambitious career. Wilson
[1985] reports that almost all the large firms had ex-civil
servants on their boards of directors in 1973.

State-ownership allows the government to select the
chairmen for nationalized companies. The MIR's power to
appoint and replace chairmen of national champions is
important, but does not guarantee the agency complete

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"Green [1986] reports that the implementation of
industrial policy has primarily been within the Finance
Ministry's domain because of the Treasury's control over the
purse strings.

"The Minister of Industry (Maisonrouge) is an ex-IBM
executive who spent 38 years with the company; he is a
French citizen."
An important mechanism for establishing and monitoring industrial policy for the MIR is the contracts de plan (i.e., three year contracts). The MIR and each public (industrial) enterprise negotiate separate three year plans. These planning contracts involve three stages. Each public national champion formulates its company specific three year projections. Next, the MIR incorporates suggestions consistent with achieving the objectives of the National Plan (e.g., to increase R & D activities). The MIR’s suggestions are not mandatory, but do tend to influence corporate behavior. Finally, a financial budget is jointly agreed upon that establishes the state and company’s respective funding obligations. Once the contract is signed, the only state intervention is to provide funds, and to review management’s performance at the end of the contract.

The MIR’s role with respect to funding and ability to persuade compliance is facilitated by the Industrial

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*During March 1983, Minister of Industry Chevenement was replaced by Fabius. Chevenement’s "constant intervention" irritated many managers. Subsequent ministers have allowed managers greater autonomy.

**Guillaume [1986] reports that during 1984, virtually all public enterprises (except public utilities) signed these planning contracts.*
Modernization Fund (established 1983). The MIR administers this fund which is used to promote innovation in products and processes. The modernization fund offers financial assistance to public (industrial) entities in the form of subordinated loans (i.e., technological participatory loans). The terms of these loans range from seven to ten years, and they are issued at substantially reduced interest rates (e.g., less than 10 percent when the market rate was about 18 percent in 1983).

The Ninth National Plan (1984-1988) contains twelve priority programmes and an annual budget in excess of 59 billion francs (including about 28 billion francs for capital expenditures). The significant programmes include introducing new technology and encouraging innovation. These two programmes account for almost half of the budgeted

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Green [1986] reports that the Finance Ministry controls most of the financial clout to persuade industry. In addition to controlling the public banking system, the Finance Ministry administers two primary funding sources: the Fonds de Développement Économique et Social (FDES) and the Comité Interministériel pour les Réstructurations Industrielles (CIRI).

Green [1986] reports that about nine billion francs are expected to be distributed in 1984 through technological participatory loans.

Hayward [1986] reports that the five year budget for expenditures exceeds 350 billion francs, and includes about 166 billion francs for capital expenditures.
capital expenditures for each of the plan's five years. In addition, the MIR targets specific industries for expansion. Those targeted include nuclear energy, energy conservation, aerospace, computers, data processing, and telecommunications industries.* The plan also calls for contraction of some industries (e.g., steel and shipbuilding) to reduce excess capacity.

**Labor Relations**

French labor relations are primarily between the employers and government. French trade unions, fragmented and weak, have been ineffective and virtually excluded from the negotiating process.** The national labor confederations include the Confederation General du Travail (CGT), Confederation Francaise Democratique du Travail (CFDT), and Force Ouvriere (FO). The three have different political allegiances and usually maintain conflicting policy approaches. The CGT, the largest with an estimated

**Driscoll and Behrman [1984] report that only France and Japan have publicly announced industries that are targeted for government support in the 1980s. The targeted industries are very similar for both countries.**

one million members, pursues a Communist ideology. The CFDT and FO adhere to Socialist doctrines. However, despite similar ideologies, the CFDT and FO rarely demonstrate solidarity. All three maintain highly decentralized structures with much local democratic control. French trade unionism lacks solidarity across national labor confederations and within each national labor organization.

Low worker participation levels create problems for the national labor confederations, since union dues are a primary source of funding. Employee membership has never exceeded 20 percent of the work force, and has been declining during the 1980s. Union leaders attribute poor participation to deep rooted divisions within the trade union movement, and a steady improvement in wages and living standards since 1945. Union membership is declining, despite stagnant wages and living standards during the last decade. Many workers perceive French unions to be too idealistic and even detrimental. French unions seek radical transformation; they consistently oppose provisions that benefit labor but also reconcile the worker to the existing capitalist system. Since low membership severely limits

\*The ECONOMIST (December 7, 1985) reports that approximately 15 percent of the work force belonged to unions in 1985.

\*Nausbaum [1985] reports that unions have never been interested in profit sharing participation by workers. The unions fear a spirit of class collaboration may evolve from
resources, the unions curtail the use of expert support services, and find it difficult to sponsor lengthy strikes.

In sum, the national labor confederations are no match for the employers' united front led by the Patronat, strong trade associations, and national champions. The unions' lack of solidarity and insufficient resources prohibit any meaningful collective bargaining in France.

Economic prosperity and state (socialist) intervention have aided the labor sector. The French economic golden years (1946-1974) were characterized by tremendous growth in productivity. Labor shared in the prosperity through steady wage increases.\(^7\) Pro-labor legislation includes mandatory worker 'participation' in management and profit sharing plans.\(^7\)

French law requires all companies with 50 or more employees to establish a works council.\(^7\) This council

\(^7\)Almost thirty years of steady increases in wages established a pattern that continued for an additional decade. However, the last ten years through 1983 were more a response to high inflation than economic prosperity.

\(^7\)Pro-labor legislation apparently is attributed to a strong Socialist Party that relies upon working class votes.

\(^7\)Hough (1982) reports that over half the companies in question are not in compliance with the works council law.
should consist of elected employees and should meet at least once a month to 'participate' in the company's management. Essentially, a works council is an important mechanism to access information that is useful in managerial functions. The works council sends representatives to attend board of directors' meetings, but participation is limited to a consultative status. French law also requires all companies with 100 or more employees to establish profit sharing plans in accordance with specified guidelines.

The Socialist government's recent labor reforms that reduce the work week to 39 hours, increase vacation time to 5 weeks, and reduce retirement eligibility to age 60. The employers are responsible for funding all reforms.

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^7^October 1982 legislation mandates disclosure by management to the works council of all relevant information about the company (e.g., planned reductions in the work force).

^7^July 1983 legislation requires worker representation on the board of directors for public enterprises.

^7^Nausbaum [1985] reports that an estimated three to four million workers are covered by mandatory profit sharing plans. However, the financial benefits are less than three percent, on average, of annual wages.

^7^The ECONOMIST [February 9, 1985] reports that the French work less hours per year on average than the Japanese, Americans, and West Germans.
A combination of high wages from a decade of inflation and generous, but expensive Socialist labor reforms have led to a successful protest by the corporate sector. The corporate executives contend that relatively higher wages and social security costs are an excessive burden. They maintain that this burden is detrimental to achieving international competitiveness, a goal shared by both the Socialist and Conservative politicians in government.

The French Socio-Economic Environment

This section provides an overview of the complex French socio-economic environment, to establish a framework for an investigation of financial accounting practices and disclosures in France. Social, political, and economic characteristics are used to describe the socio-economic environment of contemporary France. Prominent social features include stratification, bureaucratization, elitism, and personal independence. Salient political traits consist of authoritarianism, centralization, conservatism, and

A profitable production emphasis, rather than equitable (socialistic) distribution, is discussed in the "Economic Aspects" section.

Since 1983, the interests of the labor sector have been relegated to an unenviable position that includes persistently high unemployment and no wage increases. A plight that may be attributed to a new laissez faire policy that favors united employers over disorganized labor.
relative continuity. Major economic characteristics include state intervention, credit dependency, dual capital structure, sluggish economic growth, high unemployment, and a weak currency.

Social Features

Crozier [1982], Vaughan et al. [1980], and Marceau [1977] describe French society as being relatively stratified and highly bureaucratic. According to Marceau, France's three prominent social classes are the bourgeoisie (classe superieure), middle (classe moyenne), and working (classe populaire or classe ouriere). Traditionally, the bourgeoisie have been dominant; they rule through an elitist bureaucracy.

The bourgeoisie and working classes are major rivals, while the middle class is primarily a zone of transition. The dominant bourgeoisie includes businessmen, senior executives (cadres superieurs) in industry and commerce, senior civil servants, and political leaders. The transitory middle class includes middle and lower managers (cadres moyens), shopkeepers, artisans, and white-collar workers. The majority working class includes manual

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"Transition refers to being socially mobile, both upwards and downwards, usually over two generations.

Marceau [1977] is careful to point out that the French terminology differs slightly from the English, the "classe moyenne" is lower in power and prestige than the English middle class."
industrial workers, agricultural workers, and farmers.\textsuperscript{81}

Though few in number, the bourgeoisie monopolize both power and economic resources. A vast majority of those in power positions (e.g., elected government officials), appointed top civil servants, and senior business executives, are merely following in their fathers' (bourgeoisie) footsteps. Vaughan et al. [1980] report that the bourgeoisie, though less than 10 percent of the population, own over 50 percent of the nation's assets. Conversely, the working class which constitutes 50 percent of the population, own a mere 5 percent of the nation's assets. Since many of France's corporations are closely held, a small number of families possess enormous power.\textsuperscript{82}

Vaughan et al. [1980] argue that the French educational system serves as an effective bourgeoisie mechanism for preserving the status quo. Since the end of World War II, the state has operated grande écoles (i.e., technical schools to train present and future leaders for civil

\textsuperscript{81}Most French farms are small and have been absorbed into vertical processing or horizontal co-operatives, resulting in decreased autonomy that leaves farmers to be more akin to laborers in the working class.

\textsuperscript{82}Marceau [1977] reports that during the 1970s, half of France's 200 largest firms were family controlled, as were six of the 20 largest firms.
service and business). The more liberal, socialistic universities have been relegated to a secondary role. Two schools in particular, the Ecole Polytechnique and Ecole Nationale d'Administration (ENA), provide elite training for the country's 'best' prospects to become top civil servants and senior executives in business. These premier grande ecoles employ a very selective admissions policy to ensure 'quality.' However, with few exceptions, the selective admissions policy perpetuates bourgeoisie dominance by restricting social class mobility. These premier grande ecoles admit a disproportionate number of students from the bourgeoisie, while apparently discriminating against the more populous working class.\(^3\)

Crozier (1982) states that western ideals also contribute to social immobility, inequalities, and a complex bureaucracy. A passion for individual privileges and independence is very strong in France. Such ideals promote self-serving private preserves that seek to monopolize power in order to protect their position. Social fragmentation and the importance of private property create a fertile environment for a fortunate few to dominate the many. Meanwhile, those who have any privileges, particularly the

\(^{\text{3}}\)Ironically, the Fifth Republic's constitution 'requires' the state to guarantee equal access to instruction and vocational training.
lesser privileges, often resist sharing which would reduce inequalities of status and wealth.

Private preserves refer to both tangible estates and intangible societal positions. Inequalities are institutionalized throughout French society. Once entry into an influential group is achieved, the members try to keep others out. The 'upper' echelon usually maintains a pattern that is based on social distance, secretiveness, and closed lines of communication. This social stratification breeds bureaucracies that proliferate regulations which impede free communication, and allow authority to be wielded secretly at the top. Both government and business organizations exhibit this characteristic of bureaucratic remoteness.

Crozier [1982] argues that government, the educational system, and business bureaucracies have pushed stratified, self-protective structures to the point where they are totally incapable of directing human relations. The political and economic institutions create power monopolies. Castes of professional technicians and the families of high society keep the people at arms' length. According to Crozier [1982], the French bureaucratic system relies upon fragmentation through social and professional barriers (e.g., a proliferation of independent corps within government). Meanwhile, the French propensity for
regulations places the social system in a straightjacket. Any complaints about "bureaucratic insanity" (e.g., vicious circles of noncommunication or inefficiencies) are met with more rules, prohibitions, and a deluge of guidelines by those in power. The numerous independent divisions within the bureaucracies enable a select few, particularly the Finance Ministry, grande ecoles, and national champions, to dominate their respective domains.

In sum, French society is stratified, highly bureaucratic, and dominated by an elite bourgeoisie. The educational system and a strong belief in individualism promote a relatively closed, immobile, and inegalitarian society. The elite domination stems from occupying the top positions in the hierarchical bureaucracies of government and business.

**Political Traits**

France's political traits include a centralized structure that is moderately conservative and relatively stable. A hierarchical bureaucratic structure governs the nation. The National Plan symbolizes centralized control. The president, key ministers, and top civil servants wield

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8"France's political traits appear similar to those found in Japan, but are not as prominent (i.e., French political traits are not as extreme as those observed in Japan).
significant power. Meanwhile voters, parliament, trade unions, and consumers are virtually excluded from direct policy formation. Select business leaders carry an abundance of clout through a collusive interdependence with elite economic bureaucrats (i.e., key ministers and top civil servants).

Traditionally, France has been governed by a strong centralized government (e.g., Napoleon's authoritarian bureaucratic structure is still evident today). A mercantilist past and present shapes economic and industrial policies. During the seventeenth century, Finance Minister Colbert introduced an early version of industrial policy that has led to a state-sponsored capitalism.

France's industrial policy, well publicized through its National Plan, is rivaled only by Japan. The National Plan is a top-down approach that attempts to promote cooperation among business, labor, and government, and coordination among the vast number of government agencies. The

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The Constitution of the Fifth Republic (established in 1958) provides the executive branch of government with relatively unchecked powers in relationship to the legislative and judicial branches.

Labor is represented through a strong Socialist Party. The Socialists have either controlled government, or cohabited with the Conservatives, throughout the 1980s.
Interministerial Planning Agency of Federal Government (Commisariat du Plan) provides an important arena for government agencies and big business to interact.® While the Interministerial Planning Agency attempts to suggest priorities and means to implement strategic plans, the Finance Ministry provides the necessary financial clout to persuade constituents. Recent developments suggest that the planning process has shifted from an authoritarian to more of a contractual basis.® Nonetheless, the Finance Ministry remains a focal point in France's political and economic power structure.

The national champions and the Patronat effectively represent the corporate sector. The central government usually listens to these groups, although exceptions do arise. The government regularly supports national champions through subsidized loans and purchase contracts. The Patronat represents industrial and commercial enterprises, both in the private and public (state-owned) sectors, and communicates big business viewpoints to the government and

®-Organized' labor is not very well represented in practice.

®®During 1984, public enterprises and their respective ministries (i.e., finance or industry) negotiated individual three year contracts that are consistent with the five year National Plan.
the people. Big business supports and provides financial backing to Conservatives and opposes the Socialists. The corporate sector offers attractive career opportunities to top civil servants; many former top bureaucrats currently hold top executive and board of directors' positions. Pantouflage and political contributions enhance the corporate sector's political influence.

Assessing French politics is highly problematic. For a nation that claims to be the first to use the political designations "left" and "right," France provides an interesting political setting. The Left Socialist and Communist ideologies are evident in a huge public sector, courtesy of massive nationalizations. In addition, recent pro-labor laws reduced the work week, increased annual vacations, lowered the retirement age, and required 'participative' work councils in larger companies. All

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The Patronat is similar to Japan's Keidanren, but generally not as effective in coordinating the heterogeneous viewpoints of constituents.

Socialist nationalizations, pro-labor mandates, and increased social welfare benefits in the early 1980s were strongly resisted by business leaders. Whereas, the Socialist switch from consumption led economic policies to austerity, investment led economic plans for growth met with much approval by the business leaders.

Many companies were nationalized immediately after World War II and after a Socialist government was elected in 1982. These companies are currently being denationalized.
these labor reforms place an enormous financial burden upon the corporate sector in the form of relatively high corporate taxes and social welfare costs.

The Right Conservative ideology also is evident through recent privatizations, wage controls, tax cuts, subsidized loans to big business, repeal of labor laws that required the Ministry of Labor's permission to layoff workers, and an emphasis upon profitability or at least self-sufficiency in the public (state-owned) enterprises. A (productive) competitive conscious, austerity-oriented government that has tolerated persistent double digit unemployment rates throughout the 1980s appears to tip the scale in favor of a moderately conservative approach.

The 1983 austerity policy has allowed the corporate sector to generate profits with an intent to promote investment led economic growth. Profits arise from cost saving worker layoffs that not only swell the unemployment ranks but also keep wages stable. Corporate tax cuts also contribute to business profits. A strong sense of state-sponsored capitalism is evident in contemporary France.

The Fifth Republic's first three decades illustrate a relatively stable government. The Right controlled government through 1981, then the Left gained control through 1986, and cohabitation marked the most recent two
The French Right includes two major factions: Rassemblement Pour la Republique (RPR) and Union Pour la Democratie Francaise (UDF). The RPR or Gaullists (after de Gaulle) advocate Bonapartism. Gaullists emphasize the nation and authority. The Gaullist objective is to ensure the strength, vitality, permanence, and grandeur of the French nation by increasing the wealth, power, and greatness of France as a whole. Economic growth requires effort, discipline, and sacrifice. This philosophy merely stresses making the "pie" bigger, much like Japanese GNP-ism. The Gaullists have had support among nearly all groups of French society and controlled the Fifth Republic's national policy until 1974. The UDF or Giscardians (after Giscard d'Estaing) advocate Orleanism. Giscardians stress both

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^2^During May 1988, Socialist President Mitterrand was re-elected for another seven year term. He promptly named Rocard, a moderate Socialist, to be Prime Minister. In addition, the Socialists are expected to win majority control of the parliament in an upcoming election. This will guarantee five years of 'Socialist' government.

^3^Bonapartism refers to the authoritarian nineteenth century reigns of Napoleon I and Napoleon III.

^4^Orleanism refers to the relatively moderate nineteenth century reign of Louis-Philippe.
production and distribution through the free market and promoting individual liberty, while respecting hierarchies, particularly the parliamentary elites. Giscardians are moderately conservative or centrist; they support blending market forces with selective administrative corrections. Accordingly, the state's role should be smaller and indirect so that society is able to develop more freely and spontaneously. The Giscardians also advocate social reforms and progressive income taxes to improve society's inequalities. Essentially, Giscardians want to limit the role of government to distribution.

Giscard d'Estaing, France's president from 1974 to 1981, was not able to implement the Giscardian program; he was overwhelmed by pre-existing economic problems and the world's initial oil shock courtesy of the OPEC oil embargo. These disturbances forced d'Estaing to concentrate on production rather than distribution which led to Socialist criticism that the Giscardian 'center' was actually more to the right than its ideology would indicate.

The French Left includes a powerful Parti Socialiste (PS) and a rapidly declining Parti Communiste Francais (PFC). The PS (Socialists) and PFC (Communists) emphasize a re-distribution of wealth and power, but differ between working within the existing socio-economic infrastructure versus replacing it. The less radical Socialists recognize
the importance of maintaining a private sector. They advocate nationalizing the banking system and select oligopolistic corporations to ensure wealth re-distribution and to facilitate a more participative management, eventually leading to worker/stockholders. The Communists advocate a more radical change. Abolish the existing institutions through collective (state) ownership of all means of production and exchange, to establish working class control of political power, and to satisfy the needs of the whole population. The Socialists envision select renovations, while the Communists desire demolition and reconstruction. "5

The moderately 'liberal' Socialists under Mitterrand gained control of government in 1981. However after only two years of the Common Program of the Left (i.e., enhancing consumer demand strategies), the Socialists engineered a major "U-turn" toward a much more conservative economic policy (i.e., austerity and supply side investment). The Socialists adopted an austerity program that shifted priorities away from vigorously protecting employment to stressing (productive) competitiveness through corporate

"5During June 1972, the PS and PFC agreed to the Common Program of the Left. The Common Program lists the policies to be followed by a Leftist government. This compromise was later interpreted in different ways that led to a subsequent divorce of the two parties in 1982.
profitability. Socialists have awkwardly defended their conservative economic policies as being Socialistic because the Socialists are implementing 'their' policies. The Socialists may adhere to a leftist rhetoric, but have been practicing centrists.

The Socialists lost their Parliamentary majority in 1986 when the right regained control. This development led to a unique cohabitation between Socialist President Mitterrand and Conservative Prime Minister Chirac. Cohabitation has caused the once distinct boundaries between the Left and the Right to become rather gray, both appear to have moved closer to the center. The Socialists, although in control for most of the 1980s, have not been practicing a socialist ideology.

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"Parliamentary positions are five year terms unless the President dissolves the National Assembly and calls for a special election. The President's term is for seven years.

"Under Prime Minister Chirac some of the major nationalized banks and industrial giants have been returned to the private sector. However, his proposed educational reforms brought massive protests for being too elitist and had to be repealed. Chirac withdrew them when President Mitterrand threatened to publicly express his opposition.

"The recent presidential election between Mitterrand and Chirac was regarded more as a personal popularity contest rather than an ideological conflict."
During the Fifth Republic's three decades, the Gaullist Right had unquestionable control for the first 16 years. The Giscardian Right-Center then controlled government for seven years, followed by five years of Socialist Left (center) government and two years of Left/Right cohabitation. A definite break is evident when the Socialists came into power, but Socialist ideologies were only practiced for a year or two before the Socialists switched to conservative economic policies and merely gave them a 'socialist' label. Hence, from an economic perspective, French policies, although under different political leadership, have been relatively continuous.

Economic Aspects

France's major economic characteristics include state intervention, a credit based system, a dual capital structure, sluggish performance, high unemployment, and a relatively weak currency.

The government assumes an active role in directing the economy; the bureaucracy and big business have formed a partnership in the 'concerted economy.' Traditionally, France is a mercantilist nation (i.e., a nation with a protectionist government whose intent is to enhance national wealth). French mercantilism evolved into state-sponsored capitalism where the bureaucracy frequently assumed an entrepreneurial position to overcome the private sector's
failure to industrialize due to an extreme adversity towards risk.\textsuperscript{89} Government involvement includes economic controls (dirigisme), nationalizations, subsidized loans, and procurements (i.e., the purchase of products).\textsuperscript{100} Specific legislation (e.g., restrictive labor laws), price and wage controls, and the use of a "dynamique multisectional" model to allocate public funding in accordance with the National Plan enable the government to direct the economy. The government also uses its control of funds from nationalized banks to direct its macroeconomic policy. Government subsidized loans and large government purchase contracts also facilitate implementation of national industrial policies.

France's developed banking system and underdeveloped capital market necessitates a credit based system. A credit based system enables monetary policy to be a viable mechanism to attempt to manipulate the economy; particularly when French corporations (both state-owned and private) are heavily dependent upon debt financing. The powerful Finance Ministry establishes monetary policy, and thereby, has the ability to significantly influence corporate behavior. Debt

\textsuperscript{89}Eighteenth century France was a powerful world leader, while during most of the nineteenth century she simply dwelt on past glories and did not industrialize.

\textsuperscript{100}Dirigisme refers to economic controls; a phenomenon that has existed in France since the seventeenth century.
financing has a direct effect upon dependent corporations; funds can be expanded or contracted. Discriminatory credit allocation was practiced through 1986, since then a more standard monetary policy that adjusts interest rates and reserve requirements is in effect.

France's dual capital structure refers to size and ownership dichotomies. The national champions, though very few in number, dominate the vast number of small, "typically French" firms. Many of the smaller firms (i.e., petites et moyennes entreprises (PMEs) or "fortyniners") intentionally remain below 50 employees to avoid certain labor laws.¹⁰¹ Most French industries are represented by one or two national champions with monopolistic or oligopolistic power and many subservient firms.¹⁰² National champions are either owned by individuals or the government. Private ownership is generally limited and includes a significant

¹⁰¹ The Economist (February 9, 1985) reports that approximately half of the French firms employ less than 50 employees.

¹⁰² Contrary to anti-monopoly enforcement found in the United States, Aujac [1986] reports that the French government actively encouraged and even constructed significant national champions through "asset swapping" while under state ownership. Diversified state-owned companies gave up inefficient peripheral operations in exchange for familiar operations in order to specialize and concentrate production.
number of family-held entities. A sell-off of government shareholdings is currently in progress.

Economic performance (at best) has been sluggish throughout the mid-1970s and 1980s. The "golden age" of the French economy ended in 1974, when the oil dependent economy was hit hard by the first world-wide oil crisis. A serious European recession coupled with double digit inflation was especially devastating to France. Bringing inflation under control was both good news and bad. Recessionary losses caused increases to debt financing. The termination of serious inflation made servicing this additional debt difficult. Economic growth has generally been less than or equal to two percent during the 1980s. Low capital investment, high interest rates, taxes, labor and social welfare costs have been prime restrictions. Under-capitalized French enterprises suffer from high financing costs and low profits, subject to high taxes. Such a setting is not conducive to either internal or external capital investment. The former is not being generated, while the latter is too costly under a credit based system.

\(^{103}\) Castro [1986] reports that French corporate taxes and social welfare costs amount to 17 percent of GNP, compared to only 6.5 percent in the United States. Twice as much labor costs go into producing a French Renault automobile as compared to the average Japanese producer.
However, the fear of double digit inflation, prevalent in the mid-1970s through the early 1980s, curtails any thoughts of using an expansionary monetary policy to stimulate business expansion. Apparently, the French are willing to tolerate greater than or equal to 10 percent overall unemployment rates (approximately 25 percent for youth under age 25), rather than face runaway inflation. Inflation exceeded 14 percent in 1981 before being brought under control. Currently, inflation is less than 3 percent.

Attempts to revive capital investment through a new emphasis on profitability has led to substantial increases in unemployment. Enterprises, concerned with being productively competitive, reduced their 'inflated' work forces when restrictive labor laws were repealed.  

Corporate profits are improving through labor cost reductions (i.e., reduced work force and stabilized wages) and corporate tax cuts. High unemployment levels have effectively suppressed demands for wage increases. This strategy of improving profits to encourage internal capital investments and greater future economic growth is an obvious

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10 Labor legislation in 1976 and 1982 required permission from the Ministry of Labor prior to dismissing workers. A successful argument, by employers, contending that such laws restricted new hirings caused the laws to be repealed.
economic production over distribution scenario.\textsuperscript{105}

The French franc has been a relatively weak currency that has faced recent declines in purchasing power with respect to other countries. The franc's relative weakness should normally help an economy that places a lot of emphasis upon exports. However, France's dependence upon foreign productive equipment and oil, along with the weak franc, makes attaining international competitiveness all the more difficult. French exports are attractive to foreign countries with stronger currencies because of superior purchasing power. Whereas, France's inferior purchasing power makes vital foreign imports more costly.

\textbf{Mandated Financial Reporting}

Contemporary French financial reporting requires uniform annual financial reports that are influenced by external factors. The Finance Ministry mandates uniformity to acquire economic data to be used in national economic planning and to assist decision making by investors, creditors, employees, and other third parties. The government bureaucracy's need for accumulated economic data

\textsuperscript{105}Business Week [April 25, 1988] reports that long-term unemployment and no wage increases over the last four years leaves little doubt that the lower echelons in French society are made to shoulder a huge burden. Soup kitchens are appearing to help the jobless and homeless in France.
takes precedence over all of the other specified users of annual reports. National economic planning includes wealth redistribution through monetary and fiscal policies (e.g., government subsidies and corporate taxes).

Corporate management has little, if any, reason to disclose their company's actual economic performance. The financial reports are prepared to comply with the law. The coercive power of the Finance Ministry has led to management's tendency to merely respond to the letter of the law to avoid punishment.

French financial accounting regulators, in accordance with the Finance Ministry, stress compliance by emphasizing accounting principles such as regularity, sincerity, and prudence. Regularity refers to adherence to specified rules and regulations, particularly the Plan Comptable General. Sincerity forbids the alteration of facts, tempered by a prudent perspective. Prudence means that all risks and losses are anticipated and reported profits are never anticipated (i.e., a pessimistic view of economic 'reality' is emphasized).

The European Economic Community (EEC) requires all member countries to adopt specific directives, to enhance financial reporting harmony within the European community. The Fourth and Seventh Directives are most significant. The Fourth Directive promulgates a "true and fair view."
Essentially, a true and fair view should attempt to communicate actual economic performance through a profit and loss account, balance sheet, and footnote disclosure of all relevant information. The Seventh Directive mandates the preparation of consolidated financial statements. Prior to France's adoption of the directives (effective 1984), neither (footnote disclosure nor consolidated reports) was required. Compulsory footnote disclosure and consolidated reports reflect cultural importation rather than domestically generated practices.

The true and fair view concept has been altered to fit compliance oriented accounting principles. Management's prudent, good faith compliance with the uniform chart of accounts, supplemented by 'integral' footnote disclosure fulfills a French 'true and fair' perspective. Footnote disclosure is not very well defined and the (French) emphasis remains with a quantitative accuracy of accounts. The lack of footnote clarity may be attributed to their newness and the secondary status of most likely footnote users (e.g., investors, creditors, employees, and other

According to Ernst & Whinney [1984], the CNC did suggest, but not require, consolidated financial statements. The COB did require consolidated financial statements for companies seeking to sell new securities on the stock exchange.
Financial Accounting Differences

The French financial report appears to be very similar to an American financial report, although differences exist. The significant differences may be attributed to prominent social, political, and economic characteristics and structural arrangements.

The foundation for French generally accepted accounting principles (GAAP) is different from American GAAP. French code law requires uniformity of accounts, and is not necessarily derived from practice. In contrast, American common law places less emphasis upon strict conformity, and generates GAAP based upon traditional accounting practices.

A comparative review between French and American financial accounting practices and disclosures reveals that significant differences exist with respect to accounting for income taxes, legal reserves, foreign currency translation, leases, fixed assets, and a social report. Table three

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107 The bilan social is a major exception to relatively ambiguous disclosure guidelines.

108 Differences are identified by Fitzgerald, Stickler, and Watts [1979], Choi and Davishi [1983], Arpan and Radebaugh [1985], and Orsini, McAllister, and Parikh [1987].
summarizes divergent financial accounting practices, and disclosures and identifies institutional and environmental influences. The accounting for income taxes, legal reserves, and foreign currency translation shield corporate resources from taxation and/or dividend distributions. These three techniques are moderately conservative and promote capital accumulation. Accounting for leases and fixed assets primarily impact the balance sheet presentation. A required social report illustrates a strong Socialist political influence.

**Accounting for Income Taxes**

A significant difference between France and the United States occurs in accounting for income taxes. In France, tax laws essentially dictate financial accounting procedures since financial income must be equal to taxable income. No expense is tax deductible unless it is first included in the profit and loss account (i.e., there are no deferred taxes). This symmetry between financial and taxation reporting promotes the use of regulated provision or reserve (equity) accounts, and tends to depress reported earnings.

The Finance Ministry's dual role (i.e., tax assessor and administrator of corporate funds) is most prominent with

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109 Similar differences are noted between Japan and the United States. However, the Japanese practices are more conservative than the French, and thereby, more effective for promoting capital accumulation.
respect to symmetrical taxation/financial reporting and the related regulated provision accounts. The French tax assessor monitors social welfare and attempts to redistribute the wealth through taxation. Compulsory symmetrical reports minimize conflicting information about the corporate sector's financial status.\footnote{110} Tax avoidance forces companies to adopt conservative or prudent accounting principles (e.g., to expense immediately rather than to capitalize and defer).

The Finance Ministry accepts and selectively promotes the suppression of reported earnings to ensure internally generated capital funds. Allowable conservative tactics include provisions for additional depreciation, inventory price increases, long term capital gains, foreign expansion, and investments under the compulsory employee profit sharing scheme.\footnote{111} All provisions shield profits from taxation and are intended to promote re-investment within the company. Additional depreciation, inventory price increases, and employee profit sharing provisions are not available for

\footnote{110}{American corporations are able to report tax losses and financial profits in the same year.}

\footnote{111}{The provision for internal investment under compulsory employee profit sharing apparently amounts to state sponsored profit sharing through reduced corporate income taxes.}
dividend distribution. Long-term capital gains and foreign expansion provisions are subject to normal taxation rates, if they are distributed as dividends.

Corporate management adheres to symmetrical reporting because the prudent reporting practice facilitates the retention of capital funds; however, profit sharing bonuses (tantiemes) suffer, and corporate take-over threats may increase if the reports become too conservative. France's progressive corporate income tax rates encourage reporting depressed earnings to minimize income tax expenses. Understated profits also shield resources available for dividend declaration by stockholders. Resources retained within a corporation may be used to maintain or expand future operations, and thereby enhance a corporation's future productive competitiveness. Ensuring a company's survival is important to management, since officers may be held personally liable, and even sent to prison if their company fails.

Conservative financial reporting may negatively impact management's welfare by reducing management's profit sharing bonuses. Unsatisfactory reports also may lead to

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118The French annual financial report is tentative until approved at the annual stockholders' meeting. The stockholders retain the right to determine dividend amounts based upon reported profits.
management's removal. Corporate take-overs occur frequently and managers usually face dismissal. The relatively weak French franc makes French corporations prime take-over targets by foreign operations, particularly if actual economic performance is perceived by corporate raiders to be not as bleak as what is reported. The government, specifically the MIR, appears always ready to nationalize apparently financially troubled national champions to free them from 'incompetent' management.

To minimize corporate take-over threats, management presents separate accounts that reduce income taxes, particularly provisions for additional depreciation and inventory price increases. Additional depreciation refers to accelerated depreciation charges, allowed by the tax law, to promote expansion of certain types of production. The financial report clearly specifies normal, planned depreciation and additional tax-saving depreciation called derogatory depreciation. Provisions for inventory price increases (i.e., adjustments for rising prices to facilitate inventory replacement)\(^\text{113}\) shield additional capital funds from taxes by reducing profits. But, management clearly discloses these tax shield expenses to highlight their

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\(^{113}\) Last in first out (LIFO) is technically not allowed but the provision for inventory price increases provides similar results.
'true' performance; the tax related expenses are not buried in normal operating expense accounts.

Prudent, yet detailed, financial reporting favors bankers and long-term institutional investors. Both groups favor conservative practices that allow retention of funds in the business. Bankers expect repayment of principal with interest. Institutional investors seek increased future securities' values. Restrictions against overly generous income tax or dividend distributions facilitate corporate survival and future growth. Information about tax-saving tactics is relevant for attempting to assess and project a company's actual economic performance.

Legal Reserve

A compulsory legal reserve, advocated by corporate management, provides (some) protection to creditors and other third parties. All companies are required to establish a nondistributable, legal reserve through annual allocations of (at least) five percent of yearly profits, until the reserve equals ten percent of share capital. The objective is to compel companies to retain a fraction of earnings as a minimum measure of protection for creditors and other third parties. Mandatory legal reserves enable

\[^{114}\text{Orsini, McAllister, and Parikh [1987] report that the Japanese legal reserve is targeted to be 25 percent of share capital.}\]
management to shield at least some profits from stockholders, and thereby, facilitate funding for the company's future survival. Recall that under French law, corporate management may be held personally liable for their firm's financial failure. Hence any tactics that improve a company's future existence should have management's support. Meanwhile, stockholders' demands for dividend distributions is mildly curtailed, particularly with respect to new companies or those with accumulated deficits.\textsuperscript{115} The restriction is relatively insignificant since 95 percent of annual profits are eligible for distribution.

\textbf{Foreign Currency Translation}

Accounting for foreign currency translation is moderately conservative. The French accounting treatment requires unrealized exchange losses from current accounts to be included in the current period's profit and loss account; while, unrealized exchange losses from noncurrent accounts may be postponed. All unrealized exchange gains must be deferred. Such a practice depresses, but never inflates, reported earnings. The exceptions that defer unrealized exchange losses from noncurrent assets and long-term liabilities limit reductions to earnings.

\textsuperscript{115}Legal reserves are used to offset an accumulated deficit account, but then must be replenished out of future profits.
Corporate management accepts its responsibility to prepare an annual financial report when the report does not interfere with managerial functions. French managers have little need to hedge in order to avoid translation losses. A comparatively weak French franc (with respect to major trading partners), throughout the last two decades, makes this a moot point. Generally, translation gains result from restating stronger currencies (e.g., United States dollars into the weaker French currency). Since gains are not reported, foreign exchange accounting has generated little controversy. In addition, the ability to defer losses from noncurrent accounts, in the event that the contemporary foreign exchange scenario were to change, minimizes the impact upon the profit and loss account. Deferred gains, and losses from noncurrent accounts, appear in suspense accounts on the balance sheet.

Bankers and institutional investors tend to adhere to conservative profit reporting practices that create a 'secret' margin of safety to ensure a loan customer or investee's future survival. The bankers are fearful of loan defaults, while the investors despise worthless securities. The potential to postpone translation losses from noncurrent accounts may mislead bankers and institutional investors with long-term interests. However, the ability to calculate a total translation loss for the year is possible through
footnote disclosure and analysis of changes in suspense accounts. Disclosure of such information may infer a secondary user status.

**Accounting for Leases**

Accounting for leases illustrates corporate management's dominance, and an apparent lack of interest by the Finance Ministry and other users of the annual financial report. The French treatment is not conservative and full disclosure is not required. No leases are capitalized; all are treated as simple operating leases. Annual lease expenditures are merely recorded as expenses. No assets or related liabilities are recorded. In addition, only information about 'capital' leases is disclosed in the footnotes to the financial statements,\(^{11}\) therefore, users cannot determine the assets and liabilities resulting from lease contracts. French managers may favor off balance sheet financing, since the evaluations of their performance may be enhanced.

Corporate management is not motivated to provide financial information about the company, except to meet the letter of the law. In this instance, the law's simplicity favors management. Management is able to acquire productive

\(^{11}\)Ernst & Whinney [1984] reports that information about operating leases is not disclosed. Prior to the adoption of the EEC's Fourth Directive (effective 1984), footnotes were not required.
assets without having to reflect related obligations. This scenario effectively allows management to report more favorable financial ratios (e.g., return on assets, equity and debt ratios), and possibly to circumvent bank loan agreements that may restrict future liabilities.

The government bureaucracy places a strong emphasis upon quantitative aspects but is generally apathetic with respect to qualitative features. Uniformity and compliance are illustrated through codified law, particularly through the use of a uniform chart of accounts. However, subjective judgment such as deciding the substance of a rental versus purchase agreement is an issue that the bureaucracy chooses not to pursue. The prescribed treatment simply adheres to the form of an agreement. This decision is consistent with code law, but allows legal form to take precedence over actual substance in determining the accounting treatment of a transaction.

The bankers and institutional investors may be discriminated against, but are not completely helpless with respect to accounting for leases. The form over substance issue may distort a company's financial position, but the recently required EEC footnote disclosure about 'capital' leases does alleviate much of the problem. Through disclosed footnote information, the financial statements may be adjusted to reflect capitalized leases. However, the
need for such computations may infer a secondary user status.

Fixed Asset Revaluation

Accounting for fixed assets permits revaluation to counteract inflation. These revaluations may be either in accordance with a government decree or by the decision of management. The most recent government sponsored write up was in 1976 (effective through 1979). The 1976 revaluation law increased fixed assets to reflect replacement or utility value. This increase was credited to a special provision for revaluation (provision spéciale de reévaluation), a non-distributable owners' equity account. This provision was then gradually allocated to income in proportion to annual (stepped-up) depreciation charges. The 1976 revaluation had a neutral income tax impact. The contemporary treatment also allows management to voluntarily write up fixed assets on an aggregated basis to reflect replacement or utility value. Voluntary revaluations have immediate income tax consequences; the revaluation surplus is deemed to be ordinary taxable income.

The 1976 revaluation law apparently is a compromise between the Finance Ministry and the corporate sector. The Finance Ministry prefers economic data that is not inflation...

117 France has suffered from serious bouts of inflation, particularly during the mid 1970s and early 1980s.
distorted (e.g., depreciation costs that indicate replacement cost of property, plant and equipment).
Meanwhile, the corporate sector favors tax avoidance. The corporations are willing to provide inflation adjusted economic data, if such a write up of assets does not result in an immediate recognition of taxable income. In sum, the Finance Ministry permits a gradual income recognition of revaluation surplus which is then offset by higher depreciation charges.

Voluntary revaluation of fixed assets is a viable income smoothing mechanism, particularly during periods of operating losses or low (actual) profits. Management determines replacement or utility value; it is a subjective estimate. This (management) appraised increase must be included in the determination of profit and loss. During periods of anticipated operating losses, management has an incentive to revalue; operating losses can be offset by the asset write ups. For a company in a loss position, asset write ups would merely 'erase' the loss, and yet, not result in taxable income. Managers with short-term motives may even be willing to pay taxes (i.e., to report profits attributed solely to fixed asset write ups) in return for increased bonuses, or to ensure satisfactory performance evaluations.
Management's ability to influence reported economic performance requires bankers and institutional investors to decide whether certain adjustments (e.g., revaluation of fixed assets) should be regarded as income, or merely as artificial smoothing devices.

**Bilan Social**

French law (effective 1977) requires large companies to prepare a uniform social report that indicates employee benefits and working conditions (i.e., a bilan social). This quantitative, nonmonetary report includes seven information categories: (1) employment, (2) wage related costs including benefit packages, (3) health and safety protection, (4) other conditions of work, (5) employee training, (6) industrial relations, and (7) other conditions of life relating to the business, including company sponsored housing and transportation. Each category is further divided into numerous subcategories that are comprised of several quantifiable indicators (e.g., the number of employees exposed to specified noise or temperature levels). In accordance with code law, the report is quite detailed and very specific.

Boussard and Rey [1984] state that some managers had voluntarily provided the information required by the social report to trade union representatives. This mandated bilan social merely facilitates disclosure to a greater number of
employees, and defines a specific information system.

Government legislation that requires disclosure of employee benefits and working conditions may be attributed to a strong Socialist party. The Socialist party depends primarily upon labor's support, and therefore, attempts to portray a pro-labor image. Politicians benefit by 'forcing' management to disclose information that is of interest to employees. In addition, the Ministry of Labor has a direct interest; since it is has been charged with the responsibility of ensuring labor's welfare.

Generally, corporate management probably would prefer to avoid the additional bureaucratic red tape (i.e., more forms to file). However, such disclosures may be beneficial, if they diffuse radical socialist and communist propaganda campaigns by antagonistic trade unions. A lack of disclosure may connote secrecy, and trade unions may use secrecy to evoke an emotional response from workers. Some unions prefer to abolish capitalism altogether rather than work within the system. These unions oppose employee profit sharing and other arrangements that may make capitalism appear viable.
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CHAPTER VI

A COMPARISON WITH THE UNITED STATES

Japan, France, and the United States appear to have institutional similarities, but fundamental differences apparently influence their respective financial accounting processes. The Japanese, French, and U.S. financial accounting scenarios reveal structural similarities and operational differences.\(^1\) Figures seven, eight, and nine illustrate a nation-specific financial accounting process, its neighboring social systems and its socio-economic environment for Japan, France, and United States, respectively. The diagrams identify similar institutional, authoritative participants within similar social systems' dimensions for each nation. However, operational differences may be attributed to diverse socio-economic characteristics and attitudes across the three countries.

I first present a comparative description of the three political economies of accounting, so that I can interpret the divergent financial accounting practices through

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\(^1\)This chapter is structured so as to facilitate nation-specific cross references to the Japanese and French Political Economies of Accounting presented in Chapters IV and V, respectively.
a structural analysis. Divergent refers to Japanese and French accounting practices that differ from those observed in the United States. A structural analysis considers the financial accounting process's (intra-system) authoritative participants, trans-system activity among interactive social systems, and surrounding environment.

Each nation's banking system plays a vital role in supplying externally generated capital funds. The French securities market, to some extent, and the U.S. securities market, to a greater degree, affect their respective corporate management's behavior. The Japanese and French government bureaucracies are significant authoritative participants within their processes of financial accounting, capital funds and corporate sectors. Whereas, the U.S. government plays a relatively minor role with respect to the process of financial accounting and its neighboring social systems. The Japanese government bureaucracy, financial and corporate communities may be described as a well balanced tripod. The French finance and business communities appear to be subject to a government bureaucracy hegemony. In contrast, the U.S. government and society appear to be subject to a finance and business hegemony.

Mintz and Schwartz [1985] define hegemony as the ability to influence overall policy, but does not go so far as to dictate specific strategies.
The Japanese rely upon authoritative guidance and harmony rather than legislative action. The French code law, an authoritarian doctrine, attempts to encompass all activity within France. In essence, French code law requires specific legislation to make an activity legal. The U.S. common law, derived from traditional practices, responds to 'problematic' issues through due process. Due process refers to legal proceedings established to protect individual rights and liberties. Individual freedom and private property rights are held in the highest esteem in the United States; this practice confers tremendous power to private property ownership. Japanese group consciousness is incongruent with the U.S. and French social characteristics, particularly individual freedom and self-interest. The U.S. and French society accept relatively antagonistic relationships (e.g., between management and labor, or at times, between business and government). The Japanese avoid conflict and promote consensus building to achieve harmony.

Overall financial accounting differences include: underlying premises of financial reporting, accounting for income taxes, legal reserves, and foreign currency translation. Additional differences between Japan and the United States include consolidation practices, preparation

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3Crozier [1982] describes France as a traditionally authoritarian state with independent subjects.
of a cash flow statement, and calculating earning per share. Additional differences between France and the United States include accounting for leases, fixed asset revaluation, and the preparation of a social report.

The Financial Accounting Process

The financial accounting process includes regulators, facilitators, preparers, and users of financial reports. U.S. financial accounting is self-regulated, while Japanese and French regulators of financial accounting are dominated by their respective government bureaucracies. The U.S. certified public accountancy profession is the world's largest, while the Japanese and French public accounting professions are small in size. All three countries have laws that require corporate management to prepare annual financial reports. However, philosophical differences among managers across the three countries with different socio-economic environments apparently produce different responses with respect to corporate reporting. The French management's reporting duty is to provide its government with uniform economic data. U.S. financial reports focus on investors and creditors with speculative, short-term, financial profit motives. Whereas, some Japanese financial

"Refer to the center sections of figures seven, eight, and nine. The three countries' financial accounting processes are illustrated."
Regulators

Regulation of financial reporting in Japan and France appears to be similar, but different from the U.S. process. The Japanese and French acceptance of macro economic planning by the public sector is evident through their respective governments' domination of financial reporting regulation. The Japanese MOF appoints members and funds its BADC. Similarly, the French CNC and COB are agencies of the French Finance Ministry. In contrast, the U.S. Financial Accounting Standards Board (FASB) is a privately funded regulatory body. The Securities and Exchange Commission (SEC), a government agency, explicitly identifies and relies upon the FASB as the source for financial accounting standards. Financial support for the FASB comes primarily from the largest certified public accounting firms. These CPA firms derive their revenues from corporate clients.

The FASB, a group of seven full-time board members, establish standards through a majority vote, after a due process procedure. Edwards and Shildneck (1987) describe a typical due process procedure which precedes the board's

As of June 1988, the FASB has issued 97 statements of financial accounting standards and 6 conceptual framework statements.
vote to include: (a) a preliminary evaluation of an issue, (b) admission to agenda, (c) an appointment of a board member to be responsible for defining the problem and performing a literature review, (d) an appointment of a task force, (e) research, (f) the preparation of a discussion memorandum, (g) holding a public hearing, (h) the preparation of an exposure draft for public comment, (i) revisions, (j) further deliberations by the board, and (k) the final vote. The FASB's due process procedure usually incorporates responses from constituents whom are most likely to be affected by a proposed financial accounting standard. This process encourages special interest lobbying, and thereby, promotes a micro (firm specific) economic emphasis. In sum, U.S. financial accounting regulation is located in the private sector and has a micro economic orientation. The U.S. regulatory process apparently favors constituents with abundant resources (e.g., large corporations, financial analysts, and industry groups).

Facilitaters

The Japanese and French accounting professions have similar traits, but are different from the U.S. accounting profession. Both Japan and France have modest, centralized, government dominated professions. Whereas, the U.S. profession is the world's largest and functions as a private
limited plurality. The American Institute of Certified Public Accountants (AICPA) is a private national organization that represents the public accountancy profession (certified public accountants) in the United States.

Meinert [1987] reports that AICPA membership in 1987 consists of approximately 250,000 CPAs; 120,000 CPAs are in public practice and 100,000 CPAs are employed in the corporate sector. The CPAs who are employed by corporations hold powerful positions; about 40 percent are corporate officers, including 15,000 corporate presidents and vice-presidents. According to Meinert, some of the largest U.S. companies select CPAs to fill elite positions that include chief executive officers, chairmen and members of the corporate boards of directors. Corporate CPAs use their powerful positions to influence economic, financial, and governmental polices. They also communicate important corporate preferences to the FASB and SEC with respect to financial reporting aspects.

Owles [1981] argues that the U.S. public accounting profession is dominated by the ultra-large firm, particularly the "Big Eight." The Big Eight includes Arthur Anderson, Coopers & Lybrand, Deloitte Haskins & Sells, Ernst & Whinney, Peat Marwick & Mitchell, Price Waterhouse, Touche Ross, and Arthur Young. Each firm employs over 2,000 CPAs.
underwriters exhibit a bias in favor of nationally-known accounting firms, frequently incorporating a requirement that specifies an audit by one of the Big Eight firms. Underwriters likewise often require a switch from a local to a national accounting firm when a company desires to make a public securities offering.

Hermanson, Dykes, and Turner (1987) describe the auditing segment of the accounting profession as oligopolistic, since the Big Eight firms audit the companies that generate over 95 percent of all sales dollars of publicly-held companies. McConnell (1984) agrees, arguing that the Big Eight not only dominate the public accounting services provided to the largest publicly-held companies, but are increasing their dominance in the New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX) audit markets.

Olson (1982) states that liability lawsuits against public accounting firms and investigations by government officials may be attributed to the CPA profession merely servicing their corporate clients' needs with little regard for users of annual financial reports. Congressman Moss and

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7Previts (1985) reports that 63 percent of Big Eight revenues were derived from audits, 15 percent from consulting, and 22 percent from tax in 1983. In addition, the Big Eight had 8,787 SEC clients; 9 other national firms had 1,029 SEC clients; and 185 other firms had 643 SEC clients in 1983.
Senator Metcalf have each chaired committees to investigate the public accounting profession. Both committees were highly critical of the profession's self-regulatory policies, particularly with respect to allegations that a self-serving Big Eight possessed dominant control.8

Despite the litigation and critical reports by government officials, the U.S. accounting profession maintains a self-regulatory process and a close association with Corporate America. These circumstances favor financial accounting policies that are sensitive to the demands of large corporations.

Preparers

Japanese, French, and U.S. corporate management assume responsibility for financial reporting. Management must prepare an annual financial report to meet its legal obligations. However, different attitudes and circumstances within each country apparently produce different responses with respect to corporate reporting.

Japanese management, due to a group consciousness and long-term orientation, is indifferent toward speculative investors, and place the welfare of employees above these 'outsiders.' Financial reporting to external groups, particularly those with short-term oriented goals, is not

8Self-serving refers to a bias in favor of their large corporate clients, with little regard for the users of the annual financial reports.
given a high priority in Japan. The Japanese require financial reporting to appear 'modern' to the Western World. Long-term survival and lack of profit incentives may cause Japanese managers to understate reported profits so as to reduce dividend and income tax distributions.

French management, due to self-interest, government intervention, and the threat of takeover, is not as complacent as Japanese management, but less motivated than U.S. management with respect to financial reporting. A primary purpose for financial reporting in France is to provide the government bureaucracy with uniform economic information for the National Plan. The government frequently assists financially troubled (large) companies, but also has nationalized many major companies (national champions) to rescue them from 'incompetent' management. Profit sharing bonuses for corporate executives and the threat of corporate takeover apparently should encourage management to report 'healthy' profits. Whereas, redistribution of wealth through corporate income taxes or selective credit, and corporate officer liability for financial failure apparently should encourage understating profits. Hence French managers appear to be pressured by an authoritarian / self-interest dichotomy to smooth reported income.
U.S. management, due to self-interest and the threat of takeover appear to be responsive toward speculative investors, who seek short-term profits. Management's attentiveness toward speculative investors may be attributed to the U.S. environment and management's pecuniary interests. Patton [1985] reports that an executive's success is usually measured by monetary reward. Failure to receive such reward inevitably results in managers changing jobs.

U.S. executive compensation usually includes a base salary, profit sharing bonuses, stock options, and golden parachutes.¹ Performance based, profit sharing bonuses are used to motivate management. During the 1980s, stock options and (now) golden parachutes provide substantial rewards to managers, often, many times more than their base salary plus profit bonuses. Stock options, an instrument which entitles its owner to acquire a company's stock at a prescribed price, reward executives with millions of dollars because the company's stock market price rises above an established price. Stock options may make managers more

¹Japanese executives are much less likely to switch employers because of their group consciousness values.

¹Japanese managers do not have profit sharing, stock option, or golden parachute incentives. While French managers do have a profit sharing incentive, the literature is silent with respect to stock options and golden parachutes.
sensitive to investors, and thereby, may even exacerbate a short-term profit orientation. Many U.S. managers believe that reported profits are positively correlated with their company's stock price.

Golden parachutes, lucrative financial settlements for executives whose companies are acquired through corporate takeover, also increase executives' wealth by millions of dollars. managers' efforts to drive the price of their corporate stock up may provide them with lucrative supplementary compensation through stock options. However, depressed corporate stock prices may make a company a target for takeover, and a subsequent self-rewarding, golden parachute bonus for its management.

Flinkstein [1987] reports that a majority of chief executive officers (CEOs) have finance backgrounds and usually pay close attention to return on investment and annual or quarterly profits to evaluate corporate performance. Meanwhile, BUSINESS WEEK [June 20, 1988]

1 Refer to BUSINESS WEEK [May 2, 1988]: "Top Executives' Compensation". Exercising stock options is the major compensation component. Golden parachutes are rivaling the largest compensation amounts.


describes most CEOs as having an inadequate understanding of engineering and technology, particularly when such activities are expenses that reduce their compensation. According to **BUSINESS WEEK**, this lack of knowledge causes inadequate funding for necessary technological resources, particularly with respect to research and development. Executives, with their finance backgrounds, are not as able to evaluate research or production as well as their company's financial condition, so they opt to do what they know best. Hence long-term survival of the company may be jeopardized.

U.S. corporate executives have a relatively short-term, financial orientation. Drucker [1986] argues that a fear of corporate takeover, and subsequent replacement of incumbent management, is the primary reason executives manage for the short-term. Ellsworth [1985] points to executive compensation, particularly stock options and profit sharing bonuses, as primary reasons for managerial preoccupation with quarterly financial performance. According to Ellsworth, the U.S. securities market over-values short-term profits and under-values the cost of long-term competitive

\[1^{4}\text{Law} [1986] \text{ reports that most senior executives are replaced after a corporate takeover.}\]
decline. Law [1986] describes the securities market as too short-run oriented, citing immense volume trading (e.g., 100 million sharedays are common occurrences). According to Law, a "now generation" of portfolio managers, under pressure to outperform their counterparts each quarter, are quick to trade so as to gain near-instant results from their stock investments.

BUSINESS WEEK [May 18, 1987] identifies the U.S. corporate executive to be his or her own worst enemy with respect to short-term constraints. The U.S. CEO demands pension fund managers, the dominant investor group on Wall Street, to exceed market performance on a quarterly basis or be fired. This practice promotes rapid trading of securities, where 60 to 65 percent of investment portfolios are replaced annually. High volume security trading promotes stock price volatility; a scenario which may negatively impact executive earnings through worthless stock options and ultimately lead to the replacement of management by a hostile corporate takeover, or disappointed board of

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Hector [1988], Rappaport [1987], and Pickens [1986], among others, disagree with the popular criticism that the market fails to recognize long range corporate strategies (e.g., research and development expenditures). However, all agree that U.S. executives are major proponents of such market 'flaws', despite a lack of empirical evidence.
directors.\(^{16}\) Hence, management concentrates almost exclusively on short-term earnings to keep its corporate stock price up. U.S. managers are more concerned with financial appearances rather than with operations.\(^{17}\)

U.S. managers' self-interests may override corporate objectives. Patton [1985] argues that because a job change increases an executive's salary 2 to 5 times the average increase for a promotion within a company, promotions have lost out to changing employers. Jackall [1983] describes managers in the United States to be competing on a fast track, under a bureaucratic code of ethics. According to Jackall, a rising executive expects to be promoted on a regular basis, rarely staying in a position for more than 2 years.

Fast track executives have little incentive to ensure a company or segment's long run survival. The return on investment criterion actually discourages long-term capital expenditures, particularly if the decision-maker does not expect to be in a position to receive any of their

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\(^{16}\)James and Soref [1981] identify poor profit performance as the strongest and most consistent determinant with respect to the firing of a fortune 500 CEO.

\(^{17}\)Refer to Chapter IV, Japanese managers are unaffected by the stock market and concentrate upon managing production.
benefits. Hence, self-serving individual goals with respect to personal career advancement neither encourage loyalty to the company nor a concern for the company's future existence. Rappaport [1981] argues that corporate policy is based on individual managers who assess decisions in terms of personal economic rationality. Corporate and personal economic rationalities may, and often do conflict, particularly when executive incentives are short-term; whereas, a perpetually successful corporation requires long range commitments.

**Users**

The Japanese and U.S. users of financial reports are similar, but different from their French counterpart. The primary users of Japanese and U.S. financial reports appear to be nonrelated institutional investors, primarily interested in short-term profits through capital gains and dividends. But, while cross-shareholding insulates Japanese managers from being affected by these speculative investors, U.S. managers appear to be more responsive to these speculators, due to a threat of corporate takeover.

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19 Stata and Maidique [1980] describe FORTUNE 500 companies as relying upon a one dimensional, return on investment goal to reward executive performance. ROI conflicts with long-term growth by suppressing investments necessary for long-term growth.

19 Speculative investors apparently acquire equity securities because of their potential for unlimited returns rather than being an owner-entrepreneur.
Meanwhile, the primary user of the French financial report has been government bureaucrats, particularly the Finance Ministry and the MIR. Other users in France also may include speculative investors. Both the U.S. and France are experiencing numerous corporate takeovers throughout the 1980s, a phenomenon that is not present in Japan.

The Japanese fusion of power and group consciousness at the corporate level encourages sharing information between corporations and the government bureaucracy (e.g., between the Keidanren and MITI or MOF), and within a group (e.g., among Keiretsu members). In addition, employees (through enterprise unions) also have access to information about their company's economic performance. Hence, this direct access to information apparently reduces a potential for agency problems, except for those deemed to be outsiders (e.g., speculative investors). The Japanese apparently accept information asymmetries.\(^{180}\)

The French Finance Ministry requires uniform data so that it may determine financial support for select companies and industries through the use of a macro economic, regression based, planning model. Similarly, the MIR requires information so that it may evaluate corporate

\(^{180}\)Merino and Neimark (1982) argue that U.S. self-regulation of financial reporting may be threatened by government intervention, if information is not 'equally' accessible.
managements’ performances. The French government has traditionally intervened through subsidized funding and nationalization. The former may encourage understating reported profits, while the latter may encourage overstating reported profits. In addition, a recent propensity for corporate acquisitions within France also may encourage overstating reported profits.

The U.S. corporate investors are represented by a growing institutional and a shrinking individual shareholder (dollar volume) base. Institutional investors dominate the securities markets. Pension funds own substantial amounts of corporate securities for speculative rather than corporate ownership reasons. Corporate pressure on pension fund managers, to generate immediate capital gains so that the corporations’ annual pension costs are reduced, has led to a high volume of security trading and stock price volatility. In sum, U.S. managers may have an incentive to overstate reported profits so as to try to maintain or increase their companies’ stock prices to avoid being targets for takeover.

Capital Funds

Japan, France, and the United States all have established, hierarchical banking systems that are the prime suppliers of external capital funds for their corporations.
While U.S. lending practices require corporate managers to maintain a balance between debt/equity financing, the Japanese and French practices favor debt financing. Therefore, equity securities are more important to the U.S. manager; the securities market has a greater impact on financial reporting in the United States. The Japanese securities market has little impact on Japanese financial reports. Whereas, the French securities market, like the U.S. market, does force corporate management to be cognizant of corporate takeovers. However, the U.S. market's magnitude, combined with a U.S. concern over debt/equity relationships, apparently has a greater impact on financial reporting than does its smaller French counterpart. The U.S. securities market has a significant impact on corporate behavior; U.S. managers appear to divide their attention between managing their operations and reporting profits.

**Banking System**

The U.S. banking system has a more decentralized structure and less government intervention than its Japanese and French counterparts. The U.S. Federal Reserve is a unique 'central' bank that may be described as either quasi-public or quasi-private, while the Japanese and French central banks are closely regulated by the MOF and Finance Ministry, respectively.
The Japanese banking system has a close relationship with the MOF. The MOF explicitly guarantees the Japanese banks against financial failure, and ensures relatively low interest rates (cheap funds) through an accommodating monetary policy. In return, the banks adhere to the MOF's administrative guidance, particularly with respect to funding in accordance with the national industrial policy. Major Japanese banks and large corporations maintain two-way, interrelated equity holdings and interlocking directorates. The banking system is able to rely upon a large and stable source of capital because of the citizenry's propensity to save.

The French banking system has experienced frequent coercion by its Finance Ministry, yet autonomous bankers prevent a total domination of the banks by the government. Nationalization of the banking system enabled the Finance Ministry to appoint bank presidents and facilitated discriminatory credit rationing (encadrement) in accordance with the National Plan. The government's forced transfers of funds to targeted (often financially troubled) corporations has been challenged by ultraconservative bankers. French bankers adhere to prudent banking practices (i.e., to generate profits, but at a low risk), particularly since the government does not offer the banks protection against financial failure. The French propensity to save,
though not as impressive as the Japanese, far exceeds the U.S. citizenry on a per capita basis, and thereby, provides a large and stable source of capital for the banks.

The Federal Reserve (Fed) controls the U.S. banking system. The Fed is the central bank in the United States. But unlike the Japanese and French central banks, the Fed is relatively independent of government. After Presidential appointment and Senate approval, the Fed's chairman (4 year term) and board members (14 year terms) are not subject to formal restraints by the federal government. This autonomy enables the chairman's position to become very powerful, since there is no formal recourse by the President or Senate, nor is there a federal oversight body. The chairman has become the person responsible for monetary policy in the United States.

The Federal Reserve's monetary policy officially pursues three goals: to keep prices as stable as possible, to keep long-term growth as high as possible, and to keep unemployment as low as possible. Kettl [1986] reports that during the 1980s, the Fed's predominant ideology is to prevent inflation. Woolley [1984] reports that bankers are

$^{31}$Woolley [1984] describes the process of selection of appointees to include an acceptance by the financial community as a prerequisite for appointment.

$^{32}$Kettl [1986] reports that the chairman of the Federal Reserve Board is the second most influential person in the United States, second only to the President.
highly adverse to unexpected inflation, since net creditors suffer a loss when they are repaid in nominal dollars that have less purchasing power. The bankers apparently are influential in obtaining an anti-inflation monetary policy.

An elite group of commercial banks dominates the U.S. banking system. These commercial banks, through lending consortia, supply the large corporations' demand for external funding. Mintz and Schwartz (1985) argue that lending consortia are a source of immense power over major capital-flow decisions in the United States. Lending consortia are joint ventures involving many commercial banks and insurance companies who pool their financial resources to fund large corporate loans. A typical lending consortium establishes a lead bank; the lead bank usually has the largest percentage of the loan and often the longest ongoing relationship with the corporate borrower. According to Mintz and Schwartz, nearly half of all U.S. lending consortia are headed by four New York commercial banks, and 75 percent are led by 15 large banks located in New York, Chicago, Philadelphia, and San Francisco. The lending consortia impose cooperation among members which creates a united financial interest with respect to corporate borrowers.

The U.S. commercial banks' decisions about capital flows are not risk free. Banks are expected to generate
profits or else discontinue their operations. Unsuccessful lending practices do subject banks to failure and even extermination. While it is true that 99 percent of the U.S. commercial banks are insured with the Federal Deposit Insurance Corporation (FDIC), the FDIC does not protect a bank from being forced out of business. The FDIC's role is to protect a bank's depositors, not the bank itself. Bank failures and subsequent closings were very common during the 1920s and 1930s, particularly the early 1930s. Bank failures dropped drastically from the 1940s through the mid 1970s, but have become more of a common phenomenon during the 1980s. The failure rate of U.S. banks during the 1980s, rivals that of the late 1930s.

**Securities Market**

The Japanese, French, and U.S. securities markets' impact on financial reporting ranges from being insignificant, having some influence, and to being very influential, respectively.

Despite the Japanese Market's impressive size, it is a relatively thin market. Apparently, cross-shareholding, a perception by potential investors of information asymmetries, and its higher cost of capital restrict the

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market's influence in Japan. Preemptive par value issues and rigidly fixed dividend policies make equity funding more expensive than debt financing in Japan. In addition, nonrelated investors, interested in short-term profits, have little influence in Japan's fusion of power among government bureaucrats, bankers, and corporate executives.

Although the French Market is small, it is a mechanism that enables (hostile) corporate takeovers to occur. France has a tradition of nationalization, whereby the government purchases outstanding equity securities of major banks and corporations. In addition, corporate acquisitions by domestic and foreign corporations are prevalent in France during the 1980s. This takeover phenomenon forces corporate managers to be cognizant of such a threat and may impact their behavior (e.g., to report 'healthy' profits to attempt to maintain or increase their corporations' stock prices).

The U.S. Market's magnitude, a generally accepted (U.S.) financing practice, and its dominant institutional 'investors' may contribute to the market's influential status with respect to financial reporting. U.S. financiers traditionally insist upon a balance between equity and debt funding, while the Japanese and French prefer debt over equity. This balanced funding creates a greater dependency upon the stock market in the United States.
Drucker [1986] describes U.S. pension funds to be the U.S. stock market. According to Drucker, U.S. pension funds own approximately 50 percent of the equity shares in all publicly-held, U.S. corporations. In addition, the pension fund managers are trustees who are forced to act like speculators rather than owners. This speculative behavior may be attributed to defined benefit pension plans. A defined benefit pension plan exerts pressure on the pension fund manager to increase the value of pension fund assets so that annual employer contributions may be reduced. However, a dominant position of pension funds in the stock market makes the pension fund manager's role, particularly a manager in charge of a defined benefit plan, rather onerous. Drucker [1986, page 12] states that "if one is the market, one cannot possibly beat it".

Johnson and Roberts [1988], Dougall and Gaumnitz [1986], and Mintz and Schwartz [1985] describe pension fund / institutional investors as being the dominant force in the U.S. Stock Market.

Drucker [1986] reports that U.S. pension funds actually own over 50 percent of the equity shares in the largest U.S. corporations.

Drucker [1986] reports that most U.S. pension plans are defined benefit rather than defined contribution. The former enables an employer's annual contribution to vary, depending upon a change, preferably an increase, in pension fund assets. Whereas, the latter requires a fixed annual contribution.
Nonetheless, pension fund managers, rather hopelessly, strive for 'excessive' returns by investing in comparatively risky equity securities that have the potential for unlimited future returns. A potential that often is never fulfilled. In addition, a short-term, profit maximization objective requires acceptance of financial deals which provide immediate financial rewards, despite their negative, long-term side effects.

A recent, high propensity for corporate takeovers is impacting corporate management in the United States. This relatively high frequency of corporate takeovers may have both good and bad features. Drucker (1986) reports that a new wave of hostile corporate takeovers is threatening the once autonomous, professional managers, who were accountable to no one, and virtually, unchallenged by stockholders. Corporate management is now being uprooted by a new breed of corporate takeover specialists, who are bringing change into Corporate America. These takeover specialists are using leveraged buyout techniques to realize substantial, short-term profits, while potentially jeopardizing a targeted corporation's future existence.

Drucker describes the contemporary U.S. securities market to be a fertile environment for get rich quick schemes, while literally plundering the corporate sector. According to Drucker, corporate management's dominance over
stockholders, has left managers in a vulnerable position. U.S. stockholders are not compelled to be loyal to particular companies, but rather these stockholders invest to receive future returns. Stock dumping often occurs when a company faces a crisis. In addition, a significant amount of corporate stock is held by pension funds with defined benefit plans. Accordingly, pension fund managers are trustees, not owners, who are expected to maximize immediate returns so that annual employer pension contributions may be minimized. Hence pension fund managers (trustees) are forced, out of necessity, to accept takeover bids which promise immediate financial rewards. Meanwhile, the pension managers are not in a position to consider the welfare and interests of 'their' corporate property.

To finance costly takeover purchases, takeover artists have borrowed heavily.\textsuperscript{67} This debt subsequently becomes the responsibility of a targeted corporation. An acquired corporation is often saddled with debt, or key assets sold, or both to satisfy debts incurred by a 'successful' takeover artist. 'Unsuccessful' takeover attempts also reward the takeover artist and penalize the targeted company. To prevent a takeover, the artist usually is bought off at a

\textsuperscript{67}BUSINESS WEEK [May 30, 1988] reports that financing a buyout is rarely a problem because commercial banks, Wall Street investment firms, and pension funds are willing to contribute billions of dollars in return for the high profits.
premium, and thereby, is generally in a win, win situation. The targeted company either directly pays greenmail, or merges with another company and indirectly pays by outbidding the takeover artist.

Drucker identifies stock market valuation to be a contributing factor towards leveraged buyout schemes. Stock market values are generally based on expected future earnings power. Future earnings power is a longer term perspective than a leveraged buyout which uses an immediate break up value. Accordingly, takeover artists target companies that are liquid and/or owners of substantial amounts of fixed assets. According to Drucker, fixed assets may be 'undervalued' if a corporation's intent is to sell such assets rather than to use them in production. However, these break up sales, while generating immediate profits, may impair the company's future existence. Meanwhile, companies with substantial amounts of liquid assets are like vines with ripen fruits, ready and waiting to be plucked.

BUSINESS WEEK [March 21, 1988] summarizes the pros and cons of corporate takeovers to include: an important method of replacing lackadaisical management, a prime means of staying competitive, an accepted part of corporate strategy, and an easy opportunity to report quick profits. According to BUSINESS WEEK, corporate management has begun to copy takeover artists, particularly the leveraged buyout, bust-up
artists, who buy companies with debt, and resell some assets of an acquired company at a profit to repay the debt. This bust-up strategy may be interpreted to be either promoting efficiency or exploitation. Efficiency is being achieved, if the future earnings' value of the sum of the parts exceeds the whole's future earnings value. Hence acquisitions and divestments eliminate waste. However, if divesting is merely taking advantage of a discrepancy between future earnings power and immediate break up valuations, then the future may be jeopardized simply to make the present appear all the better. Efficient acquisitions create formidable business entities that are able to compete in international markets.

In sum, the U.S. Securities Market has facilitated a high propensity of hostile corporate takeovers. Threats or opportunities of takeover may force U.S. corporate management to operate on an even shorter than usual perspective. Takeovers are now an accepted corporate strategy to enhance reported earnings, and to establish corporate giants to compete on an international level.

Corporate Sector

Japan, France, and the U.S. have oligopolistic corporate sectors; a few giant corporations dominate the many smaller companies. Japan's MITI and France's MIR...
influence their corporations, particularly from a macro planning perspective. Japan’s Keidanren and France’s Patronat represent their respective corporations at a macro level. In contrast, the U.S. does not have a government agency that establishes a national industrial policy, nor does the U.S. have an umbrella organization for business which compares to the Keidanren or Patronat. U.S. corporate politics may be described as special interest (micro) based.

Japan’s Keiretsu, Keidanren, MITI, and enterprise unions apparently are products of a group consciousness and harmony at the corporate level. Interdependent relationships exist within a Keiretsu group. Cross-shareholding, interlocking directorates, and a presidents’ club strengthen the bonds between related banks, corporate borrowers, suppliers, and corporate customers. The Keidanren and MITI have a close working relationship apparently due to an interdependency, a similar organizational structure, hiring (elite) University of Tokyo graduates, interlocking institutional experiences, mutual respect and mutual goals. Enterprise unions place management and labor within the same group (i.e., their company).

France’s National Champions, Patronat, MIR, and French labor relations appear to be products of an authoritarian government bureaucracy. The government established and
supported National Champions through nationalization, asset swapping, and state subsidized funding. The contemporary French economy is a product of state sponsored capitalism. The Patronat is a useful mechanism for legitimizing government policies. The MIR hires and fires corporate presidents of state-owned National Champions. The MIR also negotiates and monitors contracts with each state-owned company to facilitate implementation of the National Plan. The Ministry of Labor promulgates pro-labor legislation which forces corporations to incur additional costs.

The U.S. government's laissez faire policy apparently subjects the U.S. government (and society) to a business hegemony. This business hegemony is reinforced by business sponsored policy making and special interest lobbying groups. The U.S. corporate sector establishes both a plurality of policy organizations and numerous corporate lobbyists that are generally separate, independent entities.

Dye [1986] uses a modified oligarchical format to describe policy making in the United States. This limited pluralistic policy making process is funded by corporate and personal wealth through private foundations that sponsor initial research studies. According to Dye, a handful of policy planning groups are the integral coordination points,

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"Refer to Vogel [1983] and Wilson [1985] for a discussion about a business hegemony over government in the United States."
which are responsible for bringing together "people at the top" to arrive at a consensus with respect to national policy. The policy planning groups develop "action recommendations" (i.e., explicit policies or programs), to try to solve or improve national problems. Notable policy planning groups include the Brookings Institution and the American Enterprise Institute (AEI).

Clawson and Clawson [1987] report that hundreds of large corporations contribute millions of dollars to both 'liberal' and 'conservative' business-dominated policy organizations. Often the same corporations fund the 'liberal/moderate' Brookings Institute and the 'conservative' AEI. Both organizations consist of a majority of directors who are interlocked with major corporations through corporate directorships. Despite a 'liberal/moderate' label, the Brookings Institute also pursues conservative issues as well. According to Dye,

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Dye [1986] describes "people at the top" to include corporate, financial, civic, intellectual, media, and governmental leaders.

Refer to Dye [1986], Clawson and Clawson [1987], and Anker, Seybold, and Schwartz [1987]; other prominent U.S. national policy planning groups are the Council on Foreign Relations, the Committee for Economic Development, the Heritage Foundation, and the Hoover Institution. All such groups are well represented and funded by big business.

Dye [1986] reports that Brookings' staffers, including Chairman Roosa, resent the implication that Brookings is 'liberal.'
both organizations are dominant think-tank, policy making
groups for U.S. national policy, and are responsible for
establishing the agenda for the more public, proximate
policy-makers (i.e., the President, Congress, etc.).
Wilson [1985] argues that U.S. business organized
little to protect its collective interests because its
collective interests were seldom challenged until the late
1960s and early 1970s. But when threatened by increased
federal regulation which impacted day-to-day operations, the
response from business was vigorous at the firm, industry,
and national levels.33 Individual firms and industry trade
associations established political action committees (PACs),
located in Washington, D.C., to aggressively lobby for pro-
business policies. These company and trade association PACs
provide influential grass roots lobbying. At the national
level, the Business Roundtable was established to counteract
a growing federal government.

The Business Roundtable, a most influential corporate
lobbyist, exists to defend the interests of big business.
The Roundtable consists of the chief executive officers from
the 200 largest U.S. corporations. The organization's
prestige comes from its impressive membership. Only elite

33Wilson [1985] describes the establishment of the
Environmental Protection Agency (EPA) in 1970 and the
Occupational Safety and Health Administration (OSHA) in 1971
to be antagonistic and threatening to the corporate sector.
chief executive officers are granted membership; these CEOs can not send surrogate representatives. Dye [1986] states that members of congress are usually impressed when a Frank Cary, chairman of IBM, appears at a congressional hearing about business regulation. The Roundtable is relatively effective in its attempts to enact deregulation, corporate income tax cuts, and federal budget restraints, particularly with respect to social regulatory agencies such as the EPA and OSHA.

Nonetheless, the U.S. Business Roundtable does not have the ongoing impact of the Japanese Keidanren nor the French Patronat. A combination of the Roundtable's effectiveness, and the Reagan Administration's restraint on the size of the federal government, contributes to a lesser role for the Roundtable. Reagan's pro-business policies, throughout the 1980s, neutralize the threats to big business interests from the federal government. Without a serious threat to their interests, the corporate elite are able to return to using more selective (sporadic) lobbying tactics. Such a strategy is more appropriate for the firm or industry level rather than at the national level.

Influential U.S. business interest groups, particularly the company and industry trade association PACs, have relatively narrow goals in comparison to the macro, umbrella approaches of the Japanese Keidanren and the French
Patronat. In sum, the U.S. has a company specific, micro emphasis. While the Japanese and French adhere to more of a macro orientation.

**Labor Relations**

Management/labor relationships depict each country's overall power structure. The U.S. management dominates labor. The Japanese managers promote harmony. While, the French government (particularly the Ministry of Labor) is a protagonist for labor.

U.S. managers and labor unions are adversaries that compete in a zero sum game. However, management has the upper hand throughout their 'competition' with labor for economic rewards. U.S. unions are weak and suffering declining memberships. Popular corporate ideologies (e.g., to become more productively competitive) have usually led to massive reductions in well paying manufacturing jobs.

Vernon [1986] is critical of excessive management compensation levels, while the workers are being forced to accept cutbacks. Workers' cutbacks include both layoffs and reduced benefits. *Business Week* [April 20, 1987] describes the plight of the U.S. worker to be caught in a vise between slowing productivity and fierce competition from low-wage foreign producers. The U.S. worker either accepts a reduction in pay or loses his or her job. According to
BUSINESS WEEK, approximately four-fifths of the nonsupervisory work force's wages have fallen, since their peak in 1972, after adjusting for inflation.

BUSINESS WEEK [January 11, 1988] reports that 'organized' labor remains fairly weak, and employers plan to resist job security demands. Throughout the 1980s, unions are fighting for job security rather than wage increases, but meet stiff resistance from management. BUSINESS WEEK reports that union pay hikes are expected to average 2.5 percent, while inflation is anticipated to be 4 percent in 1988. In addition, BUSINESS WEEK [August 24, 1987, page 55] quotes General Motor's vice-president of labor relations: "if I have to put a new product somewhere, I'm going to put it where the attitude is most cooperative." Finally, BUSINESS WEEK [July 18, 1988] describes the frustrations involving union negotiations through a quote from the president of the international union of electrical workers. The union president sums up corporate management's hegemony best by stating: "I'm not saying it's a good contract, but if we went on strike, the company (General Electric) would shift work overseas and we'd have fewer jobs than ever."

In sum, 'organized' labor in the United States is weak and is dominated by management, especially during the late 1970s and throughout the 1980s. In contrast, the Japanese harmonious relationship between corporate management and
labor is quite different than the U.S. adversarial arrangement. Whereas, the French may have weak labor unions like the United States, but the French Socialists intervene to support labor through pro-labor legislation.

The U.S. Socio-Economic Environment

The Japanese, French, and U.S. socio-economic environments are extremely complex. Nation-specific social, political, and economic characteristics are used to describe and contrast the three countries' contemporary socio-economic environments.

Social Features

The French and U.S. societies appear to have some similarities, while Japanese and U.S. social characteristics are incongruent. Japanese group consciousness and harmony promote interdependent relationships, reciprocity, compassion, and consensus building. The Japanese 'self' is an interactive self that is psychologically dependent upon membership in a group. The Japanese perceive a group as society's nucleus and confrontation as socially unacceptable.

Although stratified and highly bureaucratic, the French Society has a high regard for individualism. Independence and individual privileges (e.g., private property rights) are valued by the French.
Similarly, Cavanagh (1984) describes generally accepted U.S. values to include individual freedom, self-interest, materialism, and equal opportunity.

Individual freedom rejects government interference, particularly restrictions on personal and business activity. This freedom adheres to a social Darwinism (i.e., a harsh "survival of the fittest"). Social Darwinism encourages and rewards the 'most able' to contribute to society's advancement, while the 'less able' are unproductive and should be neglected, to die a natural death. Social Darwinism is now called "free enterprise."

Self-interest initially referred to self-reliance and self-control, but now refers to entitlement and self-fulfillment of the individual. The Puritan (Protestant) Ethic, which related an individual's hard work to worshipping God, has been replaced by a secular orientation with the individual being placed in the forefront. This shift has led social critics of U.S. society to equate self-

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[^3]: According to Cavanagh [1984], Herbert Spencer, Social Statics (Appleton, 1850) applied Charles Darwin's principles to society.
interest with selfishness.\footnote{\textcopyright{} Cavanagh \citeyear{Cavanagh} credits Alexis de Tocqueville, \textit{Democracy in America} (1831) for pinpointing a serious weakness of the American character (i.e., a narrow, inevitably selfish perspective). Tocqueville's appraisal may be relevant with respect to the contemporary corporate executive's disregard for his or her company's long-term survival.} Unfortunately, ethics are often disregarded in a technocratic dominated infrastructure where achievement of desired ends often justify the means.\footnote{Refer to Cavanagh \citeyear{Cavanagh} for examples of unethical corporate conduct that illustrate pressures on management to generate profit at all costs.}

Materialism refers to placing a high value on physical objects, particularly private property. Material prosperity is symbolic of attaining success and personal achievement.\footnote{Cavanagh reports that the United States, with but 6 percent of the world's population, consumes 30 to 40 percent of the earth's nonrenewable resources.} Profit sharing bonuses enable corporate executives to enhance their private property holdings, and thereby, 'prove' their success.

Equality refers to equal opportunity, not absolute equality. Absolute equality conflicts with individual freedom where the 'more able' are rewarded in favor of the 'less able.' This harsh reality is acceptable because of equal opportunity. Equal opportunity refers to the availability of a fair chance, without artificial discriminatory barriers. However, this value is more of an accepted ideal rather than an observed reality, particularly
with respect to economic or political opportunities. 

**Political Traits**

Japanese, French, and U.S. politics have similarities and differences. Conservatism and continuity of leadership are exhibited by all three countries. Japan and France have powerful centralized government bureaucracies. The Japanese government is an equal partner with its financial and corporate communities. The French government dominates its financial and corporate communities. In contrast, the U.S. government is subject to a business hegemony.

Schwartz [1987] describes the relationship between government and the corporate sector as a "business hegemony over government" in the United States. Schwartz defines hegemony to be significant influence over, and quite possibly control of government by the "ruling class of business elite." Schwartz argues that the business elite establishes the government's policy-making agenda, and then actively participates through lobbying in the later stages of legislative deliberation.

Anker, Seybold, and Schwartz [1987] argue that the government legitimizes and protects the interests of the business elite, while portraying an illusion of neutrality.

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Oligopolistic corporations, banks, and insurance companies are very powerful economic institutions. Similarly, most U.S. Senators and Congressmen tend to hold a disproportionate amount of wealth when compared to the electorate.
and professing a 'public interest' rhetoric. The authors discuss four structural links between business and government: personnel transfers, influential policy-planning organizations, effective advisory commissions, and the business elite's domination of public institutions' boards of directors.39

The Reagan Administration has reinforced a business hegemony (throughout the 1980s) by enacting policies that decreased, and thereby, weakened an array of social regulations that affect business, and by adopting tax laws which significantly reduce the tax rates paid by companies, investors, and the wealthy. Reagan's inaugural address made it very clear that he was committed to reversing the trend of an expanding government. According to Reagan, government is not the solution to the nation's problems, "government is the problem."40 Reagan targeted economic growth as a top priority, while his policies of deregulation and suppressed social spending enhance the corporate sector's leverage. Deregulation removes many restrictions on the 'free' enterprise system, and thereby, reduces the threat of outside (government) intervention. Suppressed social

39Dye [1986] reports that the median tenure in office of top federal executives is only two years and that 60 percent go on to private law practice or business.

spending along with generally pro-business tax reforms (e.g., reduced corporate tax rates and investment tax credits) provide a re-distribution of wealth which is favorable to business."

Economic Aspects

The U.S. economy apparently is adhering to a laissez faire doctrine in comparison with the Japanese or French economies. Both the Japanese and French explicitly practice national industrial policies, where their government bureaucracies (either informally or formally) attempt to guide their respective nation's economic activities. In contrast, the United States does not have an explicit national industrial policy, nor does it establish specific national economic goals or targets. For instance, the Japanese government (since 1955) identifies increasing the nation's gross national product (GNP) as the primary national economic goal. While the United States does recognize the importance of GNP growth, other economic indicators are also given an equivalent priority. These other economic indicators include corporate profits and the citizenry's standard of living. This preference for attaining corporate profits and a high standard of living

"Suppressing social spending may promote social ills (e.g., the homeless, a spreading AIDS epidemic, and elderly health care needs), while all demand solutions. Solutions to these, and other social ills, may require a redistribution of wealth away from the corporate sector."
may be attributed to a strong individualistic, micro economic perspective in the United States.

The U.S. economy has been influenced by "Reaganomics" throughout the 1980s. Reaganomics refers to President Reagan's supply-side economic policies, particularly the reduction of federal income taxes so as to restore economic incentives for entrepreneurial endeavors in the private sector. The Reagan administration also promoted deregulation and nonenforcement tactics in order to clear the way for a resurgence of laissez faire capitalism. According to Reagan, the government should not be relied upon to solve the country's economic problems, he viewed the government as a major problem, and thereby, curtailed its (social welfare) economic activities.

Reagan's federal income tax cuts, without reciprocal spending cuts, increased the federal budget deficit. The larger federal deficit, combined with the Fed's efforts to control inflation, helped to drive up interest rates which attracted foreign capital during the early 1980s. The foreign enthusiasm with respect to U.S. debt securities, particularly from the Japanese, helped interest rates to drop, but made the dollar too strong during the mid 1980s. Similarly, the stronger dollar hurt U.S. exports, but enhanced foreign imports which contributed to a growing foreign trade deficit. Now (late 1980s) the United States
suffers from large federal budget and foreign trade deficits. These deficits contribute to a steadily deprecating dollar. The devalued dollar helps U.S. exports, but has yet to dampen U.S. preferences for foreign (Japanese) imports. Americans apparently are willing to pay the higher prices for foreign imports, rather than have their living standards suffer. Meanwhile, the U.S. economy continues to demonstrate modest, noninflationary expansion in output and employment through 1988.

Mandated Financial Statements

Japan, France, and the U.S. require annual financial reporting. The Japanese requirement is a product of cultural importation, so as to appear 'modern' to the West. The French requirement is a product of its authoritarian government bureaucracy. The French government uses such data to formulate its National Plan. The Japanese and French scenarios support accusations that their financial reports may contain more form than substance. Japanese and French corporate management may be responding to the letter of the law rather than attempting to communicate economic 'reality.' Meanwhile, such an accusation against the U.S. (self-regulated) financial reporting may have serious consequences with respect to the status quo. U.S. financial reporting reconciles a democratic ideology and an
oligopolistic economy.

The 1933-1934 Securities Acts require all publicly-held corporations to publish their annual audited financial reports. In comparison with the Japanese and French, the U.S. corporate managers have a greater incentive to seriously respond to their financial reporting requirement. U.S. managers vigorously oppose any government intervention, particularly strong enforcement of antitrust legislation which may threaten management's relative autonomy. Meanwhile, financial disclosure helps to minimize government actions that may substantially change corporate structures and impact operational procedures.

Merino and Neimark [1982] argue that financial disclosure in the United States is necessary in order to reconcile a significant contradiction between a generally accepted democratic ideology and an observed oligopolistic economic reality, and facilitates public confidence in the existing capital market system without requiring structural changes. Jeffersonian democratic ideals envision a democratic model that depends upon a viable middle class acting as the fulcrum. This middle class should be composed of ample, small, independent businessmen and landowners who

"Publicly-held essentially refers to any company that offers its securities on a securities exchange. In contrast to the French case study, this does not mean state ownership."
combine self-interested behavior with fair competition to make a political democracy function in an effective manner. Meanwhile, increased concentration of economic power, through corporate growth and mergers, threatens the existence of competitive markets available for individual economic participation.

Merino and Neimark suggest two mediums of resolution which may facilitate competitive markets: strong enforcement of antitrust legislation and the disclosure of relevant information to present and potential constituents. Strong antitrust enforcement requires structural changes (e.g., corporate divestments to break up monopolies, and restrictive legislation to curtail potential abuses of corporate power). Whereas, disclosure keeps the corporate structure intact, while striving to eliminate information asymmetries through equal access to information for all present and potential market constituents. The equality of information allows all investors to perceive the securities market as a fair game. An equal opportunity to participate in a 'fair' securities market encourages a shareholder democracy rhetoric. A shareholder democracy is consistent with important U.S. traditions, particularly self-interest

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The democratic model, particularly its importance of the middle class, private property rights, and individual self-interests, is based on theories promoted by Mill, Locke, and Rousseau.
and private property rights.

Merino and Neimark's sociohistorical analysis suggests that the financial disclosure requirements maintain the ideological and economic status quo, while promoting public confidence in the existing market-oriented system and its constituents. Financial disclosure helps to alleviate pressures on the government to make substantive institutional changes to the existing elitist corporate infrastructure in order to preserve democratic ideals.

Any accusations of form over substance, prevalent in both Japan and France, may have serious structural and operational consequences for U.S. corporations. Hence, U.S. managers' self-interests are served by preparing financial reports that reinforce investors' perceptions of an equitable capital market. 'Informative' financial reports diffuse the more drastic measures of reform (e.g., breaking up the AT&T's and IBM's), to ensure a democratic economic system.

Financial Accounting Differences

The U.S. financial report appears similar to both the Japanese and French financial reports, although significant differences exist. The significant differences may be attributed to prominent social, political, and economic characteristics, structural arrangements, and the attitudes
of significant authoritative participants.

The foundation for U.S. generally accepted accounting principles (GAAP) is a pragmatic, common law approach that is derived from traditional practices. In contrast, Japanese GAAP is a product of diffusion (i.e., cultural importation from the United States). Whereas, French GAAP comes from an authoritarian code law foundation.

Comparative reviews between the United States and Japan, and the United States and France reveal that significant differences exist with respect to accounting for income taxes, legal reserves, and foreign currency translation. Tables two, three, and four summarize divergent accounting practices and associate nation-specific institutional and environmental influences. These structural analyses review divergent practices to try to associate whose preferences appear to be dominant, or if there is evidence of compromise among competing authoritative participants. Clear-cut evidence of a particular participant's dominance is consistent with an elitist framework. Whereas, evidence of either conflict and/or compromise is congruent with a (limited) pluralist structure.

""The following analysis attempts to associate the U.S. authoritative participants and socio-economic characteristics impact on divergent financial accounting practices. The Japanese and French scenarios were discussed in Chapters IV and V, respectively.""
The observed differences indicate that both the Japanese and French are more inclined to shield corporate resources from taxation and/or dividend distributions than are their U.S. counterparts. These protective techniques promote capital accumulation for long-term productive competitiveness.

In addition, specific differences between the United States and Japan include consolidation practices, preparation of a cash flow statement, and calculating earnings per share. Whereas, specific differences between the United States and France include accounting for leases, fixed asset revaluation, and the preparation of a social report.45

Accounting for Income Taxes

Contrary to the Japanese and French who require symmetrical financial and taxation reporting, the United States permits 'temporary' differences between financial accounting income and taxable income. 'Temporary' differences usually arise by using different accounting methods on the tax return and the financial report. Different accounting methods frequently involve inventory valuation and the calculation of depreciation.

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45Accounting differences are identified by Fitzgerald, Stickler, and Watts [1979], Choi and Bavishi [1983], Arpan and Radebaugh [1985], and Orsini, McAllister, and Parikh [1987].
Inventory valuation refers to the allocation of historical costs between goods sold (income statement item) and goods remaining (balance sheet item). Acceptable cost allocation techniques include specific identification, first-in-first-out (FIFO), last-in-first-out (LIFO), or average cost. There is no requirement that the corporate income tax method selected must be used on the financial report, except for when LIFO is used.

Depreciation refers to allocating historical costs between the income statement and balance sheet which implies the use of property, plant and equipment resources in order to generate revenues. Orsini, McAllister, and Parikh (1987) state that U.S. financial accounting and tax depreciation expenses are often materially different. Acceptable tax return depreciation techniques encourage higher depreciation expenses to be used in actual income tax determination, to minimize the immediate year's income tax obligation. Whereas, depreciation expenses on the financial report are subject to management's discretion without the direct impact on cash flow that is present with income tax reporting.

"The use of LIFO on the corporate tax return requires the use of LIFO on the financial report. This is a common phenomenon according to Orsini, McAllister, and Parikh (1987). LIFO generates a lower reported income, during periods of rising prices and stable or increasing levels of inventory."
Progressive income tax rates and efficient cash management encourage higher cost allocations, which lower reported income on the tax return, in order to depress and defer income tax expenses, an immediate cash outflow. Whereas, management's propensity to report healthy financial profits on the financial report generally supports the use of much slower expense recognition techniques. These discrepancies between the corporate tax return and financial report are reflected in a "deferred income tax" account.

A deferred income tax account is created because generally accepted accounting principles, specifically the matching principle, encourages interperiod income tax allocation. Accordingly, the income tax expense appearing on the financial report is based upon pre-tax financial accounting income, and not the tax expense shown on the tax return. The difference between the actual tax obligation per the tax return and the financial report's 'anticipated' obligation is recorded in the deferred income tax account, a 'liability' account.

Dual reporting, independent financial and taxation reports, may be attributed to the private sector's prominent role with respect to establishing accounting standards, particularly under a business hegemony. In accordance with

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"The matching principle requires expenses to be allocated to the time periods when related revenues are generated."
classical liberalism and enhanced by Reaganomics, the role of government is minimized through a delegation of authority. Left to its own devices, the private sector, primarily under corporate management's direction, is free to respond in accordance with accepted socio-economic expectations. U.S. socio-economic norms include profit-seeking, consumption-oriented, individualistic, self-interested materialism. Short-term oriented, elite corporate executives and speculative institutional 'investors' seek immediate rewards, despite warnings that such actions may jeopardize the long-term survival of U.S. corporations, particularly with respect to productive competitiveness at the international level. This reporting of 'financial' profits, independent of taxation, may create an illusion of economic prosperity so that generous profit sharing bonuses and dividends may be distributed.

This reporting dichotomy shifts a burden upon the corporations, labor, bankers, and the federal government's fiscal authorities. Reported profits are a double-edged sword for corporations. Profits may increase a corporation's appeal with respect to investors and creditors, but reported profits also drain capital funds since a portion are usually paid out in dividends. The payment of dividends to owners leaves less resources to satisfy demands of labor and bankers in a zero sum game.
Meanwhile, the federal government's fiscal authorities are hard pressed to explain why multi-billion dollar companies with highly publicized profits do not pay comparable income taxes, particularly when additional tax revenues are needed to respond to the federal budget deficit.

**Legal Reserve**

U.S. generally accepted accounting principles do not require legal reserve accounts. Whereas, Japan and France require legal reserves to shield a limited amount of corporate funds from dividend distribution. In the United States, a relatively laissez faire attitude by government and a stockholder preference in accordance with private property rights combine to override such protection to creditors and other third parties (e.g., labor). The United States' micro economic perspective permits certain individuals' self-interested material wants to be fulfilled without 'unnecessary' social welfare constraints, particularly absolute equality. In contrast, the Japanese and French emphasize a macro economic perspective which may restrict activities of certain members for the overall 'good' of society.

This unrestricted corporate resource depletion policy enables corporate management to have greater flexibility with respect to satisfying short-term, profit-seeking investors. Management's autonomy to directly determine
dividend amounts is not curtailed. However, such freedom has a potential to be detrimental to corporations, labor, and bankers, particularly in the long run.

**Foreign Currency Translation**

Accounting for foreign currency translation usually does not affect annual reported profits in the United States. In contrast, Japanese and French foreign currency translations often reduce annual reported profits. U.S. GAAP excludes translation gains or losses from income, if the "functional currency" is designated to be the national currency of the country where a foreign subsidiary is located.**

Houston and Mueller [1988] report that prior to the enactment of SFAS No. 52, the accounting treatment under SFAS No. 8 led to wide swings in a company's reported income when translation gains or losses were included. To mitigate income volatility, many companies purchased forward exchange contracts and other hedging instruments to shield reported earnings from paper losses. Hence, companies were incurring real costs to offset a bookkeeping adjustment.

Although hedging of translation exposure may be inefficient, management's self-interest (executive

**“Statement of Financial Accounting Standards (SFAS) No. 52, "Foreign Currency Translation,"” issued by the FASB (1981) replaced SFAS No. 8 which had required all translation gains or losses to be included in reported income.**
compensation) may promote such activity to be rational from an individual manager's perspective. The U.S. companies are evaluated primarily upon their reported annual and quarterly profits; the securities market generally reacts favorably to upswings in reported profits and unfavorably to downswings. The market's reaction is communicated through increases and decreases of corporate stock prices. Low stock prices usually obliterate the value of stock options and may even subject a company to a hostile corporate takeover. Meanwhile, stock options are an important component in executive compensation. In addition, most executives are replaced shortly after a corporate takeover.

Houston and Mueller (1988) argue that the controversy over SFAS No. 8 was compounded during its existence (1976-1981) because the U.S. dollar was a relatively strong currency when compared to most countries' currencies. When a translation conversion restates a comparatively weak foreign currency into a stronger U.S. dollar, it creates a translation loss. However, to include such losses in reported net income was perceived by corporate management to be detrimental to their own personal welfare."

"Ironically, recent devaluations of the dollar, due to foreign trade and federal budget deficits, would cause translation gains to be reported. Such gains would have benefited management compensation and short-term speculative investors."
SFAS No. 52 alleviates many of the practical problems of SFAS No. 8 by requiring translation gains or losses from foreign subsidiaries' restated financial statements to be reported as a separate component of stockholders' equity. Such gains or losses do not effect reported profits unless the foreign entity is either sold or liquidated.

The removal of currency restatements from reported earnings eliminates corporate management's incentive to transact questionable hedging activities. Such activities often create a real economic cost to the company solely to improve its financial report's appearance. The exclusion from income curtails an unnecessary cost to the company. This improvement to corporate efficiency also benefits employees, creditors, and investors (i.e., the participants in a zero sum game).

Japan and the United States

Specific differences between the United States and Japan include consolidation practices, preparation of a cash flow statement, and calculating earnings per share.

Consolidated Reports -- Japan and the United States both 'require' the preparation of consolidated financial reports. As previously described, the Japanese were pressured by outside influences to adopt consolidated reporting. Consolidated reporting requirements appeared in Japan despite relatively strong resistance by preparers and
a lack of domestic demand. This scenario is not observed in the United States.

An explanation of U.S. consolidated reporting is premised upon two key assumptions. First, U.S. financial reporting is a conciliatory act to alleviate a significant contradiction between a generally accepted democratic ideology and an observed oligopolistic economic structure. The disclosure of financial information that is relevant to present and potential investors and creditors enables democratic ideals to be preserved. Secondly, investors and creditors desire an accurate depiction of a corporation's financial position and its results of operations. Meanwhile, majority ownership of one company by another company usually provides the owner (parent) with an ability to control the financing, producing, and selling activities of its property (subsidiary). This ability to control subsidiary operations supports an argument that a parent and its subsidiaries are more like a single economic enterprise rather than separate independent entities. Therefore, all resources, obligations, and operating transactions of parent/subsidiary groups should be reported as one large enterprise to illustrate a more complete financial position and results of operations. In contrast, simple unconsolidated or piecemeal financial reports may be construed to be incomplete or inadequate by investors and
creditors which may aggravate the ideological/actual contradiction. This situation may lead to government intervention which includes more drastic means of reconciliation (e.g., to legislate changes to the economic infrastructure).

Cash Flows Statement and E.P.S. -- The presence of a cash flows statement and earnings per share information in a U.S. financial report and their absence in the Japanese report illustrate the contrasting attitudes observed in the two countries. U.S. managers are very concerned with reporting short-term profits and do acknowledge a responsibility to respond to the information needs of investors and creditors.

Short-term profits are an important indicator of economic performance in the United States; they frequently determine a corporate management's bonus and influence corporate stock prices. The primary objectives of a cash flows statement (formerly called the statement of changes in financial position) are to assist investors to project future dividends and to allow creditors to assess the likelihood of future interest receipts and principal recoveries. Reporting to investors and creditors, and responding to their perceived needs, are given a high

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5. An antithesis viewpoint may contend that aggregated data suffers from a loss of information.

6. This scenario is not observed in the relatively closed-group, long-term oriented Japanese society.
priority in the United States.

Specific differences between the United States and France include: accounting for leases, fixed asset revaluation, and the preparation of a social report.

Accounting for Leases -- U.S. accounting for leases demonstrates a serious effort to provide substantive financial reports. Lease agreements are carefully examined so that the essence of these transactions are reflected in a company's financial position and related operations. Accordingly, if an agreement fits the FASB prescribed standards of a capital lease, then the transaction is recorded as an acquisition of an economic resource and its related obligation is recognized in full; both an asset and liability are shown on the balance sheet. In contrast, the French do not require transactions that are essentially a purchase, but are in the form of a lease, to be substantively reported. The French managers conform to the letter of the law (i.e., to provide quantitative data for macro economic planning). Whereas, U.S. managers are willing to provide 'substantive' reports to individuals in order to diffuse any threat of government intervention directed at protecting a democratic ideology.

Fixed Asset Revaluation -- Unlike the French, U.S. accounting does not permit revaluation of fixed assets to
counteract the efforts of inflation. U.S. accounting for inflation, particularly the revaluation of fixed assets, illustrates its (special interests) reactionary policy of establishing generally accepted accounting principles (GAAP). GAAP are temporal solutions, derived from the FASB due process procedure, that attempts to extinguish existing problems related to financial reporting. During the mid and late 1970s, double digit inflation presented a serious threat to the historical cost basis of financial reporting, and thereby, warranted the attention of the FASB. Meanwhile, suggested valuation solutions were so controversial that the FASB opted to experiment with footnote disclosure. However, throughout the 1980s, inflation has stabilized at relatively low levels. The problem of distorted historical costs is no longer a pressing issue. In sum, the FASB concluded its experiment by withdrawing the required footnote disclosure because inflation is no longer a problem. A response that is very short-sighted.

A consideration of social relations (particularly between the SEC, the accounting profession, and the courts) may offer some insight into this apparently awkward response. Although the SEC is empowered by Congress to

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\[52\] This footnote disclosure of inflationary effects was enacted because of strong prodding by the SEC.
establish financial accounting standards, it opts to rely upon the private sector's FASB. The SEC's delegation does not shield the agency from being subject to public criticisms of failure to carry out its duties whenever problems about financial reporting arise (e.g., the inflation distorted financial reports). Meanwhile, the FASB appeared to be stuck at an impasse. The FASB recognized inflation distortion, but also considered the suggested solutions to be just as problematic to the accounting profession, if not more so. The problematic solutions may be attributed to the accounting profession's growing involvement with costly litigation. Auditors are fearful of abandoning the verifiable, objective historical cost basis for more subjective valuation methods, especially during a period of heavy litigation and unfavorable judgments against CPAs. Nonetheless, the SEC forced the FASB to require disclosure, when the agency issued an accounting series release that required replacement cost information to be disclosed. This accounting series release was subsequently repealed, when the FASB issued its standard that required disclosure of inflationary effects. The FASB had to respond with a standard or be subject to

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Olson [1982] refers to the 1970s as the "years of trial." He reports that large national CPA firms were defendants in literally hundreds of lawsuits involving millions of dollars.
relinquishing accounting standard-setting to the government.

In conclusion, when inflation subsided, the FASB "experiment" was terminated much to the relief of the accounting profession.

Social Report -- U.S. financial reporting does not address social accountability issues. Most annual financial reports contain only brief statements (if any) about social responsiveness. The U.S. financial report has an implicit scope limitation which restricts its coverage to a neoclassical, micro economic reality. According to such a reality, a firm's profits and financial position are critical to the elite suppliers of capital funds, and thereby, should dominate the contents of a financial report.

Social reporting requires an enlarged scope that transcends a microscopic quest of reporting dollar profits to attract capital funds or at least preserve the status quo. To be socially accountable, a corporation must be willing to respond to its overall impact upon society which includes ecological effects on the surrounding air, water or land, and the "quality of life" for its employees. However, neoclassical micro economics places the rights of profit-seeking property owners above all others. The French, by virtue of a strong Socialist political party, require a detailed social report (bilan social) that thoroughly discusses employee benefits and working conditions.
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CHAPTER VII

SUMMARY AND FUTURE RESEARCH

A political economy attempts to recognize both explicit and implicit purposes of nation-specific financial accounting processes. An explicit structural purpose usually responds to a perceived need of society (i.e., a 'functional' response). An implicit social relations' purpose often protects an existing (underlying) power arrangement (i.e., maintenance of a status quo). Political economy also assumes that the social relations' objective modifies a structural purpose.

The Japanese structural purpose of financial reporting is to appear 'modern' so as to facilitate foreign trade and international financial activities. But, the Japanese fusion of power and harmony relegate financial reporting to a ceremonious exercise.

The French structural purpose of financial reporting is to provide economic data to facilitate the National Plan in order to enhance the production and distribution of wealth. But, the French authoritarian / individualism dichotomy leads to compromise and an ineffective communication of economic performance.
The U.S. structural purpose of financial reporting is to provide 'equal' access to economic information for investors, creditors, and 'others.' But, the U.S. business hegemony (due to self-interested corporate managers and speculative 'investors') promotes a short-term profit orientation. Therefore, financial reports do not provide an effective "means" for evaluating a company's long-term financial performance. The corporate managers' compensation and speculative investors' (short-term) wealth enhancement apparently drive the financial reporting process in the United States.

Political Economies

A political economy, through an emphasis upon social relations, contends that the process of financial accounting is often directly or indirectly influenced by certain authoritative institutional representatives, who possess special interests. These authorities usually attempt to establish required financial accounting policies that are congruent with their expectations or objectives. This study summarizes the Japanese, French, and U.S. authorities' relationships and goals, and traces their impact on divergent financial accounting practices.
Japan

The Japanese financial accounting process is influenced by a fusion of power among the government bureaucracy, major banks, and large corporations. The three authoritative institutions have a mutual objective, to improve productive competitiveness at the international level.¹ The government relies upon monetary policy to implement its macro-oriented industrial policies. Accordingly, the government provides the banking system with cheap funds and a guarantee against financial failure. Meanwhile, the major banks and large corporations are usually members of a Keiretsu (corporate grouping), and thereby, frequently have an interdependent (creditor/owner) relationship. Corporations are dependent upon bank financing, while mutual ownership exists in these two sectors through cross-shareholding. The banks lend, and even overloan, to debt dependent corporations at relatively low interest rates. This common goal of productivity requires a special emphasis upon physical capital maintenance. The government bureaucracy and the Keiretsu (i.e., both major banks and large corporations) attempt to protect and enhance the nation's productive capacity. Physical capital maintenance requires resource retention. Hence the shielding of resources from income tax or dividend

¹Productive competitiveness refers to acquiring a competitive advantage rather than parity.
distribution is a necessary and desirable condition.

Personal ties among elite bankers, corporate managers, and government bureaucrats strengthen this tripod. These elite individuals usually have similar educational backgrounds (e.g., graduates of the University of Tokyo). Government bureaucrats often pursue post-bureaucratic careers in finance and business. Bankers and executives often communicate their expectations through the Keidanren to MITI and the MOF. MITI and the MOF rely upon the approval from finance and business to legitimize their government's macro economic policies.

A group consciousness and harmony within the Japanese corporation also promote productive competitiveness. Corporate managers seek consensus, avoid confrontation, and are sensitive to labor's needs. All members with long tenures within the group (company) accumulate prestigious, social capital that is not transferable. Seniority based executive compensation avoids agency problems and potential conflict with labor. Managers and labor work together rather than act as adversaries. This (company) group's future existence requires a physical capital maintenance.

The Japanese are a production conscious society, efforts to make the total pie bigger is consistent with group harmony; whereas, a conflict over wealth distribution is inconsistent with social norms. Group members are
sensitive to fellow constituents, but they do not recognize the existence of nonmembers (e.g., institutional investors with speculative motives are outsiders).

In sum, the Japanese fusion of power promotes a uniform economic goal of production which may encourage understating profits so as to maintain or increase productive capacity. Low (reported) profits protect against income tax and dividend distributions, and therefore, permit capital to remain within a company.

France

The French financial accounting process is influenced by an authoritarian / individualistic dichotomy (i.e., a respect for authority and a pursuit of liberty). A paternalistic government bureaucracy attempts to orchestrate financial and corporate affairs, but is frequently challenged by independent subjects (e.g., the autonomous bankers). The government bureaucracy, particularly the Finance Ministry and the MIR, has aggressively pursued state-sponsored capitalism through nationalization, encadrement and construction of National Champions. Nationalization enables the Finance Minister and the Minister of Industrial Redeployment to hire (and fire) bank presidents and top corporate officers, respectively.

The government bureaucracy also has a social welfare orientation that re-distributes the nation's wealth.
Financially troubled, state-owned companies have received government ordered funding from state-owned banks, despite objections from bankers that such loans were contrary to prudent banking practices. Pro-labor legislation, granting shorter work weeks, longer vacations, and earlier retirements, force companies to make wealth distribution to their employees that are more equitable.

Like many parents, the French government may be guilty of trying to do too much. The government attempts to direct both production and distribution which sometimes are mutually exclusive activities. The bureaucracy sends out mixed signals. For instance, managers should report immediate profits or be fired, but financial bailouts are available for those in trouble, and profitable companies must share their wealth with employees and fiscal agents.

Independence and individual privileges (including property rights) within the French corporate sector, like its U.S. counterpart, create agency problems and adversarial relations between managers and labor. Managers receive profit-sharing bonuses for 'motivation.' They also face another constraint (i.e., the threat of a corporate takeover). The bonuses place management and labor into a zero sum game. The corporate takeover threat requires a sensitivity to an interventionist government and to speculative 'investors.' Both variables tend to make
management focus upon short-term profits which may impede long-term investment objectives. In addition, onerous French laws hold managers liable for financial failure and mandate increased labor costs.

In sum, the French government's dual economic objectives of production and distribution may influence corporate managers to smooth reported profits. High profits increase a French company's social welfare responsibility through higher corporate income taxes and distributions to labor and to stockholders. High profits also may reduce state subsidized funding. However, high profits increase the corporate executives' profit sharing bonuses and may protect against hostile corporate takeovers. Whereas, low profits 'protect' against social welfare and dividend distributions, and may 'reward' a company with state subsidized funding. However, low profits reduce executives' profit sharing and may make a company a target for takeover.

United States

The U.S. financial accounting process is influenced by a business hegemony and prominent social characteristics. The U.S. corporate sector appears to be afflicted with agency problems that may place a precarious emphasis upon distribution over production. The managers and investors adhere to self-interest and materialism which may promote a selfish behavior. For instance, managers may be more
concerned with maximizing their own (immediate) compensation, through profit sharing or golden parachutes, at the expense of their company's long run survival.

Similarly, speculative takeover artists and pension fund trustees may be more concerned with immediate (exploitative) rewards, through questionable leveraged buyouts that are based upon break up values rather than future earning power.

A break up value emphasis may jeopardize a targeted company's long run survival. U.S. executive compensation and exploitative hostile takeover threats may contribute to making a short-term profit seeking goal even shorter. There is little incentive for U.S. managers to under report profits, and thereby, protect productive capacity. Whereas, reporting higher profits increases management's profit-related compensation, and may prevent a company from being a takeover target. Higher profits also are subject to higher dividend distributions.

Financial Accounting Differences

The U.S. financial report appears similar to both the Japanese and French financial reports, although significant differences exist. Comparative reviews between the United States, Japan, and France reveal that significant differences exist with respect to accounting for income taxes, legal reserves, and foreign currency translation.
The observed differences indicate that both the Japanese and French are more inclined to shield corporate resources from taxation and/or dividend distributions than are their U.S. counterparts. These protective techniques may promote capital accumulation for long-term productive competitiveness. This scenario raises an important concern: will the U.S. (self-interest materialism) micro focus on distribution be able to compete with the Japanese fusion of power (group consciousness and harmony) production emphasis, or the French authoritarian production / distribution goals?

Limitations

An exploratory study that ventures into a relatively new frontier can expect to encounter research limitations. The scope is limited to three countries; all three countries are democratic and industrialized. The data comes from secondary sources that are written in English.

Future Research

Overcoming limitations of an exploratory study is the role of future research. Future research should expand the study to include not only other significant industrialized democracies (e.g., West Germany and Great Britain), but all industrialized democracies, developing countries, and communistic nations. The future research possibilities of
replication to other countries are virtually infinite.
Future joint research efforts that incorporate collaboration
with respective nationals should provide significant
improvements with respect to data gathering. In addition,
participation in international exchange programs would allow
researchers to acquire knowledge based on firsthand
observations. These nation-specific case studies should be
replicated and may be cultivated through constructive
criticism.

Descriptive studies are a necessary condition for later
more developed stages of research. This study represents
the first in a series of building blocks to develop a
foundation for future theoretical international accounting
research. An understanding of political economies of
accounting should enhance harmonization studies. Cluster
analyses of nation-specific financial accounting processes
may be based upon observed nation-specific social relations.
Political economies of accounting also may be used to
explain or predict similarities and differences of
particular financial accounting practices among various
countries.

*Refer to Figure One: "Relationship Between Basic and
Applied Research." This is a basic research study that
attempts to improve an understanding of financial reporting
in three countries.*
FIGURES

1. Relationship Between Basic and Applied Research

2. The Two Concepts of Capital and Their Relationship

3. Political Economy: A Two Dimensional Approach

4. Conceptual Location of Trans-Systems and Intra-System Activity

5. Structural Elements of the System of Corporate Regulation in Japan


FIGURE ONE

RELATIONSHIP BETWEEN BASIC AND APPLIED RESEARCH

Basic Research

- Subject Matter

Applied Research

- Reporting
  - provides account of phenomena
    - Description
      - extends account of phenomena to provide understanding and explanation
        - Explanation
          - attempts to formulate conceptual framework or theoretical model

Definitions of Capital

(A) Social Relations of Production

Institutional Realm.

(B) Forces of Production

Methods of organizing productive resources (i.e., types of economy)

FIGURE THREE

POLITICAL ECONOMY: A TWO DIMENSIONAL APPROACH

[A]  
SOCIAL RELATIONS OF PRODUCTION

[B]  
FORCES OF PRODUCTION

* Type of society
  * Determine all participants and their respective roles

* Qualitative orientation
  * Examine socio-political institutions' policies and practices for underlying culture, values, beliefs, and norms.
  * Refer to nation-specific sociological literature.

* Type of economy
  * Determine arrangement of production inputs and distribution channels

* Quantitative orientation
  * Examine economic institutions for transaction volume data regarding inputs and outputs.
  * Refer to nation-specific macroeconomic literature.
FIGURE FOUR

CONCEPTUAL LOCATION OF TRANS-SYSTEMS
AND INTRA-SYSTEM ACTIVITY

* * * * * * * * * * * * * Neighboring System
* * * * * * * * * * * * * Neighboring System

* * * * * * * * * * * * System of Regulation
* * * * * * * * * * * * * regulation authority
* * * * * * * * * * * * * regulation authority
* * * * * * * * * * * * * regulation authority

* * * * * * * * * * * * Nation-Specific Social Environment

(* * *) represent trans-systems activity among systems located within the environment and the system of regulation.

( . . . ) represent intra-system activity among different authorities within the system of regulation.

FIGURE FIVE

STRUCTURAL ELEMENTS OF THE SYSTEM OF CORPORATE REGULATION IN JAPAN

Courts of Law

Diet and Bureaucracy

System of Regulation

Ministry of Justice

Ministry of Finance

Corporations and Keidanren

Japanese Social Environment

FIGURE SIX

A NATION-SPECIFIC FINANCIAL ACCOUNTING ILLUSTRATION: THE PROCESS, NEIGHBORING SOCIAL SYSTEMS & ENVIRONMENT

Capital Funds

Corporations

Financial Accounting Process

regulators

users of capital

facilitators (accountants)

suppliers of capital

Government

Labor

(Social, Political & Economic Environment)

( . . ) represent intra-system participants.

(*) (*) represent social systems.
AN ILLUSTRATION OF JAPANESE FINANCIAL ACCOUNTING:
THE PROCESS, NEIGHBORING SYSTEMS & ENVIRONMENT

Capital Funds
- Banking System
- Securities Exchange
- MOF

Corporations
- Zaibatsu/Keiretsu
- Keidanren
- MITI
- Enterprise Unions

Financial Accounting Process
- MOF-SEL/BADC
- Corporate Management
  + required
  + long-term
  + secrecy
- JICPA
- Institutional Investors & Securities Firms
  + audit
  + capital gains
  + dividends

Japan's Socio-Economic Environment
(social) (political) (economic)
- group consciousness
- relative ranking
- harmony
- centralized
- expensive
- conservative
- continuous
- GNP-ism
- investment led
- foreign trade
- dual capital structure
- strong yen
AN ILLUSTRATION OF FRENCH FINANCIAL ACCOUNTING:
THE PROCESS, NEIGHBORING SYSTEMS & ENVIRONMENT

Capital Funds
- Banking System
- Finance Ministry
- Securities Exchange

Corporations
- National Champions
- Patronat
- MIR
- Labor Relations

Financial Accounting Process
- CNC
- COB
- EEC

Corporate Management
+ conformist
+ conservative

The Ordre + accounting
The Compagnie + auditing

Government
Banks
Institutional Investors

France's Socio-Economic Environment
(social) (political) (economic)
- stratified
- bureaucratic
- elitist
- independent
- authoritarian
- centralized
- moderately conservative
- relatively continuous
- interventionist
- credit-based
- dual capital structure
- sluggish growth
- unemployment
- weak franc
FIGURE NINE

AN ILLUSTRATION OF U.S. FINANCIAL ACCOUNTING:
THE PROCESS, NEIGHBORING SYSTEMS & ENVIRONMENT

Capital Funds
- Banking System
- The Fed
- Securities Exchange

Corporations
- Fortune 500
- Policy Organizations
- Corporate Lobbyists
- Labor Relations

Financial Accounting Process
- FASB
- SEC
- The Big Eight
- The AICPA
- State Societies
- Institutional Investors

The United States' Socio-Economic Environment

(social) (political) (economic)
- individual freedom - classical liberalism - Reaganomics
- self-interest - conservative - GNP & profits
- pragmatic - business hegemony - standard of living
- materialistic - deregulation - oligopolies

- business
- deregulation

- Reaganomics
- GNP & profits
- standard of living
- oligopolies
- deficits
- unstable dollar
TABLES

1. Underlying Philosophical Assumptions and Derived Accounting Research Perspectives


3. An Analysis of Divergent Financial Accounting Practices/Disclosures in France

TABLE ONE

UNDERLYING PHILOSOPHICAL ASSUMPTIONS AND DERIVED ACCOUNTING RESEARCH PERSPECTIVES

A Classification of Assumptions

A. Beliefs About Knowledge

Epistemological
Methodological

B. Beliefs About Physical and Social Reality

Ontological
Human Intention and Rationality
Societal Order / Conflict

C. Relationship Between Theory and Practice

Dominant Assumptions of Mainstream Accounting

A. Beliefs About Knowledge
* Theory is separate from observations that may be used to verify or falsify a theory. Hypothetico-deductive account of scientific explanation is accepted.
* Quantitative methods of data analysis and collection which allow generalization are favored.

B. Beliefs About Physical and Social Reality
* Empirical reality is objective and external to the subject. Human beings are also characterized as passive objects; not seen as makers of social reality.
* Single goal of utility-maximization for individuals and firms. Means-ends rationality is assumed.
* Societies and organizations are essentially stable; "dysfunctional" conflict may be managed through the design of appropriate accounting control.

C. Relationship Between Theory and Practice
* Accounting specifies means, not ends. Acceptance of extant institutional structures.

Dominant Assumptions of the Interpretive Perspective

A. Beliefs About Knowledge
* Scientific explanation of human intention sought. Their adequacy is assessed via the criteria of logical consistency, subjective interpretation, and agreement with actors' common-sense interpretation.
* Ethnographic work, case studies, and participant observation are encouraged. Actors are studied in their everyday world.

B. Beliefs About Physical and Social Reality
* Social reality is emergent, subjectively created, and objectified through human interaction.
* All actions have meaning and intention that are retrospectively endowed and grounded in social and historical practices.
* Social order is assumed. Conflict is mediated through common schemes of social meanings.

C. Relationship Between Theory and Practice
* Theory seeks only to explain action and to understand how social order is produced and reproduced.

Dominant Assumptions of the Critical Perspective

A. Beliefs About Knowledge
* Criteria for judging theories are temporal and context-bound. Historical, ethnographic research and case studies are often used.

B. Beliefs About Physical and Social Reality
* Human beings have inner potentialities which are alienated (prevented from full emergence) through restrictive mechanisms. Objects can only be understood through a study of their historical development and change within the totality of relations.
* Empirical reality is characterized by objective, real relations which are transformed and reproduced through subjective interpretation.
* Human intention, rationality, and agency are accepted, but this is critically analyzed given a belief in false consciousness and ideology.
* Fundamental conflict is endemic to society. Conflict arises because of injustices and ideology in the social, economic, and political domains which obscure the creative dimension in people.

C. Relationship Between Theory and Practice
* Theory has a critical imperative: the identification and removal of domination and ideological practices.

### TABLE TWO

**AN ANALYSIS OF DIVERGENT FINANCIAL ACCOUNTING PRACTICES/DISCLOSURES IN JAPAN**

<table>
<thead>
<tr>
<th>Aspect</th>
<th>Accounting for Income Taxes</th>
<th>Legal Reserves</th>
<th>Foreign Currency Translation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reported Profits</td>
<td>-</td>
<td>N/A</td>
<td>-</td>
</tr>
<tr>
<td>Dividend Distribution</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Taxation Distribution</td>
<td>-</td>
<td>N/A</td>
<td>-</td>
</tr>
<tr>
<td>Resource Retention</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Capital Funds</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Banks</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Corporations</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Keiretsu Members</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Enterprise Unions</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Financial Accounting Process</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management’s LT Goals</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Investor’s ST Profits</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Environmental Norms</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Group Consciousness</td>
<td>*</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Conservative</td>
<td>*</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Continuity</td>
<td>*</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Productive Competitiveness</td>
<td>*</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Economic Expansion</td>
<td>*</td>
<td>*</td>
<td>*</td>
</tr>
</tbody>
</table>

**NOTE:**

(-) is unfavorable treatment.
(+ ) is favorable treatment.
(N/A) is not applicable.
(*) is consistent with norm.

Foreign currency translation assumes the yen is strong with respect to other currencies. A phenomenon that has existed since the BADC's (1979) foreign currency pronouncement.
TABLE THREE
AN ANALYSIS OF DIVERGENT FINANCIAL ACCOUNTING PRACTICES/DISCLOSURES IN FRANCE

<table>
<thead>
<tr>
<th>Accounting for Income Taxes</th>
<th>Legal Reserves</th>
<th>Foreign Currency Translation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reported Profits</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Dividend Distribution</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Taxation Distribution</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Resource Retention</td>
<td>+</td>
<td>+</td>
</tr>
</tbody>
</table>

Capital Funds
- Finance Ministry (a) +/- + +/-
- Bankers + + +
- Institutional Investors + + +

Corporations
- Management (b) +/- + +/-
- Labor +

Financial Accounting Process
- Mgmt’s. ST Goals - - -
- Mgmt’s. LT Goals + + +
- Gov’t. Bureaucrats (c) +/- + +/-

Environmental Norms
- Bureaucratic * * *
- Elitist * * *
- Authoritarian * * *
- Moderately Conservative * * *
- State Intervention * * *
- Productive Competitiveness * * *
- Economic Expansion * * *

NOTE: (-) is unfavorable treatment.
(+ ) is favorable treatment.
(*) is consistent with norm.

a. Finance Ministry has conflicting roles: source/use of capital funds.
b. Corporate managers have both short term and long term goals that may conflict.
c. Includes Finance Ministry, the MIR, and Ministry of Labor.
TABLE FOUR

AN ANALYSIS OF DIVERGENT FINANCIAL ACCOUNTING PRACTICES/DISCLOSURES IN THE UNITED STATES

<table>
<thead>
<tr>
<th>Accounting for Income Taxes</th>
<th>Legal Reserves</th>
<th>Foreign Currency Translation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reported Profits            +</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Dividend Distribution       +</td>
<td>+</td>
<td>N/A</td>
</tr>
<tr>
<td>Taxation Distribution       N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Resource Retention          -</td>
<td>-</td>
<td>N/A</td>
</tr>
<tr>
<td>Capital Funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bankers                     -</td>
<td>-</td>
<td>+</td>
</tr>
<tr>
<td>Institutional Investors     +</td>
<td>+</td>
<td>+/-</td>
</tr>
<tr>
<td>Corporations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FORTUNE 500                 +/−</td>
<td>−</td>
<td>+</td>
</tr>
<tr>
<td>Labor                       −</td>
<td>−</td>
<td>+</td>
</tr>
<tr>
<td>Financial Accounting Process</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management's ST Goals       +</td>
<td>+</td>
<td>+/−</td>
</tr>
<tr>
<td>Investors' ST Goals         +</td>
<td>+</td>
<td>+/−</td>
</tr>
<tr>
<td>Environmental Norms</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individual Freedom          *</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Self-Interest               *</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Materialism                 *</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Classical Liberalism        *</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Business Hegemony           *</td>
<td>*</td>
<td>*</td>
</tr>
</tbody>
</table>

NOTE: (+) is favorable treatment.
(-) is unfavorable treatment.
(N/A) is not applicable.
(*) is consistent with norm.
APPENDIX B

A SURVEY OF INTERNATIONAL ACCOUNTING LITERATURE

INTERNATIONAL ACCOUNTING BOOKS


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Barrett, Edgar, Price and Gehrke (1974), Bellanger (1986),
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Someya (1977), Ernst & Whinney (1981 and 1982), Evans,
Taylor and Holzmann (1985), Fujita (1966), Hiramatsu (in
Choi & Hiramatsu 1987), Hirose (in Choi & Hiramatsu 1987),
Iino and Inouye (in Holzer 1984), JICPA (1979 and 1982),
Kajiura and Kosuga (in Choi & Hiramatsu 1987), Kester
(1986), McKinnon (1986), Minami (1986), Morgan (1985),
Mueller and Yoshida (1967), Ohno and Kodama (1975), Orsini,
McAllister and Parikh (1987), Parente and Weintraub (1988),
Pucik and Hatvany (in Mouer & Sugimoto 1981), Shibata
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B. References for Capital Funds and Corporate Sectors
include Aoki (in Yamamura & Yasuba 1987), Barrett, Price and
Gehrke (1974), Bellanger (1986), Business Week (Articles
listed below), Deakin, Norwood and Smith (1974), Dore
(1986), Hamada and Horluchi (in Yamamura & Yasuba 1987),
Hanami (1981), Hiramatsu (in Choi & Hiramatsu 1987),
Hirschmeier (1970), Kajiura and Kosuga (in Choi &
Hiramatsu 1987), Kester (1986), Koike (in Yamamura & Yasuba
1987), McKinnon (1986), Minami (1986), Morgan (1985),
Stonehill et al. (1975), Uekusa (in Yamamura & Yasuba 1987),
listed below), Yoshimura (in Choi & Hiramatsu 1987).

C. References for Environmental Characteristics
include Baerwald (1986), Business Week (Articles listed
below), Fukutake (1981), Hanami (1981), Hrebenar (1986),
Ishida (1983), McKinnon (1986), Minami (1986), Mouer and
Stockwin (in Mouer & Sugimoto 1981), Tsuneishi (1966), Valeo
and Morrison (1983), Wall Street Journal (Articles listed
below), Yamamura and Yasuba (1987).

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**Business Week**

June 1, 1987 "Waiting for the Yen to Stop Pummeling Profits" by Armstrong and Holstein, pp. 58-59.


July 13, 1987 "A Lockstep Society is Learning to Cut Loose" by Berger, pp. 50-51.

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The Wall Street Journal

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June 17, 1987 "Economy Grew 2.6% in Japan in Fiscal Year"


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"Current-Account Surplus in Japan Declined in May" p. 10.


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"Japan's Use of Hostile Takeovers Abroad Isn't Likely to Extend to Domestic Scene" p. 10.


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