POSITIVE ACCOUNTING THEORY, POLITICAL COSTS AND SOCIAL DISCLOSURE ANALYSES: A CRITICAL LOOK*

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Abstract

This paper critically reviews the literature seeking to establish evidence for a positive accounting theory of corporate social disclosures. It carefully traces through the original work of Watts and Zimmerman (1978) showing their concern with the lobbying behaviour of large US oil companies during the 1970s. Such companies were argued to be abusing monopolists and likely targets of self-interested politicians pursuing wealth transfers in the form of taxes, regulations and other 'political costs'. Watts and Zimmerman's reference to "social responsibility" is shown to be a passing remark, and most likely refers to "advocacy advertising", a widespread practice amongst large US oil companies at that time. Subsequent literature that relies on Watts and Zimmerman to present a case for social disclosures is shown to extend their original arguments. In the process, concern over the "high profits" of companies is shown to diminish, and the notion of political costs is so broadened that it blurs with other social theories of disclosure. Consequently, the positive accounting-based social disclosures literature fails to provide distinct arguments for self-interested managers wealth maximising. This paper also shows that the empirical evidence gathered to date in support of a positive accounting theory of social disclosures largely fails in its endeavour.

Keywords

Positive Accounting Theory, Political Costs, Social Disclosures, Watts and Zimmerman, Advocacy Advertising.

INTRODUCTION

Along with numerous other rationales (e.g., decision usefulness, legitimacy theory, stakeholder theory, critical or political economy theory—see Gray *et al.*, 1995 for a review), positive accounting theory or the political cost hypothesis has been suggested to explain why firms make voluntary social disclosures. Based on the original work of Watts and Zimmerman (1978, 1986), several empirical studies (e.g., Belkaoui and Karpik 1989; Ness and Mirza, 1991; Panchapakesan and McKinnon, 1992; Lemon and Cahan, 1997) have directly sought to establish evidence for the political cost hypothesis as an explanation for firms' social disclosures. Several related empirical studies have also sought to use the political cost hypothesis to explain other types of voluntary disclosure, including value added statements (Deegan and Hallam, 1991), disclosures by statutory authorities (Lim and McKinnon, 1993), and disclosures in pursuit of reporting excellence awards (Deegan and Carroll, 1993).

Along with numerous others[1], Gray *et al.*, (1995, pp. 51-52) dismiss the positive accounting arguments and literature on the grounds of the underlying assumptions of the theoretical framework. As they suggest, positive theories are not about what (social) reporting should be, but rather about what it is. As a basis for change and improvement, positive theories are seen to offer little or no development of corporate (social) reporting. Gray *et al.* (1995, p.52 and fn. 11) go on to admit, however, having been persuaded by many of the critiques, that they have not seriously engaged this literature because they believe it to be "virtual rubbish" and prefer their position as "heretics".

On the face of it, however, and as a basis for explaining *why* firms *are* making social disclosures, positive accounting explanations are less easily dismissed. Casual observation, for example, reveals that positive accounting explanations rely on empirical evidence largely identical to that used in support of other explanations (most notably, legitimacy theory) of social disclosures; explanations which, incidentally, Gray *et al.* (1995) seem to find more acceptable. As Gray *et al.* (1995, p. 49; 2001) note, a number of empirical studies have shown strong associations between disclosure and firm size, and between disclosure and type of industry. In fact, the size-disclosure relationship appears empirically the most robust.[2] Such results are claimed in support of legitimacy theory (e.g., Patten, 1991, Deegan and Gordon, 1996), as well as in favour of positive accounting theory. Lemon and Cahan (1997, p. 79), in fact, could not have put the issue more clearly when they state:

> Patten finds that the public pressure variables [firm size, and industry classification] are significant while the profitability variables [ROA, ROE] were not. Patten interprets these results as supporting legitimacy theory where a firm must satisfy an implied contract with the society it operates in. To the contrary as firm size is commonly used to represent a firm's political visibility, we interpret Patten's results as consistent with the political cost hypothesis.

If positive accounting theory is to be rejected as a basis for explaining why firms are making social disclosures, then it requires a more rigorous examination of the arguments and empirical evidence than has occurred to date. Of course, according to Watts and Zimmerman's theory, the answer why firms (managers) make social disclosures is because it is in their interests to do so[3]. Of interest to this paper, however, is upon what basis, and particularly if at all, do researchers go about demonstrating such a claim, and to what extent are such claims persuasive.

Watts and Zimmerman (1978, 1986) provide the stated theoretical basis for a number of social disclosure studies and so their work is reviewed first in some detail. Direct reference to social disclosure or social responsibility by Watts and Zimmerman themselves, however, appears extremely scant. From the later section on social disclosure, it will become clear that the use of Watts and Zimmerman's work relies on interpretations and extensions to the original. In the process of reviewing this work, it will be shown that the original arguments of Watts and Zimmerman have

been, if not misused, misunderstood or taken out of context, then only partially argued and tested.

WATTS AND ZIMMERMAN (1978) AND SOCIAL RESPONSIBILITY

A review of Watts and Zimmerman's original positive accounting theory papers (1978, 1979), their subsequent book, *Positive Accounting Theory* (1986), and their own review paper on positive accounting theory (1990), reveals that reference to "social responsibility" is *only* made in the original 1978 paper. I shall turn to that reference next, but first it is worth noting that no title of any paper they have either jointly or separately published since 1978 contains any reference to social responsibility[4]. Furthermore, only 1 paper (Blacconiere & Patten, 1994) with any reference to matters of social or environmental responsibility/disclosure in the title has been published in the *Journal of Accounting and Economics* —a journal which has been strongly associated with positive accounting theory, and which Watts and Zimmerman founded in 1979.

That social responsibility/disclosure is an issue that appears to be of only passing interest to Watts and Zimmerman and their positive accounting theory project is further substantiated when one carefully examines the original reference to it, and the context in which it was made. Watts and Zimmerman (1978), builds on Watts (1977), and seeks to (p. 112):

> …develop a positive theory of the determination of accounting standards. Such a theory will help us to understand better the source of the pressures driving the accounting standard-setting process, the effects of various accounting standards on different groups of individuals and the allocation of resources, and why various groups are willing to expend resources trying to affect the standard-setting process.

Watts and Zimmerman (1978, p. 113) *assume* that "individuals act to maximise their own utility" and consequently "management lobbies on accounting standards based on its own self-interest." They go on to suggest their purpose is to "identify factors which are likely to be important predictors of lobbying behaviour…", and a key part of this task is to examine how accounting standards affect management's wealth.

Management wealth, it is argued, is a function of changes in share prices (via stocks and stock options), and changes in cash bonuses (via compensation plans). Ordinarily, managers are predicted to have greater incentives to lobby for accounting standards that lead to increases in reported earnings and thereby management wealth. Since changes in cash flows and stock prices can also be affected (reduced) by taxes, regulatory procedures (for regulated firms), information costs, and political costs, however, managers also have to consider the effects reported earnings might have on the likelihood that such costs could be imposed on the firm. In some cases, the extra costs of accounting standards that lead to increases in reported earnings may outweigh the benefits (to management) of the reported earnings, and so management is predicted to lobby against such changes. More specifically, Watts and Zimmerman (1978, p. 118) argue that:

> …managers have greater incentives to choose accounting standards which report lower earnings (thereby increasing cash flows, firm value, and their welfare) due to tax, political, and regulatory considerations than to choose accounting standards which report higher earnings and, thereby, increase their incentive compensation. However, this prediction is conditional upon the firm being regulated or subject to political pressure. In small, (i.e., low political costs) unregulated firms, we would expect that managers do have incentives to select accounting standards which report higher earnings, if the expected gain in incentive compensation is greater than the forgone expected tax consequences.

Subsequent literature (e.g., Zmijewski and Hagerman, 1981; Healy, 1985, Press and Weintrop, 1990) has sought to refine these arguments and extend them beyond lobbying behaviour on

accounting standards to accounting method choice, where managers have the discretion to choose among a set of accounting procedures. Reviewing this literature, Watts and Zimmerman (1986, 1990) highlight three key hypotheses as follows:

(1) *The bonus plan hypothesis*: *Ceteris paribus,* managers of firms with bonus plans are more likely to choose accounting procedures that shift reported earnings from future periods to the current period.

(2) *The debt/equity hypothesis*: *Ceteris paribus,* the larger a firm's debt/equity ratio, the more likely the firm's manager is to select accounting procedures that shift reported earnings from future periods to the current period.

(3) *The size hypothesis*: *Ceteris paribus,* the larger the firm, the more likely the manager is to choose accounting procedures that defer reported earnings from current to future periods.

So where within this argument does "social responsibility" fit? To understand this, we need to further examine Watts and Zimmerman's notion of political pressure, political costs and their 'size hypothesis'.

Political Costs and the Size Hypothesis

According to Watts and Zimmerman (1978, p. 115), politicians have the power to effect upon corporations wealth re-distributions by way of corporate taxes, regulations, subsidies etc. Moreover, certain groups of voters have incentives to lobby for the "nationalisation, expropriation, break-up or regulation of an industry or corporation", which in turn are seen to provide incentives to politicians to propose such actions. This idea that politicians seek to intrude into the affairs of corporations and redistribute wealth away from them comes from the earlier work of Stigler (1971), Peltzman (1976) and Jensen & Meckling (1978).

To counter such pressure from politicians, Watts and Zimmerman (1978, p. 115) suggest:

> … corporations employ a number of devices, such as social responsibility campaigns in the media, government lobbying and selection of accounting procedures to minimize reported earnings. By avoiding the attention that "high" profits draw because of the public's association of high reported profits and monopoly rents, management can reduce the likelihood of adverse political actions and, thereby, reduce its expected costs (including the legal costs the firm would incur opposing the political actions). Included in political costs are the costs labor unions impose through increased demands generated by large reported profits.
>
> The magnitude of the political costs is highly dependent on firm size.

The *source of concern* Watts and Zimmerman have in mind for the public and so politicians, then, is "large profits" and their association with monopoly power. Environmental degradation by companies, depletion of resources, exploitation of workers, the production of unsafe products, and so on, as sources of public and political concern are not mentioned. It is the potential abuse of monopoly power that lies at the heart of Watts and Zimmerman's notion of political costs. Their reference (1978, p. 115, fn. 12) to Menke's US Congressional statements that "Huge accounting profits, but not high profit rates, are an inevitable corollary of large absolute firm size. This makes these companies obvious targets for public criticism." further substantiates this point. Similarly, their subsequent references (see 1986, p. 235, and fn. 3 to Alchian & Kessel, 1962, and Jensen & Meckling, 1978) to the "size hypothesis" emphasise the concern of the press and politicians with size of profits and potential monopoly abuses. As Watts (1977, p. 68) states in interpreting his work with Zimmerman, "They [W&Z, 1978] argue that the corporate manager has an incentive to select accounting procedures and to lobby with politicians and bureaucrats for accounting procedures

which reduce the net income reported in financial statements. Political entrepreneurs use "high" profits to create "crises"." Wong's (1988, pp. 27-29) interpretation and examples of political costs, too, are consistent with an emphasis on large profits. Watts and Zimmerman also reinforce this idea in their 1990 review by stating "…political costs are a function of reported profits. Thus, incentives are created to manage reported accounting numbers" (p. 133). Worth noting, then, is that Watts and Zimmerman make constant reference to *reported accounting numbers,* but make no reference to other annual report disclosures and certainly no reference to narrative social disclosures.

Precisely how "social responsibility campaigns in the media" were envisioned to fit into Watts and Zimmerman's notion of political costs is not made clear. Unless they involve significant expenditures (both on actual social responsibility activities, and in the form of "advertising costs"), by themselves they would unlikely provide much reduction in "large profits" and so reduce the apparent source of concern to the public and politicians. Alternatively, or perhaps as well, these "campaigns *in the media*" are believed to be devices to distract attention away from a firm's large profits, and so soften the image of abusive monopolies; in other words, to legitimise the firm's large profit making. Yet, again, these campaigns in the media may have little to do with profit making and monopoly abuses, but with other aspects of business behaviour found unacceptable to members of society.

Oil Companies and Advocacy Advertising

Some insights into Watts and Zimmerman's reference to social responsibility campaigns in the media are possible from their discussion of political costs. Nearly all of their examples come from the oil industry (see, Watts, 1977, p. 68, W&Z 1978, p.115, p.121; W&Z 1986, p. 236-237; Zimmerman, 1983; Holthausen and Leftwich, 1983, p. 88). Oil companies during the 1970s dominated the largest of the US companies, and they were also subject to much public outrage and political scrutiny during and immediately following the 'oil crisis' of 1973.[5] Also during this same period, a number of companies, including oil and energy companies, and especially Mobil Oil (Inc), undertook what Sethi (1976, 1977a, 1977b) as referred to as 'advocacy advertising'.

Advocacy advertising often undertakes an editorial style approach and represents a deliberate attempt on the part of the corporation to present a point of view about a major public issue. The strength of such advertising, according to Sethi, is that the content of the message is controlled and defined in a manner favourable to the sponsor and the environment of the message is carefully controlled, thus making otherwise one-sided viewpoints appear more objective. Furthermore, Sethi (1977b) suggests that the sociocultural environment of the advertisements was one of traditional American values, such that if one sought to raise objections to the advertisements' content one must invariably also be seen to be criticising such traditional values. Several examples of such advertising are provided in the appendix.[6]

In the context of Watts and Zimmerman, Sethi's work on advocacy advertising is particularly illuminating for several reasons. First, advocacy advertising obviously comes much closer to lobbying behaviour than annual report social disclosures. Sethi (1976), for example, reports that many critics of advocacy advertising tried to have such advertising classified as "grass-roots" lobbying —a practice specifically exempt for corporate tax expense deductions. Second, the role of politicians and the media, and particularly the news media are clearly implicated as a rationale for advocacy advertising. Raleigh Warner, Jr., Chairman of Mobil Oil, for example, suggested the purpose of Mobil's advocacy advertising campaign was to defend his company against slander and unfair treatment in the media (Sethi, 1977a, p.52). Similarly, quotes found in Sethi (1977a) further substantiate this rationale:

> Corporations are constantly under attack from every quarter. Charges by consumer groups, Congressional Committee and Subcommittee Chairmen, individual Congressmen and the various organs of federal, state and local government get front-page headlines….Silence by a company in the face of attacks upon its policies and practices is interpreted as an admission of guilt. Corporate advertising provides one avenue of self-defense (Frederick West, Jr., president of Bethlehem Steel Corporation in letter to Senator Hart 1974, quoted in Sethi, 1977a, p. 53).

> It is understandable that the affected businesses may not like what they read about themselves in the newspapers. They use the argument of media bias in objecting to these stories. This alleged bias then becomes an excuse for publishing the kind advocacy advertisements that we're beginning to see. The problem has developed more markedly since the oil crisis, when oil and energy companies have become more aggressive in buying advertising space to respond to public criticism of their businesses (John B. Oakes, *New York Times*, quoted in Sethi, 1977a, p. 54).

Third, the evidence provided by Sethi (1976) suggests the direct impact of such advertising campaigns on profits is likely to have been minimal. Citing evidence provided at the U.S. Senate Hearings into *Energy and Environmental Objectives* in 1974, Sethi (1976, p. 10) suggests "actual business spending on institutional goodwill advertising is small when measured in terms of total advertising expenditures, sales revenues, or net profits." He goes on to point out that the costs of institutional advertising by the largest ten corporate advertisers in 1974 amounted to 0.046% of their sales revenues, and 0.67% of their net income. The potential of such advertising to *preserve* existing and future profitability, however, should not be underestimated. According to Harold Johnson, vice president of American Electric Power (quoted in Sethi, 1976, p.10), his company's advertisement campaign was a major factor in "persuading the White House, the EPA, and important senators and congressmen to postpone the enforcement of the Clean Air Act standards from 1975 to 1985." Furthermore, according to Sethi (1976, p.10), Johnson believes how government regulates business can and does affect corporate profits, and ultimately its survival, in a major way. Such advertisement campaigns are seen as of major importance to a company's performance, and to the public it serves.

Fourth, and as already noted with respect to Johnson's American Electric Power, many of these advertisements were being used to counter sources of public and political concern other than "large profit" making. In American Power's case, the advertisements were clearly targeted to prevent or stall the Clean Air Act, a piece of legislation targeting air polluters.

It seems likely, then, that Watts and Zimmerman's notion of political costs was largely derived from observations of the behaviour to and of US oil companies during the early and mid 1970s.[7] Reference to social responsibility campaigns in the media was most likely based on the popular US practice of advocacy advertisements at that time. Such advertising, however, seems to only partially fit Watts and Zimmerman's argument. It is clearly a means of lobbying behaviour, and lobbying behaviour most often directly targeted at prospective legislation, an outcome of which could well forestall reduction in future firm profitability. Whether such advertisements were intended to reduce "high profits" or the visibility of high profits, however, is much less certain. Yet, the clear objective for managers of such firms, according to Watts and Zimmerman's theory, is to make current profits lower and so remove the source of public and political concern.

While managers of firms may undertake social responsibility disclosure, media manipulation and/or government lobbying, these activities seem unlikely by themselves to aid the management of reported accounting numbers. Furthermore, as a means of lobbying against prospective legislation that could reduce future firm profitability, targeted advocacy advertisements seem far more likely to succeed than annual report social disclosures. Extending Watts and Zimmerman's observations about social responsibility *campaigns in the media* to social disclosures *in annual reports* seems to be stretching too far. However, if managers are undertaking social responsibility disclosures in

annual reports as part of a strategy to reduce political costs and enhance their welfare, then at the very least we should also expect to see evidence of those same firms undertaking other more direct means to reduce reported profits (i.e., certain accounting method choices).

Testing Watts and Zimmerman's Positive Accounting Theory

Before turning to studies of voluntary disclosure, several useful insights to testing Watts and Zimmerman's theory can be gained from briefly considering more conventional (i.e., accounting choice) studies. First, their theory involves *three,* and I would say joint, predictors of accounting choice behaviour. These three predictors, however, are not reinforcing, they imply opposing incentives, and so trade-offs, for the management of earnings (Watts and Zimmerman, 1986, p. 246). Second, managers most likely have discretionary choices over a combination of accounting procedures, and not just a single procedure like depreciation. Zmijewski and Hagerman (1981), for example, show that four accounting procedures, each of which could be used in one of two ways (i.e., income increasing or income decreasing), generates a possible set of 16 portfolio choices. Consequently, Watts and Zimmerman's model involves multiple (and joint) predictors of a portfolio of procedures. As they suggest, however, it is difficult to specify *a priori* the relative magnitude of the three opposing incentives (Watts and Zimmerman, 1986, p. 243), and so studies typically use separate independent variables as surrogates for the offsetting incentives. Notwithstanding this weakness, studies that seek to explain single procedures, rather than multiple procedures (including perhaps social disclosure strategies) are less powerful tests of the hypotheses (Watts and Zimmerman, 1986, p. 246). Likewise, studies that isolate and focus on single predictors (e.g., political costs) of management behaviour are also incomplete and less powerful tests of their theory.

In addition to concerns over correctly specifying an empirical model to test Watts and Zimmerman's theory, concerns have also been raised over the choice of proxies for the three independent variables, and especially proxies for political costs.[8] Watts and Zimmerman (1978) originally used firm size (*Fortune* 500 rank of asset size) to proxy for political costs, but they and others (see, for example, Ball and Foster, 1982; Whittred and Zimmer, 1990) have subsequently criticised size as too noisy a proxy. Bujaki and Richardson (1997), for example, from a citation review of the empirical use of firm size in accounting journals, claim to have found *eighteen* distinct theoretical constructs for which size was used to proxy.[9] They note that many of these studies fail to attempt to establish either convergent or discriminant validity for size. While one might disagree with their classification scheme, size is clearly found to proxy for more than political costs.

Subsequent to Watts and Zimmerman (1978), empirical studies have tended to use or suggest a wider range of measures to proxy for political costs. These include: profits, rates of return, risk, capital intensity, industry concentration, industry membership, effective tax rates, number of employees, number of shareholders, labour intensity, press coverage, and even social responsibility disclosures themselves.[10] In some cases, the metrics involve alternative measures of *firm size* (e.g. number of employees). In other cases, however, they represent attempts to find alternative measures of *political visibility or political cost* (e.g., capital intensity). In all cases, however, the extent to which they are acceptable measures should depend upon the extent to which they can be related back to the original arguments about "high profits" attracting public and political attention. It will be seen that some studies, in suggesting or using measures of political cost, seem to ignore the original arguments of Watts and Zimmerman, or, in the process of justifying their chosen proxies, change the argument.

DISCLOSURE STUDIES AND WATTS AND ZIMMERMAN'S THEORY

Belkaoui & Karpik (1989)

Belkaoui & Karpik (1989) was one of the earliest and more comprehensive attempts to test Watts and Zimmerman's arguments with respect to annual report social disclosures. It is also perhaps the only study that remains largely consistent with their original arguments. Specifically, Belkaoui and Karpik (1989) invoke the debt/equity (measured by debt/assets and dividends/unrestricted earnings) and political cost (measured by size, capital intensity and beta) hypotheses, but omit the bonus plan hypothesis, when seeking to explain social disclosures. Politically visible firms are argued to disclose more, while firms with high debt/equity ratios are argued to disclose less. Measures of social and economic performance are also included in their model, but social disclosure behaviour is the only dependent variable tested. Evidence for both hypotheses is found in a regression model that generates an adjusted R^2 of 44%, with size, beta (risk) and leverage being the significant variables. Social performance is also significant in the model.

Several issues arise from Belkaoui & Karpik (1989) that expose it as a weak assessment of Watts and Zimmerman's theory. Belkaoui & Karpik (1989, p. 38) acknowledge that "image-building and public interest concerns may govern the decision to spend for social performance and to disclose social information". However, they prefer to remain consistent with Watts and Zimmerman's argument and so emphasise that "specific and material expenditures are necessary to achieve social performance goals. These same expenditures reduce net income." The key to Watts and Zimmerman's argument, of course, is current income reducing accounting choices undertaken by monopoly and large profit makers, and so the key to Belkaoui & Karpik's (1989) argument is the size of firms' social spending (relative to current earnings). Belkaoui & Karpik (1989), however, offer no evidence of firms' social spending whatsoever, and also choose to use measures of firm size other than profits.

To test their argument Belkaoui & Karpik (1989) use *an index of social disclosure* developed for the Ernst and Ernst 1970s surveys of *Fortune* 500 annual reports, and a *reputational ranking* of firms' social performance based on a survey of business executives. Belkaoui & Karpik (1989) show these two variables to be significantly correlated (r=0.55), but doubts must remain about the extent to which *actual* (as opposed to perceived) social performance relates to social disclosures (Wiseman, 1982; Deegan and Rankin, 1996). More importantly, however, there is no necessary reason why social performance (either actual or perceived) and/or social disclosures should be related to levels of *social spending*. The Ernst and Ernst index captures the *variety* of social programmes a firm *claims* to be involved in. However, even if it were a true and accurate claim, why should a firm involved in say ten different types of social responsibility programmes necessarily be spending relatively more than a firm only involved in one type of activity?[11] Likewise, why should having a reputation for doing "good" necessarily be a function of spending levels? Not only might a reputation for doing good be based on non-cash donations (e.g., staff time), there is also the prospect that the business executives' reputational index is based on what they read about each others' companies' social performance as disclosed in annual reports. Belkaoui & Karpik (1989), then, while remaining consistent with Watts and Zimmerman and arguing that levels of social spending are a way for self-interested managers to reduce current period income, fail to test this proposition.

A second aspect of Belkaoui & Karpik's (1989) study, and indeed most other (social) disclosure studies, is their failure to take the opportunity to establish a wider basis for their findings. Clearly the intent of social disclosure studies is to uncover management motives, and, in the case of positive accounting theory, to uncover evidence of self-interested managers who are using social expenditures and/or social disclosures to manipulate current reported earnings. As such, then, we

should expect these same managers to be exercising other accounting method choices consistent with these aims (e.g., depreciation method choices). Panchapakesan and McKinnon (1992), in fact, suggest using measures of social disclosure as a proxy for political visibility in more traditional accounting choice studies. So far, however, all the positive accounting theory studies (including those discussed below) fail to show the coincidence of social spending, social disclosure, and other income reducing accounting methods.

Concern Over "High Profits" Diminishes

Belkaoui & Karpik's (1989) sample is limited to 23 very large US organisations measured in 1973. Seven of these 23 were large oil companies. As with Watts and Zimmerman (1978), Zimmerman (1983), and others, the extent to which results are a function of US oil companies during the 1970s remains an issue. Watts and Zimmerman (1986, p. 236, p.239) point out that at that time, "…the "large" firms tend to be the oil companies." And "Besides the firm's size, its industry probably also affects its political vulnerability. Firm size proxies for industry because firms within an industry have similar sizes (Ball and Foster, 1982, p. 183). Therefore, industry membership is a confounding factor. Finding a statistical association between firm size and choice of accounting procedures might be due to firm size proxying for industry membership."

Precisely how a firm's industry membership "affects its political vulnerability" is not made clear by Watts and Zimmerman. Are they suggesting that, consistent with their original argument, certain industries contain large firms that make "large profits" and so attract public and political attention (e.g., oil and gas)? Or, are they now suggesting certain industries, regardless of their profit making, attract public and political concern (e.g., old growth forest loggers, chemical companies)?

Blacconiere and Patten (1994) seem to adopt this latter perspective when they investigate environmental disclosures in the chemical industry. Unlike Belkaoui and Karpik (19890, they do not tie their argument to high profits and abuses of monopoly power, but refer to "regulatory costs" that might be expected to arise within the chemical industry as a result of the Union Carbide Bhopal Disaster in India. They suggest investors might anticipate increased regulatory costs as a result of the disaster and consequently an adverse market reaction and decrease in firm value is expected. Firms with extensive (positive) environmental disclosures prior to the disaster, however, are hypothesised and found to experience significantly less adverse stock market reactions. While Blacconiere and Patten (1994) suggest the disclosures signal lower environmental risks, and that firms would be more likely to release positive environmental news, they present no arguments or empirical tests that tie such disclosures to self-interested management behaviour. To do so would require that managers be shown to plan on such disclosures as a "hedge" against future industry disasters and falls in firm value, which in turn are tied to (decreases in) management compensation.

Cahan *et al*. (1997), in investigating the discretionary accruals and earnings management (but not disclosures) of US chemical firms exposed to the potential 'Superfund' legislation, seem to argue it both ways. On the one hand, they (p. 44) suggest:

> Some members of congress suggested that profits in the chemical industry were unreasonably high. These charges are consistent with the view that politicians, in choosing targets for regulatory intervention or other wealth transfers, prefer industries with high incomes because these industries can "afford" to pay for the political costs imposed on them… This suggests that one way chemical firms could appear less politically attractive is by reducing income.

As well as this perspective, however, they (p. 44) also argue that:

> In this study, however, we expect that the distribution of costs would not be equal across firms within the industry. To be exact, the firm-specific cost of Superfund should be positively related to

> the volume of taxed chemicals produced and the firm's involvement in hazardous waste sites.

This latter perspective led Cahan *et al.* (1997, p. 46) to formulate the hypothesis that "Chemical firms with high cost exposure to Superfund were more likely to take larger income-reducing discretionary accruals…" Note the twist in the arguments. It is no longer "large profits" that create the need for income-reducing behaviour, but being a large and potentially hazardous polluter. Furthermore, despite the argument about large profits, Cahan *et al.* (1997) develop no empirical tests of that argument. Instead they develop proxies for the magnitude of potential costs of the legislation faced by each firm. They consider (1) the number of taxed chemicals produced, (2) the ratio of revenues from chemicals to total firm revenues, (3) the number of hazardous sites identified with the firm, and (4) the potential costs of hazardous sites. But if the number and volume of chemicals a firm produces, and the number of hazardous sites to which it is identified are driving the potential costs (to the firm) of proposed legislation, how does managing (reducing) reported income help?[12] If there is a link it is one that Cahan *et al.* (1997) fail to state, and, furthermore, given their lack of concern over profit measures, it is one they fail to test.[13]

Panchapakesan and McKinnon (1992), in offering seven different potential proxies for political visibility in addition to firm size, waver back and forth between the "high profits" and monopoly abuse arguments and wider social interpretations depending upon the particular proxy. 'Market Share' and 'Capital Intensity', for example, are clearly tied to concern over the size of profits. Yet when arguing for 'Industry', 'Number of Employees', 'Number of Shareholders', 'Social Responsibility Disclosure' and 'Level of Press Coverage' a raft of social pressure arguments come to the fore, some of which may have a connection with increased spending and so reduced profits, and some of which do not. For example, we are told:

> …a firm with a large number of employees is likely to be more visible to trade unions and the media…[14]

> …strong public opinion and lobbying, have over a sustained period imposed costs on tobacco companies in the form of periodic increases in sales tax, restrictions on advertising and sponsorship, and mandatory health warnings on cigarette packets.

> …corporations with a large number of stockholders tend to be more in the public eye and, as such, are more subject to pressure for accountability for their actions.

> One way of establishing a favourable public image, or of moderating an already unfavourable one, is to be seen to be voluntarily undertaking socially desirable activities…This voluntary investment in socially desirable activities may be viewed as a form of 'social taxation'. Firm management voluntarily commits resources to activities that it perceives will be viewed favourably by society. Hence, the firm voluntarily taxes itself in an attempt to avoid larger resource transfers imposed by outside agencies.

Panchapakesan and McKinnon's (1992) argument for social responsibility disclosures as a proxy for social spending clearly runs into the same problems already outlined against Belkaoui & Karpik (1989). However, it is also clear they interpret the notion of political costs differently from Watts and Zimmerman (1978). While the *outcome* of the interpretation differs little (i.e., exposed firms become subject to costly regulation that eats away at future profitability), it is the *source of concern* that differs, and so do the firms identified as exposed and likely targets of such regulation.

Such distinctions are not only an issue for Watts and Zimmerman, and Panchapakesan and McKinnon (1992) who ultimately seek to explain accounting method choices, but also for social disclosure studies. If high profits are no longer the only focus as sources of public and political concern, the arguments for income smoothing strategies become weaker, since firms may now be attacked by the public and politicians for a host of other reasons that have little or nothing to do

with profiteering. In the context of this study, though, for those seeking to explain social disclosure behaviour, and especially for those who have chosen to singularly focus on disclosure behaviour and singularly on the political cost hypothesis as an explanation for such behaviour, major problems arise.

Tests of the Political Costs Hypothesis Blur with Social Explanations of Disclosures

Without Watts and Zimmerman's other hypotheses (e.g., monitoring/contracting costs and bonus plan), and/or evidence of other accounting choices to corroborate the disclosure findings, it becomes extremely difficult to set the political cost (size) hypothesis apart from other social explanations of disclosure behaviour (e.g., stakeholder theory, legitimacy theory). As Belkaoui & Karpik (1989) had recognised, without tying significant and material social spending to reductions in current net income, "image-building and public interest concerns" could also explain social spending, performance and so disclosure. These difficulties are best illustrated by reference to the work of Deegan and several co-authors, and the work of Lemon and Cahan (1997).

Deegan and Hallam (1991) adopt a political cost perspective and explore corporate management's incentive to voluntary disclose value added statements in the annual reports. Specifically, they hypothesise value added statement disclosure is related to labour intensity, corporate tax payments, rate of return, firm size and industry volatility. They find size (absolute after tax profits and market concentration), tax, and the industry to which a firm belongs are all related to the incidence of value added statement disclosure. The arguments for market concentration, tax payment, size and rates of return are all closely tied to Watts and Zimmerman's notion of high profits and monopoly abuses, and so proxy for firms as targets of union activity *due to profits*. Labour intensity and industry volatility, however, are argued more along the lines of proxies for *vulnerability to unions* and *relative union power*. While two industry-groupings are found to differ from 5 others, neither of the hypothesised 'vulnerability to unions' or 'relative union power' arguments could be supported. Generally, then, the arguments and evidence are close to Watts and Zimmerman's original arguments.

Deegan and Carroll (1993, p. 219) specifically aim "to determine whether those companies that apply for an [annual reporting excellence] award appear to be relatively more susceptible to wealth transfers in the political process." In the process of establishing political cost arguments, the paper makes the usual references to the work of Watts and Zimmerman and other related studies (e.g., Hagerman & Zmijewski, 1979). Five measures of political sensitivity are used: firm size, rates of return, market concentration, tax and media exposure. Apart from media exposure, the arguments for the other proxies are tied into large profits and monopoly power abuses. For media exposure we are told (p. 223) "There is an expectation that firms that are constantly in the media spotlight are more susceptible to political transfers than firms that rarely receive media attention." As with Panchapakesan and McKinnon (1992), however, no reference is made of what might be the *source* of the media attention (e.g., profiteering, polluting, plant closures), and the construct is measured by reference to the total number of articles appearing on a firm in a given year.

In addition to these usual arguments, Deegan and Carroll (1993) also make reference to Trotman's (1979) work on social disclosures. To quote in full from Deegan and Carroll (1993, p. 222):

> As Trotman (1979, p. 27) argued when examining the propensity of firms voluntarily to disclose social responsibility information:
>
> > …social responsibility reporting may contribute to public image and this is turn may lead to greater public acceptance, more identification and avoidance of confrontation such as strikes and boycotts… by reporting social responsibility information companies are showing that they are acting responsibly and that there is no need for further legislation

to force them to do so.

> Consistent with Trotman's discussion of social responsibility disclosures it is suggested that being identified as an ARA winner may reduce the likelihood of confrontation, reduce the arguments that the firm is not acting responsibly, and decrease the likelihood of further specific legislation—actions which may be more likely to be taken against politically sensitive firms.
>
> Hence the central proposition of this [Deegan and Carroll's] paper is:
>
> *Firms subject to higher political costs will be more likely to apply for an Annual Report Award than firms subject to low political costs.*

Either Deegan and Carroll's (1993) reference to Trotman (1979) creates the usual untested assumptions noted earlier that disclosure proxy's for social spending and so reduced levels of current net income, or it is an indication of a wider definition of political visibility and costs. Either way it is one that blurs the distinction of political costs with stakeholder and legitimacy perspectives.

Further evidence of this blurring can also be found in Deegan and Gordon (1996) which finds strong empirical associations between the environmental sensitivity of a firm's industry as determined by members of environmental pressure groups and levels of firms' (positive) environmental disclosures.[15] Firm size is also found to be associated with levels of disclosure, and especially so for firms in the most sensitive industries. Now, however, Deegan and Gordon (1996), complete with the same quotation from Trotman (1979), claim evidence to "support a view that environmental disclosures are used to legitimise the operations of firms that operate industries of concern to environmental groups." And that "once an industry is deemed to be environmentally damaging…larger firms create more environmental costs…unless they provide evidence to the contrary." Of course it is not difficult to imagine that these size/industry/disclosure findings could have just as easily have been framed in the same political cost arguments that have been used in other studies to explain like findings. Indeed, upon finding the incidence of environment-related disclosures was higher among oil firms than others, Ness and Mirza (1991) claim to have evidence of Watts and Zimmerman's positive accounting theory. Likewise, this is precisely how Lemon and Cahan (1997) argue for a positive accounting theory explanation of environmental disclosures.

Lemon and Cahan's (1997) work needs examining in some detail because it shows an awareness of many of the difficulties discussed so far, and yet in many respects fails to avoid them. At the outset Lemon and Cahan (1997, p. 79) suggest "one reason for the persistence of multiple views [of why firms make social disclosures] is that researchers have not been very successful in developing tests that allow them to assess the validity of different theories." They acknowledge legitimacy theory and critical theory, but their stated intent is clearly to establish a political cost explanation for social disclosures. To do this they seek to examine environmental disclosures both pre and post the introduction of a specific piece of environmental legislation (New Zealand's Resource Management Act). They also allude to the inadequacies of other empirical results, however, and, as noted at the start of this paper, point out that Patten's (1991) legitimacy theory results are entirely consistent with the political cost hypothesis. Patten's (1991) arguments and results, of course, are largely identical to Deegan and Gordon's (1996), but Lemon and Cahan's (1997) observation is correct. Findings of size/industry/disclosure relationships are not an adequate basis on which to distinguish between the two positions, and especially so if positive accounting theorists do not insist on their size/industry measures being related to "high profits" and monopoly behaviour, and their disclosure measures to social spending.

Unfortunately, Lemon and Cahan (1997) fail to deliver an adequate test because their arguments and research design lose touch with Watts and Zimmerman (1978) and Belkaoui and Karpik

(1989). In the process they blur with the very social theories they so adamantly seem to reject. Lemon and Cahan (1997) acknowledge that most political cost hypothesis studies focus on whether firms "reduce reported income", and correctly note that Belkaoui and Karpik's (1989) argument is about interest groups criticising firms because of reported profits and firms using social spending to reduce these. Yet they (p.85) go on to say:

> The political cost hypothesis postulates that a firm operates in society based on upon explicit and implicit contracts with individuals and groups. These groups include government, employees, consumers, special interest groups, and the public in general…
>
> While annual reports are a key source of information used by governments in identifying firms for wealth transfers (Wong, 1988a), the causal link between political costs and environmental disclosures is more tentative than the causal links associated with the related debt/equity and bonus plan hypotheses. This study assumes that public members, in particular environmental activist groups, will pressure government officers to impose costs on firms with poor environmental records. Consequently, firms that are subject to a high level of scrutiny by the public about their environmental programmes, or are politically visible, would have more incentive to disclose information to the public.

These statements encapsulate many of the issues already raised about partial examinations of positive accounting theory, but they also clearly indicate the confusion of political costs with legitimacy theory. Patten (1991, p. 298), for example, states:

> To a great extent, legitimacy theory has a basis in the notion of the social contract. According to Shocker and Sethi (1974, p. 67), "any social institution [including business] operates in society via a social contract, expressed or implied…"
>
> Thus a business can use social disclosure to attempt to affect public policy. Such disclosures may address policy issues themselves or, alternatively, may be used to attempt to create an overall image of social responsibility for the firm. The goal is to deal with what Miles (1987) calls throughout his book the "exposure" of a business to both the social environment and the political environment…

Interestingly, Jantadej and Kent's (1999) study of BHP Australia's disclosures around the period of the Ok Tedi Copper Mine disaster in Papua New Guinea contains extensive and broad arguments regarding the political costs hypothesis, yet goes on to argue and claim to have tested a legitimacy perspective. In fact, they suggest (p. 76) "legitimacy theory relating to the explanation of incentives for environmental disclosures is an extension of the political cost framework. This is because legitimacy theory relates not only to economics and political factors, but also to social factors." Of course, they in no way establish links between legitimating behaviours and self-interested managers wealth maximising—a behaviour that lies at the core of Watts and Zimmerman's political cost hypothesis. Nonetheless, a broadening of the notion of political costs in the manner that Panchapakesan and McKinnon (1992), Deegan and Carroll (1993) and Lemon and Cahan (1997) suggest, creates problems for positive accounting theorists seeking to distinguish themselves from other social theories of disclosure behaviour.

Lemon and Cahan's (1997) study, however, also falls down on method. Noted early in this discussion is that Watts and Zimmerman's original study is largely about predicting accounting method choices and lobbying behaviour to avoid or reduce wealth transfers. Also noted was American Electric Power's successful attempt to stall the Clean Air Act standards by way of advocacy advertising. Cahan *et al*. (1997, p. 42) also examined the behaviour of US chemical firms in 1979—a time they say when "the outcome of the [Superfund] legislation was still uncertain, creating a setting where firms with chemically related operations would have incentives to take actions influencing the outcome of the political deliberations." Whether political costs are defined

broadly or narrowly, in all cases, as with legitimacy theory, the purpose of the firms' reactions is argued to *reduce or avoid* political intervention, regulation and costs. Given this pre-emptive element, then, one might have expected Lemon and Cahan's (1997) study to focus on the behaviour of firms *before* the Resource Management Act came into force.

In fact, their test is based on increases in disclosure *after* the Act came into force, showing that for a group of companies in environmentally sensitive industries, disclosure increased as a result of the RMA. As a test of political costs this seems illogical. The politicians by passing the Act have already imposed the costs on all firms. It is true that, as Lemon and Cahan (1997) point out, the RMA does have the potential to impose fines upon firms (and imprison directors) breaching the regulations, but these are not costs self-interested politicians can impose, they are determined by the regulators and courts.[16] A consistent and more appropriate test of the argument would be to examine disclosure behaviour in the time period leading up to the passing of the Act, when firms had an opportunity to stall or influence the final shape of the legislation. This seems particularly appropriate in the case of the Resource Management Act because it was the result of a unique and almost 4-year long Resource Management Law Reform process that resulted in extensive public consultation, submissions, round tables, workshops, discussion documents, and finally the Resource Management Bill (Gow, 1991). If there was a time for firms and managers to be involved in lobbying for their self-interest it was during this period and not after the Act was passed. Lemon and Cahan's (1997) study, then, suffers from both a lack of theoretical clarity and weaknesses of method that render its results largely suspect as a basis to establish evidence for Watts and Zimmerman's notion of political costs.

SUMMARY AND CONCLUSIONS

This paper has set out to critically review the positive accounting literature as it relates to social disclosure analyses. In the process of doing so it has paid careful attention to the arguments presented in Watts and Zimmerman's (1978) original positive accounting theory paper and several of their subsequent reviews (1986, 1990). Watts and Zimmerman (1978) are often cited as the theoretical basis for the empirical social disclosure studies. Such a review shows Watts and Zimmerman's theory is largely concerned with three joint predictors of lobbying behaviour and accounting method choice based on assumptions of self-interested managers' wealth maximising. Managers of firms making large profits and potentially abusing monopoly powers, it is hypothesised, are likely to use a raft of accounting method choices to reduce reported earnings. Their own reference to social responsibility disclosure and its relationship to their main arguments is obscure. Most likely their reference to "social responsibility campaigns in the media" relates to the common practice in the US at the time of advocacy advertising. Advocacy advertising was a tactic used by several companies, but most notably Mobil Oil (Inc.), to counter media news reports and influence public policy and political debates.

In reviewing the subsequent social and voluntary disclosure studies that have relied on Watts and Zimmerman (1978) for their theoretical base, several things are noted. First, none of the studies provide the full arguments of Watts and Zimmerman as they relate to discretionary management behaviour. That is, none of the studies employ all three of the (joint) hypothesised predictors of behaviour. Most, in fact, only use the size or political cost hypothesis, and for this reason alone they must be considered weak tests of the original argument. Second, none of the studies take the opportunity to examine management behaviours other than the chosen disclosure variable that one might expect to exist if self-interested income reducing strategies were being adopted as hypothesised, therefore, further weakening the tests.

The need for corroborating evidence seems vital when the stated rationale for disclosure seems so obscure in the first place. Indeed, the arguments regarding the *purpose* of social (or other voluntary) disclosures are not consistent among the positive accounting literature. Belkaoui and Karpik (1989), and Panchapakesan and McKinnon (1992) on the one hand, do not see a direct role for social disclosures. To them disclosure is merely the by-product of *social responsibility expenditures,* which in turn are argued to result in reported income reductions. This line of argument is most consistent with Watts and Zimmerman's (1978) original concerns with high profit takers and abusing monopolists. In the absence of data on social spending, however, Belkaoui and Karpik (1989) rely on social disclosures as a proxy for social spending, and so largely fail in their tests.

On the other hand, several studies (e.g., Jantadej and Kent, 1999; Lemon and Cahan, 1997; Deegan and Hallam, 1991) focus directly on disclosure itself as management behaviour, yet the purpose of such disclosures is often left vaguely specified. Showing such disclosures were consistent with other accounting method choices would help, but there is an added problem for these studies, and that is that all of them fail to argue how such disclosures relate to reductions in profits. Consequently, they move away from Watts and Zimmerman's (1978) original arguments and extend the notion of political costs. In the process, however, they blur their arguments with other social theories of disclosure, and so fail to rule out alternative explanations. Moreover, they fail to convince or provide any evidence on how such disclosures might serve as a lobbying device. That advocacy advertising (a targeted, timely, often repeated, and widely publicly disseminated message) might have the ability to persuade the public and politicians to keep their distance seems inherently more plausible than annual report disclosures. This seems likely regardless of whether one believes firms are targeted for anti-trust monopoly behaviour, pollution, labour exploitation or any other social wrong.

This review reaches the same conclusion as Gray *et al*. (1995) that positive accounting studies have little to offer our understanding of firms' social disclosure behaviour, but for different reasons. Rather than reject their arguments on their assumptions, it shows positive accounting theorists have failed to offer any substantive evidence whatsoever to support the view that firms' management use annual report social disclosures in pursuit of their own wealth interests. In fact, in almost all cases the empiricists setting out to examine positive accounting theory as a basis for social disclosure behaviour have failed to follow the arguments of Watts and Zimmerman's original thesis. Furthermore, and contrary to positivism in the methodological sense, in all cases so far, the studies have failed to generate adequate tests of the arguments they do present.

Notes

[1] There have been numerous critiques of Watts and Zimmerman's positive accounting theory. Gray *et al*. (1995) themselves cite several of these including Christenson (1983), but also see Ball and Foster (1982), Tinker *et al*. (1982), Lowe *et al*. (1983), Whittington (1987), Hines (1988), Whitley (1988), Sterling (1990), Chambers (1993) and Tinker and Puxty (1995).

[2] See, for example, Kelly (1981), Trotman and Bradley (1981), Belkaoui and Karpik (1989), Patten (1991), Panchapakesan and McKinnon (1992), Adams *et al*. (1995; 1998), Deegan and Gordon (1996), Hackston and Milne (1996), Lemon and Cahan (1997).

[3] As Sterling (1990, p. 117, *emphasis in original*) and others (e.g., Chambers, 1993) make clear, understanding *why* firms choose certain accounting methods is not at issue. Utility maximisation is *always* the answer according to the assumption of W&Z. The research objective is to demonstrate a set of relationships consistent with that assumption. Of course, 'self-interest' could, quite reasonably on the available evidence to date, be claimed to lie at the heart of all voluntary disclosure behaviour, even where such disclosure behaviour is made to appease certain constituents and retain organisational legitimacy. W & Z's assumption, however, is that accounting manipulations serve managers' economic self-interest.

[4] See their web-based publication lists at: http://www.simon.rochester.edu/fac/zimmerma/html/pubs.html, and http://www.simon.rochester.edu/fac/watts/html/publicat.html.

[5] During the 1970s several books were released critically examining the oil industry. See, for example, Blair's (1976) *The Control of Oil*, Sampson's (1975) *The Seven Sisters*, and Engler's (1977) *The Brotherhood of Oil.* The thrust of many of these analyses was abuse of power, collusion and profiteering.

[6] While the adverts shown in the appendix have been selected to illustrate the arguments here, Sethi (1977b, p. 16) provides ample evidence that such advertising was dominated by oil companies, and especially so during the 1970s. For example, he states "In 1971, of the top ten companies running institutional advertising, one was an oil firm, three were public utilities, and one was an automobile concern. By 1972, the number of oil firms had risen to four, utilities decreased to one, as did automobile manufacturers… in 1974… five of the top ten corporate advertisers were oil companies…". The content of such adverts were tracked by Benson & Benson, and during 1975 typically covered *energy (40%), economics/regulation (20%), ecology (15%), corporate social responsibility (10%) and capital investment (9%).* Oil companies and utilities dominated the energy advertisements, with Mobil and American Electric Power dominating the economics/regulation advertisements, and 60% of all corporate social responsibility advertisements were accounted for by four oil companies: Mobil, Gulf, Arco, and Exxon (see Sethi, 1977b, p. 55).

[7] The more general point that Watts and Zimmerman's theory is largely only applicable to the US has been made before by others. See, for example, Lowe *et al*. (1983) and Peasnell and Williams (1986).

[8] See Sterling's (1990) remarks in his foonote #24, for example.

[9] These included, for example, political costs, risk, analyst following, liquidity, management ability, expected returns, trading frequency, bankruptcy likelihood, and social responsibility disclosure. It is notable in some cases, however, that Bujaki and Richardson have confused *empirical associations* found between size and other measures (e.g., number of social disclosure pages/words) as evidence of the use of size to proxy for such constructs/measures.

[10] See, for example, Zmijewski and Hagerman (1981), Holthausen and Leftwich (1983), Watts and Zimmerman (1986), Deegan and Hallam (1991), Panchapakesan and McKinnon (1992), Deegan and Carroll (1993), Lemon and Cahan (1997).

[11] Ernst and Enrst's surveys of the 1970s involved analysing the content of the Fortune 500 annual reports against an index of social responsibility activities (e.g., waste recycling, pollution abatement, training minorities, drug addiction control). Early surveys identified 14 such items, while the later surveys listed 27 such items. In most cases, however, companies either failed to disclose the level of expenditures involved or confined such disclosures to specific activities (Beresford, 1974; Beresford and Feldman, 1976). Beresford (1974, p.43, also see Elias and Epstein, 1975, p. 37), for example, notes "…disclosure of expenditures for social purposes is still quite small. The number was 73 [out of 500] in 1972 and 53 in 1971. Nearly 90 percent of the expenditure disclosures related to environmental controls, with the remaining 10 percent relating mainly to charitable contributions. None of the other categories referred to above included any significant number of companies which reported their socially responsible actions in dollar amounts." Beresford also noted at that time "most present disclosures can be characterised as imprecise, verbal rather than quantitative, selective, non-normative and non-comparative."

[12] Watts and Zimmerman's other two hypotheses, of course, predict self-interested managers would want to increase reported income to derive larger bonuses. Consequently, if politicians' concerns are no longer argued to be about abusing monopolists making too much money, it seems the incentive to *reduce* reported income, and so avoid the costly legislation is weakened.

[13] Cahan's *et al.*'s study was also set around 1979, and its sample of 43 'chemical' companies included at least 9 major oil and petroleum companies. Consequently, the possibility remains that Cahan *et al.*'s (rather poor) R^2 results may be a function of the behaviour of the same large US oil companies during the 1970s as have appeared in so many other positive accounting studies.

[14] Watts and Zimmerman, of course, as we saw earlier had argued that it is large profits that attract union demands for higher wages.

[15] It is well known that the vast majority of disclosures are positive, and this was so in this study too. This result would likely be unchanged if all disclosures were tested rather than just positive. It is the level of disclosures that is driving the result rather than the nature of the disclosures.

[16] Several other authors seem to adopt this broader interpretation of 'political costs' including Blacconiere and Patten (1994) (although they refer to "regulatory costs"), and Jantadej and Kent (1999).

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