PhD Seminar in Management Accounting Research[1]

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Tentative schedule

The seminar has three **objectives**. First, you will become familiar with some topics and paradigms in management accounting research. We will discuss a number of alternative approaches to both analytical and empirical research. I aim to build bridges between the various methodological approaches to managerial accounting research by offering content that is topic driven rather than methodology driven. Each session on a topic typically starts from the economic theory that underlies testable hypotheses. A firm believer in the importance of theory to inform any research effort, I will start with discussing the core theory papers that constitute the root thinking on a particular topic. These are sometimes older papers that are heavily (and sometimes wrongly) cited, yet scantly read. Then, we move on to discuss empirical work that tests such hypotheses.

Second, it will illustrate the evolution of research paths on a topic, the hurdles encountered, and the steps taken to overcome them. Discussion time is devoted to identifying what the problems are for empirical researchers to test the theory, where the gaps in the theory are, how empirics and theory can be bridged, and how the various empirical methods can best contribute to the empirical testing of theories. Insights here should help you when carving out your own research path.

Third, I aim to build bridges from managerial accounting to other research areas within (and outside of) accounting. In doing so, I show management accounting's relevance to other fields in accounting, trying to overcome the silo-thinking of the different accounting areas which I perceive to be an impediment to learning and progress of the accounting field as a whole. The seminar will exemplify how an understanding of both real managerial decisions and information

[1] A management accounting system is typically viewed as a system that provides information for internal decision making and decision influencing in an organization. Hence, the internal information serves two roles: planning and control. If you have very little exposure to management accounting or have no idea as to what might be considered management accounting research topics, read Ittner, C. and Larcker, D. (2001). "Assessing empirical research in managerial accounting: a value-based management perspective", *Journal of Accounting and Economics* 32, 349-410.

production within firms is crucial to improve understanding of many issues typically considered to belong in the other areas of accounting research.

Preparation:

I expect all students to come well prepared to each class by having read and tried to digest the assigned main papers, skimmed the further reading, and resorted to the refresher reading if necessary. I attach the few working papers on the program with this syllabus. I expect an active participation by each student; please make comments and ask questions.

Students taking the seminar for credit: Students that need to receive credit or a grade for taking the seminar will be graded on the following 2 components:

- Participation (20%): Students can participate through asking questions and making comments. Bear in mind that it is the quality of your contributions that counts, and not the quantity. Criteria considered in evaluating your class participation are the following. Is the participant a good listener? Would the quality of the seminar discussion diminish if this student were not a member of the class? Are the points made relevant to the discussion? Is there a tendency to make “safe” comments (e.g. regurgitating facts of the papers on the program), rather than a willingness to try out communicating new ideas and attempting to see links between the papers on the schedule? Do the comments made by the participant reflect a thorough preparation of the course material?
- Open book exam (80%): A set of comprehensive questions re the course material will be emailed to you after the seminar and you will have some time to write out your answers. The expectation is that you do not spend more than 1 day on answering the questions. The exam is open book, and will not be focused on details of proofs and mathematical derivations, but instead ask questions that query your more high level understanding of the material and your ability to see links between the various papers. Furthermore, the comprehensive questions will probe your ability to creatively apply the knowledge gained to novel topics.

Meetings:

We will meet each day from 9.15 to 12.30 (with a 15-minute break halfway through) and from 14 to 15.30. On Tuesday, I will also present in the workshop from 16.15 to 17.45.

<u>Day 1 AM (Monday June 25, 9.15-12.30): Introduction to the Seminar; Agency theory, Performance Measurement, and Target Setting</u>

After an introduction to management accounting and the seminar, we start with characterizing the role of information in both a decision making and a performance measurement context. We kick off the performance measurement literature with a coverage of Holmström (1979) to make sure also those students who have not covered this seminal paper in much depth previously are up to scratch on basic agency theory. Holmström (1979) shows that any publically observed piece of information that does not satisfy the sufficient statistic condition generates value for an agency. This is good news for accounting, since many of the accounting numbers we provide do not satisfy the sufficient statistic condition. A slew of empirical papers concerns the difficulty of setting targets in an employee's incentive plan, many of them supported by psychology based theories. We will briefly look at economics based theories that are available to support this research, and discuss where the gaps are in our understanding. In some cases, private pre-decision information can be useful in the agency, as it provides the principal with more tools to resolve the control problem. This theoretical work helps understand the widespread practice of participative budgeting and target setting where subordinates provide information to their supervisors they will later be judged against. Very often, though, the Principal sets the target in the performance contract. Less theoretical guidance is available here, as papers like Holmström (1979) and the literature following this model only derive compensation as a function of a measure, but do not specify particular cut offs. In practice, though, targets are used often, and contracts often take the Healy (1985) shape. Unlike the title suggests, Bol et al (2010) empirically look into supervisee participation in the target setting process. Indjejikian and Nanda (2002) is mostly an empirical paper on the topic, yet develops its hypotheses based on agency theory.

Main papers:

- Labro, E (2015). "Journey of management accounting research: hobby horses ridden", *Journal of Management Accounting Research*, 27(1), 133-138. Please read this paper as an introduction to my perspective on management accounting research.
- Holmström, B. (1979). "Moral Hazard and Observability", *Bell Journal of Economics* 10 (Spring), 74-91.

- Bol, J., T. Keune, E. Matsumura, and J.Y. Shin (2010). "Supervisor Discretion in Target Setting: An Empirical Investigation", *The Accounting Review*, 85(6), 1861-1886.
- Indjejikian, R. and D.J. Nanda (2002). "Executive Target Bonuses and What They Imply about Performance Standards", *The Accounting Review* 77(4), 793-819.

Refresher reading:

If you have limited exposure to Management Accounting, I recommend you read Chapter 3 in Dierynck and Labro (2018) "Management Accounting Information Properties and Operations Management", *Foundations and Trends in Technology, Information and Operations Management*. This presents an introduction to the properties of management accounting information, and introduces some terminology, for a reader who is new to management accounting research.

DAY 1 PM (Monday June 25, 14-15.30) Incomplete Contracting, Transaction Cost Economics and the Role of Management Accounting in the Supply Chain

So far, the theory we have relied on comes from the complete contracting literature. Even though I am not a huge fan of the incomplete contracting literature from a theoretical point of view (I will explain why during the seminar), this literature has been informing empirical research on the role of management accounting information, in particular within the context of the supply chain. Research questions around the role of management accounting in outsourcing and other supply chain contracting decisions are often couched within this theoretical framework. Furthermore, this theory can also be used to study internal organization, as is done in Aghion et al (2014).

Main papers:

- Baiman, S. and M. Rajan. (2002). "Incentive issues in inter-firm relationships", *Accounting, Organizations and Society* 27:213-238.
- Costello, A. (2013). "Mitigating incentive conflicts in inter-firm relationships: Evidence from long-term supply contracts", *Journal of Accounting and Economics*, 56: 19-39.

Further reading:

- Aghion, P., Bloom N. and J. Van Reenen (2014). "Incomplete contracts and the internal organization of firms", *Journal of Law, Economics and Organization* 30(1):37-63.

Refresher reading:

- Brickley, J.A., Smith, C.W. and J.L. Zimmerman (2009). Chapter 19 "Vertical integration and outsourcing" in "Managerial Economics and Organizational Architecture". McGraw-Hill Irwin, 714 pp.

DAY 2 AM (Tuesday June 26, 9.15-12.30): Information and Internal Capital Allocation

This class will look at the role of information in internal capital allocation. Stein's (2002) model introduces a distinction between hard and soft information, and connects it to organizational design. This has implications for the role of managerial accounting which can potentially harden soft information. We will briefly look at an empirical paper by Berger et al (2005), which relies strongly on this theory. Then we will discuss two empirical papers in this realm more deeply. Giroud (2013) uses a cool data set on airline routes to shock access to soft information and studies its impact on plant-level investment. Moving already in the direction of the theme for tomorrow, Shroff et al (2014) study how the external information environment helps mitigate information frictions within multi-national firms' internal capital markets.

Main papers:

- Stein, J (2002). "Information production and capital allocation: decentralized versus hierarchical firms", *Journal of Finance* 57(5): 1891-1921.
- Giroud, X. (2013). "Proximity and investment: evidence from plant-level data", *Quarterly Journal of Economics*, 861-915.
- Shroff, N., Verdi, R., and G. Yu (2014). "Information environment and the investment decisions of multinational corporations," *The Accounting Review* 89(2): 759-790.

Further reading:

- Berger, A., Miller, N., Petersen, M., Rajan, R. and J. Stein (2005). "Does function follow organizational form? Evidence from the lending practices of large and small banks", *Journal of Financial Economics*, 76: 237-269.

DAY 2 PM (Tuesday June 26, 14-15.30): Information, Delegation, Performance Measurement and Incentives

Information needs differ from firm to firm, and hence information production will also differ. Delegation can create incentives for information production and use, but comes at a cost of increased agency problems between the principal in headquarters and the agent in the business unit. These agency problems may, in turn, be resolved through incentive compensation and performance measurement. As Prendergast (2002)'s theory explains, this may be the reason for puzzling results in the empirical literature. Acemoglu et al (2007) presents an interesting empirical take on where the performance information used in decentralized firms may come from.

Main papers:

- Prendergast, C. (2002). "The Tenuous Trade-off between Risk and Incentives", *Journal of Political Economy* 110(5), 1071-1102.
- Acemoglu, D., P. Aghion, C. Lelarge, J. Van Reenen, and F. Zilibotti (2007). "Technology, Information, and the Decentralization of the Firm", *Quarterly Journal of Economics*, Nov, 1759-1799.

DAY 3 AM & PM (Wednesday June 27, 9.15-12.30 & 14-15.30): Interdependence of Managerial Accounting and Other Areas of Accounting

As discussed at the start of the seminar, I strongly believe in the interconnectedness of the various accounting subfields, even though many researchers take a more "pigeon holed" perspective. I also discussed the importance of focus on the second pillar of management accounting: decision making. This class, we will combine both of my pet peeves – what a great day! We explore the theoretical relation between earnings and market returns as well as the properties of accounting earnings frequency distributions under the maintained hypothesis that managers use unbiased accounting information benevolently to prudently make decisions to manage the firms of which they are appointed stewards (Hemmer and Labro, 2017). This paper finds that reported losses are less persistent than reported gains, the market response to earnings exhibits an "S-shape" and earnings relate to returns asymmetrically in the way documented by e.g. Basu (1997). Furthermore, the implied frequency distribution of aggregate earnings is neither symmetric nor necessarily unimodal. Instead, it is likely to exhibit a clear discontinuity at zero and looks similar to the plots reported by Burgstahler and Dichev (1997). However, within our set-up, none of these phenomena are due to reporting noise, bias or some undesirable strategic managerial behavior. Rather, the manager using information internally to learn about the quality of his decision making causes these phenomena. Li et al (2014) use a cool external communication setting to create insights about the distribution of knowledge within the firm. Then, we will move onto some of my empirical work that documents the role of internal information in optimize tax planning decisions, thereby bridging managerial accounting and tax (Gallemore and Labro, 2015).

Main papers:

- Hemmer, T. and E. Labro (2017). "Management by the numbers: a formal approach to deriving informational and distributional properties of "un-managed" earnings". Working paper.
- Li, F., M. Minnis, V. Nagar and M. Rajan (2014). "Knowledge, Compensation, and Firm Value: An Empirical Analysis of Firm Communication", *Journal of Accounting and Economics*, 58, 96-116.
- Gallemore, J. and E. Labro (2015). The Importance of the Internal Information Environment for Tax Avoidance. *Journal of Accounting and Economics*, 60, 149-167.

The last empirical paper that we will look at is a paper in this area for which I was one of the reviewers at a top journal, where it received a revise and resubmit decision. I will hand paper-based copies of the first and second round paper out in the first class, and include the first round referee reports. **Your assignment** for this class is to read these versions critically, and think about which points you would make in a second round referee report on this paper. You do not need to write an actual referee report, but I expect you to be prepared to discuss your points in class. We will also discuss the refereeing process more generally, in particular from the viewpoint of what can be expected in a second round review (a little different from a first round review). We will also compare the refereeing process to the process of discussing a paper at a conference.