Essays on Determinants of Accounting Conservatism

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ABSTRACT

This study consists of two essays. Using a dataset from 38 economies, the first essay examines the association between product market competition and accounting conservatism as well as whether this association varies with legal institutions and product market competition. In addition, I also investigate whether product market competition affects the positive association between legal institutions and accounting conservatism documented by prior studies. I find that: (1) product market competition is positively associated with accounting conservatism; (2) the positive association between product market competition and accounting conservatism is significantly stronger in countries with better legal institutions; (3) the positive association between product market competition and accounting conservatism only exists in competitive industries; (4) the positive association between legal institutions and accounting conservatism documented by prior literature only exists in competitive industries. My empirical findings suggest that product market competition could drive managers to adopt conservative accounting. Moreover, this study indicates that legal institutions and product market competition are important for each other to function well. This study contributes to the literature on country- and industry-level determinants of accounting conservatism and stresses the important governance role of product market competition.

In the second essay, I examine the association between ownership structure and accounting conservatism as well as how legal institutions influence this association. Using a comprehensive, firm-level ownership dataset for thirteen Western European countries to conduct the empirical analysis, I find that: (1) both wedge between control rights and cash-flow rights and dispersion of cash-flow rights across multiple large owners are positively associated with accounting conservatism; (2) legal institutions strengthen the positive association between wedge/dispersion of cash-flow rights and accounting conservatism. This study contributes to the literature in a number of ways. Firstly, it adds to the growing body of literature on the role of accounting conservatism in mitigating agency problems. Secondly, this study highlights the importance of the second largest controlling shareholder in affecting the level of accounting conservatism. Thirdly, this essay reinforces the important role played by legal institutions in influencing the installation of firm-level corporate governance mechanisms.

Keywords: Legal Institutions; Product Market Competition; Ownership structure; Accounting Conservatism
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