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THE PREMIER GLOBAL SOCIETY OF FINANCIAL EXECUTIVES

Message from the Chairman

A year and a half has passed since I assumed the role of Chairman of IAFEI in January of last year. I would like to express my sincere appreciation to all Board members, ExCom members, Advisory Committee Chair Dr. Conchita Manabat and her team, Overall Technical Committee (OTC) Chair Professor Piergiorgio Valente and his team, as well as my Secretariat team, Mr. Nobuki Taga and Mr. Anson Kee, for their unwavering support of IAFEI's initiatives.

In alignment with our ongoing goals to **1) promote collaboration** and **2) advance professionalism**, the OTC has been active in organizing CFO E-Roundtables and educational webinars under the capable leadership of Professor Valente.

To further enhance IAFEI's visibility among global finance professionals, I traveled to Malaysia in April to attend a roundtable discussion hosted by the International Ethics Standards Board for Accountants (IESBA) in Kuala Lumpur, accompanied by Dr. Manabat. She also attended GTAP (Global Tax Advisers Platform) meeting in March. I also attended the GTAP meeting in May. We would like to promote collaboration with IESBA, GTAP and also other international professional organizations for seeking mutual benefit.

After the IESBA meeting in Malaysia, we visited Singapore to meet with local leaders who are working to establish a CFO Club in Singapore with the support of Mr. Bach of VCFO. After a productive discussion, they expressed interest in attending the upcoming IAFEI Day in Taipei as observers. It is our shared hope that they successfully establish a non-profit professional association, engage local executives and finance professionals, and eventually join IAFEI—just as 3H recently did, bringing new ideas and fresh perspectives.

IAFEI Day 2025 will be held on **Friday, October 17**, in **Taiwan**. Ms. Jennifer Wang, Area President for Asia, and her team, with the full support of FEI Chinese Taipei, are diligently preparing the program, venue, and other logistical details. In advance of the IAFEI DAY, we're excited to present a special "Road to Taipei" Webinar on August 1, designed to deepen the conversation around the official IAFEI DAY theme. Please check the **IAFEI Weekly Update** for the details. If you are interested in participating as a **speaker** or **panelist** on topics such as sustainability, digitalization, or other areas of expertise, please do not hesitate to contact us.

This issue of IAFEI Quarterly features two insightful original articles from 3H, two from CACFO, one from FINEX and one from JACFO. I would like to extend special thanks to these contributors. Each of these articles is thought-provoking and highly relevant, and I strongly encourage all readers to take the time to read them.

The first article "**1 Cyber-Diplomacy in the Digital Era**" by Professor Valente is an eye opening for me. He said that "The cyberspace is considered the ***fifth domain of warfare***. Alongside the more traditional sea, land, air and space". We may need to understand the importance of Cyber-Diplomacy to mitigate the risk toward our digital future.

The second article **2 Accounting for New Capitalism - After Shareholder Primacy** by Dr. Tomo Suzuki may hold historical significance since his *New Capitalism* concept has never been translated into English although he is a globally recognized expert in management accounting and sustainability and served for over 15 years as Professor and Head of Accounting & Sustainability Management at Oxford's Saïd Business School. We are very honored to feature, for the first time in English, his groundbreaking ideas and proposals to revive Japanese economy by revitalizing listed companies on the TSE, It may also offer valuable insights for other aging economies around the world.

I am hoping that you should enjoy reading these articles and make discussions based on these new ideas and concept.

IAFEI achieved a great deal in 2024 and we are in the process of building on this momentum in this year. Your feedback and suggestions remain invaluable as we continue striving to enhance the value of IAFEI for all our members.

Let us keep working together to shape a brighter future for IAFEI.

Sincerely,

Tsutomu Mannari
Chairman of IAFEI (2024 - 2025)

TABLE OF CONTENTS

(Total 55 pages)

Cyber-Diplomacy in the Digital Era

Piergiorgio Valente | IAFEI Overall Technical Committee Chair President CFE Tax Advisers Europe Chair GTAP Global Tax Advisers Platform

In the digital age, cyber-diplomacy has become an essential tool for international relations, addressing the challenges posed by cyberspace. Cyberspace can sometimes seem very abstract and incomprehensible. But in 2024 cyberspace is considered the fifth domain of warfare. Alongside the more traditional sea, land, air and space, cyberspace has become a space with active collaboration but also a target for attacks. As in our relations on the "real world" we need diplomacy to keep the peace, we also need secure, commonly understood cyber-diplomacy, to keep war away from our cyber-space.

Cyber-diplomacy involves the use of diplomatic strategies to manage issues such as cybersecurity, digital trade, and internet governance. While traditionally focused on national security, cyber-diplomacy now overlaps significantly with legal and economic considerations. Cyber-diplomacy is the term used to describe the diplomacy in cyberspace (the use of diplomatic resources and the diplomatic functions to secure national interests and peace in cyberspace).

Despite ongoing efforts through public awareness campaigns, research and development, and educational initiatives, individuals and organizations remain today still highly vulnerable to cyber-attacks. As the world becomes more and more connected, the impact of cyber-attacks extends beyond individuals and can affect critical infrastructure, government systems, and international networks, posing significant global challenges.

The future of cyber-diplomacy will depend on nations' ability to negotiate a shared vision for a secure, open, and digital world with a great potential. It is widely recognized in today's world that the ability to shape the rules in cyberspace can grant significant influence over other stakeholders. However, perspectives on what is considered right or wrong might vary significantly across regions. For instance, views on privacy differ significantly between countries, and so do opinions on different surveillance practices. As a result, we are witnessing a new form of competition, reminding us of the space-race during the Cold War, with different regions striving to set standards for cyberspace regulation.

Frameworks that Help to Shape Cyber-Diplomacy

The rise of so-called data localization laws has further complicated the economic landscape of cyber-diplomacy. These laws require data to be stored within a country's borders in order to protect national security and privacy. But on the other hand, these laws can also act as barriers to international trade. Negotiations in cyber-diplomacy often focus on balancing these concerns, seeking to harmonize regulations and facilitate the free flow of data while safeguarding privacy. For example, agreements like the EU-U.S. Data Privacy Framework aim to resolve conflicts between differing privacy standards and enable smoother cross-border data exchanges [European Commission. "Questions & Answers: EU-US Data Privacy Framework." European Commission, 9 July 2023].

EU-USA Data Privacy Framework ensures that the USA ensures an adequate level of protection for personal data transferred from the EU to companies participating in the EU-U.S. Data Privacy Framework. With the adoption of the adequacy decision, European entities can transfer personal data to participating U.S. companies without the need for additional data protection measures. This framework provides EU individuals, whose data would be transferred to participating companies in the US, with several new rights [European Commission. "Questions & Answers: EU-US Data Privacy Framework." European Commission, 9 July 2023].

The global digital economy also demands cyber-norms and standards of behavior for states in cyberspace. Because even as it seems abstract and something that we cannot see or touch, we all participate actively in that "abstract" space. By establishing agreements on what can be considered as acceptable cyber activities, nations can reduce the risk of economic disruptions and foster trust among their international partners. These are just some examples of diplomatic efforts that are crucial for building a secure environment for digital trade and investment.

European Union Member States have acknowledged the urge to set down common rules in a series of actions already for a while. Revised guidelines together with a common toolbox against cyber-attacks have been created by the Council of the EU [Council of the European Union. "Revised Implementing Guidelines, Cyber Diplomacy Toolbox." 2023].

Although, conceptually, cyber-defense was initially meant for the protection of military assets, its influence is widening, given that the military sphere, just like the civilian sphere, depends on a safe cyber-space to protect critical infrastructure such as electric grids, water systems, banking, transport, communication systems and the flow of goods and services. The same attitude is shared by various States around the world, taking unilateral or multilateral positions regarding cyber-attacks and cyber-diplomacy.

In recent years, a variety of proposals have emerged concerning frameworks and regulations aimed at governing cyberspace. Notable examples include the EU Cybersecurity Strategy, the Cyber Diplomacy Toolbox, the General Data Protection Regulation (GDPR), the Convention on Cybercrime (commonly referred to as the Budapest Convention), and the OECD Cybersecurity Policy Framework. These initiatives highlight the active efforts of different players to shape the landscape of cybersecurity. Despite great progress, the world still lacks a unified and commonly accepted global framework for cybersecurity. There are many proposals and projects, but one certain set of rules, with what all the stakeholders agree, is still missing.

Legal Challenges of Cyber-Diplomacy

Digitalization of our everyday life, together with activities and relationships with the state one lives in, and economic relations is a norm in today's world. The aim of overall digitalization is to simplify the way of doing things, to save time and to make everything more efficient. However, by simplifying one thing, we might unintentionally complicate something else. The inevitable digitalization brings with it also many new forms of crime and wrongdoings that need to be penalized and legally dealt with. This raises some issues.

One of the primary legal issues in cyber-diplomacy is the application of international law to cyberspace. For instance, the issue of recognition - determining who is behind an occurred cyber-attack - or even what exactly is a cyber-attack - is particularly problematic. There are some rules set on this topic, but the task remains still complicated. Cyber operations can be conducted anonymously, making it difficult to identify the offenders and apply legal consequences, such as, for example, the Budapest Convention on Cybercrime, that has established guidelines for cooperation and harmonization of national laws. Moreover, not all nations have adopted these agreements, and significant players like Russia or China have decided to use alternative frameworks, challenging the establishment of a universal legal approach to cyber threats ["CETS 185 - Convention on Cybercrime]. Their main point of concern being the question of sovereignty.

The question of state sovereignty in cyberspace remains highly controversial not only for China and Russia. While some countries stand for sovereignty over their use of digital space, others emphasize the importance of an open and connected internet and cyber-space. Missing a cohesive legal framework

stays on the way of effective diplomatic efforts and increases the risk of conflicts escalating into cyber warfare.

Cyber-Diplomacy and Digital Economy

Cyber-diplomacy also plays a critical role in shaping the digital economy, now more than ever. Cybersecurity is considered as a top priority for global economic stability as huge part of businesses operate online. Recently, key economic sectors such as commerce, transport, finance and energy have become more and more reliant on digital technologies, and the risk from cyber threats and attacks keeps on growing.

Recent data highlights the substantial growth of the digital economy, significantly outpacing traditional so-called brick-and-mortar sectors in recent years. For example, in the United States, the value added by the digital economy increased by 6.3% in 2022, while the overall economy grew by only 1.9% [The Journal of the U.S. Bureau of Economic Analysis. "U.S. Digital Economy: New and Revised Estimates, 2017-2022", 6 December 2023]. Over the last decade, there has been a clear pattern of rapid growth in the digital sector compared to traditional industries. It emphasizes the growing importance of digital services such as e-commerce, cloud computing, and telecommunications, which have become key drivers of economic activity ["OECD Digital Economy Outlook 2024 (Volume 1) : Embracing the Technology Frontier | OECD Digital Economy Outlook." OECD iLibrary, 2024].

It is the case not only in the USA. Globally, the digital economy's expansion has been remarkable as well. The OECD reported that digitalization has contributed significantly to GDP growth across its member countries. The rise of e-commerce and digital services has transformed industries, particularly after the COVID-19 pandemic, which strongly pushed digitalization and innovation ["OECD Digital Economy Outlook 2024 (Volume 1): Embracing the Technology Frontier | OECD Digital Economy Outlook." OECD iLibrary, 2024].

As from one hand, globalization and overall connectivity of the world's economy is positive and enriching by creating economic growth and trade possibilities, on the other hand it makes the whole economy also very vulnerable. Cyber-attacks, such as intellectual property theft, system run downs by hackers and tax-crimes pose significant threats to businesses and can even disrupt global supply chains. Therefore, it is of utmost importance that cyber-diplomacy in collaboration with cyber-security is applied when operating in digital economy in order to prevent crimes from happening.

Tackling Tax Crime in The Digitalized Economy

With the overall digitalization of our lives, tax and other financial crimes are more global than ever which can undermine the rule of law as well as public confidence in the legal and financial system. As mentioned previously, technological development brings with it endless positive opportunities, but unfortunately it creates also new risks and ideas for crimes. The growth of cybercrimes, including the increasing misuse of cryptocurrencies and people who can create opaque structures and move around money increasingly in real-time, has been noteworthy. All these developments give fighting tax crimes a new importance. This new era calls for increasing international co-operation and for all jurisdictions to have a robust domestic set of legal and operational tools in place to effectively detect, disrupt and sanction tax crime offenders and those who enable tax crimes [OECD. "Fighting Tax Crime – The Ten Global Principles, Second Edition." 2021]. What is more, uncertainty in the taxation of online business models can have adverse implications for tax compliance.

OECD published a report in 2021 outlining The Ten Global Principles, which detail the comprehensive set of tools that countries should aim to implement to tackle the new problems of tax crimes. These include implying tougher laws to criminalize tax offenses, developing a unified tax crime strategy to

detect threats and target criminal activities and establishing mechanisms to seize the criminal gains following a conviction [OECD. "Fighting Tax Crime – The Ten Global Principles, Second Edition." 2021].

Furthermore, the report proposes that jurisdictions dedicated to helping developing countries' tax capacity-building efforts, such as the Addis Tax Initiative or the G7 Bari Declaration, should investigate more effective collaboration with developing countries. This collaboration should concentrate on improving tax crime investigations and encourage more widespread adherence of the Ten Principles. Proposals for next steps include sending expert trainers to the OECD International Academy for Tax and Financial Crime Investigation, participating in the Tax Inspectors Without Borders pilot program for criminal investigations, assisting with the implementation of the Tax Crime Investigation Model, and collaborating on regional or bilateral projects [OECD. "Fighting Tax Crime – The Ten Global Principles, Second Edition." 2021].

The OECD´s Task Force on Tax Crimes and Other Crimes (TFTC) will continue to support international coordination in the fight against tax crime, particularly in areas where coordinated global action is critical, such as asset recovery and dealing with professional facilitators. Furthermore, the TFTC should collaborate with other stakeholders to develop a coordinated strategy for addressing cross-border tax crimes. This strategy should include mechanisms for risk identification, potentially expanding available data sources, and ensuring effective data and information-sharing agreements. All of this must be adapted to the digital world, using cyber-diplomacy to prevent threats and cyber-security to tackle potential criminals.

Conclusion

Cyberspace contains an enormous amount of economic, social, and political possibilities. If properly managed, it can foster long-term growth and shared success for all. However, without proper regulation, it risks becoming a battleground for destructive confrontations. Cooperation through diplomacy among states, international bodies, and supranational authorities is essential to harness its benefits while mitigating the risks.

While the digital economy and technical advancements provide limitless benefits, they also expose governments and businesses to cyberattacks and vulnerabilities. To create a secure and thriving cyberspace, it is critical to develop widely accepted norms that apply to all participants. Furthermore, the rising digital economy presents difficult challenges such as taxation and financial crime. Cybercrime, cryptocurrency misuse, and sophisticated money laundering networks emphasize the need for close monitoring and international collaboration. Addressing these risks will require continuous innovation, coordinated efforts and shared responsibility to secure the future of the digital age.

Diplomacy has been a cornerstone for international relations, and overall relations between people, since the beginning of time. Cyber-diplomacy will be the next cornerstone of our future world, shaping how nations collaborate, resolve conflicts, and protect our shared digital space. As technology continues to be the protagonist of global connectivity, the ability to navigate and negotiate in cyber space is essential for ensuring peace, security, and continuous development. Embracing cyber-diplomacy is not just a necessity, it is an investment to ensure a stable and cooperative digital future.

Professor Piergiorgio Valente is the Managing Partner of Crowe Valente. He is a known International Tax Advisor who has held various leadership roles in European and global Tax Organizations like President of the CFE Tax Advisers Europe and Chair of the GTAP Global Tax Advisers since 2019 and President of International Tax-Policy Commission at CNDEC. He is active in the Academia and is the Professor of Diritto Internazionale and International Tax Law at the Link Campus University in Rome.

Accounting for New Capitalism
- After Shareholder Primacy -

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Accounting as Nudge for "New Capitalism"

Today, I would like to discuss a topic of great importance for Japan, and indeed for the international communities which will eventually face the challenge of mature economy which Japan is currently experiencing. It is about the way how the "globalized limited-liability corporations and stock exchange" market system would function negatively on management practices in mature economies, and about how we should mitigate such "aporia" by reforming current accounting and finance practices.

For CFOs in Japan, I may be best recognized as the author of the 'Oxford Report' (2012), which was submitted to the Financial Services Agency to change the course of then established policy to mandate IFRS. I considered at that time, and even today, that the mandatory adoption of IFRS in this country would not help the country's sustainable development – which I will explain later in this lecture, too. It is indeed about how accounting functions and counter-functions in capitalist economies in a long cycle, say 30 years or so.

Does accounting matter to foster sustainable development of socio-economies? Let me explain. I have worked not only in the UK and Japan but also in China and India. In India, for example, where there are 8,000 listed companies, I proposed the Ministry of Corporate Affairs to implement a law for companies which may then be induced to voluntarily engage more in CSR (corporate social responsibility) practices. The law merely required a change in the format of Profit and Loss (PL). Instead of allowing maximizing short-term profits at the bottom of PL, I wanted to see whether a different form of PL can foster CSR-friendly corporations.

Imagine an emerging economy where 8,000 listed companies compete for larger profits and dividends to meet expectations of investors. Yes, India is growing and will grow further, which is good for investors, managements and employees. But we all know, at the same time, the rich-poor gap would also grow, and poverty classes may stay poor. How can accounting help to make the situation better?

I suggested "One Additional Line" of CSR expenses to be independently disclosed in the main PL (Companies Act 2013, Section 135, GN (A) 34, Presentation and Disclosure in Financial Statements, 2015). The law is about the disclosure format only. It does not mandate actual spending. Now, would managements of 8,000 companies spend CSR expenses, despite the fact that the pressure for larger profits and dividends is clearly evident?

The answer was yes, and a big Yes. But why? It was because the new accounting form of PL made managements realize that they are watched not only by investors, but also by a wide range of stakeholders. "One Additional Line" is considered among some policy researchers as a little revolution in which accounting format created a new market which transformed the nature of the market, from the one in which the short-term profits were sought to the one in which the appropriate balance of profits and CSR is sought.

Turning to Japan, may I just point out without any details and evidence in this lecture that the post-World War II Japanese "triangle accounting formation" (i.e., accounting for Commercial Code, Securities and Exchange Act, and Tax Law co-existed under the single set of Accounting Principes) was considered

by the US at that time a Win-Win-Win accounting framework which promoted 'truly democratic' socio-economy? John Kenith Galbraith and Shigeto Tsuru of the General Headquarters of the Supreme Commander for the Allied Powers (GHQ SCAP) believed the Japanese accounting regulations were better than those of in the United Kingdom and the United States, as they accommodate and mediate diverse interests of a wide range of stakeholders, rather than prioritizing exclusively the interests of investors (Suzuki, 2007 a&b).

Suzuki, T. (2007a) Accountics: Impacts of Internationally Standardized Accounting on the Japanese Socio-Economy. Accounting Organizations and Society Vol. 32(3) P263-P301

Suzuki, T. (2007b) A History of Japanese Accounting Reforms as a Microfoundation of the Democratic Socio-Economy: Accountings Part II. Accounting Organizations and Society Vol. 32(6) P543-P575

Drawing on such a historical background and reasons, the 'Oxford Report' argued that rather than indiscriminately enforcing international accounting standards, it is essential for Japan to employ specific accounting for specific conditions of the country. I do believe the same applies to today's corporate governance regulations in Japan. In today's lecture, too, I would like to discuss the necessity of designing financial systems that suit Japan as mature socio-economy which is clearly different from the one in the US, Europe, or emerging economies.

Critical Review of Quarterly Disclosure

Upon returning to Japan after lecturing in Oxford for 20 years or so, I wrote the "Research on Disclosure, Corporate Governance and Market for the Sustainable Development of Mature Socio-Economy <With Critical Review of Quarterly Disclosure>" (2020), commonly known as the "Mature Socio-Economy Report," or "Kankeiren Report" commissioned by the Kansai Economic Federation (i.e., Kankeiren).

The initial request was "a critical review of the quarterly disclosure." Mr. Masayoshi Matsumoto, President of the Kansai Economic Federation (and President of Sumitomo Electric Industries, Ltd.), must have expected a report of about 20 to 30 pages. However, the final report ended up with 315 pages. For me, the assignment was not merely a matter of the frequency of financial reporting, but a matter of philosophy of economics and accounting, which required the large volume.

From "Shareholder Primacy" to "Fair Distribution of Value Added"

With a good surprise, this report came to be thoroughly examined by the members of Diet, leading to a formal parliamentary discussion. Furthermore, Mr. Fumio Kishida, who was at that time considering to run for the Liberal Democratic Party's Presidential election, also reviewed the main figures and graphs presented in the "Mature Socio-Economy Report," together with several influential members of Diet who became ministers of Kishida Cabinet.

As a pavement for the Prime Minister, Mr. Kishida established the "Diet Members Caucus for New Capitalism." At the very beginning of the Founding Purpose Statement, it stated that the shareholder primacy is the most significant aggravating factor behind Japan's stagnation. The statement emphasized the need to reassess shareholder-centric governance, and argued that increasing investment in employees through fair distribution of value added is critically important to revitalize the national economy. This principle became the foundation and starting point of what then came to be called "New Form of Capitalism," or simply "New Capitalism."

I was personally surprised to see how widely the "Mature Socio-Economy Report," was read and analyzed, ultimately contributing to the foundation of policies of New Capitalism. Subsequently, I received a

request from an influential figure to publish a book that would be accessible to the general public. ***Accounting for New Capitalism: Trapped in "Profit" - Aporia of Mature Socio-Economy*** (Chuokeizai-sha, 2022) was the response to the request. While there are countless books on "growth strategies" worldwide, there are virtually no research works or textbooks, as far as I know, that explicitly address "distribution strategies" (not government redistribution but primary distribution by corporations). This book was designed as a versatile resource for politicians, bureaucrats, researchers, and the general public. (Note: no royalties or fees were pursued for the publication of this book, as it aimed to contribute to public policy.)

In 2023, I had the opportunity to speak at conferences hosted by Keidanren, Keizai Doyukai, and other leading business organizations, where I advocated for the "Fair Distribution Management." This concept has now garnered significant attention and has been promoted as a joint statement by the major business organizations.

Today, through this lecture, I would like to seek for the understanding and cooperation of CFOs in advancing the fair distribution of value added, with the ultimate goal of revitalizing Japan's economy, or mature economies which the international communities will face before long.

Difference between "Profit" and "Value Added"

In response to the question, "the higher profits, the better?" no one would say "No." Similarly, in terms of GDP, macroeconomic policy generally leads us to believe that "the larger GDP, the better." Setting aside discussions on ESG, SDGs and other extensions, the conventional macroeconomic knowledge tells us that "the larger GDP is the better for people's lives."

Note, however, that GDP is the sum of the "value added" created by each company, which is largely different from our ordinary "profit." Value added is calculated as the total revenue (gross value) minus the value generated by external stakeholders (mainly suppliers and subcontractors). The issue is that in microeconomics and ordinary management, what we typically aim to increase is "profit," and not "value added."

Profit is actually merely a portion of value added which belongs to shareholders alone, at the bottom of Profit and Loss. During the period of growth economy, say between 1960s and 1980s, profit increased mainly through an increase in revenue, which also meant increase in value added. In other words, when management tried to increase profit, they also automatically increased value added, which made all stakeholders happy.

However, now in the mature economy with declined population, where increase of revenue is structurally difficult, majority of companies focus on cost-cutting to keep profit high – the major cost being salaries and R&D costs. This approach can increases "profit" for shareholders in a short term, but largely at the cost of value added which previously belonged to the other stakeholders. And, in the long run, investors and shareholders can move on to the other investment opportunities, once the company reached the sage where it can no longer pay high dividends. This meant that the function of profit as the nudge of macroeconomic policy to make the public happy has now been lost, in the mature economy where global capital market is efficient.

Surprisingly, even among researchers, bureaucrats, and politicians, there are very few who understood this point. Efficiency of global financial market may be good for the Earth as a whole, but not so for the local mature economy. This fundamental lack of understanding over the counter-function of "profit" in mature economies is hindering the sustainable development of this country.

New Tool for Sustainability Management: Distribution Statement (DS) of Value Added

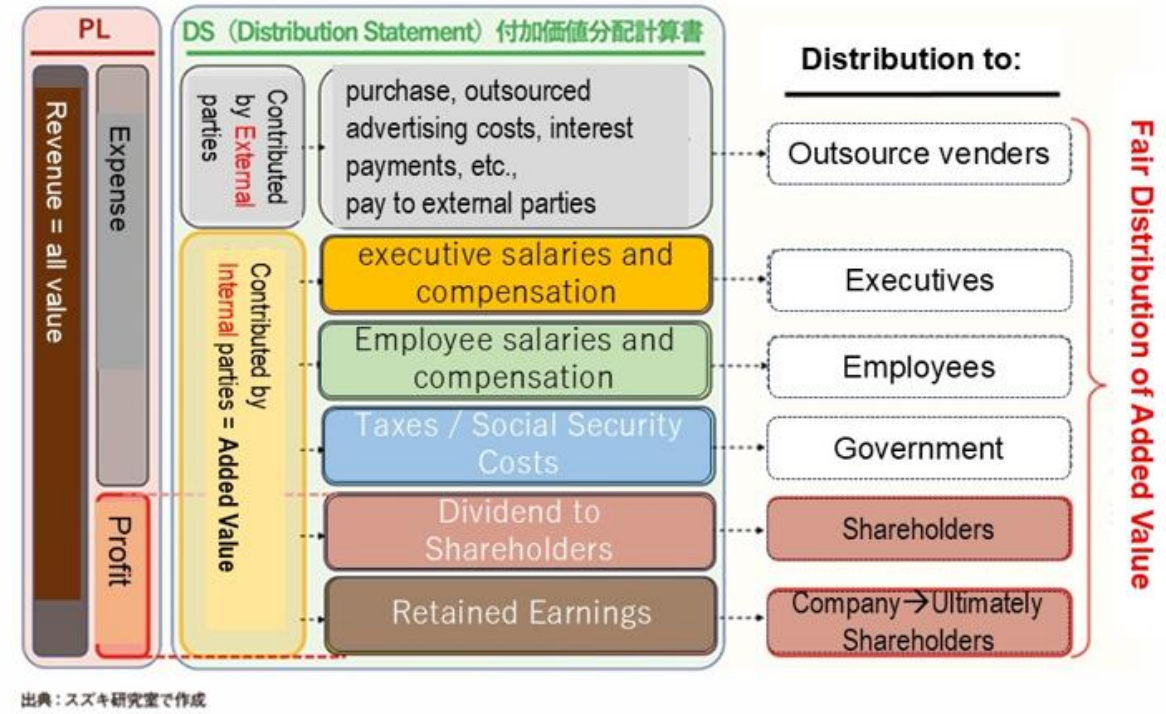
The profit and loss statement (PL) that we use daily calculates profits by deducting expenses from revenues. The outcome of profits is either distributed to shareholders as dividends or retained internally as retained earnings. Retained earnings are assumed to be automatically reinvested into the business, contributing to the company's growth, and we generally believe this to be “nice and normal”. These days, however, there is a tendency in Japan to demand the distribution of retained earnings, often used for deficit dividends or share buybacks. Some CFOs may feel frustrated but endure it as the "fate of capitalism." Naturally, in Japan's mature socio-economy with limited growth expectations, once profits are calculated, they quickly flow out to shareholders with little chance of returning.

Let me repeat the point again. If management aims to increase revenues to maximize profits, there is no issue. However, over the past 30 years, despite various policies, Japan's corporate revenues have plateaued on a macroeconomic scale. While some companies may say, "Our revenues are growing," statistically, the 3,800 listed companies have not seen revenue growth over the past 30 years. In this situation where revenues, macro-economically and structurally, do not grow, efforts to maximize profits inevitably lead to cost-cutting, which does not increase GDP nor enrich the socio-economy. What makes the nation wealthy is the GDP, the sum of Value Added, and not profits.

So, how can we increase value added? To consider this, I have thought of a new financial statement called the "the Distribution Statement (DS) of Value Added". The DS starts similarly to the PL, focusing first on revenues, which embody the whole realized value in terms of financial accounting. Next, in considering “who” contributed to the revenues, we simply divide the contributions into those by external parties and those by internal parties.

[Illustration A]

PL vs DS: Profit vs Added Value



The contributions by external parties are measured by purchase figures, outsourced advertising costs, interest payments, etc.. On the other hand, there are contributions by internal parties. The generated

value by internal parties is called "value added." Internal value creators include executives (to whom, the company pays executive salaries and compensation), and most importantly, employees (to whom, the company pays employee salaries and compensation). We consider the government as part of the internal contributor which supports our business, to which the company pays taxes and social security costs. Other stakeholders include shareholders (who are compensated through dividends), and the company itself as the legal entity, to which retained earnings (internal reserves) are saved to re-invest in itself.

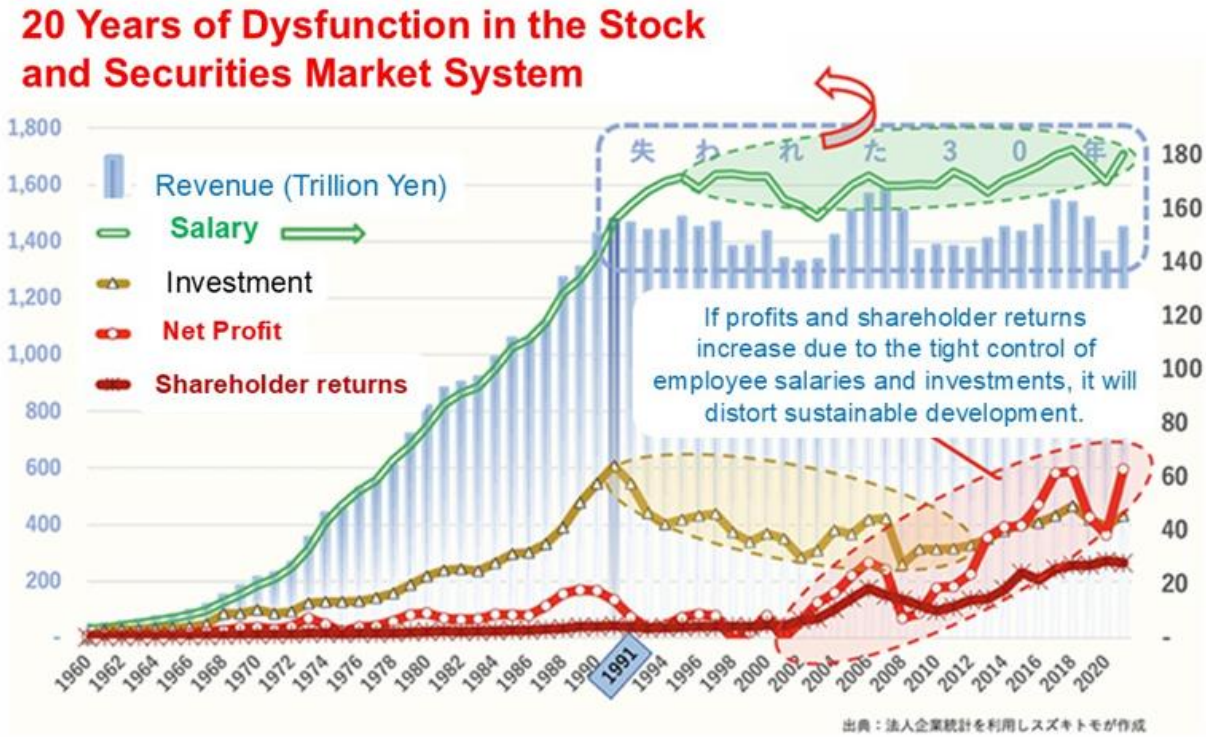
While "expense" may carry a negative connotation in ordinary management practices, from a macroeconomic policy perspective, paying executive and employee salaries is a realization of distributed value added, and is positive. Assuming stagnated revenues, and if we aim to maximize profits, it will lead to reductions in expenses such as executive and employee salaries, which does not help macroeconomic development. This will make shareholder rich and raise share prices. But many stakeholders in the socio-economy do receive benefits, resulting in what we sometimes refer to the "growth without happiness" (although the growth here is the one of profits and share prices, and not value added).

In the following, we will consider Management by Fair Distribution for sustainable development in a mature economy. We will explain it through macroeconomic statistics, followed by microeconomic, i.e., managerial cases.

Dysfunction in the Stock and Securities Market System

Looking at the trend of national sales from 1960 to 2021, sales steadily increased until 1991, but for the next 30 years, it stagnated. We refer to this period as the "Lost 30 Years." However, this term does not help suggesting a solution, so I instead call it "Dysfunction in the Stock and Securities Market System," and attempt to introduce desirable policies.

[Graph B] <20 Years of Dysfunction in the Stock and Securities Market System" >



When looking at the change of employee salaries relative to sales, from 1960 to 1991, employee salaries grew in tandem with sales growth. During this period, for shareholders, maximizing profits meant planning to maximize revenues, and for that, it was rational to pay employees well so that they sell well. Such a period ended in 1991.

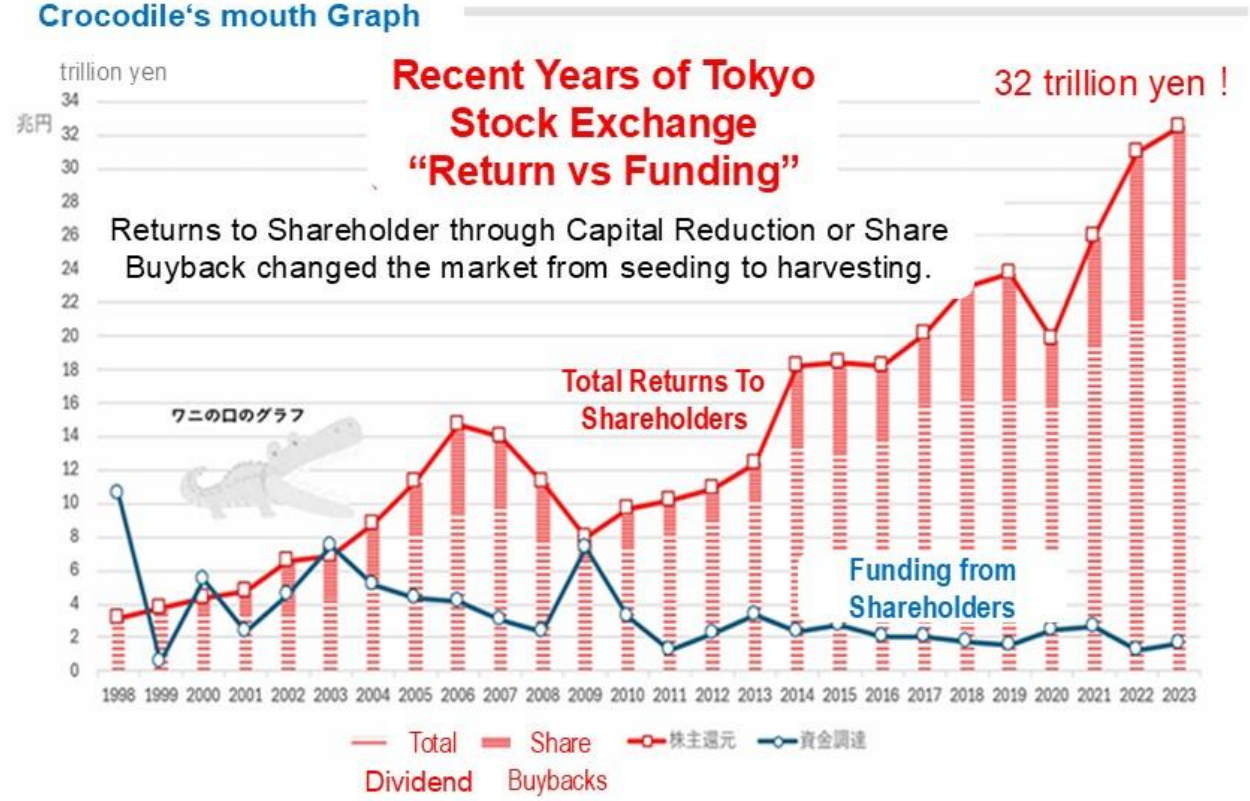
After 1991, it became an era where even salary increase did not lead to revenue growth. This was due to significant structural changes, such as population decrease and the rise of China and India, which reduced Japan's competitiveness.

Capital investment peaked in 1991 and then began to decline sharply. As sales stopped growing, capital investment was reduced to generate profits. This is, of course, a management strategy that should not be practiced for medium- to long-term growth, but is often practiced for short-term profit maximization.

As a result, from around 2000, profits and dividends began to grow. By suppressing employee salaries and capital investment, profits and shareholder returns increased. When I returned from the UK and noticed this correlation, I couldn't help but feel concerned about the future of this country.

Let's now look at the relationship between investments and returns. Using data from the Tokyo Stock Exchange, I graphed the money investors put into companies (equity finance) and the money companies paid out to shareholders (shareholder returns) from securities reports. The data spans from 1998 to 2023. Equity finance gradually decreased to about 1 trillion yen in 2023. In contrast, shareholder returns (dividends + share buybacks) in 2023 were about 31 trillion yen, and the gap between the two has been widening. We named this graph as the **"crocodile's mouth**," and it has become widely known among researchers, politicians, and bureaucrats.

[Graph C]



However, this phenomenon is, in a sense, inevitable. Currently, the Tokyo Stock Exchange is a market worth 900 trillion to 1,000 trillion yen. The market, which started at 8 trillion yen soon after World War II, has expanded significantly owing to active funding from investors. However, today, as the Japanese economy has matured, and only modest growth is expected, funding decreases and dividends increase. This should not be surprising in a mature socio-economy.

Next, let's look at the distribution of value added in an index form. When the value in 1960 is set to 1, the graph shows, how the values of "sales," "employees," "executives," "capital investment," and "shareholder returns" changed thereafter? Sales, which continued to grow until 1991, increased 30 times but then plateaued. In contrast, employee salaries grew about 45 times by 1991 and 50 times by 2022, and although very slowly, they are still growing.

The low growth of salaries in Japan is a widely recognized issue, but there is actually another hidden problem. That is executive compensation. Executive compensation grew 60 times in the 1990s but has since decreased to 50 times. Although not often discussed, I recognize it as a concerning issue. The average executive compensation for the 3,800 listed companies is about 20 million yen, which is extremely low even among listed companies in Southeast Asia.

Capital investment also declined after 1991, as mentioned earlier. The Koizumi Cabinet, which was established in 2001, took this seriously and introduced a distinguished policy. This was a shift to so-called "neoliberalism," and was also called the "Big Bang of Securities and Accounting" in the world of accounting and finance.

Professor Heizo Takenaka of Keio University (at the time), who supported the Koizumi Cabinet's policies, was in the position to suggest, "Don't worry, Japan has money." In 2000, household financial assets amounted to 1,400 trillion yen, half of which was dormant in bank deposits. The idea was that, allowing investors' free will to seek profits, if this money were directly invested in companies, production facilities would expand, production efficiency would increase, competitiveness would improve, profits would rise, dividends would increase, and the economy would circulate, leading to the nation's revival.

To make this cycle begin, a specific measure, the so-called Financial Big Bang, came to be implemented. This included quarterly reporting, segment information, consolidated financial statements, and international accounting standards. The policy aimed to increase direct investment by providing more information to investors more frequently.

At that time, I thought that this policy makes sense. However, the problem is that we have neglected to review this policy for a long time. Policy evaluations have not been conducted to today.

We are now witnessing a reality where funding, executive salaries, employee salaries, and capital investment are not increasing, while only shareholder returns are increasing. Initially, the intention was to disclose more information to shareholders to discover new investment opportunities and provide funding. However, despite the counter function is observed, where funds are being returned to shareholders, the initial policy is still touted as a success and continues to be promoted, as the profits are increasing. This may be the result of "officially" legitimate lobbying by stakeholder groups who benefit from it. As the Japanese economy entered a mature stage, investors who obtained more information more frequently focused on the ample internal reserves and cash to pursue measures to efficiently collect them. In this sense, "Investors" are now "Collectors" in Japan.

10 Trillion Yen Share Buybacks and Foreign Investors

Furthermore, the source of shareholder returns is no longer limited to profits. When I was a student, I was taught that dividends from capital were illegal. However, through amendments to the Commercial Code and the Companies Act in the early 2000s, it became possible to reduce "Share-Equity" and transfer it to "Other Capital Surplus," allowing shareholders to claim dividends. The amount of shareholder returns from capital already exceeded 20 trillion yen in 2021, and additional 30 trillion yen is expected to be paid in the future.

Furthermore, from around May 2023, the media began to frequently cover the issue of PBR (price-to-book ratio) falling below 1, and the Tokyo Stock Exchange started to demand that companies not meeting the PBR≧1 rule disclose improvement measures. Officially, the Tokyo Stock Exchange and the Financial Services Agency (FSA) claim that companies should present investment projects to satisfy investors, who would then purchase shares and provide funding to companies.

"This will not happen" was my prediction. To meet the PBR≧1 standard, managements are likely to reduce the capital, the denominator or PBR, as a quick solution. With the help of two young researchers from the Suzuki Laboratory, we collected all "Timely Disclosure Reports" and conducted a comprehensive survey. Even in just one month of May 2023, 220 companies announced share buybacks totaling 3.25 trillion yen. In fiscal year 2024, an additional 10 trillion yen in share buybacks came to be planned. Most of the reasons for the share buybacks announced in May 2023 were "improving capital efficiency" and "strengthening shareholder returns." Funding is not happening. The return of funds to shareholders is steadily progressing.

The survey also revealed that companies conducting share buybacks generally have a high proportion of foreign investors. Contrary to the government's initial intention of "returning benefits to Japanese citizens," Japanese individual investors are decreasing, while foreign investors are becoming shareholders of Japanese companies. CFOs in Japan are well aware of this. It is said that as of August 2024, the average proportion of foreign investors is approximately 30%, but this is a superficial figure. Detailed analysis of custodians and others suggests that more than 40-50% of Japanese listed companies may be owned by foreign investors. One of the reasons Abenomics, which claimed that companies would generate profits, shareholders would become wealthy, and this would cause a trickle-down effect to enrich the nation, did not work lies here.

The Misconception of the "ROE 8% Standard"

Recently, shareholders, not limited to foreign investors, have been demanding higher ROE (Return on Equity) and higher dividend payout ratios. The Ministry of Economy, Trade and Industry (METI) also recommends a ROE of over 8%, and the market atmosphere has been created where CFOs and IR officers of companies feel that ROE must exceed 8%, and recently even 10% or 15%, in the country where the long-term interest rate has been nearly zero for a long time.

When the market globalized, the logic was that "Japan's ROE and dividend payout ratios are half or even a third of those in the US, making it uncompetitive. If US companies have double the ROE of Japanese companies, Japanese companies need to work harder," and thus ROE management came to be almost mandatory.

However, there is a significant misunderstanding here. While it is true that Japan's "dividend payout ratio" does not match that of the US, if we look at the "dividend-paying ratio (cf. the number of companies out of 100 companies which are paying dividends)," Japan's is approximately 90%, whereas the US's was only 40% or so (according to a paper at the time, and 20% according to data from the Suzuki Laboratory in 2023).

In the US, as long as companies are growing, they generally do not pay dividends. The idea is, "The stock price is rising, so that's fine." The US approach to dividends is to pay them because the company has grown and become ready to pay dividends. Therefore, even if the overall dividend payout ratio is 40% or 20%, the dividend payout ratio for the few companies that do pay dividends is high, but the remaining 60% or 80% of companies do not pay dividends at all. This aspect has not been taken into account at all. In contrast, 93% of Japanese companies pay dividends. If 93% of Japanese companies were to return

dividends to shareholders at the same payout ratio as the US, business funds would rapidly flow out of Japanese companies.

Conducting a survey of foreign investors on Japanese stocks and finding that the average expected ROE is 8%, and then setting this as a target value for the entire Japanese capital market is an overly simplistic policy. While it may be rational for individual investors to aim for high ROE and payout ratios, there is no reason to use the same policy indicators or figures for macroeconomic management policies. Researchers and the government need to reflect deeply on this point.

In an environment where companies are struggling due to the COVID-19 pandemic, if the policy intends to have "constructive dialogue" with investors, funding should be promoted. However, in reality, deficit dividends and subsequent share buyback demands accelerated. Even during the COVID-19 pandemic, the fact that high ROE and PBR (Price-to-Book Ratio) were met was something which came to be reported as desirable among major media. This is almost insane, I thought. With future generations in mind, a swift policy shift should be sought.

Blame NOT Investors

When I was teaching at a business school in Oxford, my students were business professionals, aged 30 to 40, who had experience in investment and management. They often used the phrase "Suck Japan to the very marrow." "Suck" means to exhaust, and "marrow" means the bone marrow. Conversations like "Suck Japan dry to the bone marrow" and "Sell out just before Japan ultimately collapses" were common and once posted on Twitter (now X). While this may be emotionally charged, it is rational for investors, and it is incorrect to blame them for this inconvenience.

First, we must acknowledge that we have accepted the limited-liability corporations as the vehicle of national development, and we did enjoy its benefits. After World War II, when we needed to rebuild the country, we established the limited-liability corporation system to encourage risk-taking and capital provision. The limited liability system meant that investors' responsibility was limited to their investment amount, with only shareholder rights remaining afterward, thus expanding investment. The listed company system has been more extensive and efficient in this regard. Our country has become prosperous by benefiting from this capital market system and continues to enjoy its advantages.

However, we forgot that investment is a two-stage process: "investing small in the early stage and recovering large in the later stage." Macroeconomically, we are now in the later stage, where shareholders are seeking to collect their money. Among major countries, Japan is the only one in this situation, and we lack knowledge about the economic and managerial consequences of late-stage capitalism.

It may come as a surprise, but the UK and the US will continue to see population growth for the next 100 years. Due to the English language and increasing immigration, their populations will grow. The conventional wisdom of macro growth accounting is that economic growth occurs where the population increases. This is the case for the UK and the US. In contrast, Japan has experienced 13 consecutive years of population decline, with only few willing to invest money, leading to suppressed economic growth. Despite this, we still use UK and US textbooks, imitate their policies, and believe that the free will of investors will enrich the country. Although I do not intend to conveniently claim the "Japan exceptionalism," we also need to understand Japan's characteristics and develop policies necessary for Japan.

I repeat, I do not intend to blame investors. They say, "If there are growth opportunities, we will still invest money," and that is the behavior of investors. Politicians are also working to increase startups,

nurture unicorns, and develop new investment destinations. Mapping the world's unicorns (unlisted companies within 10 years of establishment with a market value of over $1 billion) on a world map, the US remains strong, with many unicorns being born. It is easy to imagine the growth of China and India, but the UK also stands out for its number of unicorns. In contrast, Japan has almost none.

In Japan, amidst population decline and international circumstances, companies that will bear the future have not been nurtured. Of course, companies must aim for growth, discover new investment projects, and strive to create startups and unicorns. I sincerely believe that the traditional role of investors remains vital.

However, regardless of what I or the government say, or what the objective facts are, these are of little relevance. What matters is the "expectation" of investors as a whole, more than the facts. Prominent Japanese think-tanks (often the bosses of investors) have released forecasts stating that "Japan will not grow in ten years. "Whether this is a "fact" or not is another matter, but it is hard to imagine a situation where these investors' bosses would inject large amounts of capital into the market they expect to have zero growth. Securities and banking-affiliated think tanks have reached a consensus that institutional investors, on a macro level, are inclined not to invest in Japan. At the very least, the policies and management that Japan needs must be formulated with such an environment in mind. If the prediction is incorrect and growth occurs, that's perfectly fine.

If we cannot expect much from startups, unicorns, or new funding, I believe we must aim for sustainable development based on the existing 3,800 listed companies to support and maintain the lives of 125 million citizens. I talk with METI officials and ask them, "Not only Japan, where on earth will there be room for growth and sustainable living 30 years from now? The earth will be rapidly aging and the human population will be decreasing. While it is necessary to dream of a space life, we have an obligation to provide a certain level of life and happiness to the young people who are born on this planet. For this reason, what is required in Japan is to reconsider the distribution of funds among existing listed companies. It is rational for investors to distribute more money to shareholders in a short period of time because there are few opportunities for growth, but not for the economy and society. We must aim for sustainable development by appropriately distributing funds to the stakeholders who support the country's economy and society. This is different from the economic models and policies of the U.K., U.S., and emerging countries. The Kishida administration called it "New Capitalism," although unfortunately it was not well understood by most people in Japan.

Aporia of Capital Market in the late Capitalism

Let's delve into corporate management and finance at the micro level. Examining the capital policies of Japan's 3,800 listed companies reveals a significant shift: while investors traditionally injected funds into these firms, equity finance has now become almost nonexistent. (Detailed graphs for each company are available for free from the Suzuki Research Institute; simply scan the QR code and enter the company's four-digit securities code.)

A similar trend is evident in the capital policy of the Tokyo Stock Exchange (TSE), which transitioned from a public entity to a private corporation. During its demutualization, then-Chairman Masaaki Tsuchida remarked in a Diet session that "the limited-liability corporation system is an excellent system that has advanced with the times, and its merit lies in the discipline it provides to corporate operations, not in the pursuit of profit." Both the Ministry of Finance's Market Division Director, Tadaharu Matsukawa, and TSE Senior Managing Director, Yoshiaki Kaneko, supported the privatization and listing, asserting that it would facilitate and diversify corporate finance.

However, actual outcomes tell a different story. Fundraising activities have dwindled, while shareholder returns have surged. Historically, shareholder returns amounted to ¥365.6 billion, contrasted with a mere ¥1.6 billion in capital financing. This raises the question: Is the TSE truly not an organization that prioritizes profit?

My intention isn't to criticize or be sarcastic toward the TSE. Rather, I aim to highlight that even institutions like the TSE are grappling with a "aporia of capital market." Once a company enters a capital market, the logic of capitalism prevails, and in this mature stage of capitalism, shareholder returns often take precedence. The TSE's data suggests that Japan may be ensnared in such an aporia—a perplexing and challenging situation to overcome.

In 2020, during the COVID-19 pandemic, I ranked companies with significant dividend payouts despite reporting losses. For example, Bridgestone, which ranked second in this "red dividend" list, caught my attention. In December 2021, news articles reported that the company planned to cut or relocate 8,000 employees. This move was likely aimed at offsetting losses, but it raised the question: why distribute such substantial dividends under these circumstances? Furthermore, just two months later, in February 2022, reports indicated that Bridgestone had achieved the record high profits. I found this sequence of events perplexing.

In the 1980s and 1990s, before I moved to the UK, "Japanese management practices" were highly praised. American sociologist Ezra Vogel authored "Japan as Number One," urging the U.S. to learn from Japan. He highlighted that practices like lifetime employment and employees' loyalty to their companies contributed to long-term development and innovation.

Now, however, we see companies transferring 8,000 employees while issuing dividends despite losses, achieving record profits through cost-cutting, and returning profits to shareholders. Major newspapers and economic media commend this as exemplary management aligned with the Corporate Governance Code, focusing on investors and shareholders.

Another example involves the 15 publicly listed railway companies during the COVID-19 crisis. With restrictions on movement, all these companies incurred significant losses. Yet, they all continued to pay dividends. Dissatisfied with this approach, I directly asked an executive of a railway company I am acquainted with:

"Why are you paying dividends despite reporting losses? Isn't this the time to seek support from investors willing to engage in constructive dialogue and inject capital?"

The response was: "Professor Tomo, you need to know the truth. We are no longer in such an environment. Investors consistently demand returns, and if we don't comply, we risk not being reappointed at the shareholders' meeting. We have no choice but to manage the railway company under these conditions. Every company is grappling with these challenges. Please look into the new truth, however inconvenient, and find ways to support Japan’s businesses."

Indeed, it's unlikely that executives desire to make unreasonable shareholder returns, and it's unfair to blame individual companies or managers. This situation embodies the aporia of a mature socio-economy and late-stage capitalism in which investors no longer take any responsibilities. They have no incentives to investment but rights to recover their capital and profits.

Dysfunction of Shareholder Rights

In early 2024, between January and May, Japanese companies announced share buybacks totaling ¥10 trillion, surpassing the previous annual record of ¥9.6 trillion in 2023. Majority of business media praised this trend, highlighting the improved ROE, stock prices, and capital efficiency. Some CFOs must have privately question the impact of such significant capital reductions and cash outflows. While academics, like myself, can voice their dissatisfaction openly (if they are willing, which is rarely the case, though), executives cannot.

In June 2024, the Nikkei reported that the Kishida administration received high marks for "market reforms," scoring an average of 4.5 out of 5. Among ten financial experts surveyed, six awarded a perfect score of 5, three gave a 4, and only one assigned a 3. Initially, the Kishida administration faced criticism from the market; following Kishida's victory in the party leadership election, stock prices declined for eight consecutive days. Policies such as "suspending quarterly disclosures" and "prohibiting share buybacks" under the new capitalism framework were met with disapproval. However, in the latter half of the administration, policies favoring shareholders led to near-perfect evaluations from financial experts. Foreign investors also responded positively, suggesting that continued implementation could sustain high stock prices.

On social media platform X (formerly Twitter), discussions emerged about the approval rates for executive appointments at Nomura Holdings' shareholder meeting. Chairman Nagai received a 79.3% approval rate, while President Okuda garnered 89.7%. A senior editor from the Nikkei commented on the slightly lower approval for Chairman Nagai, noting that even President Okuda did not reach 90%, and no one achieved over 95%. The editor commented that this low level of approval was possibly due to Nomura's PBR (price-to-book ratio) which lagged behind competitors like Daiwa. The reason why I came across this post on X is that someone from Nomura brought this to my attention. The management do care about the approval rate and comments on it on the SNS. Through such mode of information, there is daily increasing pressure to management for high ROE, high PBR, and high dividends.

In fact, Nomura Securities is much better off. In January 2023, during a conversation with the CEO of a conglomerate (which I have to disguise the name) with ¥3 trillion in consolidated revenue, I observed the following:

Suzuki: "Your company's approval rate used to be around 95%, but recently it's 90% and then 85%. Do you think it could drop to 80% or 75% in the future?"

President: "I don't think it will go that low (laughs)."

However, at the June 2023 shareholder meeting, the president's reappointment approval rate dropped approximately to 65%. Consequently, the company had to prioritize shareholder returns in its management strategy. This scenario is not unique; in many companies, approval rates at shareholder meetings, shareholder proposal rights, and dividend claims significantly influence Japanese corporate management.

Furthermore, consider a slightly different case. Tosoh Corporation previously engaged in capital raising, notably executing a ¥30 billion financing in 2016—a substantial amount for the company. This suggests that the capital market was functioning normally, reflecting the desirable behavior of a listed company. Tosoh's mid-term management plan (FY2022–2024) set an ROE target of “over 10%”, achieving 16.3% in 2021. Media outlets praised this as an excellent management plan and performance. But is it truly so?

Until 2014, Tosoh's shareholder returns were consistently under ¥5 billion. After the ¥30 billion financing in 2016, returns increased to ¥15 billion the following year. For the next three years, returns remained at ¥18 billion annually, and in the subsequent year, including share buybacks, shareholder returns reached ¥30 billion. I have not studied the case with care, but it is plausible that high returns were demanded to satisfy shareholders who joined during the 2016 capital raise.

If management plans based on ROE standards lead companies to sustainable development, there is no issue. However, as an outsider, I worry about the longevity of such practices. Even companies with growth strategies that engage in capital raising face these pressures, suggesting that the overall situation for Japanese firms is increasingly challenging.

What ROE Standards and Corporate Governance Codes Have Brought

In 2015, after returning to Japan due to a serious illness and undergoing surgery, I lay in my hospital bed reading the Nikkei newspaper. An article caught my eye: ISS (Institutional Shareholder Services), a proxy advisory firm, announced that it would raise the ROE (Return on Equity) threshold applied in Japan from 5% to 8%, aligning with the so-called 'Itoh Report'. They advocated for incorporating outside directors to promote management that listens to shareholders' opinions.

Lying in that hospital bed, I felt that corporate management in Japan would become increasingly challenging. I clipped the article and kept it; I still have it and use it in my presentations today (which is displayed in the Power Point slide). This event in 2015 marked the beginning of a trend leading to the Corporate Governance Code, the Stewardship Code, and collaborative engagement initiatives.

Mr.Tajima, one of members of the Suzuki Laboratory, analyzed the impact of the Corporate Governance Code since its introduction in 2015, striving to eliminate as much noise as possible to assess its direct effects on management. Using a statistically rigorous "difference-in-differences analysis," he aimed to isolate the impact of the code's introduction. The results indicated that the implementation of the Corporate Governance Code did not lead to increases in sales, investments, or employee wages; only shareholder returns saw a 56% increase.

At this point, it's essential to review the official rationale for introducing the Corporate Governance Code. The code was said to be necessary to maintain sustainable growth, and Japanese companies have been implementing it accordingly. However, a decade after its introduction, empirical analyses have become possible, revealing data suggesting that only shareholders have benefited. If the Corporate Governance Code was introduced for the “sound development of the national economy” (Financial Instruments and Exchange Act, Article 1 Purpose), a policy review from that perspective is naturally warranted. If the promised outcomes have not been realized, appropriate revision procedures should be undertaken. This is a point that corporate executives and CFOs should communicate, urging the government to take action.

Investors’ Excessive Demands for Return as "Abuse of Rights"

We must critically reassess the management principles we've long considered prudent, such as "shareholder-centric management," "ROE," "PBR ≥ 1," and "dialogue with investors." "Investor protection" is legally defined, and management from the perspective of investors and shareholders is promoted through various codes. However, there is a lack of understanding that in laws like the Financial Instruments and Exchange Act, the Certified Public Accountants Act, and the Companies Act, "investor protection" presupposes the "sound development of the national economy." Reading Articles 1 of these laws, which state their "purpose," it is clear that "investor protection" is advocated for the sake of "sound

development of the national economy." It is inconceivable for any law to stipulate investor protection or preferential treatment at the expense of the general public. This is self-evident.

We might perceive that enhancing ROE, increasing dividends, and raising PBR constitute management in compliance with the law, but this is a partial understanding. Shareholder-centric management and investor protection are premised on contributing to the sound development of the national economy; shareholders and investors should be protected only under the condition that this fundamental purpose is achieved. It is essential to comprehend the objectives, structure, and socio-economic significance of laws and systems.

Therefore, if the excessive pursuit of investors' and shareholders' rights—namely, overly strong demands for shareholder returns—is undermining the potential for the sound development of the national economy, I believe this constitutes an "abuse of rights" by investors and shareholders, contrary to the fundamental purposes of the law. Of course, it would be challenging to litigate and win on grounds of "abuse of rights," as such legal battles are rare. Nonetheless, I voice this concern because I feel that the emphasis on returns to investors and shareholders, their demands, and the exercise of their rights have become excessively dominant. When countering this, we must reconsider based on whether it contributes to the "sound development of the national economy." If, despite emerging empirical data, there is a refusal to even examine such concerns, then indeed, it should be regarded as an "abuse of rights" and subjected to public scrutiny.

Initially, I thought I was alone in holding such views, but after my perspective was featured in the Nikkei newspaper and receiving messages from top-ranked corporate legal professionals saying, "Professor Tomo, your thoughts aren't entirely incorrect - in fact, very sound. Considering Japan's current situation, current trend of excessive investor protection amount to an abuse of rights. Let's work together," I feel that a shift towards a new corporate governance is beginning to take shape.

From "Profit Maximization" to "Fair Distribution of Value added"

How can we achieve this shift? By utilizing the "Distribution Statement" (DS), we can consider the fair distribution of value added. In traditional profit and loss (PL)-based management, when sales plateau, maximizing profit often necessitates minimizing costs and expenses. The maximized profit legally belongs entirely to shareholders, leading to cash outflows as dividends in the next term. The remaining retained earnings are eventually returned to shareholders through dividends in the following years, deficit dividends or any other forms of returns. Rushing shareholder returns can result in significant short-term cash outflows, raising concerns about the depletion of funds for business operations.

In contrast, DS-based management allows for the following budgeting process: After accounting for sales, cost of goods sold, and necessary expenses, instead of aiming to maximize profit, the focus shifts to the “target profit” which will be paid as dividends. If the company managed to produce value-added more than the “target profit,” then value added created beyond the planned dividend (=profit) is then fairly distributed to stakeholders other than shareholders.

For example, assume shareholders have provided capital of 1,000 and the management agree to a stable annual return of 5% (determining the return on equity), the planned dividend amount equals the net income for the period (i.e., payout ratio of 100%), which would be 50. If the company has the capacity to generate a net income of 120, even after paying out 100% of the planned dividend, there remains a surplus of 70 to distribute. This surplus is primarily divided between executives and employees; for instance, allocating 10% to executives and the remaining 90% to employees.

However, distributing the entire amount to employees in cash would deplete funds available for business operations. Therefore, for example, 80% of the employee distribution is returned in the form of their asset formation (i.e., reinvestment in their business), such as granting shares to employees or long-term loans from employees to the company. This design ensures that 80% remains as cash within the company, equating employee returns to providing stable investment funds for the company. Additionally, by having employees become shareholders or creditors, they can potentially offer more effective monitoring and governance functions compared to current foreign shareholders.

Simulation of Fair Distribution Management

To intuitively understand the effects of fair distribution management, let's simulate this across all listed companies. The current Dividend on Equity ratio (DOE) is 4.7% on average across industries. Considering the prolonged zero-interest-rate policy, this represents a substantial return to shareholders, which increases further when including share buybacks. Therefore, we'll conduct the simulation under the assumption that share buybacks are restricted. This is because share buybacks indicate that management cannot identify projects that generate positive cash flows with the available funds, leading them to return the capital to shareholders—a practice that could accelerate the decline of Japanese management and economy. In the following simulation, we restrict share buybacks and assume a 1 percentage point reduction in the currently standard DOE.

For example, in the information and communication services industry, even if executive salaries are increased to 150% and employee salaries to 110% of their previous levels, there remains a sufficient distributable surplus. If the remaining surplus is returned to employees in the form of asset formation, it equates to 100% of their previous salaries, resulting in a total return to employees of 210%. Business reinvestment increases to 128%, and distributions to the government rise to 149%. If similar changes occur across all 3,800 listed companies in Japan, the average asset formation portion would be 57% higher, and business reinvestment would be 46% more. Simply by restricting share buybacks and reducing the standard DOE by 1 percentage point, we can create significant financial leeway for such substantial changes.

[D: Simulation by Industry] **Dividend 1% ⇩ Executives 50% ⇧ Salaries 10% ⇧**

Industry	Dividend /Equity	A Executives	B1 Salaries	B2 Asset Formation	Employees B1 + B2	C Reinvesting	D Government
Foods	7.4→6.4%			8%	118%	381%	115%
Automobile/transport	6.7→5.7%			43%	153%	305%	128%
Trading/Wholesale	6.3→5.3%			68%	178%	81%	163%
Pharmaceuticals	5.9→4.9%			50%	160%	138%	148%
Electorical/Precision	5.7→4.7%			12%	122%	88%	121%
Machinary	5.0→4.0%			34%	144%	92%	124%
IT/Service	4.9→3.9%	150%	110%	100%	210%	128%	149%
Chemical/Materials	4.9→3.9%			41%	151%	152%	126%
Financial(Except Banks)	4.7→3.7%			96%	206%	104%	133%
Construction & material	4.4→3.4%			46%	156%	151%	117%
Retail	3.8→2.8%			29%	139%	103%	119%
Real Estate	3.6→2.6%			193%	303%	128%	119%
Steel & metals	3.2→2.2%			19%	129%	52%	137%
Electric Power & Gas	2.9→1.9%			22%	132%	129%	116%
Banks	2.7→1.7%			80%	190%	207%	131%
Transport & Logistics	2.4→1.4%			56%	166%	104%	121%
Energy Resources	1.9→0.9%			79%	189%	Err. (-7 ⇒ 56)	143%
Average	4.7→3.7%	150%	110%	57%	167%	146% ⇧	130%

Now, let's consider the pharmaceutical industry, as an example. Similarly, by restricting share buybacks and reducing the DOE by 1%, the dividend per share naturally decreases. However, reallocating these funds allows for an increase in executive compensation by approximately 20 million yen per person to about 50 million yen, and an increase in employee salaries by 1 million yen per person to 8.82 million yen. There remains a distributable surplus, which can be used to enhance asset formation, providing 3.97 million yen (10% as long-term loans, 90% as employee stock ownership) per employee, effectively boosting retirement benefits. The total distribution to employees increases by 64%. The 7.4 billion yen in employee stock compensation remains within the company as business reinvestment funds. Unlike traditional retained earnings from shareholders, this constitutes capital from employees, serving as stable funds for business reinvestment. While traditional retained earnings of 6.4 billion yen were often interpreted as business reinvestment, they were unstable funds that could be returned to shareholders at any time. Even if it appears that business reinvestment decreases in a single fiscal year under Distribution Statement (DS) management, in the medium to long term, DS management facilitates the securement of stable funds.

Distributions to the government increase from 12.7 billion yen to 17 billion yen due to higher income tax, resident tax, and statutory welfare expenses associated with increased employee salaries. The simulation confirms that this approach contributes to fiscal consolidation, enhancing the business and economic environment in the medium to long term. This is one reason why it garners support from government officials.

Experiment: Supports from Job-seeking university students

At Waseda University, approximately 310 students annually participate in a simulation exercise where they assess the capital policies of their preferred employers and forecast future outcomes. Upon reviewing the short-term profit and dividend maximization strategies of their chosen companies, students often question, "Is it truly safe to join this company?" This experience leads them to place greater expectations on companies that promote DS management.

The simulation results indicate that students frequently shift their preference from their initial top choice, Company A, to their second choice, Company B, which publicly commits to DS management, i.e., fair value-added distribution management. Quantitative data reveals a significant majority of students favoring companies practicing fair distribution over those focused solely on profit maximization.

Qualitative feedback includes comments such as: "Previously, I selected companies based on profit, but now I believe that achieving the company's mission through fair distribution is more important." Others express a newfound interest in executive roles within such companies, stating, "I hadn't considered becoming an executive before, but if a company practices fair distribution and investment in employees, I'd like to take on that role to fulfill the company's mission together." Additionally, some students aspire to lead and pursue missions with social significance, aiming for promotions and higher salaries as a result.

Today's youth seek employment that offers not only financial rewards but also opportunities for meaningful participation in management, a sense of purpose, and pride in their work. They desire to work for companies where their contributions can lead to executive positions, and whose management practices increase distributions to the government and society, thereby contributing to the stable operation of the socio-economic system. The simulation results suggest a shift from traditional external governance by shareholders to internal governance driven by employees.

This simulator is publicly available for free use. By simply entering a four-digit securities code, individuals can experience simulations related to the capital policies and future projections of their own or any company of interest. We encourage widespread utilization of this tool. ds-simulator.com

Will investors accept DS management?

When transitioning from a profit maximization approach to a management style that emphasizes the fair distribution of value added, a primary concern is the reaction of investors who might perceive a reduction in immediate returns. To address this, the concept of a "DS Fund" has been proposed to garner investor support. To understand this, consider the current popularity of "SDGs Funds." SDGs Funds have seen stock price appreciation, even when they seek for a wide range of SDG goals. We, instead, proposed "DS Fund" which focuses specifically on SDG Goal No. 8, which emphasizes "decent work and economic growth," particularly concerning employee income and job satisfaction. The idea is that by concentrating on companies that actively invest in their employees, investors might find these funds appealing, leading to business success.

The question then arises: would investors actually purchase such a "DS Fund"? This essentially tests investor reactions to funds associated with companies that might "slightly reduce dividends." In July 2023, during a lecture attended by approximately 100 institutional investors, the concept was presented, and the feedback was notably positive, with an evaluation score of 4.7 out of 5. Qualitative feedback revealed that Japanese institutional investors expressed a preference for supporting companies sustainably, rather than engaging in investments that merely extract value. They indicated that if they could receive fair distributions while supporting companies, it would be the ideal scenario.

Intelligent and conscientious investors understand the necessity of limiting short-term profit maximization and share buybacks for Japan's sustainable development. They are exploring their roles as true investors. The challenge lies in market structures and institutional environments that currently hinder these aspirations. While immediate solutions may not be apparent, efforts to address these challenges are underway.

For more insights into DS management and its implications, you can refer to the DS Simulator already mentioned above.

DS Management in Europe

It seems that some European companies are taking the lead in moving away from shareholder primacy and establishing a management approach that equitably distributes value added. In December 2008, Unilever's CEO, Paul Polman, declared at his inaugural press conference, "We will not provide quarterly reports. We are moving away from shareholder primacy." Having previously served as Nestlé's CFO, he was a business leader I closely followed during my MBA lectures at Oxford. This declaration of breaking away from short-term profit-driven shareholder capitalism drew significant attention from the market.

Immediately afterward, Unilever's stock price plummeted by 8%, and the proportion of major shareholders who were hedge funds decreased from 15% to 5%. However, this was precisely Polman's strategic plan. By eliminating shareholders opposed to the new management approach, he aimed to boost employee morale and increase sales in the medium to long term, which the market eventually responded to positively, leading to a rise in stock prices over that period. In 2019, after a decade, Polman stepped down as CEO and became the Chairman of Oxford University's Business School. Gradually, DS management is being established as a new management model in Europe. I aspire to promote this management model in Japan as well.

Additionally, Germany's BMW clearly includes a value-added statement in its Integrated Report. They not only highlight profit growth but also transparently show how much value added is distributed to whom, promoting stakeholder-oriented management. In some years, distributions to employees are prioritized over those to shareholders. When viewed over a span of five to ten years, the value added consistently increases. At the individual company level, this indicates corporate growth, and at the national level, it reflects a steadily growing GDP, signifying development. Such narratives can be discerned from the value-added distribution statements included in their Integrated Reports.

Japanese Companies Turning to DS Management

In Japan, two years have passed since the publication of Accounting for New Capitalism (2022). How are Japanese companies perceiving "DS management"? Here are some examples I am aware of:

The head of a company (which I need to disguise the identity today), considered a winner in the capital market with increasing dividends and strong stock performance, visited me one day for advice. This global industry leader sought my counsel due to high employee turnover. Despite high dividends, profits, and stock prices, employees, particularly researchers, were leaving one after another. The CEO expressed concern, stating, "We need to address this issue." Researchers were particularly prone to leaving, because they " can't engage in fundamental and interesting research," "We can't undertake medium- to long-term innovative projects," and "We don't want to conduct research solely aimed at securing patents that yield immediate profits." There was a growing concern about researchers migrating to other companies or overseas.

Another CEO, leading a conglomerate with consolidated sales of 2 trillion yen, remarked, "If we don't exercise more caution in how we use terms like profit or ROE, Japanese management itself will eventually deteriorate." He was seriously contemplating the need to establish new KPIs to replace ROE and shared a commitment to appropriate value-added distribution management.

Furthermore, a vice president of a company with 3 trillion yen in sales, who attended one of my lectures, stated, "Yesterday, at our global management meeting, we decided on a 65 billion yen share buyback. However, after listening to today's lecture, I will return to the company and halt this plan." He indeed canceled the 65 billion yen share buyback.

In July 2024, Maruichi Steel Tube, a leading pipe manufacturer, announced that it would grant an average of 8.7 million yen worth of company shares to all employees (635 individuals, including those at subsidiaries). With an average salary of 6.94 million yen, the company aimed to boost motivation and drive innovation by allowing employees to sell the shares upon retirement.

Itochu Corporation has introduced a "stock incentive plan" utilizing an employee stock ownership plan to foster a sense of corporate value enhancement among employees. When performance exceeds a certain threshold, special incentives are provided, and an equivalent amount of shares is granted. The company's 2019 integrated report introduced this system, expressing a commitment to enhancing corporate value collectively. The report included graphs comparing employee stock ownership participation rates and PBR with industry peers, demonstrating how appropriate distribution to employees leads to increased stock prices.

It appears that companies, previously considered winners in the capital market, are gradually shifting towards appropriate value-added distribution management.

As of March 2023, there are 262 Japanese companies with a market capitalization exceeding 500 billion yen. Among them, 76 companies (29.0%) have employee stock ownership plans listed among their top

ten major shareholders. This suggests that the remaining companies have room to alter their shareholder composition by expanding employee stock ownership plans or employee stock compensation systems. Such changes could increase returns to employees and bolster stable internal investment funds. With this potential in mind, I am currently collaborating with influential ruling party members, the chief economist at Nomura Securities, and leaders in accounting consulting firms to advance these initiatives.

Collaboration with accountants and consultants

Various stakeholders are now taking more active steps. The government welcomes "DS management," which increases government allocations without raising taxes. In April 2024, parliamentary discussions referenced my DS-based fair value-added distribution management charts, and Chief Cabinet Secretary Hayashi, standing in for the Prime Minister during his visit to the U.S., stated, "We will promote stock compensation systems." The following May, I authored an article titled "The Ideal Corporate Governance: Rethinking Fair Distribution of Value-Added" in the Nikkei's influential collum "Economic Classroom." Shortly thereafter, the Liberal Democratic Party's promotion of this initiative was reported on the front page of the Nikkei.

I have also explained and advised to Ms. Tomoko Yoshino, President of the Japanese Trade Union Confederation, and 50 or so major labor unions. They have conducted the Spring Labor Offensive using the term "fair distribution of value-added." I have advocated for a new labor movement where, instead of the traditional confrontational approach against management, labor and management collaborate to address unreasonable demands from shareholders. With government support, it is well known that we have achieved unprecedented level of wage increase in recent years.

Furthermore, many accountants and consultants have joined this effort. Among the Japanese Institute of Certified Public Accountants and the Big Four accounting firms, I have many colleagues who passed the CPA exam with me approximately 30 years ago. In fact, I have made criticisms directly. "Aren't you ashamed?" I candidly expressed, "Simply reducing capital to artificially boost ROE and taking pride in that—aren't you embarrassed to conduct such consulting for high fees? Can you be proud of this to your children and grandchildren?"

Masahiro Miyahara, President of KPMG Consulting, and Masami Katakura, Chair-person of EY ShinNihon LLC, have strongly agreed. They acknowledged, "We have deployed consulting businesses that technically reduce capital to create the illusion of improved KPIs, but we feel this has led to the weakening of Japanese management." They support the shift to DS management and are teaming up to promote fair value-added distribution management as "sincere consultants." Tetsuya Motegi, President of the Japanese Institute of Certified Public Accountants, and Masahiko Tezuka, former President, have also expressed heartfelt support. If sustainable development through fair distribution of value-added is challenging at the individual company level, I encourage the utilization of accountants and accounting consultants. From planning to disclosure, sincere consulting businesses are emerging as comprehensive, medium- to long-term management strategies.

Lastly, students are engaging in interesting activities. They have started a campaign stating, "# We will not seek employment unless companies are practicing DS management." Until now, investors and shareholders may have been what management feared. However, now, another stakeholder to be more concerned about than investors and shareholders is students. Talented students are planning a campaign declaring they will only seek employment with companies that publicly commit to DS management. If such a movement rapidly gains traction through social media, it could lead to a groundbreaking management movement. This should be seen not as a threat to management but as an opportunity. Companies should align with these students and appropriately respond to the demands of investors and

shareholders. Without such balance, securing talented students and employees will become uncertain. This approach is also consistent within the context of human capital management.

United in Our Aspirations for the Future

In conclusion, beyond the simulations available on the previously introduced website, I would like to outline a more advanced simulation supported by consulting firms. Currently, we are advancing practical high-level simulations leading to management implementation in collaboration with KPMG Consulting and EY Consulting. These simulations address:

- When, at what point, and how much of our own stock to repurchase;
- Allocating these assets without unnecessary amortization (i.e., avoiding nullification);
- Determining when, to whom, and how much to allocate (for example, to employees over ten years);
- Establishing an appropriate shareholder composition;
- Assessing the impact on PL (Profit and Loss), BS (Balance Sheet), CF (Cash Flow), and KPIs;
- Developing strategies to achieve high motivation, secure stable funding, and establish effective governance;
- Planning disclosures to realize stakeholder management.

We are preparing to propose these points as a comprehensive mid- to long-term management strategy. For instance, companies that currently lack sufficient employee stock ownership plans or do not practice fair distribution can, through this simulation, anticipate changes achievable in five to ten years and communicate with stakeholders. Unlike previous consulting approaches that merely improved superficial KPIs by reducing capital or assets, this initiative is led by accountants and accounting consultants, focusing on substantive management consulting that contributes to business operations. For accountants, this represents a new business opportunity to discover and pursue value added in a mature capital market with diminished capital procurement, differing from traditional superficial consulting, and substantially benefiting client business management.

Our aspiration is unified. In each company, executives and CFOs feel that "excessive shareholder primacy is misguided," yet they are swayed by conformist pressures. Indeed, Japan has grown with funds provided by investors and shareholders. However, in Japan's advanced mature economy, further pursuit of shareholder primacy will prevent us from leaving a good society for future generations. I earnestly wish to advance "fair distribution management" together with the members of the CFO Association.

I have published "Accounting for New Capitalism" without royalties or manuscript fees and have not received compensation from consulting firms. Even when serving politicians, I did so without remuneration. My sole desire is for the future generation in a mature socio-economy. I want to engage in works that I can proudly present to my children and grandchildren. I hope CFOs and executives to hold their heads high with pride. Let us move forward together.

Thank you for your attention.

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ESG Disclosure Framework for Centras SOEs and Implications for Management Accounting: A Case Study

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KEYWORDS

ESG report; Information disclosure; PowerChina; Management accounting

ABSTRACT

Environmental, Social, and Governance(ESG)has recently emerged as a pivotal philosophy and practical guide for enterprises navigating the financial market. Enterprises are increasingly expected to balance economic returns with ESG considerations in order to achieve sustainable development. The ESG disclosure standards for central state-owned enterprises(SOEs)serve as guidelines and benchmarks for other organizations' disclosure on ESG information, necessitating research on the ESG disclosure of central SOEs. This paper began with a review of existing literature on ESG disclosure and identified key issues specific to central SOEs, considering their distinct characteristics. It then synthesized the ESG disclosure practices of central SOEs in the electric power industry through comparative analysis and case study methods. Using Power Construction Corporation of China (hereinafter referred to as "PowerChina")as the research object, this study analyzed its ESG disclosure practices and proposed recommendations for enhancing the ESG disclosure framework, along with the implications for advancing management accounting practices.

I. Introduction

Since its inception, Environmental, Social and Governance(ESG)principles have been a significant focus for governments and regulatory bodies. In China, ESG is gaining momentum and gradually aligning with international standards. However, the establishment of a well-developed disclosure framework remains a work in progress, and challenges persist in the preparation, content, and processes of ESG

reports due to the absence of a mature system of disclosure standards. Therefore, case studies on ESG practices can provide valuable insights to address these challenges and contribute to the development of ESG disclosure frameworks.

Central state-owned enterprises(SOEs), as foregoers of policy implementation, are obligated to leverage their strengths in capital, technology, and talent to integrate ESG principles as a new development philosophy into management practices and ensure the effective disclosure of ESG information. In 2021,PowerChina,a leading enterprise in the electric power industry, published its first-ever ESG report, demonstrating its approach to preparing and disclosing ESG- related information. However, the quality of environmental and social responsibility disclosures among Chinese enterprises remains inconsistent. Using PowerChina's ESG disclosure as the research object, this paper seeks to improve ESG practices among central SOEs and provide insights for other enterprises in their ESG reporting.

II. Literature Review

1. Motives for ESG disclosure

ESG disclosure is crucial for enterprises. Solomon and Lewis (2002) found that a company's environmental disclosures typically increase as the company grows. Investors seem to be particularly drawn to firms with higher ESG ratings, and enterprises' willingness of ESG ratings, and enterprises' willingness of disclosures is increased to align with investor preference. Using event analysis, Xiao Hua and Zhang Guoqing (2008)summarized that the management often increases environmental disclosures following negative events in an attempt to foster a more favorable corporate image. Similarly, Nofsinger et al.(2019) highlighted that corporate value is determined not only by business performance but also by social responsibility initiatives. Stakeholders are increasingly focused on social returns, differentiating enterprises based on this broader value framework. Investors, motivated by altruistic principles, may prioritize social benefits, favoring firms whose corporate social responsibility (CSR) activities align with their own values. Additionally, enterprises may disclose ESG information to comply with regulatory requirements. Through case studies on Baoshan Iron &Steel and Anyang Iron & Steel, Ma Wenchao (2016) showed that enterprises tended to increase environmental disclosures when subjected to regulatory pressures.

Firms may also disclose ESG information as a strategy to secure financing. Dhaliwal et al. (2012) found that companies often issued shares after ESG disclosures to attract investors, strengthen their financial position, and reduce debt burdens. In a study on high-pollution industries, Huang Rongbing et al. (2019) revealed that enterprises employed various strategies to gain investor support. Their findings indicated that firms with greater capital needs were more likely to embellish their environmental metrics to achieve higher ESG ratings and improve market recognition.

2. The role of ESG disclosure

Alsayegh et al.(2020)argued that the disclosure of social responsibility information enhanced a company's long-term economic performance, with strong environmental and social practices significantly contributing to overall corporate success. Gillan et al.(2021) further established a connection between ESG factors and key aspects such as market, leadership, risks, and performance. Xu Guanghua et al (2022), in an empirical study of A-share manufacturing firms in China from 2016 to 2019, identified a strong positive correlation between ESG disclosure and corporate value. Their findings also revealed that this impact became more pronounced after the release of relevant policies. Similar trends are observed in the securities market. Busco et al. (2020) examined the relationship between ESG ratings and stock price returns, concluding that enterprises and industries with higher ESG ratings tended to attract greater investor interest. Similarly, Zhou Fangzhao et al.(2020),

through regression analysis, identified a significant positive relationship between ESG performance and excess returns for A-share listed companies in China from 2010 to 2018.

ESG disclosure also increases the likelihood of securing financing, as previously discussed by Dhaliwal et al.(2012). Bai Murong and Zhang Jiaxin (2022) further demonstrated that companies with robust ESG disclosures enjoyed lower financing costs and higher success rates in obtaining funds compared to those with inadequate or nonexistent disclosures.

3. Content and framework design for ESG disclosure

Kotsantonis and Serafeim (2019) argued that ESG reports were intended to meet the growing societal demand for transparency by illustrating how enterprises manage natural, social, human, and other resources to influence societal outcomes. Zhang Sa(2017) identified the focus of ESG disclosures as reliable monitoring data and indicators mandated by regulatory authorities, advocating for the development and gradual expansion of industry-specific ESG disclosure standards. Ma Xianfeng et al.(2016)analyzed the disclosure practices of foreign enterprises and suggested measures to improve disclosure quality, such as evaluating the necessity of disclosure based on "materiality" and providing more comparable and cost-effective indicators. Wang Danli and Guan Zhusun (2017) examined key performance indicators (KPIs) outlined in the Stock Exchange of Hong Kong's (SEHK) ESG Reporting Guide and guidelines for the preparation of sustainability reporting, concluding that companies should tailor disclosures to reflect industry-specific characteristics. He Yuting and Bu Jun (2022) proposed an ESG disclosure framework centered on the quality of accounting information, recommending an expanded scope, a clearly defined medium, and a standardized format of the disclosure report. Sun Yuefan and Wu Yanping (2016) reviewed the development of environmental information disclosure indicators both within and outside China, highlighting the need to address poor comparability in disclosure quality due to inconsistent indicator standards.

4. Literature review

A review of Chinese and international research reveals that much of the current work focuses on evaluating ESG performance. However, in China, establishing a unified and standardized ESG disclosure framework — comparable to financial reporting —remains a significant challenge. A mature framework has yet to develop, and existing regulations are fragmented. As a result, enterprises often tailor their disclosures to serve their own interests, leading to significant variations in the quality of ESG reporting. This lack of standardization undermines comparability and complicates cross-industry and cross-scale comparisons of ESG information. In response, this paper analyzed PowerChina's ESG disclosure framework, taking into account its unique characteristics and drawing conclusions with implications for management accounting practices.

III. ESG Disclosure Framework for Central SOEs

In May 2022, the State-owned Assets Supervision and Administration Commission (SASAC)issued the Work Plan for Improving the Quality of Listed Central State-Owned Enterprises, setting a target for full coverage of relevant special reports by 2023. This marks China's transition from voluntary to mandatory ESG disclosure, with listed central SOEs making consistent progress in their ESG reporting practices. According to the Blue Book for the ESG of Listed Central State-Owned Enterprises (2022), over 60% of such companies had established dedicated ESG departments by 2022, reflecting a 10- percentage-point increase from the previous year, while 17.7% of these companies reported plans to establish such departments in the near future.

The ESG disclosure framework for central SOEs is developed in alignment with mainstream international standards, incorporating ESG disclosure guidelines from global stock exchanges and relevant Chinese regulations. These include the Measures for the Administration of the Law-based Disclosure of Environmental Information by Enterprises issued by the Ministry of Ecology and Environment of the PRC (December 2021), the Standards for the Contents and Formats of Information Disclosure by Companies Offering Securities to the Public No.2: Contents and Formats of Annual Reports (2021 Revision) issued by the China Securities Regulatory Commission, and the Guidance for Enterprise ESG Disclosure issued by the China Enterprise Reform and Development Society(April 2022).

The framework is also tailored to reflect the unique characteristics of central SOEs.

1. Environmental issues

Central SOEs should prioritize compliance with environmental laws and regulations when disclosing environmental information, particularly for areas subject to mandatory disclosure requirements. Resource utilization, a key focus for environmental authorities and the public, directly influences the sustainability of corporate development. In this context, central SOEs are required to disclose, at a minimum, the following: (1) compliance with environmental laws and regulations, including the establishment and implementation of environmental systems; (2) resource utilization (including natural resources and energy consumption); (3)pollution control and emissions (including but not limited to the discharge of industrial wastewater, waste gas, solid waste, and carbon emissions); (4) investments in environmental protection technologies and initiatives related to green and clean energy development; and (5) rewards or penalties imposed by environmental authorities.

2. Social issues

Central SOEs' CSR encompasses both economic and societal dimensions. They are expected to uphold foundational principles such as prioritizing a people-centered approach, driving technological innovation, and contributing to the Belt and Road Initiative, while maintaining a focus on core operations, improving product quality, protecting employee rights, and making meaningful contributions to markets and industries. In this context, central SOEs should disclose, a t a minimum, the following: (1)product quality and customer feedback; (2) employee training programs, welfare initiatives, and turnover rates; (3) supply chain management practices and industry contributions; and (4) innovation efforts and engagement in social welfare activities.

3. Governance issues

Enhancing the governance systems of central SOEs is conducive to boosting the competitiveness and influence of the state-owned economy. With mature, well-established organizational and management frameworks in place, central SOEs should focus on modernizing governance systems and governance capacities. In alignment with the goal of building China into a socialist market economy, they are expected to disclose strategic plans and their implementation progress, improve risk awareness and prevention capabilities, and strengthen internal controls to ensure timely and accurate disclosure.

Furthermore, central SOEs should reinforce asset supervision and management to mitigate the risk of asset loss. In this context, central SOEs should disclose, at a minimum, the following: (1) governance structure (including but not limited to shareholder and management frameworks); (2) governance systems (including but not limited to the articles of association and internal control mechanisms); (3) risk management strategies and asset supervision practices; and (4) information disclosure systems.

IV. Case Study on PowerChina's ESG Disclosure

1. ESG disclosures of central SOEs in the electric power industry

As a key pillar of energy supply, the electric power industry is a major consumer of carbon resources due to its capital-and technology-intensive nature .It is also among the first industries to participate in the carbon emissions trading market since its launch. Today, however, most companies in this industry remain in a critical stage of transitioning to green, low-carbon operations and undergoing industrial restructuring, making overall ESG performance a key indicator of their phased progress in these transitions and upgrades.

(1) Disclosure forms and ESG-related research

In December 2022,the SASAC published a directory of central SOEs, listing 98 enterprises and groups,16 of which are part of the electric power industry. Table 1 summarizes the disclosure practices of these enterprises based on the information available on their official websites. In 2022, 14 of these 16 entities released ESG-related reports. Among them,12 issued only social responsibility or sustainable development reports, while PowerChina and China Energy Engineering Corporation Limited went a step further by releasing dedicated ESG reports alongside their social responsibility reports, demonstrating a strong commitment to ESG initiatives. Furthermore, 12 enterprises detailed their ESG-related work plans. Notably China Southern Power Grid set up the Energy Development Research Institute to develop an ESG evaluation system for grid projects. Among the 12 enterprises, five had subsidiaries recognized in the "Central SOEs ESG·Pioneer 50 Indexes", and two were among the first to join the ESG Alliance of Central SOEs, gaining recognition for their contributions to ESG research. Several enterprises also received national and international awards for their achievements in ESG-related efforts.

Table 1 ESG Disclosures and Research by Central SOEs and Groups in the Electric Power Industry (2022)

Central SOE//Group	Report Title	ESG-related Research and Achievements
State Grid Corporation of China	CSR Report	• Joined the ESG Alliance of Central SOEs • State Grid NARI listed in the "Central SOEs ESG · Pioneer 50 Indexes" and recognized as a top ESG-performing listed company
China Southern Power Grid Co., Ltd.	CSR Report	• Established the Energy Development Research Institute and developed an ESG evaluation system for grid projects under the new power system
China Huaneng Group Co., Ltd.	Sustainability Report	• Huaneng Power International recognized as a top ESG-performing listed company
China Datang Corporation Ltd.	CSR Report	• DRP included in the "Central SOEs ESG · Pioneer 50 Indexes"
China Huadian Corporation Ltd.	Sustainability Report	• Featured in the 2022 *Fortune* China ESG Influential List
State Power Investment Corporation (SPIC)	CSR Report	• SPIC Fund Management Co., Ltd. advanced its ESG operational system
China Three Gorges Corporation	Sustainability Report	• Became the first central SOE to set up a dedicated CSR department
China Energy Investment Corporation	CSR Report	• Joined the ESG Alliance of Central SOEs • Longyuan Power and SDIC Power included in the "Central SOEs ESG · Pioneer 50 Indexes" • Released the CHN ENERGY & CSR ENERGY (CE · CE) CSR system
Harbin Electric Corporation	Sustainability Report	–
Dongfang Electric Corporation	Sustainability Report	• Dongfang Electric listed in the "Central SOEs ESG · Pioneer 50 Indexes"
Power Construction Corporation of China	CSR Report, ESG Report	• Listed in the Central SOEs ESG · Pioneer 50 Indexes • Featured in the *Forbes China's* 2022 China ESG 50
China Energy Engineering Group Co., Ltd.	CSR Report, ESG Report	• Featured in the *Forbes China's* 2022 China ESG 50
China Anneng Construction Group Corporation Limited	–	–
China General Nuclear Power Corporation	CSR Report	• CGN Power featured in the *Forbes China's* 2022 China ESG 50
China Electrical Equipment Group Co., Ltd.	–	–
China Energy Conservation and Environmental Protection Group	CSR Report	–

Source: Compiled from official websites and publicly available data.

(2) Preparation bases and indicator disclosures

Enterprises do not follow a standardized preparation basis when disclosing relevant information; instead, they draw on multiple sources. For example, State Grid referenced eight preparation bases, while China Huaneng Group Co., Ltd. and Dongfang Electric Co., Ltd. each referred to seven. An analysis of the preparation bases referenced in ESG-related reports by 14 central SOEs in the electric power industry (see Table 2) shows that the most frequently used standards are the Global Reporting Initiative (GRI)'s Sustainability Reporting Standards and the Guidelines on the Preparation of Corporate Social Responsibility Reporting for Chinese Enterprises (CASS-CSR-4.0), followed by the Guidance on Social Responsibility.

Table 2 Frequency of Preparation Bases Referenced in ESG-Related Reports

Preparation Basis	Frequency of Reference
GRI Sustainability Reporting Standards	12
Guidelines on the Preparation of Corporate Social Responsibility Reporting for Chinese Enterprises (CASS-CSR-4.0)	12
Guidance on Social Responsibility (GB/T 36001-2015)	9
UN 2030 *Agenda for Sustainable Development* and the Sustainable Development Goals (UN SDGs)	8
ISO 26000	8
Guidelines to the State-Owned Enterprises Directly Under the Central Government on Fulfilling Corporate Social Responsibilities	8
Guidelines to the State-Owned Enterprises on Better Fulfilling Corporate Social Responsibilities	4
Guidelines on the Social Responsibility for Industries of China	3
Ten Principles of the UN Global Compact	1
Report on the CSR Fulfillment by Listed Companies	1
SEHK's *ESG Reporting Guide*	1

Source: Compiled from relevant reports.

Currently, there is no standardized framework for ESG report preparation. Enterprises typically rely on a range of instructive or practical guides to make selective disclosures aligned with their specific development goals and information release strategies. As a result, disclosure practices vary significantly, even within the electric power industry, compromising both accuracy and comparability, hindering report users from conducting effective analyses. For enterprises that do not publish standalone ESG reports, the lack of a systematic approach to identifying key topics often leads to inadequate disclosures, ultimately undermining their credibility.

In terms of indicator disclosures, inconsistencies in environmental disclosure are apparent among central SOEs in the electric power industry. Statistics of disclosed environmental indicators reveal significant variation. China Huaneng Group Co., Ltd., for instance, reported nearly 20 environmental indicators, including metrics such as installed PV capacity and NOx emissions from thermal power, in addition to total investment in environmental protection, and investment in energy-saving technological upgrades. These indicators, alongside comparative data spanning the past five years, provide a comprehensive and credible basis for analysis. In contrast, some enterprises disclosed only five indicators, lacking detailed environmental data aligned with industry-specific standards. Furthermore, the disclosure methodologies for these indicators differ widely. For instance, energy consumption is reported either as energy consumed per RMB10,000 of output value or per RMB10,000 of operating income, complicating cross-comparisons for report users.

Over half of the central SOEs in the electric power industry do not disclose information related to clean energy development. In contrast, disclosures on social matters are relatively thorough, covering topics such as tax contributions, employee benefits and security, employee satisfaction, and participation in social welfare initiatives. Some also provide information on the employment of individuals with disabilities and ethnic minorities, workplace safety, and negative aspects, including safety incidents and employee turnover. Regarding corporate governance, most enterprises disclose details about their organizational structures and governance systems, reflecting an emphasis on stakeholder communication. However, these disclosures primarily focus on system design and institutional frameworks, with limited voluntary reporting on executive information and internal control measures. There is also little discussion on how these enterprises address stakeholder concerns or balance competing interests

Overall, ESG disclosures among central SOEs (groups) in the electric power industry show significant variation. Many enterprises lack sufficient emphasis on ESG reporting, resulting in poorly managed disclosure processes, inconsistent formats and content, insufficient identification of key topics, overly discretionary selection and measurement of indicators, and a lack of targeted and convincing ESG disclosures. Addressing these shortcomings requires an analysis of best practices both within the sector and across other industries for adoption and improvement.

2. PowerChina's ESG disclosure

(1) Disclosure process

At PowerChina, the Board of Directors oversees the ESG management framework. A dedicated department, including the CSR Leadership Group, the Office Brand and CSR Division, and the ESG Work Leadership Group, is responsible for preparing ESG reports. Senior leaders, such as the General Manager and the Deputy Party Committee Secretary, coordinate the preparation of CSR and ESG reports, with input from external experts for review.

(2) Preparation bases and structure

To date, PowerChina has published a total of ten CSR reports. In 2021, it released its first ESG report, prepared with detailed references listed in Table 3.These include 38 indicators from the GRI Standards and 68 indicators from the CASS- CSR-4.0,which are comprehensively indexed in sequential order at the end of this report.

The report is structured into three main sections: "Governance", "Environmental", and "Social". "Governance" encompasses five key areas —enhancing corporate governance, mitigating integrity risks, strengthening core business operations, safeguarding customer rights, and ensuring a high-quality supply chain. "Environmental" addresses four priorities —advancing management practices, addressing climate change, adopting green production methods, and preserving ecological and environmental resources. "Social" highlights four focal areas — fostering win- win partnerships, upholding stringent safety standards, supporting talent development, and contributing to social welfare initiatives.

Table 3 Preparation Bases for PowerChina's 2021 ESG Report

Issued by	Preparation Basis
Shanghai Stock Exchange	*Report on the CSR Fulfillment by Listed Companies*
	SSE Directive on Environmental Disclosure
State-owned Assets Supervision and Administration Commission of the State Council	*Guidelines to the State-Owned Enterprises Directly Under the Central Government on Fulfilling Corporate Social Responsibilities*
Global Reporting Initiative	GRI Sustainability Reporting Standards
International Organization for Standardization	ISO 26000
Research Center of Corporate Social Responsibility, Chinese Academy of Social Sciences	CASS-CSR-4.0
United Nations	SDGs

Source: Compiled based on PowerChina's 2021 ESG Report.

PowerChina's 2021 ESG report marked its first standalone publication of this kind.

Previously, ESG-related research findings were incorporated into the company's CSR reports. However, despite the introduction of a separate ESG report, key indicators such as operational performance, employee rights and interests, safety management, and environmental protection remain consistent with those in earlier CSR reports. These indicators align with widely recognized industry standards, enabling

users to perform both horizontal and vertical comparative analyses with ease and make informed evaluations.

The structures of PowerChina's CSR reports from 2017 to 2021 are summarized in Table 4. The company tailored its disclosures to align with evolving policies and development priorities, maintaining a consistent focus on innovation, cooperation, environmental protection, talent development, public welfare, and CSR. Environmental protection disclosures, in particular, have been refined to better reflect core industry indicators. In CSR management, PowerChina has emphasized establishing a dedicated CSR organization and improving its CSR system, resulting in more standardized management practices, with clear guidelines and effective implementation.

Table 4 Breakdown of Sections in PowerChina's CSR Reports from 2017 to 2021

2017	2018	2019	2020	2021
Brand innovation	Production responsibility	Management innovation	Management innovation	Management innovation
Open cooperation	Cooperative innovation	Strategic cooperation	Win-win cooperation	Win-win cooperation
Care for talent	Employee growth	Green ecology	Green ecology	Green ecology
Environmental protection	Ecology and environment	Safety and people first	Talent and public welfare	Talent and public welfare
Assistance in poverty alleviation	Public welfare initiatives	CSR management	CSR management	CSR management
CSR management	CSR management	–	–	–

Source: Compiled based on PowerChina's CSR reports and ESG reports from 2017 to 2021

The CSR reports feature a clean layout, seamlessly combining text, images, charts, and figures. The design highlights key characteristics and priorities, making the reports both engaging and impactful. Furthermore, the reports address critical topics such as integrity risk control, climate change mitigation, and talent development in dedicated sections. Key terms are defined in the appendix, and a feedback questionnaire is included at the end for readers. Overall, PowerChina's CSR reports are well-structured and highly readable.

3. Identification and disclosure of material topics

In its 2021 ESG Report (as summarized in Table 5), PowerChina identified 43 material topics using a two-dimensional analysis matrix, which were categorized into three aspects:11 governance topics, including responsibility strategy, responsibility governance, and CSR training;26 social topics, such as ensuring engineering quality, pursuing innovation-driven development, and protecting client privacy; and 6 environmental topics, including advancing clean energy development, conserving energy and resources, and strengthening emissions management.

Figure 1 illustrates the assessment of 43 material topics, evaluated by their importance to external stakeholders and their importance to PowerChina's sustainable development, highlighting key focus areas for the ESG reporting year. This two-dimensional approach balances the company's internal growth objectives with external expectations. According to the matrix results, topics such as ensuring engineering quality and advancing clean energy development are critical to both PowerChina's sustainability goals and stakeholder priorities, making them focal points for disclosure

These material topics are further integrated into various sections based on their category and significance, with KPIs disclosed as shown in Table 6.In 2017,PowerChina disclosed 19 economic performance indicators, a number that increased to 28 from 2018 onward. Environmental performance indicators totaled 8 in 2017, but beginning in 2018,t wo indicators — cumulative clean energy development scale and annual clean energy investment — were excluded, although the clean energy section remained. Over the past five years ,the number of social performance indicators has steadily increased, reflecting a growing emphasis on employee well-being and participation in social welfare initiatives.

Table 5 PowerChina's Identification of Material Topics

Governance	Social		Environmental
1. Responsibility strategy	1. Ensuring engineering quality	14. Health and safety	1. Advancing clean energy development
2. Responsibility governance	2. Pursuing innovation-driven development	15. Training and development	2. Conserving energy resources
3. CSR training	3. Protecting client privacy	16. Work-life balance	3. Strengthening emissions management
4. Stakeholder communication	4. Offering high-quality services	17. Localization procurement	4. Addressing climate change
5. Optimizing governance structure	5. Operating with integrity	18. Driving local employment	5. Promoting environmental education
6. Aligning with national strategy	6. Practicing responsible procurement	19. Cultivating local talent	6. Participating in environmental public welfare initiatives
7. Strengthening Party building	7. Standardizing supply chain management	20. Protecting the local environment	–
8. Risk management and internal control	8. Strengthening strategic cooperation	21. Engaging in charitable donations	–
9. Clean governance and anti-corruption	9. Driving industry development	22. Contributing to rural revitalization	–
10. Standardizing information disclosure	10. Protecting intellectual property rights	23. Supporting COVID-19 prevention efforts	–
11. Managing investor relationships	11. Compliant employment	24. Assisting with rescue and disaster relief	–
–	12. Democratic management	25. Supporting community public welfare initiatives	–
–	13. Remuneration and benefits	26. Conducting volunteer services	–

Source: "Identification of Material Topics" in PowerChina's 2021 ESG Report.

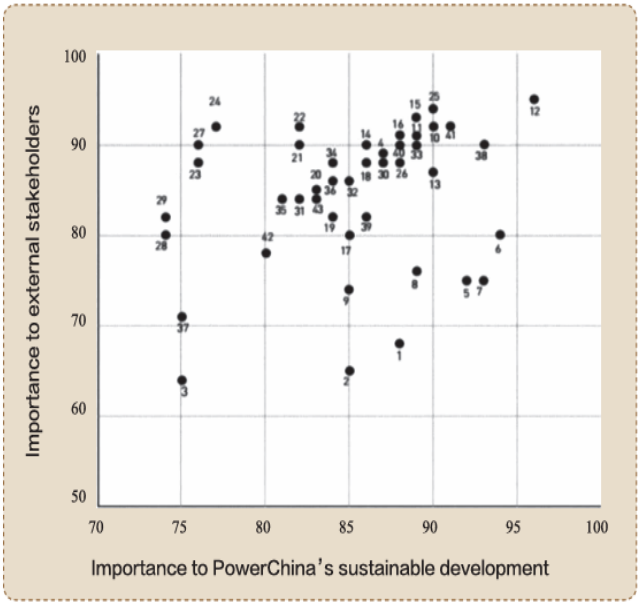

Figure 1 PowerChina's 2D Analysis Matrix of Material Topics

Source: PowerChina's 2021 ESG Report.

Table 6 KPIs Disclosed in PowerChina's CSR Reports

Unit: Number of indicators

Indicator	2017	2018	2019	2020	2021
Economic performance	19	28	28	28	28
Environmental performance	8	6	6	6	6
Social performance	21	21	24	24	27

Source: Calculated based on the indicators disclosed in PowerChina's 2021 ESG Report.

V. Implications for Management Accounting Practices

1. Releasing standalone ESG reports

CSR reports address a wide spectrum of stakeholders, fulfilling varied usage scenarios and often incorporating qualitative information. In contrast, ESG reports are tailored for market investors, providing a comprehensive view of corporate practices across various dimensions. Guided by the principle of" comply or explain", ESG reports are characterized by a more formal structure, adherence to normative standards, and industry-specific disclosures in terms of environmental ,social, and governance performance.

2. Accounting management indicators' important role in ESG disclosure

The indicators disclosed in PowerChina's 2022 ESG Report are organized into four categories: "operational performance", "science and technology (S&T) engineering and management", "compliant operation", and "responsible supply chain". While the report elaborates on the company's achievements in areas such as energy savings, emission reduction, carbon neutrality, and resource conservation, these accomplishments are not fully reflected in the disclosed indicators. Operational performance is primarily assessed using financial accounting indicators, whereas the other three categories predominantly rely on management accounting indicators. For example, indicators such as R&D investment, patent applications, and client satisfaction under the S&T engineering and management category, as well as contract fulfillment rates, training frequency, and participant numbers under the compliant operation

category, highlight the important role of management accounting indicators in assessing an enterprise's disclosure of its ESG performance.

3. Standardized ESG disclosures signal a transformation in corporate management

Unlike financial accounting, which evaluates corporate performance through financial statements, ESG disclosures introduce a new dimension to corporate evaluation. By integrating management accounting with financial accounting, ESG disclosures provide investors with a more comprehensive view of corporate governance. For investors ,this evolution is a welcome advancement, while for central SOEs, it signifies a shift in corporate management practices. In an era where Chinese enterprises increasingly strive for sustainability, embracing social responsibility has become crucial for achieving holistic development. Enterprises are moving beyond a narrow focus on financial growth, prioritizing sustainability while emphasizing employee physical and mental well-being and environmental protection.

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Cost or Capital: Labor Investment Research in Management Accounting

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KEYWORDS

Labor investment; Human capital; Cost management; Managerial incentives; Personnel economics

ABSTRACT

This paper provides an overview of labor investment research in management accounting. It begins by highlighting the importance of labor investment and offers a review of existing research. The summary reveals that prior research has largely focused on managerial incentives; therefore, the author suggests several directions for future research that extend beyond incentives ,including the impact of emerging technologies and the influence of managerial backgrounds. The paper concludes by offering insights on how the discussed academic findings can be utilized by management professionals.

*This paper has benefited from the excellent research assistance of Yifan Wang.

I. Introduction

In the inaugural issue of this journal, Robert Kaplan (2017) remarked that "the sources of competitive advantage have shifted away from tangible physical and financial assets to how well a company manages its 'intangible assets', such as its employees" Reflecting this shift, recent accounting research has increasingly focused on labor and human capital. This paper provides an overview of labor investment research in management accounting, aiming to awareness and encourage dialogue among both academics and industry professionals. Rather than providing an exhaustive review of all studies at the intersection of accounting and labor economics, this paper focuses on direct labor investments, specifically employee wages, and headcount.

In the following section, the author summarizes key arguments from academic literature to outline the importance of labor investments. The author then reviews existing research on labor investment and

proposes potential directions for future studies. Finally, the author offers insights on how managers can apply these research findings in practice.

II. Importance of Labor Investments

For most management professionals, the importance of labor investments is self-evident. Nevertheless, the author will briefly summarize some commonly cited reasons from academic literature as a basis for further discussion.

First, labor investments are important because labor costs are often the largest expense category for companies (Hall,2016). Beyond their sheer size, there is evidence that labor cost management has gained increasing importance over time. As shown in Figure 1, the proportion of labor costs in the total operating expenses of U.S. companies has grown considerably, from about 25%in 1980 to just under 30% in 2022. A persistent issue among U.S. firms, however, is the lack of transparency in disclosing labor costs. In fact, as Ballester et al. (2002) pointed out, the decision to disclose labor costs often reflects their strategic importance to the firm, a trend that has also grown over time.

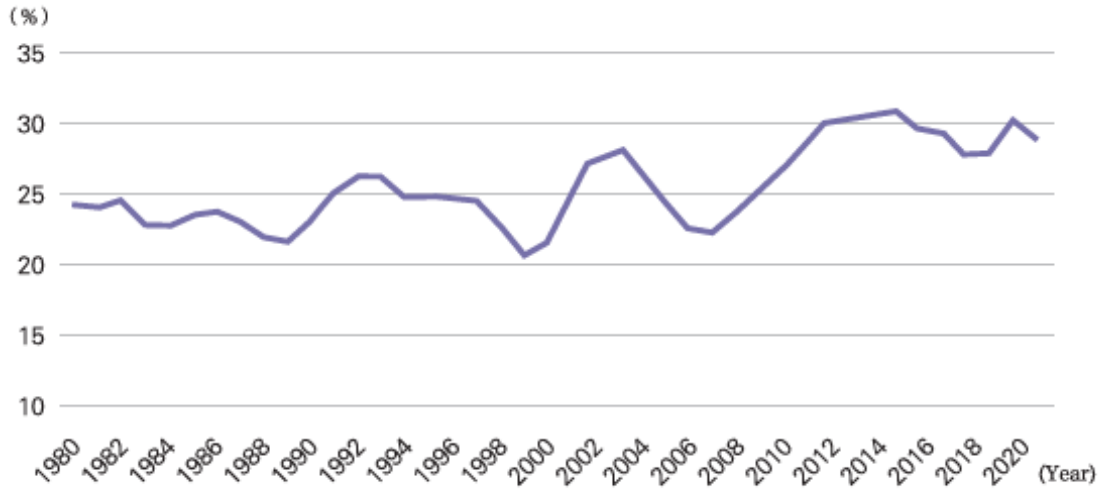

Figure 1 Labor Costs as a Percentage of Total Operating Costs (1980-2022)

Notes: It shows the mean percentage of labor costs as a share of operating costs, using Compustat data. Labor costs are represented by the "staff and labor expense" (xlr) variable in Compustat. Operating costs are calculated as annual revenue minus operating income.

Figure 2 shows that the proportion of firms disclosing total labor costs increased from 16.6% in 1980 to 27.8% in 2022. Given the low disclosure rates, academic research has frequently used SG&A expenses as a proxy for labor costs (Li & Nagar, 2013). Table 1 presents the average SG&A expenses by industry and decade, adjusted to 2020 dollars. Here we see significant growth: across all firms analyzed, the average SG&A expense per employee increased from US$56,000 in the 1980s to US$110,000 per employee after 2010. Similar growth trends, albeit with some industry-specific variation, can also be observed. Clearly ,if one were to follow the Willie Sutton Rule, labor costs would be a good starting point for cost analysis.[1]

1. Rober Kaplan coined the term" Willie Sutton Rule" to emphasize the importance of prioritizing activity-based costing for the highest expenses first. The rule is named after the infamous bank robber Willie Sutton who robbed banks "because that is where the money is".

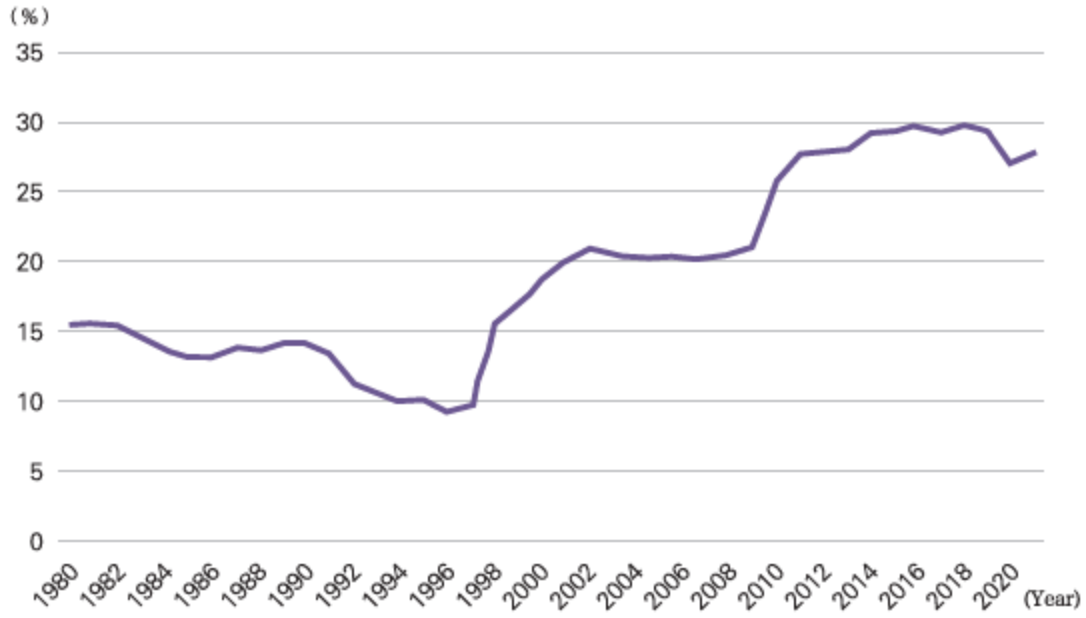

Figure 2 Percentage of Firms Disclosing Total Labor Expenses (1980-2022)

Notes: It shows the percentage of firms disclosing total labor expenses from calendar year 1980 to 2022, using Compustat data. A firm is considered to have disclosed labor expenses if the variable *xlr* in Compustat is non-missing.

Second, managers have greater control over labor costs compared to other expenses (e.g., raw materials and rent),and investments in employees are often seen as more flexible than capital expenditures (Pinnuck & Lillis, 2007). In fact, previous research shows that managers can influence both the price (wages) and the quantity of labor inputs. For example, Bertrand and Mullainathan (1999) found evidence of managerial discretion in wage setting, noting that wages tend to increase when managers are protected by state-level anti-takeover legislation, suggesting that managers may take advantage of lower-effort wage bargaining. Similarly, studies in accounting, such as Dierynck et al. (2012), indicate that employee headcounts and working hours may fluctuate based on managerial incentives.

Third, a manager's ability to recruit, motivate, and retain employees directly impacts the output of labor resources. Traditional economic analysis often assumes that labor inputs are homogenous and that hiring or firing employees incurs no cost. However, this assumption clearly does not hold in the context of the modern economy. Recent studies have deepened our understanding by providing evidence supporting theories that link human capital to firm value (Carlin & Gervais, 2009). Notable examples include Edmans (2011), who demonstrates a relationship between employee satisfaction and stock returns; Li and Nagar (2013), who show a correlation between firm diversity policies and performance.

Finally, the demand for human capital disclosures in financial statements has increased, as evidenced by the US Securities and Exchange Commission's (SEC) recent Human Capital Disclosure Rule(Regulation S-K), effectived in November 2021. Under this rule, publicly traded companies must now disclose workforce information, including employee numbers and a description of their human capital resources, if deemed material to the business. Highlighting the importance of these disclosures, then-Chairman Jay Clayton noted, "I am particularly supportive of the increased focus on human capital disclosures, which, for various industries and companies, can be an important driver of long-term value."

Table 1 Average SG&A Expenses Per Employee by Industry and Decade

Unit: US$ thousand

1-digit SIC	Industry	1980-1989	1990-1999	2000-2009	2010-2022
1	Mining and Construction	61.51	64.94	86.80	94.03
2	Manufacturing: food, textiles, lumber, furniture, paper, printing, and chemicals	60.08	82.67	115.68	144.21
3	Manufacturing: plastics, stone products, metals, transportation, electronics, and machinery	49.25	73.96	99.47	101.81
4	Transportation, Communications, Electric, Gas, and Sanitary Services	56.21	75.65	103.41	99.82
5	Wholesale and Retail Trade	57.12	63.56	73.26	82.20
6	Finance, Insurance, Real Estate	74.60	92.77	101.00	118.95
7	Trade and Services	57.90	100.12	123.39	126.75
8	Industrial Applications and Services	37.26	42.42	61.05	59.94
All	All Industries	56.00	76.94	100.89	110.06

Notes: It lists the mean selling, general, and administrative (SG&A) expenses per employee across four time periods: 1980-1989, 1990-1999, 2000-2009, and 2010-2022. The SG&A figures are expressed in thousands (000s) and adjusted to 2020 dollars using the Consumer Price Index. Data on SG&A and employment are obtained from Compustat. The analysis includes firms with more than 50 employees and SG&A expenses exceeding US$1 million (inflation-adjusted).

III. Labor Investment Research

If human capital is an important driver of long-term value, managers should focus on making high-quality labor investment decisions. However, the accounting literature argues that agency problems can hinder this objective. Specifically, when managers do not have full ownership of the firm, they may make decisions that favor their own interests at the expense of other shareholders. This issue is especially evident in publicly traded companies, where managers often hold a small ownership stake but maintain full control over daily operations. Such agency problems can lead to behaviors like empire building, where managers expand the firm beyond its optimal size for private gains, such as higher compensation, increased employee admiration, or the prestige of managing a larger enterprise (Chen et al., 2012).

Seminal papers on labor management have emphasized reducing agency problems, often measured by lower labor costs. In a series of studies collectively referred to as the "quiet life papers", Bertrand and Mullainathan (1999; 2003) identified wages as a potential agency problem and found that employee wages tended to increase following the adoption of state-level anti-takeover laws. These results suggest that when managers are shielded from the risk of takeovers, they may opt for a "quiet life", engaging in low-effort wage bargaining.

Accounting is another mechanism to mitigate agency problems by requiring periodic financial reporting ,allowing external stakeholders to monitor management activities. Along these lines, Pinnuck and Lillis (2007) suggested that reporting a loss acts as a heuristic, encouraging firms to exercise their abandonment option and terminate unproductive investments. Their analysis of U.S. firm data shows that companies reporting small losses tend to invest less than expected compared to those reporting small profits. Moreover, the findings support the abandonment option theory: firms transitioning from

profit to loss cut more labor compared to firms experiencing similar earnings declines but not crossing into a loss.

While accounting pressure can help mitigate agency problems related to empire building, it may also induce real earnings management, as temporary reductions in labor costs can artificially boost current period earnings. Drawing from the financial accounting literature on earnings management to meet profit benchmarks, Dierynck et al. (2012) analyzed labor cost behavior using detailed employee data from privately held Belgian firms. Their findings indicated that managers tend to spend less on labor when reporting a small profit, suggesting efforts to avoid reporting losses .Further analysis by Dierynck et al. (2012) revealed that, compared to firms with large profits, managers of firms avoiding losses (reporting a small profit) are more likely to lay off blue-collar workers, as they are less costly to terminate. Additionally, to maintain their reputation, managers of firms with large profits tend to reduce working hours instead of opting for layoffs when faced with sales decline.

The findings from the two studies above illustrate that managerial incentives play a crucial role in labor cost decisions. Hall (2016) compared labor decisions between publicly traded and privately held firms using data from U.S. banks. He first observed that, compared to private banks, public banks exhibit more elastic labor cost behavior, suggesting that managers of public banks prefer greater flexibility in adjusting labor resources when necessary. Regarding management incentives, he found that publicly traded banks reduced labor costs to avoid reporting earnings declines, while private banks reduce labor costs to prevent regulatory capital declines. These findings highlight an important tradeoff in ownership structure: while public ownership exerts financial reporting pressure, which can lead to myopic decisions, it also alleviates regulatory pressure by offering greater access to capital.

The previous studies discussed in this section primarily explored how accounting incentives impact labor decisions. In contrast, Jung et al. (2014) examined the influence of accounting quality on labor investment efficiency, suggesting that higher-quality accounting information increases investment efficiency by reducing information asymmetry between firms and external capital providers. Supporting this view, their findings indicated that better accounting quality leads to more efficient net hiring, mitigating both over- investment and under-investment in labor. Furthermore, Jung et al. (2014) found this relationship to be especially pronounced in industries with stronger union presence, where firms face greater labor adjustment costs due to union pressures.

Unions undeniably play a significant role in shaping labor decisions. Chang and Dai (2022) examined the effect of labor unions on cost behavior using firm-level union data, and their analysis confirmed that unionized firms exhibit stickier labor costs but, interestingly, less sticky SG&A costs. The term "cost stickiness" refers to the phenomenon where costs decrease less when sales decline compared to their increase when sales grow. Their findings suggested that higher labor adjustment costs resulting from unionization prompt managers to pursue cost savings in other areas.

Obviously, managers' labor decisions must also consider external factors. Banker et al. (2013) provided evidence on the impact of employment protection legislation (EPL) on cost behavior. In this study, country-level EPL served as a readily available proxy for labor adjustment costs, with stricter EPL translating to higher labor adjustment costs. Using data from 19 OECD countries, Banker et al. (2013) found support for the intuitive economic argument that stricter EPL is associated with stickier operating costs. This finding highlights the need for managers to account for both internal and external factors in decisions related to labor and other operating costs.

In summary, academic research on labor investment in top-tier accounting journals has largely focused on managerial incentives. However, managerial decisions involve more than just incentives. While some studies have examined specific internal factors, such as accounting quality, and external factors, like EPL,

they scratch only the surface. In the following section, this paper will present potential directions for future research.

IV. Future Research

1. The role of technology

A key area for future research is studying the impact of technological advancements on labor decisions. This concept is not entirely new — John Maynard Keynes famously predicted widespread technological unemployment, where labor-reducing technologies would outpace new job creation. However, as noted by Autor (2015), there were still many jobs available. This paradox arises because technology acts both a substitute for labor and as a complement to it.

In this context, future research could explore how technology influences managers' decisions on the types of labor they invest in. For example, previous studies have suggested that blue-collar workers are more susceptible to automation (Katz & Margo, 2014)and are less costly to lay off (Dierynck et al., 2012). However, recent estimates by Frey and Osborne (2017)suggested that emerging technologies, such as artificial intelligence (AI) and mobile robotics (MR), put 47% of U.S. employment at high risk of computerization, affecting both white-and blue-collar positions. Notably, Frey and Osborne (2017) identified several accounting roles as being among those most at risk of computerization. The primary driver of this risk is whether the job involves routine and repetitive tasks. Supporting this view, Ham et al. (2022) found that accounting firms investing heavily in technology tend to demand more employees with advanced cognitive and social skills. Future research could expand this analysis across different industries or organizational types (e.g., nonprofits). Additionally, researchers might investigate how the benefits of technological advancements are distributed within firms(i.e., between production and administrative employees).

Another approach to studying the relationship between technology and labor decisions is to analyze the impact of strategy on the substitution of technology for labor. As Michael Porter (1997) noted, companies compete on quality, price, and service. For example, consider whether a high-end consumer would be willing to pay the same amount for a Rolex made by a robot or for private wealth advice generated by AI. Intuitively, computerization may be more feasible and effective for firms that compete on price rather than on quality or service. Researchers can use empirical measures of strategy from managerial accounting (Ittner et al., 2003; Chang et al., 2022) to explore this further.

In some cases, technology may not fully as replace human employees but instead alter the nature of their employment contracts. Information technology (IT) has been shown to reduce transaction costs (Cordella, 2001), which can make outsourcing labor more appealing for firms (McIvor, 2009). For example, in the medical field, IT enables X-rays and other medical images to be taken in one location and analyzed by qualified specialists elsewhere — sometimes even in different countries. This innovation not only reduces costs but can also enhance quality, as outsourced professionals may specialize in specific types of image analysis. Future research could examine why some firms choose to invest in outsourced IT solutions while others do not. For instance, Dai and Qiu (2023) found that firms tended to increase IT spending after a minimum wage hike. Moreover, researchers could investigate how labor unions, which have a vested interest in preventing outsourcing, affect a firm's IT investment decisions.

2 .Managerial characteristics

Managerial characteristics have been shown to influence management decisions, even when accounting for incentives. Just as labor is not homogeneous, neither are managers. High- ability managers are associated with higher earnings quality (Demerjian et al., 2013), and those with strong forecasting skills tend to make better investment and acquisition decisions (Goodman et al., 2014). Given this evidence, it begs the question of whether higher-quality managers make more effective labor decisions. For example, if high-ability managers demonstrate higher earnings quality, it may result in greater efficiency in labor investment. Researchers might further investigate whether managerial ability has an incremental effect on labor efficiency beyond the mediating role of accounting quality. If high-ability managers are more adept at generating and analyzing information, they may also be more effective in understanding labor adjustment costs.

A widely cited study by Betrand and Schoar (2003) used managerial fixed effects to demonstrate that managers exhibit distinct styles in corporate decision-making, influenced by various background characteristics. For example, the study found that managers with a master's degree in business administration tend to act more aggressively, opting for higher capital expenditures, taking on more debt, and paying fewer dividends. Focusing on the relationship between management and labor, recent research by Acemoglu et al. (2022) found that business-educated managers (those with a degree in business administration) are better at reducing labor costs(wages and labor share)than at growing sales or profits in response to export opportunities. The study also noted that non-business-educated managers tend to share profits with employees, unlike business-educated managers. Future research could investigate whether business-educated managers are more likely to implement broad labor cost reductions or whether they might spare or favor certain roles under their management.Previous studies have suggested that managers tend to favor employees who share similar backgrounds(Westphal &Zajac, 2013).Cronqvist et al.(2009)also found that entrenched CEOs are more likely to overcompensate employees who hold higher positions in the corporate hierarchy or are geographically closer to corporate headquarters. This raises the question:Are business-educated managers less likely to reduce the pay of employees with business-related backgrounds or those located at headquarters? Furthermore, it is worth investigating whether different types of business backgrounds influence decision- making. For example, do CEOs with a finance background make different labor management decisions compared to those with expertise in production or human resources?

3. International perspective

As previously discussed, understanding how country-level differences affect labor investments is crucial. While Banker et al. (2013) highlighted regulatory and legal variations across countries, these are not the only international factors worth examining. Researchers can also explore many other cross- country differences, such as variations in economic development or cultural influences.

As countries develop economically and become wealthier ,their labor force tends to transition from an agriculture-based and manufacturing- based economy to one that is more service- oriented. China serves as a notable example of this trend. Table 2 presents the labor share of the services sector at the country level for the top 15 economies over a 30-year period. China's service sector labor share has increased by approximately 150% ,rising from around 19% in 1991 to over 47% in 2021. In contrast, the U.S. service sector labor share remained relatively stable, growing by just 8.8%, from about 72.72% in 1991 to a little over 79.15% in 2021. What challenges and opportunities do managers in countries like China face as job demand shifts? Are there enough qualified workers to meet this changing demand, and how does competition for various skill sets influence managers' perceptions of labor adjustment

costs? Does the impact of economic development on labor cost behavior vary based on other national factors, such as the education system or immigration policies?

Cultural differences also vary across countries. One widely recognized framework for categorizing these differences is Hofstede's (2001) model of six dimensions: individualism, uncertainty avoidance, power distance, long-term orientation ,masculinity, and indulgence. Kitching et al.(2016) investigated the impact of five of these dimensions on cost behavior decisions across 39 countries, revealing that operating cost stickiness is less pronounced in countries with higher levels of uncertainty avoidance, masculinity, and long-term orientation. However, there is still much to learn about how culture influences labor decisions. Focusing solely on the collectivism-individualism dimension, defined as the" degree to which people in a society are integrated into groups" (Hofstede, 2011), could yield valuable insights. Countries like Republic of Korea and China have very low individualism scores of 18 and 20, respectively, while Australia and the United States score much higher, at 90 and 91, respectively. 'Researchers could examine how collectivist countries adapt their labor decisions when facing pressure from foreign investors. For example, Shin et al. (2015) noted that Republic of Korea experienced a shift from pay systems based on collectivist values to Western-style performance-based compensation following the Asian financial crisis in the late 1990s. Another potential research direction could explore the effects of cultural conflict when a manager's national culture differs from that of the organization they lead (e.g., a manager from a collectivist country overseeing a company in an individualist country, or vice versa).

Table 2 Labor Share in the Services Sector by Country
(Top 15 Economies by GDP)

Unit: %

Country	1991	2001	2011	2021
United States	72.72	75.48	78.80	79.15
China	18.90	27.69	35.70	47.35
Japan	58.67	64.54	70.62	73.12
Germany	56.57	64.60	70.12	71.12
India	21.58	24.25	27.63	30.70
United Kingdom	67.25	73.97	79.60	81.00
France	65.92	69.90	74.92	77.99
Brazil	57.86	61.67	65.41	69.68
Italy	56.65	63.06	68.03	69.31
Canada	72.63	74.78	77.93	79.40
Russian Federation	54.68	57.78	64.86	67.32
Republic of Korea, Rep.	47.68	62.21	69.08	70.05
Australia	71.14	74.51	76.35	78.81
Spain	56.03	61.99	74.14	75.75
Mexico	50.59	56.46	62.02	62.02

Notes: It lists the percentage of employment in the services sector as a share of total employment for selected years across the top 15 economies by GDP in 2022. Data are sourced from the World Bank's World Development Indicators Databank: https://databank.worldbank.org/source/world-development-indicators/preview/on.

V. Discussion and Conclusion

This paper provides an overview of labor investment research in management accounting. Labor decisions are among the most crucial responsibilities of managers. A review of existing studies on labor investment indicates that much of the academic focus has centered on the role of incentives, leaving substantial room for exploring other managerial and institutional factors, such as the effects of emerging technologies, managerial backgrounds, and cultural differences. In conclusion, this paper provides concise and practical insights on how future research could better guide managerial perspectives on labor investment.

First, managers and board members should consider how their company's incentives align with long-term value creation. While performance-based compensation, such as bonuses and stock options, aims to align employee incentives with shareholder interests, it has been criticized for encouraging myopic behavior (Brochet et al., 2015). For example, managers might cut staffing levels to meet short-term budget targets, only to face higher rehiring costs in the future. This issue can be alleviated by adopting longer-term incentive contracts that pay out gradually over time, or by using performance evaluation tools like the balanced scorecard, which link compensation to non-financial, leading indicators of performance (Malina & Selto, 2001).

Second, managers must acknowledge that labor decisions are influenced by external factors beyond their control. This is worth emphasizing because managers, like most people, tend to overestimate their control over business outcomes (Durand, 2003). The studies discussed in this paper cover only a small subset of the external factors affecting labor investments. There are far too many examples to list, but common factors include changes in minimum wage, technological advancements, shifts in preferences for social responsibility among customers and employees, and, of course, catastrophic events like a global pandemic. While it is unrealistic to anticipate every scenario, managers should conduct risk assessments related to their labor investments and develop contingency plans. For instance, how might managers address a potential labor shortage? They should first assess the likelihood of such a shortage affecting their workforce. If a shortage seems likely, managers can prepare by securing agreements with external labor providers or investing in on-the-job training to expand the pool of available candidates.

Third, labor decisions should be aligned with long-term corporate value. To achieve this, managers need to assess how their labor investments fit with the company's strategy and value proposition. This goes beyond immediate financial impacts, such as the costs of rehiring after shortsighted layoffs. Poorly planned workforce reductions can result in serious strategic setbacks, including damage to brand reputation, lower employee morale, and even the loss of trade secrets. Previous research has suggested that cost-cutting measures should first target non-core resources, while safeguarding core resources as they are most likely to generate value (Balakrishnan et al., 2010). While cost considerations are important, the author argue — along with many others — that employees are the core drivers of value in today's companies. As Alfred Marshall famously stated: "The most valuable of all capital is that invested in human beings. "In conclusion, managers would be wise to regard employees not merely as costs but as capital.

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The Impact of Geopolitical Conflicts on Global Tax Policies

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Confrontations between countries or areas motivated by territorial, political, or economic objectives are referred to as geopolitical conflicts. These confrontations might end up as military tensions, bringing with them trade wars, sanctions and diplomatic standoffs. The consequences that these geopolitical conflicts bring are felt across the global economy, influencing potentially trade routes, resource availability, investment flows, and financial markets.

In a globalized economy, our national tax systems are deeply interdependent, because corporations tend to operate across multiple jurisdictions, supply chains stretch across different continents, and financial flows cross borders in a blink of an eye. International agreements, such as those created by the OECD for example, try to standardize tax policies but these agreements have not yet achieved their full potential.

A Glimpse to the History

One of the most inclusive examples of a big geopolitical conflict that had an important impact on tax policies can be considered the Cold War. During the Cold War, geopolitical tensions divided the world into two significantly influenced tax and trade policies, reflecting in this way the growing rivalry between the Eastern and Western blocs.

Many Western nations used corporate tax policies to promote economic growth and competitiveness. For example, the United States lowered corporate tax rates in the 1980s under President Reagan as part of a broader strategy to stimulate investment and challenge the Soviet economic model. This action was in line with more general neoliberal policies that prioritize deregulation and tax cuts to promote the expansion of the private sector. In contrast, Soviet-aligned economies maintained centralized control over taxation, focusing on state-driven economic plans. Corporate tax policies, however, were much less relevant in these economies because the state owned most of the enterprises. Trade within the bloc was also governed by agreements under entities like the Council for Mutual Economic Assistance.

With the end of the Cold War, trade between previously rival blocs expanded rapidly. The end of the Cold War also coincided with the hyper-globalization period of the 1990s and 2000s with technological innovations, unilateral and multilateral trade liberalization, and geopolitical and institutional changes all gathered to bring economic integration to levels not seen before.

Geopolitical tensions force governments to reassess their fiscal strategies due to critical questions raising: How do nations balance the need for increased revenue during conflicts with the risk of stifling economic growth? Do global tax cooperation initiatives, such as the OECD's global minimum tax, survive or weaken during geopolitical crises? How do sanctions, defense budgets, and trade disruptions reshape national and international tax frameworks?

Mechanisms of Influence

Geopolitical conflicts, from trade wars to military standoffs, have far-reaching consequences that extend beyond just diplomacy and security. Among the mainly affected sectors is the global tax landscape. These conflicts influence tax policies through a variety of mechanisms, including disruptions in trade flows, shifts in cross-border investments, and the strategic reallocation of multinational profits. Understanding these mechanisms of influence is essential to understanding the connection between global politics and economic governance.

The most common mechanism for influencing the geopolitical actors in times of conflict are sanctions, a common geopolitical tool that not only restricts trade but also destabilizes the tax bases of targeted nations by shrinking economic activity and redirecting capital to less transparent jurisdictions. At the same time, increased political risks force companies to change their operating footprints, which frequently forces governments to modify their tax structures to either minimize losses or take advantage of new opportunities. Furthermore, these actions influence negatively also the global tax collaboration, making it more difficult to tackle urgent problems like tax evasion and profit shifting.

Here is an overview of the actions by which geopolitical tensions shape global tax policies:

a) Sanctions

Sanctions disrupt tax revenues, trade flows, and fiscal stability in several connected ways, creating economic challenges for targeted nations because sanctions often restrict a country's ability to export or import goods, directly impacting trade volumes. This is particularly severe when key sectors, such as energy or technology, are targeted. Complete trade sanctions can reduce bilateral trade by as much as 90%. Additionally, trade sanctions reduce the flow of taxable economic activities, including imports and exports. For countries that rely on trade charges and tariffs, the sanctions very quickly lower the government revenue. The economic slowdown brought on by sanctions also reduces employment and business activity in general, which weakens the tax base even more.

What is more, sanctions also increase borrowing costs and limit access to international financial markets, exacerbating fiscal instability. In some cases, sanctions lead to a rise in informal or black-market activities as businesses and individuals attempt to circumvent restrictions. This shift reduces the effectiveness of tax collection mechanisms and weakens fiscal governance.

However, the effects of sanctions can lead to inflation, currency depreciation, and reduced foreign direct investment, all of which negatively affect government finances and fiscal health. In response to increasing sanctions, many countries have proactively strengthened their reserves to safeguard their stock markets against potential shocks, signaling a shift toward more resilient economic defense strategies in the face of growing geopolitical tensions.

b) Defense Spending and Taxation

Increased defense budgets during periods of conflict often necessitate changes in tax policies to secure additional government revenue. Many countries in these situations are increasing their military expenditure to upgrade and modernize their military capabilities, and the main source of state revenue is taxation. In times of crisis, when the need to increase military spending is greatest, revenue from indirect taxation can be generated swiftly and without threatening political support for the country's leadership. Indirect taxation is less obvious, requires less tax collection capability, and is therefore simpler to implement.

c) Regional Tax Alliances

Geopolitical alliances significantly influence member nations' tax policies, particularly regarding harmonization or divergence during crises. These impacts arise from collective decision-making frameworks, economic interdependencies, and the need to respond to shared challenges.

d) Disrupted Supply Chains

During geopolitical conflicts, and not only the trade routes might also become disrupted. This significantly undermines customs and VAT systems since it reduces trade volumes, increases administrative challenges, and fosters informal trade. Governments must adapt by diversifying revenue sources and improving customs enforcement to mitigate these impacts.

Consequences for Global Taxation Frameworks

In times of geopolitical conflicts, multilateral tax agreements, such as the OECD's global minimum tax initiative, can be seriously disrupted by introducing political, economic, and strategic challenges that prevent international cooperation. Countries involved in geopolitical conflicts may prioritize national sovereignty and economic strategies over global tax cooperation, viewing multilateral agreements as threats to their fiscal autonomy or competitive advantages. For instance, low-tax jurisdictions might resist uniform tax standards to maintain their appeal to multinational corporations. Moreover, geopolitical tensions, such as trade disputes or political rivalries, can erode trust among the nations, making consensus on complex tax reforms challenging.

Without trust, countries tend to hesitate to commit to agreements, fearing non-compliance or exploitation by others. This can lead to the formation of rival blocs with differing priorities, undermining the universality required for initiatives like the global minimum tax, which depends on broad international support.

As in the conflict situation, timing is the key; nations often focus on immediate economic or security concerns rather than concentrating and devoting to long-term tax collaboration efforts. In such cases, resources and political capital may be diverted to address defense or trade disputes, delaying the tax policy reforms like this.

These are just examples to demonstrate how geopolitical conflicts can impede the development, adoption, and implementation of multilateral tax agreements. For these agreements to work, a dialogue needs to exist, through which it is possible to build trust and accommodate diverse national interests to achieve effective global tax cooperation.

Conclusion

In conclusion, geopolitical wars have a far-reaching impact on the global economic and fiscal landscapes, going well beyond immediate and more obvious military and diplomatic issues. The interplay between these conflicts and tax policies brings out and shows clearly the fragility of international cooperation in times of crisis.

Defense spending, supply chain disruptions, sanctions, and regional alliances all have an impact that might disrupt the functioning of multilateral agreements like the OECD's global minimum tax proposal and calls into question currently setting up tax structures. These disruptions show weaknesses but also bring out the need for stronger methods in collaboration.

To solve emerging issues like tax evasion, profit shifting, and economic inequality, nations must keep a careful balance between the wish to preserve their sovereignty and the need to promote international cooperation. Building trust, ensuring inclusiveness, and maintaining open dialogue are critical to forging effective solutions in an interconnected yet increasingly polarized world.

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‘America Doesn't Avoid Problems. It just Solves Them’ Abelardo Cortez

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From what we've seen, the second Trump administration wouldn't exactly tiptoe around US interest rate timing. Just recently, US President Donald Trump called US Federal Reserve Chairman Jerome Powell a “fool” for acting “too late” in lowering the central bank’s benchmark rate; this is just the latest in a string of criticisms where President Trump has taken Chairman Powell to task for keeping interest rates steady this year. The last time the Federal Reserve made a rate cut was in December 2024, when the US Federal Reserve lowered the rate from 4.50 percent to 4.25 percent.

Fed Chairman Powell, never one to back down, swiftly responded to the criticism, saying that the US Fed’s decision to hold off on any interest rate decrease is the right call right now since the economic data paints a picture of a U.S. in pretty good shape. He made it clear that the US Fed wouldn't budge until the impact of President Trump’s recent tariff policies, particularly on inflation, becomes clear. By the way, Trump’s hike in import tariffs was seen by many as an unprecedented flexing of presidential muscle.

Trump and his inner circle, it seems, have a somewhat unconventional view of world trade, especially when it comes to trade deficits—that gap between what the USA sells and what it buys from other countries. Plenty of economists have pointed out that trade deficits don’t necessarily put the brakes on economic growth. They argue that trade deficits aren’t a sign of national weakness, highlighting, in particular, the US economy which has ballooned to four times its size during this half-century of trade deficits. Still, Trump sticks to his gut feeling that the United States is getting economically mugged by Europe, China, Mexico, Japan, and Canada. He’s convinced he knows where interest rates should be headed and he’s itching to make a big bet on it and come out on top.

Interestingly enough, Trump has again threatened to escalate his trade war, floating the idea of a hefty 50 percent tariff on European Union goods starting June 1. He also put Apple on notice, warning he might slap a 25 percent levy on all its imported iPhones. When Trump dropped this latest bombshell,

sure enough, US stock indexes and European shares took a hit, the dollar weakened, and yields on US Treasury notes also dipped, all thanks to the anticipated impact of these new tariffs on US economic growth.

Now, monetary policy is basically a toolkit that a country's central bank uses to manage the overall money supply, encourage economic growth, and implement strategies like tweaking interest rates and adjusting bank reserve requirements. Obviously, it's not a roll of the dice, so every potential risk needs to be clearly spelled out. Fiscal policy, on the other hand, is another tool, but it's strictly for governments, not central banks. In the United States, it's the Federal Reserve Bank that's in charge of monetary policy, aiming to achieve that dual goal of maximum employment while keeping inflation in check.

When it comes to The Federal Reserve Open Market Committee, which gets together eight times a year to hash out changes to the country's monetary policies, the aim is to adjust the level of reserve balances, review or tweak short-term interest rates, and chew over related issues that affect both short and long-term interest rates. The Fed, without seeming to worry too much about pushback from elected officials, gets to pick and choose from various interest rates and different timeframes, which it can then measure and justify. The newly-approved rate then becomes the new discount rate that banks will use to lend, more or less, freely. Expansionary monetary policy is geared towards lowering interest rates, which can get business activities humming and, at the same time, boost the job market.

The U.S. Federal Reserve (often just called the Fed) wields a lot of global power because it's the central bank of the United States, solely responsible for running its monetary policy and keeping its financial house in order, which, let's face it, directly impacts both the U.S. economy and global financial markets. The Fed manages the total amount of U.S. dollars floating around, including dollar substitutes, giving it a platform to influence the amount of money in circulation. Given that the U.S. dollar is the world's go-to reserve currency, any move the Fed makes on the dollar sends ripples across global economies and international capital markets.

As Warren Buffett, widely seen by TIME magazine as one of the sharpest investors around and a beacon of honesty and wisdom in finance, often put it, "America doesn't avoid problems. It just solves them."

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