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Multinational investment and voluntary disclosure: Project-level evidence from the petroleum industry

Anthony P. Cannizzaro *, Robert J. Weiner [1]

George Washington University, Department of International Business, 2201 G Street NW, Suite 401, Washington, DC 20052, United States

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ABSTRACT

This paper analyzes the multinational enterprise's decision to voluntarily disclose information regarding its investments, a choice we term *investment transparency*. When disclosing investment information, managers must weigh the costs and benefits of reducing asymmetries between the firm and three stakeholder audiences: capital markets, civil society and governments. We use a unique transaction-level dataset of reserve acquisitions by oil-industry multinationals compiled by IHS Herold to examine managerial decisions to reveal or withhold value-relevant information about firm investment. Contrary to the agency-theoretic motivations traditionally ascribed to voluntary disclosure, our results suggest institutional and informational factors drive investment transparency. We find that firms disclose less in cross-border transactions, more when societal expectations of transparency are high, and less when faced with political risk. These results should be of interest to scholars of accounting and international business, as well as managers and policy makers involved in the ongoing debate on transparency in the extractive industries.

Introduction

How transparent are multinational enterprises (MNEs) regarding their investments? In this study, we use the global market for petroleum reserves as a laboratory to examine *investment transparency* – value-relevant information MNEs choose to disclose voluntarily about investment projects. For a given investment, firms may disclose no information, partial information, or full information about the value of the investment.

We use a unique transaction-level dataset compiled by IHS Herold, which allows us to identify which party discloses each transaction and how much information is revealed about the investment. We find that firms disclose less about cross-border than domestic investment. This result is robust to controls for the firm's capital needs, national institutions, ownership of the firm and characteristics of the investment. Further, we find that firms investing in countries with strong transparency norms (proxied by government fiscal openness, freedom of the press, and quality of the accounting system), and strong political constraints are more likely to disclose partial information. Firms from countries marked by less political risk and corruption are more likely to disclose full information.

We draw on theories of voluntary disclosure and the institutional and political economy literatures to suggest that MNEs use voluntary disclosure strategically to manage information asymmetries between the firm and three primary stakeholder groups: capital markets, civil society, and governments. Our results do not support traditional agency-theoretic motivations such as increasing disclosure to secure external financial resources, and increased disclosure in multinational operations. This runs counter to the view in the literature that MNEs disclose more in response to capital market demands for information about their operations abroad (Cahan, Rahman, & Perera, 2005).

* Corresponding author. Tel.: +1 202 994 6880; fax: +1 202 994 7422.
E-mail addresses: tony_c@gwu.edu (A.P. Cannizzaro), rweiner@gwu.edu (R.J. Weiner).
[1] Tel.: +1 202 994 5981; fax: +1 202 994 7422.

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Rather, institutional factors such as societal expectations of transparency and political risk play an important role in multinational disclosure. Our results are consistent with the view that voluntary disclosure is driven by social norms (Cho, Guidry, Hageman, & Patten, 2012), as MNEs seek to be perceived as legitimate by key stakeholders (Parsons, 1960). Further, our findings are consistent with MNEs' strategically reducing transparency to protect investments from government predation.

Multinational enterprises typically operate numerous investment projects in a variety of countries and institutional environments. Despite empirical evidence that exposure to international markets increases the complexity of assessing and transmitting value-relevant information (Callen, Hope, & Segal, 2005; Hope, Kang, Thomas, & Vasvari, 2008; Portes & Rey, 2005; Thomas, 1999), the literature has only recently begun to explore how countries matter for corporate transparency (Healy & Serafeim, 2013; Shi, Magnan, & Kim, 2012).

We extend this literature beyond financial-statement reporting by examining value-relevant disclosures specific to firm investments. The importance of investments to firm strategy is highlighted in the scholarly literatures in finance (Maksimovic & Phillips, 2001; Maksimovic, Phillips, & Prabhala, 2011) and strategic management (Capron, Mitchell, & Swaminathan, 2001), yet is underrepresented in the literature on voluntary disclosure.

More broadly, society has long been concerned over accountability and corruption in foreign investment. Widely-held suspicions of MNEs are based in part on perceptions that their secrecy masks illicit behavior. Stiglitz (2008) argues that MNEs are more likely than domestic firms to exploit asymmetries in bargaining power and information, and use cross-border transactions to avoid accountability. Transfer pricing, the ability to manipulate internal prices to shift profits between subsidiaries in different tax jurisdictions, is an advantage of multinationality (Eden, 2012). Meek and Thomas (2004) note opacity of foreign operations as an ongoing issue in international disclosure research.

Our study is relevant to debates over transparency initiatives by governments, intergovernmental organizations (IGOs), and civil society (through non-governmental organizations – NGOs). This debate is particularly contentious in the extractive industries, of which petroleum is the largest. Survey evidence suggests that petroleum and mining are among the industries most prone to bribery (Transparency International, 2011). Darby (2009) notes that failure by MNEs in the extractive industries to disclose information is often interpreted as these firms having something to hide. A majority of the 20 worst-performing countries on the Transparency International (2012) corruption index are natural-resource rich. Both IGOs and NGOs[2] have been expanded or created to push increased transparency, discourage corruption, and address other ills of resource-rich societies (Durnev & Guriev, 2007; Jensen & Johnston, 2011).

Recent years have seen policy initiatives and disclosure rule changes designed to enhance transparency. In the United States, Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank," passed in 2010), amends the Securities Exchange Act of 1934 to require disclosure of government payments by extractive industry firms listed on US exchanges. In 2012, the Securities and Exchange Commission adopted rule 13(q)-1, which requires US-listed firms in extractive industries to include project-level disclosures of payments to governments at home and abroad in their annual reports, starting in late 2013.[3] However, following industry challenges the rule was vacated.[4] The European Union, Hong Kong, and Canada have enacted or have committed to enact similar regulations on listed extractive industry MNEs.[5]

Project-by-project disclosure requirements, intended to create accountability and reduce corruption, have proven extremely controversial (Hunt, 2011). Strong opposition from listed petroleum MNEs, such as the effort that challenged the 2013 Dodd-Frank rule, are grounded in claims that project-level reporting will be detrimental to firms by disclosing private information to governments and competitors, many of which are state-owned.[6] Numerous state-owned firms are unlisted, and hence not bound by these rules. In contrast, NGOs assert that project-level disclosure will not have significant consequences for competitiveness (Rosenblum & Maples, 2009).

The debate over mandatory project-level disclosure raises the question of the extent to which such data are now reported voluntarily. Thus, we examine investment-level disclosure patterns and the institutional factors driving them. If investment project disclosures are costly to firms, these costs should influence managerial decisions to reveal information. Relating disclosure decisions to MNEs' investment locations, our approach integrates existing insights from the accounting literature on corporate transparency with work from institutional theory and political economy to model the decision to disclose. Our work complements recent research on corporate-level disclosure of performance and payments to governments in publicly-traded petroleum MNEs (Healy & Serafeim, 2013).

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[2] The primary IGO example is the Extractive Industries Transparency Initiative (EITI), an international collaboration between governments, businesses, and civil society groups that promotes disclosure of aggregate firm payments. NGO examples include Oxfam International (an NGO that promotes poverty alleviation worldwide), and Publish What you Pay, a global network of NGOs (including Transparency International and Global Witness) devoted to promoting transparency in the oil industry.

[3] The language of the law is broadly interpreted as requiring issuers to disclose granular, disaggregated information on a project-by-project basis. Hunt (2011) provides a comprehensive review of the legislation.

[4] The rule was vacated in July 2013 by the US District Court for the District of Columbia (see Memorandum Opinion filed July 2, 2013 for Civil Action Number 12-1668 (JDB)).

[5] For example, new EU Transparency and Accounting Directives require country-by-country and project-by-project disclosure of all government payments over €100,000 (European Commission MEMO/13/541 dated June 12, 2013).

[6] SEC Release No. 34-67717; File No. S7-42-10. *Final Rule Making on Disclosure of Payments by Resource Extraction Issuers, 17 CFR Parts 240 & 249*, summarizes inter alia industry views.