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Management Forecasts in Japanese Multinational Enterprises

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Abstract

The research problem:

This study investigates the degree of internationalization and disclosure quality of mandatory management forecasts (MF) of Japanese multinational enterprises (MNEs).

Motivation or theoretical reasoning:

Investors in internationalized MNEs demand better disclosure under the complexity of internationalized geographical diversity. However, the research question remains as to whether internationalization affects disclosure quality, especially regarding MF. Our research was conducted in a unique setting characterized by mandatory-effective MF required in Japan, unlike in the United States, where voluntary MF are adequate.

The test of hypotheses:

This study tests whether the disclosure quality of mandatory MF is lower in highly internationalized MNEs. Additionally, we test whether foreign investors (FI) are positively associated with better mandatory disclosure in highly internationalized MNEs.

Target population:

The initial study sample comprised all non-financial firms listed on the Tokyo Stock Exchange from 2007 to 2018. We obtained financial data, MF, and corporate ownership from Data Solution and Astra Manager. Our final sample comprised 13,280 MNE-year observations and 7,330 non-MNE-year observations.

Adopted methodology:

We estimated the relationship between the disclosure quality of MF and internationalization based on a multiple regression analysis. Additionally, we considered endogeneity using 2SLS analysis.

Analyses:

Our dependent variables were the initial MF optimism, measured as the initial earnings errors (*Forecast Error*), *Forecast Accuracy* as the absolute value of *Forecast Error*, and the magnitude of forecast revisions (*Magnitude*). Our key independent variable was the internationalization diversification proxy (*Internationalization*).

Findings:

Our empirical results showed that the disclosure quality of MF tends to be lower in highly internationalized MNEs. This finding implies that the geographical complexity of internationalized MNEs lowers the disclosure quality of mandatory MF. Moreover, we found that greater FI positively moderates the negative relationship between the disclosure quality of MF and the degree of internationalization, suggesting that disclosure pressure of FI enhances the quality of mandatory MF. Our study illustrates how internationalization affects managerial disclosure quality and contributes to the understanding of the governance costs imposed by the complexities caused by internationalization.

Keywords: internationalization; corporate governance (CG) ; comparative accounting systems and practice; MNEs; FI

1. Introduction

Under financial globalization, institutional shareholders enhance disclosure demands for greater accountability and transparency (Aggarwal et al., 2011; Boone & White, 2015). Firms attract FI with different national-level corporate governance (CG) logic (Aguilera et al., 2018). Thus, the CG of multinational enterprises (MNEs) is strongly influenced by recent globalization trends (Aguilera et al., 2019). Well-functioning accounting practices and CG mechanisms are complementary, and cross-national differences in CG systems also affect accounting practices (Aguilera et al., 2021). While a growing interest in CG exists in MNEs, the accounting literature on MNEs remains relatively scarce (Aguilera et al., 2021). Research on MNEs' CG shows that the adoption of accounting standards tends to progress when cross-national differences exist in CG systems (Judge et al., 2010). In Japanese MNEs, adopting international accounting standards has progressed in response to demands of FI (Sakawa et al., 2021). Additionally, Japanese MNE managers face pressure from FI to achieve better disclosure (Aguilera et al., 2017). Owing to the increasingly varied demands of investors with increasing geographical diversity, analysts face difficulty making higher-quality forecasts (Duru & Reeb, 2002). Therefore, investors in internationalized MNEs demand better disclosure because of the complexity of internationalized geographical diversity. This raises the research question of whether internationalization affects the disclosure quality of MF, aligning with the accounting literature on MNEs.

From international CG (ICG) research perspective, shareholder-oriented CG in the United States (U.S.) is remarkably different from that in Germany and Japan (Shleifer & Vishny, 1997). In such countries, bank–firm relationships, or the mechanism through which banks monitor their client firms, are known to function effectively (Aguilera et al., 2008; Aoki et al., 1994; Yoshimori, 1995). However, with the rising financial globalization trend, disclosure pressures from FI on the Japanese MNEs have increased (Aguilera et al., 2017; Sakawa & Watanabel, 2019; Sakawa et al., 2022).¹

This study aimed to discover how internationalized MNEs realize better disclosure of mandatory MF. MF play a central role in improving corporate disclosure (King et al., 1990). Additionally, the impact of FI on managerial reporting behavior in stakeholder-oriented CG is critical for academics and practitioners (Aguilera et al., 2017). Given this, the present study focused on assessing the disclosure quality of MF by examining subsequent revisions of MF.

We intended to reveal how MNEs under stakeholder-oriented CG adapt to pressures from FI accustomed to shareholder-oriented logic. Previous studies have focused on managerial incentives to disclose forecasts in the U.S. (Skinner, 1994; Stocken, 2000). In U.S. corporations, MF are released voluntarily to avoid concerns about the enormous legal costs of false disclosures. Under China's voluntary MF systems, politically connected firms tend to issue fewer voluntary disclosures because of their weaker disclosure incentives (Hung et al., 2018). In Japan, however, MF are mandatorily released because of the relatively lower regulatory and legal costs of biased forecasts (Kato et al., 2009). Therefore, Japanese corporations' MF are considered less biased and differ in how they are revised (Aguilera et al., 2017; Nagata & Nguyen, 2017). Effectively mandated MF in Japanese corporations mitigate information asymmetry between managers and outside shareholders (Kato et al., 2009). Listed companies are expected to

¹ The increase in FI would enhance disclosure pressure on Japanese corporations (Sakawa et al., 2014).

issue annual MF on annual earnings announcement dates. Thus, MF produce information useful to analysts, especially at the start of the fiscal year, when alternative corporate information disclosure is generally not released (Ota, 2010).

Japanese MNEs are suitable for investigation regardless of whether internationalization affects disclosure quality in stakeholder-oriented CG for three reasons. First, investigating managerial disclosure quality under the effectively mandated MF systems in Japan is desirable (Kato et al., 2009). As previously mentioned, in the U.S., producing evidence to examine the credibility of MF is generally difficult.² thus, the Japanese context is suitable for investigating the overall disclosure quality of MNEs' MF. Second, progress in the internationalization of Japanese MNEs has been remarkable. In 2018, Japan had its largest foreign direct investment (FDI) outflow, as measured by the diversity of its host countries (JETRO, 2018). Thus, the Japanese MNEs setting is preferable for investigating how internationalization affects corporate disclosure quality. Third, Japanese stakeholder-oriented CG is distinct from Anglo-American shareholder-oriented systems (Aguilera & Jackson, 2003). FI has also increased in Japanese corporations (Desender et al., 2016). The increased presence of FI with a shareholder-oriented logic emphasizes disclosure quality (Desender et al., 2016; Sakawa et al., 2021).

However, little is known about how the disclosure quality of Japanese MNEs is affected by the progress of internationalization and the pressure exerted by FI's shareholder-oriented logic. To address this research gap, we aimed to clarify how the disclosure quality of MF is affected by the internationalization of MNEs in the face of complexities and uncertainties. Thus, we examined whether the disclosure quality of MF was low in highly internationalized Japanese corporations under complex and uncertain conditions. To measure the degree of internationalization of MNEs, we used the level of diversification of internationalization (Lu & Beamish, 2004).

Using data from 2007 to 2018 from a sample of Japanese corporations, we assessed the relationship between the degree of internationalization and the disclosure quality of MF under an effectively implemented mandated MF system. First, we found that the disclosure quality of MF was lower in highly internationalized MNEs. Second, the negative relationship between the disclosure quality of MF and internationalization was positively moderated by FI. Due to the stronger disclosure pressure on firms with larger FI (Sakawa et al., 2014), the disclosure quality of MF is positively moderated by greater FI in highly internationalized firms.

This study, which focuses on the intersection of international accounting and ICG research, contributes to the current body of literature in several ways. First, we observed how the complexity of internationalization affects the disclosure quality of mandatory MF in Japan (Aguilera et al., 2017; Kato et al., 2009). The complexity of internationalization increases the risks and costs, which can negatively impact a firm's future returns (Geringer et al., 2000; Ruigrok & Wagner, 2003). Previous research has revealed that firms can enjoy the benefits of internationalization in the initial stages (Vrontis & Christofi, 2021), whereas the overexpansion of internationalization generates greater costs (Gomes & Ramaswamy, 1999; Lu & Beamish, 2004). Thus, our study aimed to understand whether the complexity of internationalization benefits or harms managerial disclosure quality in Japanese MNEs. Second, this study contributes to the

² In the United States, the MF is endogenously determined, as managers decide to disclose forecasts with the different managerial incentives under the voluntary MF systems (Ajinkya et al., 2005; Karamanou & Vafeas, 2005; Verrecchia, 2001).

ICG research, which focuses on the role of FI in heterogeneous ownership structures (Aguilera et al., 2018; Desender et al., 2016). Our study attempted to reveal how foreign and domestic shareholders respond to management disclosure quality in Japanese MNEs with divergent interests. Third, we add to the literature on ICG (Aguilera et al., 2019) by shedding light on a novel aspect of MNEs' governance costs; that is, the accounting gaps in the internationalization process and determining the situations under which such costs would be reduced (i.e., when MNEs have greater FI).

2. Institutional Backgrounds and Hypotheses Development

2.1. Institutional backgrounds

The interests of stakeholders, such as bank–client and inter-firm relationships, are crucial in stakeholder-oriented CG, which differs from shareholder-oriented CG (Yoshimori, 1995). In Japan, bank–client relationships have been maintained for extended periods (Desender et al., 2016). Such relationships function as effective monitoring mechanisms to mitigate agency problems (Kang & Shivdasani, 1995; Morck et al., 2000; Sakawa & Watanabel, 2021b, 2022). Additionally, firms with close relationships with banks tend to enhance the quality of their earnings (Sakawa & Watanabel, 2021a).

Since the financial deregulation in the 1990s in Japan, FI have increased (Aguilera et al., 2017). FI's ownership of Japanese corporations was only approximately 5% in the early 1990s (Desender et al., 2016). This figure increased to approximately 15% post-2010.³ FI exert pressure on listed firms to disclose (Sakawa et al., 2014). Additionally, the greater presence of FI is linked with higher corporate risk-taking to achieve corporate innovation (Sakawa, Watanabel, Duppati, and Faff, 2021)⁴.

Under globalization, Japanese firms have expanded over the past two decades (Sakawa et al., 2021). In 2018, Japan became the world's largest FDI outflow economy (JETRO 2018). Agency theory predicts that internationalized MNEs demand better disclosures to realize effective CG (Aguilera et al., 2019). Thus, internationalized Japanese MNEs are expected to achieve better quality MF because FI demand better disclosure.

Japanese mandatory-effective MF disclosures are based on lower legal costs than voluntary U.S. MF disclosures (Buchanan et al., 2012; Kato et al., 2009). We discuss the costs and benefits of issuing management disclosure in the Japanese MNE setting. Specifically, we separately consider the costs (i.e., proprietary and litigation costs) and benefits (i.e., lower cost of external financing) of issuing mandatory forecasts for Japanese MNEs. First, regarding proprietary costs, the disclosure of earnings information by Japanese MF does not include proprietary information, such as custom identification, which affects the choice of management disclosure in the U.S. (Ellis et al., 2012). Thus, proprietary costs do not affect the choice of management disclosure among Japanese MNEs. Second, regarding litigation costs, managers in Japanese MNEs can benefit from mitigating litigation risks from FI by issuing and revising MF using the lower legal and litigation costs in Japan (Kato et al., 2009). Third, regarding the benefits of MF disclosure, Japanese MNEs can enjoy lower costs of external financing from FI. FI favor stakes in

³ The stakes increase from 15 % in 2010 to approximately 20% in 2017.

⁴ Aman et al. (2021) describe the corporate environment and internal monitoring systems in Japan.

firms with lower information asymmetry (Sakawa et al., 2014). Thus, we conjecture that the benefits of issuing reliable MF exceed the costs incurred by Japanese MNEs.

The Japanese disclosure system enables the analysis of unbiased MF observations. This saves us from sample selection bias, unlike the U.S. system of voluntary disclosure (Ishida et al., 2021). This system enables Japanese managers to manage their initial MF strategically and subsequently revise their MF (Conroy et al., 2000; Edelman, 1992). Under effectively mandated MF, managers' initial MF for a fiscal year are systemically upward biased (Kato et al., 2009). In firms with greater FI, managers with shareholder-oriented logic have been seen to make highly optimistic initial forecasts to attract FI (Aguilera et al., 2017) because FI place more importance on shorter firm value than longer firm value (Geng et al., 2016).

The Japanese mandatory-effective MF system is useful for investigating the effect of managerial optimism on subsequent revisions of MF (Aguilera et al., 2017). The disclosure quality of MF has been enhanced by voluntary revisions by Japanese corporations (Nagata & Nguyen, 2017). Thus, the credibility of MF is reflected in the magnitude of earnings adjustments in revised MF.

2.2. Theoretical frameworks and hypotheses development

We argue that complexity is essential to understanding the influence of international expansion on managerial reporting practices in Japanese MNEs. The institutional theory implies that complexity influences firms' strategies, decisions, and performance (Greenwood et al., 2011; Palmer & Wiseman, 1999). From the perspective of international business research, MNEs are affected by the institutional complexity of conflicting tensions arising from multiple incompatible institutions (Kostova & Zaheer, 1999; Kostova et al., 2008). As the number of institutional environments (number of countries) increases, institutional complexity increases for internationalized MNEs (Arregle et al., 2016). Thus, institutional complexity is crucial in determining managerial disclosure quality in the Japanese MNE setting.

This study analyzes the disclosure quality of mandatory managerial reporting in stakeholder-oriented CG from an institutional complexity perspective (Arregle et al., 2016). Agency theory predicts that outside shareholders urge better disclosure by internationalized MNEs, which can be achieved under effective CG by MNEs (Aguilera et al., 2019). FI place more weight on shareholder-oriented logic in stakeholder-oriented CG (Aguilera et al., 2017). Internal monitoring mechanisms and bank–firm relationships help improve the effectiveness of CG by monitoring outside shareholders and managerial incentive systems in Japanese corporations (Aguilera et al., 2008).

The concept of institutional complexity explains how formal and cultural institutions in countries in which Japanese MNEs expand their business affect their internationalization decisions made by those MNEs (Arregle et al., 2016). ICG research has shown that MNEs also face foreign pressure from shareholder-oriented logic (Aguilera et al., 2019). In other words, managers of internationalized MNEs face difficulties achieving better disclosure because of their higher degree of uncertainty and complexity. Given the uncertainty and complexity of internationalization, there may be two alternative views on the relationship between internationalization and disclosure quality in MNEs. First, internationalization enhances the disclosure quality of MNEs. The frequency of MF tends to be higher in U.S. cross-listed MNEs (Shi et al., 2012). Alternatively, disclosure quality may be lower in internationalized MNEs. In the U.S., better disclosure, measured as analyst forecasts in internationalized MNEs, is lower

because MNEs face a higher degree of complexity due to geographical diversification (Duru & Reeb, 2002). In addition, analysts assess FI's internationalization (Luo & Zheng, 2018).

In an economy where MF are effectively mandated, managers face difficulty releasing accurate MF under complexity and uncertainties (due to internationalization). During internationalization, Japanese MNEs face accounting gaps between their home and host subsidiaries (Sakawa et al., 2021). The complexity of accounting gaps is increased by a higher degree of internationalization. The complexity of consolidated financial reporting reduces management disclosure quality. We predicted that managers of highly internationalized MNEs would issue less accurate forecasts. Therefore, we propose:

Hypothesis 1: Disclosure quality of mandatory MF is lower in highly internationalized MNEs.

Several studies have analyzed why and how managerial disclosure quality is characterized by ICG logic. From the perspective of ICG research, FI affect managerial reporting behavior (Aguilera et al., 2017). FI demand compatibility with financial reporting in MNEs (Sakawa et al., 2021). With the rise of financial globalization, Japanese corporations have been coping with pressures from FI within the boundaries of existing governance practices (Desender et al., 2016).

In stakeholder-oriented CG, the managerial incentive is provided by firms with larger stakes of FI (Geng et al., 2016; Sakawa et al., 2012). Thus, managers in Japanese firms cope with pressure from FI using shareholder-oriented logic by enhancing disclosure quality. For example, Japanese corporations are increasingly adopting international accounting standards because of the increased presence of FI (Sakawa et al., 2021). Information asymmetry decreases in firms with larger FI stakes because of the high disclosure pressure they exert (Sakawa et al., 2014). Therefore, we propose that FI improve the disclosure quality of MNEs:

Hypothesis 2: FI are positively associated with mandatory disclosures in highly internationalized MNEs.

3. Data and Methodology

3.1. Sample

We include all firms listed on the Tokyo Stock Exchange (TSE) from 2007 to 2018. Financial firms were excluded because their accounting systems are distinct from those of non-financial firms. We obtained financial, management, and corporate ownership data from Data Solution and Astra Manager. We collected data on Japanese overseas investments from Toyo Keizai Inc. (David et al., 2010; Goerzen & Beamish, 2005).⁵ We followed selection criteria established in a previous study (Arregle et al., 2016). The resulting sample comprised 13,280 MNE-year observations and 7,330 non-MNE-year observations. The data were classified based on Japanese industry codes.

3.2. Methodology

⁵ Toyo Keizai data is the most reliable data for research on Japanese MNEs (Hong et al., 2019).

Our hypotheses were tested using the following equation to estimate the relationship between MF quality and internationalization:

$$\begin{aligned} & \text{Management Forecast}_{i,t} \\ &= \beta_1 \text{Internationalization}_{i,t} + \beta_2 \text{Internationalization}_{i,t} * \text{Foreign}_{i,t} \\ &+ \beta_3 \text{Foreign}_{i,t} + \sum_j \beta_j \text{Control}_{i,t-1} + \varepsilon_{i,t} \cdot \cdot \cdot (1) \end{aligned}$$

In Equation (1), the dependent variable is $MF_{i,t}$. The control variables are represented by $Controls_{i,t}$. To mitigate *endogeneity* concerns, we adopted independent variables to measure at the start of the fiscal year (Aguilera et al., 2017). We also controlled for industry and year effects by adding industry and year dummy variables. The error term is represented by $\varepsilon_{i,t}$. Subscripts i and t refer to the firm and year, respectively.

3.2.1. Dependent variables

We measured the disclosure quality of MF using both initial MF and their revisions. Under effectively mandated MF systems, initial MF reflect managerial optimism and are subsequently revised (Aguilera et al., 2017). Thus, disclosure quality is enhanced when managers issue more accurate and optimistic forecasts. Additionally, disclosure quality is enhanced by revising optimistic MF. We also focused on *net income* forecasts because, for investors in Japan, a high *net income* forecast is more important than sales or operating income forecasts (Kato et al., 2009).

We defined the quality of initial MF using two variables: initial MF optimism, measured as initial earnings errors (*Forecast Error*) (Aguilera et al., 2017; Kato et al., 2009). We defined *Forecast Error* as:

$$\frac{(\text{Initial MF of year } t) - (\text{Earnings of year } t-1)}{\text{Total Assets at year } t-1}$$

Forecast Error tends to have larger negative values when MF fall under managerial optimism. Second, we measured *Forecast Accuracy* as the absolute value of *Forecast Error* (Ajinkya et al., 2005; Kato et al., 2009). As *Forecast Accuracy* decreases, MF become more accurate.

We also measured the disclosure quality of MF revisions using the magnitude of the forecast revisions (Aguilera et al., 2017; Ishida et al., 2021). The corporation's disclosure quality was measured by the propensity of management to provide revised MF. Under the effective Japanese mandatory MF system, MF tend to be optimistically biased owing to lower legal and litigation costs (Kato et al., 2009). Given the tendency to make optimistic initial MF, voluntary revision of MF is an important measure of better disclosure (Nagata & Nguyen, 2017). *Magnitude* (magnitude of forecast revisions) is defined as:

$$\frac{(\text{Last MF Revisions } t) - (\text{Initial MMF } t)}{\text{Total Asset at year } t-1}$$

3.2.2. Key independent variables

We adopted the internationalization diversification (*Internationalization*) proxy to calculate the degree of internationalization by combining the number of countries and subsidiaries (Lu & Beamish, 2004; Sakawa et al., 2021). Ownership variables also influence the quality of management disclosures in internationalized firms. We measured

foreign ownership (*FO*) as the ratio of foreign shares to total outstanding shares. We measured bank ownership (*Bank*) as the ratio of bank shares to total outstanding shares.

We controlled for two CG variables: audit firm quality and board independence. First, we adopted a dummy variable, the big four auditors (*Big 4*: EY, Deloitte, KPMG, or PwC), to control the quality of auditors (Aguilera et al., 2017; Sakawa & Watanabel, 2021a, 2022). We expected that high-quality audit firms to mitigate managerial incentives to make more optimistic forecasts (Aguilera et al., 2017). Second, board independence was measured as the proportion of outside directors to the total number of directors. Post-2000, board independence (*Board Independence*) has gradually begun to function in stakeholder-oriented CG (Desender et al., 2016). Thus, we expected the effective monitoring of firms through a stronger assertion of board independence to be associated with less optimistic forecasts.

Finally, we adopted firm characteristics, such as size, leverage, profitability, sales growth, prior optimism, and asset turnover (Aguilera et al., 2017; Kato et al., 2009). We adopted total assets as firm size (*Size*). Larger firms face greater external discipline and/or reputational costs; thus, they would display less managerial optimism than smaller firms. Firm leverage (*Leverage*) is the ratio of total liabilities to total assets. Firms with higher leverage levels are under more pressure to issue optimistic forecasts (Barton & Simko, 2002). To control for MF optimism in firms with low performance, we controlled for past firm performance using return on assets (*ROA*) and sales (*Sale Growth*) (Aguilera et al., 2017). *Prior optimism* was controlled for by a dummy variable that was 1 when the firm's net earnings were below its initial forecast; otherwise, zero. If managerial optimism persists in year *t*, this dummy was positively associated with initial earnings optimism (Kato et al., 2009). Low operating turnover (*Asset Turnover*) equaled one when the ratio of sales dividends to net operating assets was below the median for the respective industry year assessed using TSE industry codes and zero otherwise (Aguilera et al., 2017).

4. Results

4.1. Descriptive statistics

Descriptive statistics are presented in Table 1. The descriptive statistics align with those of previous studies (Aguilera et al., 2017; Kato et al., 2009). The average forecast error is negative for the initial disclosure of MF. The average accuracy of MF is 2.145, and the average *Magnitude* is 1.851, indicating that disclosure quality is enhanced by correcting initial managerial optimism (Ishida et al., 2021).

Next, we present the descriptive statistics of the independent variables. *Internationalization* is 0.036 on average, aligning with previous findings (Lu & Beamish, 2004). *FO* are about 10.6% on average, consistent with previous findings that the presence of foreign shareholders in more than half of firms is less than 10% (Aguilera et al., 2017). For the control variables, the averages of *Size* and *Leverage* are approximately 10.85 and 49.6%, respectively, consistent with Sakawa et al.'s (2021) results. The average *ROA* and sales growth are approximately 2.3% and 3.1%, respectively, consistent with Aguilera et al.'s (2017) results. *Prior Optimism* is 0.510 (on a scale of 0 to 1), indicating the presence of prior optimism in initial MF, aligning with Kato et al. (2009). As for CG variables, approximately 72% of firms are audited by Big Four auditors. In addition, board independence is approximately 13.5%, lower than that in Anglo-American countries. *Asset Turnover* is approximately 50%, on average.

Table 2 lists the correlation matrices. *Forecast Accuracy* is negatively correlated with *Magnitude*. This implies that, in line with previous findings, MF revisions mitigate managerial forecast accuracy (Kato et al., 2009). In addition, *Forecast Accuracy* is positively related to *Size* and *ROA* and negatively related to leverage and the Big 4, consistent with Aguilera et al. (2017).

4.2. Estimated results

Table 3 shows the estimated results of the relationship between the disclosure quality of MF and internationalization, and the interaction terms of internationalization and FO. The dependent variables are the disclosure quality of MF and managerial optimism proxy variables (Aguilera et al., 2017; Ishida et al., 2021). Table 3 introduces the basic models with *Forecast Error*, *Forecast Accuracy*, and *Magnitude* in Models (1), (4), and (7). Subsequently, we introduce the estimated results by adding *Internationalization* to Models (2), (5), and (8) to examine whether Hypothesis 1 is supported. We also add the interaction terms of *Internationalization* and *FO* to Models (3), (6), and (9) to investigate the relevance of Hypothesis 2.

Table 1. Descriptive Statistics

Variable	Number	Mean	Standard Deviation	Median
Forecast Error	20610	-0.799	3.788	-0.017
Forecast Accuracy	20610	2.145	3.557	0.946
Magnitude	20610	1.851	3.324	0.725
Internationalization	20610	0.036	0.056	0.017
FO	20610	10.599	11.539	6.310
Bank	20610	19.571	13.088	17.525
Size	20610	10.851	1.618	10.678
Leverage	20610	0.496	0.198	0.500
ROA	20610	0.023	0.052	0.026
Sale growth	20610	0.031	0.143	0.025
Prior Optimism	20610	0.510	0.500	1.000
Big 4	20610	0.718	0.450	1.000
Board Independence	20610	0.135	0.147	0.111
Asset Turnover	20610	0.497	0.500	0.000

Table 2. Correlation Matrix

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
1. Forecast Error													
2. Forecast Accuracy	-0.70 *												
3. Magnitude	-0.69 *	0.95 *											
4. International	0.06 *	-0.07 *	-0.06 *										
5. FO	0.04 *	-0.06 *	-0.06 *	0.51 *									
6. Bank	0.12 *	-0.19 *	-0.17 *	0.44 *	0.43 *								
7. Size	0.15 *	-0.24 *	-0.22 *	0.60 *	0.63 *	0.64 *							
8. Leverage	-0.02 *	-0.02 *	-0.01	0.03 *	-0.16 *	0.05 *	0.14 *						
9. ROA	0.26 *	-0.31 *	-0.31 *	0.07 *	0.20 *	0.13 *	0.14 *	-0.24 *					
10. Sale Growth	0.29 *	-0.11 *	-0.13 *	0.01	0.05 *	0.00	0.00	-0.03 *	0.10 *				
11. Prior Optimism	-0.20 *	0.16 *	0.16 *	-0.05 *	-0.09 *	-0.09 *	-0.11 *	0.03 *	-0.39 *	-0.14 *			
12. Big 4	0.07 *	-0.10 *	-0.09 *	0.14 *	0.16 *	0.14 *	0.24 *	-0.01 *	0.09 *	-0.02 *	-0.02 *		
13. Board Independence	0.00	0.04 *	0.03 *	0.10 *	0.21 *	-0.06 *	0.08 *	-0.05 *	0.03 *	0.02 *	-0.03 *	0.07 *	
14. Asset Turnover	-0.01	0.00	0.01	-0.06 *	0.07 *	0.03 *	0.04 *	-0.25 *	-0.04 *	0.06 *	0.02 *	-0.02 *	-0.01

* $p < .05$

Table 3. OLS Estimated Results

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Forecast Error			Forecast Accuracy			Magnitude		
Internationalization		-2.531 ** (-4.26)	-4.020 ** (-5.04)		4.398 ** (6.30)	5.916 ** (6.26)		3.853 ** (6.10)	5.149 ** (6.14)
Internationalization * Foreign			0.046 ** (2.79)			-0.047 * (-2.27)			-0.040 * (-2.25)
Foreign		-0.037 ** (-8.12)	-0.039 ** (-8.07)		0.048 ** (9.64)	0.051 ** (9.46)		0.039 ** (8.62)	0.040 ** (8.51)
Bank		0.008 ** (2.96)	0.008 ** (3.16)		-0.014 ** (-4.52)	-0.015 ** (-4.70)		-0.012 ** (-4.31)	-0.013 ** (-4.47)
Size	0.197 ** (9.14)	0.388 ** (9.67)	0.392 ** (9.72)	-0.383 ** (-14.44)	-0.640 ** (-13.47)	-0.644 ** (-13.52)	-0.327 ** (-13.59)	-0.535 ** (-12.35)	-0.538 ** (-12.41)
Leverage	0.628 ** (2.62)	0.120 (0.50)	0.100 (0.41)	-0.925 ** (-3.84)	-0.244 (-1.01)	-0.223 (-0.92)	-0.718 ** (-3.42)	-0.172 (-0.79)	-0.154 (-0.71)
ROA	15.630 ** (10.55)	15.800 ** (10.77)	15.790 ** (10.76)	-19.810 ** (-13.56)	-19.970 ** (-14.03)	-19.960 ** (-14.02)	-18.130 ** (-14.26)	-18.240 ** (-14.63)	-18.230 ** (-14.61)
Sale Growth	6.986 ** (20.99)	7.106 ** (21.38)	7.117 ** (21.38)	-1.606 ** (-5.07)	-1.773 ** (-5.67)	-1.784 ** (-5.70)	-1.944 ** (-6.63)	-2.080 ** (-7.16)	-2.089 ** (-7.18)
Prior Optimism	-0.573 ** (-10.41)	-0.554 ** (-10.07)	-0.551 ** (-10.01)	0.033 (0.62)	0.005 (0.10)	0.002 (0.05)	0.043 (0.88)	0.021 (0.43)	0.019 (0.38)
Big 4	0.265 ** (3.67)	0.250 ** (3.57)	0.252 ** (3.61)	-0.314 ** (-3.77)	-0.292 ** (-3.69)	-0.294 ** (-3.72)	-0.234 ** (-3.16)	-0.216 ** (-3.04)	-0.218 ** (-3.07)
Board Independence	-1.103 ** (-4.22)	-0.611 * (-2.51)	-0.612 * (-2.52)	1.910 ** (6.00)	1.214 ** (4.13)	1.216 ** (4.14)	1.759 ** (6.13)	1.192 ** (4.43)	1.193 ** (4.44)

Asset	-0.044	-0.083	-0.093	-0.080	-0.017	-0.006	-0.040	0.014	0.023
Turnover	(-0.78)	(-1.47)	(-1.63)	(-1.29)	(-0.28)	(-0.11)	(-0.72)	(0.26)	(0.42)
Year	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Number	20610	20610	20610	20610	20610	20610	20610	20610	20610
Adjusted R2	0.232	0.240	0.240	0.206	0.223	0.223	0.207	0.220	0.220
F Value	61.17 **	58.45 **	57.18 **	40.31 **	38.99 **	38.09 **	45.67 **	43.55 **	42.57 **

Note. Models (1)–(9) are estimated using liner. All independent variables are lagged by one term. Standard errors are clustered by firm. The

t-values are shown in parentheses. See Appendix for definitions and measurements of the variables.

* $p < .05$, ** $p < .01$

Model (2) shows that *Internationalization* is significantly and negatively related to *Forecast Error*. In addition, *FO* is significantly negative for *Forecast Error* in Model (2). Regarding the accuracy of initial MF, *Internationalization* is significantly and positively related to *Forecast Accuracy* in Model (5). This finding suggests that the disclosure quality of initial managerial forecasts is lower in highly internationalized firms. Furthermore, in alignment with Aguilera et al.'s (2017) findings, greater *FO* would enhance managerial opportunism. Regarding the disclosure quality of management revisions, we find that both *Internationalization* and *FO* were significantly positively related to *Magnitude* in Model (8). This implies that the disclosure quality of initial MF and earnings revised by the management is lower in highly internationalized firms. These results offer consistent support for Hypothesis 1. Moreover, we observe that managerial optimism of initial MF and MF revisions increased with greater stakes of *FO*, aligning with a previous finding (Aguilera et al., 2017).

Next, to investigate the relevance of Hypothesis 2, we use the regression results in Models (3), (6), and (9). We find that the interaction terms of *Internationalization* and *FO* are significantly positively related to *Forecast Error* in Model (3) and negatively related to *Forecast Accuracy* in Model (6). This implies that managerial optimism in highly internationalized firms is moderated by the greater stakes of *FO*. In other words, the disclosure quality of MF improves in MNEs with a higher degree of internationalization, which results in greater disclosure pressure from FI. Finally, the interaction terms of *Internationalization* and *FO* trade are negatively related to *Magnitude* in Model (9). The implication is that the optimism of initial MF in highly internationalized firms is diminished by the greater stakes of FI. Overall, these results support Hypothesis 2. *FO* are positively associated with better mandatory disclosure in highly internationalized MNEs; that is, internationalization negatively influences optimism in the MF of firms with higher *FO*. These results imply that initial optimistic MF are subject to revision to a greater extent for firms with more FI. This finding is consistent with the predictions of previous studies (Nagata & Nguyen, 2017).

The estimated results in all the models also show that the control variables are significantly associated with the disclosure quality of MF. In Models (1), (2), and (3), the *Forecast Error* is smaller for larger firms, which have higher *Sale growth* and *ROA*, lower levels of *Leverage*, lack *Prior Optimism*, and are audited by *BIG 4*. Models (4), (5), and (6), which consider *Forecast Accuracy* and *Magnitude*, predict the opposite (less positive) results. We find that *Forecast Accuracy* is more precise for larger firms that have higher *Sale growth* and *ROA*, a lower level of *Leverage*, and are audited by *BIG4*. Models (7), (8), and (9), which consider *Magnitude* indicate that initial managerial optimism undergoes much more revision in the cases of firms that have larger *Size*, higher *Sale growth* and *ROA*, a lower leverage ratio, and are audited by *BIG4*. These results support the predictions of Aguilera et al. (2017). *Bank* is positively and significantly related to *Forecast Error* in Models (2) and (3). We also observe that *Bank* is significantly negatively related to *Forecast Error* in Models (5) and (6) and *Magnitude* in Models (8) and (9).

4.3. Additional analyses

We perform additional analyses to mitigate *endogeneity* concerns. Using a two-stage least squares (2SLS) regression, we adopt *Industry adjusted internationalization*, calculated by the

average degree of internationalization (excluding the contribution of the focal firm) for each industrial sector-size pair, based on total assets as an instrument for *Internationalization*.⁶ We hypothesize that the degree of internationalization of other firms within the same sector of a similar size may influence a focal firm's degree of internationalization degree but is unlikely to affect its disclosure quality on MF. Thus, we conclude that the assumption of the exclusion restrictions is satisfied.

We adopt stock membership in *TOPIX 500* as an instrument for *Internationalization*. *TOPIX 500* equals one if a firm is included in the *TOPIX 500* in a given year and zero otherwise. The assumption of an exclusion restriction is satisfied because the firm's management disclosure quality does not depend on whether the firm is included in the stock membership in *TOPIX 500*. This *Industry adjusted Internationalization (IV)* is relevant because firms selected as *TOPIX 500* tend to realize higher internationalization. Highly internationalized firms tend to have a larger market capitalization (Sakawa et al., 2021), and firms selected as the stock members in the *TOPIX 500* account for more than 85% of the market capitalization in the 1st Section of the TSE (Chizema & Shinozawa, 2012; Sakawa & Watanabel, 2020). This suggests that *TOPIX 500* selects highly internationalized firms, which face complexity and uncertainties that would reduce the quality of management disclosure.

In Table 4, the first-stage regression results, where the dependent variable is *Internationalization*, are shown in Models (1) and (2), and the second-stage regression results are shown in Models (3), (4), (5), (6), (7), and (8). The first stage assesses whether the *IV* is associated with *Internationalization*. To ensure the validity of the instrumental variable (*Industry adjusted internationalization*), we check the F-tests for the significance of the instruments in the 1st stage regression and show that the F-tests are rejected at the 1% level in Models (1) and (2). This indicates that this *IV* is relevant⁷.

The coefficients of *Internationalization* show significantly negative signs in Models (3) and (4). The coefficients of *Internationalization* are positive for *Forecast Accuracy* in Models (5) and (6) and *Magnitude* in Models (7) and (8). Our findings provide consistent support for Hypothesis 1. This implies that the initial managerial disclosure quality is lower in highly internationalized firms.

The interaction terms *Internationalization* and *FO* are positively and significantly related to *Forecast Error* in Model (4). In addition, the interaction terms are significantly and negatively related to *Forecast Accuracy* in Model (6) and the *Magnitude* in Model (8). Our findings support Hypothesis 2, and we can infer that the lower disclosure quality of MF with a higher degree of internationalization is increased by the greater stakes of FO. Thus, we confirm the robustness of our results by considering *endogeneity*.

⁶ Following Desender et al., (2016), we use 33 industrial sectors by TSE industry classification and four categories of firm size using the quartile cut-off points first Quantile (Q1) – second Quantile (Q2) – third Quantile (Q3) based on total assets.

⁷ We also check the Weak identification test (Cragg-Donald Wald test) of IV. In Table 4, we show that the values in Columns (3)–(8) exceed 10% of the maximal IV size (Stock and Yogo). Thus, we confirm that our IV is not weak.

Table 4. Results of 2SLS

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	1st stage				2nd stage			
	Internationalization		Forecast Error		Forecast Accuracy		Magnitude	
Internationalization			-9.662 **	-24.700 *	25.210 **	65.140 **	20.660 **	53.020 **
			(-2.80)	(-2.31)	(5.10)	(3.27)	(4.74)	(3.16)
Internationalization		0.017 **		0.407 *		-1.082 **		-0.876 **
* FO		(10.90)		(2.06)		(-2.71)		(-2.63)
FO	0.001 **	-0.001 **	-0.031 **	-0.048 **	0.031 **	0.076 **	0.024 **	0.061 **
	(5.17)	(-5.30)	(-5.82)	(-6.53)	(4.78)	(5.64)	(4.32)	(5.41)
Bank	0.000	0.000 **	0.009 **	0.014 **	-0.018 **	-0.032 **	-0.015 **	-0.026 **
	(1.36)	(4.08)	(3.20)	(3.40)	(-4.41)	(-4.10)	(-4.32)	(-4.05)
Size	0.012 **	0.007 **	0.501 **	0.565 **	-0.969 **	-1.140 **	-0.801 **	-0.939 **
	(9.85)	(9.53)	(6.63)	(5.35)	(-9.69)	(-6.65)	(-8.94)	(-6.37)
Leverage	0.000	-0.007 **	0.115	-0.063	-0.230	0.243	-0.161	0.223
	(0.02)	(-2.67)	(0.48)	(-0.25)	(-0.89)	(0.75)	(-0.71)	(0.80)
ROA	-0.040 **	-0.022 **	15.510 **	15.350 **	-19.120 **	-18.680 **	-17.550 **	-17.190 **
	(-4.13)	(-3.76)	(10.85)	(10.72)	(-13.78)	(-12.91)	(-14.47)	(-13.61)
Sale Growth	0.005 *	0.006 **	7.152 **	7.259 **	-1.905 **	-2.191 **	-2.187 **	-2.418 **
	(2.16)	(4.38)	(21.51)	(21.35)	(-6.05)	(-6.43)	(-7.50)	(-7.76)
Prior Optimism	0.017 **	0.001 **	-0.546 **	-0.520 **	-0.017	-0.085	0.003	-0.052
	(2.63)	(3.35)	(-9.80)	(-8.67)	(-0.30)	(-1.25)	(0.07)	(-0.85)
Big 4	0.001	0.000	0.235 **	0.251 **	-0.247 **	-0.291 **	-0.180 *	-0.215 *
	(1.58)	(0.06)	(3.32)	(3.46)	(-2.87)	(-2.93)	(-2.36)	(-2.51)
Board	-0.002	0.007 +	-0.493 +	-0.473 +	0.870 *	0.818 *	0.914 **	0.871 *
Independence	(-1.16)	(1.70)	(-1.93)	(-1.81)	(2.53)	(2.08)	(2.98)	(2.53)
Asset	-0.011 **	-0.008 **	-0.158 *	-0.266 **	0.201 *	0.488 **	0.190 *	0.422 **
Turnover	(-6.65)	(-7.46)	(-2.44)	(-2.61)	(2.38)	(2.74)	(2.54)	(2.80)

Industry-adjusted Internationalization	0.030 **	0.011 **										
	(7.44)	(3.60)										
Year	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Number	20610	20610	20610	20610	20610	20610	20610	20610	20610	20610	20610	20610
Adjusted R2	0.516	0.783	0.234	0.219	0.169	0.0338	0.180	0.0781				
F Value	31.77 **	117.2 **	57.38 **	56.14 **	33.75 **	29.56 **	38.81 **	34.69 **				
Under-identification (Anderson LM test)			56.00 **	12.78 **	56.00 **	12.78 **	56.00 **	12.78 **				

Note. Models (1) and (2) show the results for stage (IV). Models (3) to (8) show the results for stage (IV). Standard errors are clustered by firms. t-values are shown in parentheses. See the Appendix for definitions and measurements of the variables.

+ $p < .10$, * $p < .05$, ** $p < .01$

5. Discussion

This study utilizes a unique institutional background to investigate the effect of international diversification on managerial disclosure quality in multinational enterprises (MNEs) in Japan, using a unique institutional background. We find that the disclosure quality of MF tends to be lower in highly internationalized MNEs, which is attributed to the complexity and uncertainties they face. These findings are consistent with those of Duru and Reeb (2002). Additionally, MNEs with greater FI achieve better disclosure, consistent with previous findings that assert that greater FI stakes increase the disclosure quality of MF (Aguilera et al., 2017). With their shareholder-oriented logic, we posit that FI pressure managers to enhance the quality of management disclosures in stakeholder-oriented CG. Our findings are consistent with those of previous studies of Indian MNEs. Chen et al. (2015) find that FI controls effectively increase the disclosure quality of Indian MNEs.

This study makes several theoretical contributions to the literature. First, we examine how internationalization affects managerial disclosure quality under Japan's mandatory MF system in Japan (Aguilera et al., 2017; Kato et al., 2009). Due to the complexity of the increasing geographical diversity of MNEs' investments abroad, the disclosure quality of analysts' forecasts decreases (Duru & Reeb, 2002). During the internationalization process, most Japanese MNEs face accounting gaps between their home and host countries (Sakawa et al., 2021). In other words, Japanese MNEs face complex internationalization, which results in accounting gaps. A higher degree of internationalization increases the accounting gaps between the home and host countries, and the resultant complexity of consolidated financial reporting lowers management disclosure quality.

Second, this study examines how managers are differently pressured by shareholder-oriented FI (Aguilera et al., 2017). In the internationalization process, domestic corporations are required to attract FI who are accustomed to using different national governance logic (Aguilera et al., 2018). FI play an effective monitoring role in stakeholder-oriented CG (Aguilera et al., 2017). They emphasize the compatibility of financial reporting in internationalized Japanese MNEs (Sakawa et al., 2021). Hence, managers of highly internationalized MNEs with high FI enhance their corporations' disclosure quality.

Third, this study contributes to ICG research. From the ICG perspective, the effect of disclosure requirements on MNEs' governance costs is a valuable research topic (Aguilera et al., 2019). When the headquarters of an MNE faces challenges when evaluating the performance of foreign subsidiaries, monitoring costs increase thereby becoming a burden for the MNE (Tomassen & Benito, 2009). The finding that managerial disclosure quality is lower in complex MNEs indicates that MNEs' governance costs are incurred by complexity due to internationalization.

This study has implications for stakeholder-oriented CG based on ICG research (Aguilera et al., 2019). Our findings imply that FI pressure MNE managers to make better disclosures because of their shareholder-oriented logic of FI (Aguilera et al., 2017). Thus, pressure from FI helps enhance the disclosure quality of MNEs in stakeholder-oriented CG.

Our study has several limitations. First, we could not determine how the internationalization affects other aspects of financial reporting, such as accounting conservatism and earnings management. Second, we could not analyze how board members'

expertise or monitoring roles affect managerial disclosure quality in MNEs. After the TSE reforms, we urge the appointment of independent board members with special expertise. Furthermore, FI are likely to appoint directors to large corporations (Schmid & Roedder, 2021). Given this, these findings provide promising avenues for future research.

6. Conclusion

We analyzed the relationship between internationalization and the disclosure quality of mandatory MF in Japanese MNEs from 2007 to 2018. Under the unique setting of mandatory-effective MF systems in Japan, managers must address the benefits and costs of issuing MF. Given the lower legal and litigation costs in Japanese corporations (Kato et al., 2009), managers of Japanese MNEs can benefit from mitigating litigation risks from FI by issuing and revising MF at lower costs. In addition, managers can benefit from the lower costs of external financing from FI by issuing and revising MF. This is because FI favor investing in firms with higher disclosure quality. Considering the benefits and costs for managers of Japanese MNEs, we assume that managers have an incentive to enhance disclosure quality by issuing and revising MF under mandatory-effective MF systems.

Our results imply that internationalization lowers the disclosure quality of MF in Japanese MNEs because of the complexities caused by expanding countries. Furthermore, greater FI result in higher managerial disclosure quality, consistent with previous findings (Aguilera et al., 2017). From an institutional complexity perspective (Arregle et al., 2016), institutional diversity makes management forecasting a complex task for managers of Japanese MNEs. This results in reduced disclosure quality. In addition to compelling managers of Japanese MNEs to make disclosures that suit their needs, FI encourage Japanese MNEs to be financially compatible (Sakawa et al., 2021). Thus, FI contribute to the achievement of higher disclosure quality by internationalized Japanese MNEs.

Our study contributes to academic research and practice on ICG (Aguilera et al., 2019) and accounting research (Aguilera et al., 2021). First, we find that the complexities caused by the internationalization of Japanese MNEs that follow a unique mandatory MF system reduce managerial disclosure quality. In other words, Japanese MNEs that face complexities do not necessarily provide sufficient information to FI. Thus, our study sheds light on the effect of institutional complexity on the MNEs' disclosure quality (Arregle et al., 2016).

Second, we find that the pressure for higher disclosure quality from FI enhances managerial disclosure quality. Thus, we provide evidence on the role of FI in internationalized MNEs related to ICG research. From the perspective of accounting practices in cross-national CG settings, better CG mechanisms are needed to complement reporting quality in MNEs (Aguirela et al., 2021). In our view, pressure from FI is essential to improve disclosure quality in complex MNEs under stakeholder-oriented CG.

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Appendix. Definitions of Variables

Variable	Definition
<i>Forecast Error</i>	$\frac{[\text{Realized earnings for year } t - \text{Initial MF of year } t \text{ earnings}]}{[\text{Total assets at } t - 1 \text{ year-end}]}$
<i>Forecast Accuracy</i>	Absolute value of <i>Forecast Error</i>
<i>Magnitude</i>	$\frac{[\text{Last MF} - \text{Initial MF}]}{[\text{Total assets at } t - 1 \text{ year-end}]}$
<i>Internationalization</i>	The international diversification index (Lu & Beamish, 2004)
<i>FI</i>	Percentage ownership by FI for the year (t-1)
<i>Bank</i>	Percentage ownership by banks and financial institutions for the year (t-1) (Sakawa et al., 2021)
<i>Size</i>	Log of total assets for the year (t-1)
<i>Leverage</i>	Percentage of debt: equity ratio for the year (t-1).
<i>ROA</i>	Net income over total assets
<i>Sale Growth</i>	The change in annual sales scaled by the previous year's sales.
<i>Prior Optimism</i>	A dummy variable that takes the value of 1 if the firm's net earnings were below its initial forecast, and zero otherwise.
<i>Big 4</i>	A dummy variable that takes the value of 1 if the firm is audited by one of the big four auditors, and zero otherwise.
<i>Board Independence</i>	The proportion of outside board members over the total board size
<i>Asset Turnover</i>	A dummy variable that takes the value of 1 if the sales divided by total assets is below the median of the corresponding Tokyo Stock Exchange industry-year, and zero otherwise.
<i>Industry-adjusted Internationalization</i>	The average level of internationalization degree (excluding the contribution of the focal firm) for each industrial sector-size pair, based on total assets.