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Voluntary adoption of International Financial Reporting Standards by large unlisted companies in Portugal – Institutional logics and strategic responses

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ABSTRACT

Common explanations for the voluntary adoption of International Financial Reporting Standards (IFRS) have been based on economic efficiency arguments. This paper introduces new theoretical arguments to explain how institutional pressures influence decisions to adopt IFRS voluntarily. Through recourse to an institutional theory context, we combine the analytical framework proposed by Oliver (1991) with the concept of institutional logics, and apply this framework to the financial accounting field for the first time. This combined model shows how multiple forms of rationality constrain company responses to pressures to adopt a new accounting regime.

We find that companies in a code law country are willing to change from a code-law institutional logic to a common-law institutional logic if they consider such a change will have positive overall benefits to them. Companies assess the net benefits of change after considering the legitimacy they achieve with IFRS, the consistency of IFRS with their goals and institutional context, and the loss of autonomy they believe they are likely to sustain from adopting IFRS. Contrary to predictions in earlier formulations of institutional theory, we find that the acquiescence of companies in adopting IFRS is not a blind response to institutional demands, but is largely predictable by virtue of the inherent nature and importance of such institutional pressures to them. Prevailing institutional logics are shown to provide important insights to the decisions of companies to adopt IFRS voluntarily. We draw on our results to contend that a company's acquiescence to institutional pressures to adopt IFRS occurs notwithstanding that they can also contemplate more active strategies (through decoupling).

Introduction

Globalization of financial and commercial operations has provided strong incentives for the adoption of International Financial Reporting Standards (IFRS) throughout the world. Empirically, the principal motives for adopting IFRS have been explained in terms of a quest for economic efficiency. Here we investigate whether broader motives have been influential too. Our argument is consistent with a more encompassing view that to survive "[o]rganizations need to achieve not only technical, operational efficiency but also social legitimacy" (Abernethy & Chua, 1996, p. 571). To accommodate this broader view, we use an institutional perspective to examine the voluntary adoption of IFRS by companies. We contend that institutional theory can render useful insights in analysis of decisions by com-

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panies to adopt IFRS, by revealing the complexity of their responses to important external pressures and environmental constraints.

In the 1990s many studies investigated the specific characteristics of firms which had adopted non-local GAAP voluntarily – in particular, with respect to decisions to adopt International Accounting Standards, the forerunner to IFRS (Al-Basteki, 1995; Dumontier & Raffournier, 1998; El-Gazzar, Finn, & Jacob, 1999; Murphy, 1999). However, these studies tended not to take account of differing institutional settings. More recent studies of reasons for choosing non-local GAAP have begun to explore the institutional settings in which companies operate (such as the level of legal protection of investors, quality of national accounting standards, development of financial markets, and aspects of legitimacy) (Collin, Tagesson, Andersson, Cato, & Hansson, 2009; Cuijpers & Buijink, 2005; Francis, Khurana, Martin, & Pereira, 2008; Renders & Gaeremynck, 2007; Touron, 2005). This study continues in that vein by invoking an institutional perspective to argue that the adoption of organizational practices is influenced by the institutional environment (Scott, 2001) and by the view of rationality that is inherent in the institutional logics prevailing where organizations are situated (Thornton, Ocasio, & Lounsbury, 2012).

For empirical support, we combine the strategic response model proposed by Oliver (1991) with the concept of institutional logics to examine reasons for the voluntary adoption of IFRS by large Portuguese companies. Consistent with Grafton, Abernethy, and Lillis (2011), we argue that Oliver's model allows us to relax the assumption that organizational choices are driven purely by economic rationality. We extend theory by contending that the strategic behavior of organizations is constrained by a meaning of rationality that is defined by their dominant institutional logics. This argument is used in the context of recent developments in institutional analysis: in particular, to ideas of practice variation and resistance that are grounded in the concept of institutional logics (Lounsbury, 2007, 2008; Marquis & Lounsbury, 2007; Thornton & Ocasio, 2008). Specifically, we seek to better understand why unlisted companies in Portugal decided to adopt IFRS voluntarily, rather than to maintain the [then existing] regime of Portuguese Accounting Standards. In doing so, we analyze how strategic choice of accounting standards is constrained by the institutional logics of large companies, especially regarding the process of accounting harmonization. Our central thesis is that an organization's choice among different accounting standards regimes (that is, different institutional forms) represents a strategic response to institutional pressures; and that such response is constrained by broader taken-for-granted rationales associated with the use of IFRS.

We respond to the call in this journal by Carpenter and Feroz (2001, p. 593) to engage in research that "might be fruitfully directed to investigating Oliver's strategic response model [by] ... incorporating institutional variables in a statistical model of the GAAP decision-making process." Although some of the studies that have used Oliver's (1991) framework have provided supporting evidence (Abernethy & Chua, 1996; Carmona & Macías, 2001; Clemens & Douglas, 2005; Etherington & Richardson, 1994; Goodstein, 1994; Hyvönen, Järvinen, Pellinen, & Rahko, 2009; Ingram & Simons, 1995; Jamali, 2010; Milliken, Martins, & Morgan, 1998; Modell, 2001), Oliver's strategic response model has never been applied in the financial accounting field. Applications of this model in the accounting field have been confined to empirical settings in public organizations like hospitals, universities and other state-owned organizations. In the present study the focus is on private firms and on the financial accounting field. The circumstance of whether or not companies adopt IFRS voluntarily is used as an empirical research setting for the first time to explore Oliver's strategic response model. Such a focus is important because the diffusion of IFRS worldwide has not been a consensual process. Rather, it has been grounded largely in the International Accounting Standards Board's (IASB) vision of international standardization as being primarily to service the needs of investors (Suddaby, Cooper, & Greenwood, 2007). The suitability of applying this vision, and this grounding, to all types of companies, and to all countries has been questioned in numerous studies (Alp & Ustundag, 2009; Chand & Patel, 2008; Irvine, 2008; Mir & Rahaman, 2005). Despite such questioning, large companies have adopted IFRS voluntarily over the years. Accordingly, further understanding of the institutional conditions that have influenced large unlisted companies to adopt IFRS voluntarily is needed. Thus, Oliver's framework is beneficial in facilitating the investigation of how institutional conditions and organizational interests influence the selection of a particular response to pressures to adopt a regime of accounting standards.

This study contributes to the literature in four principal ways. First, we address criticism of institutional theory for downplaying the role of agency and interest in organizational decision processes (Covaleski & Dirsmith, 1988; DiMaggio, 1988; Oliver, 1991; Powell, 1991; Scott, 1987). Oliver's model is an ideal mechanism for addressing such a criticism because of its fundamental theoretical proposition that conformity or resistance by organizations to institutional pressures is a strategic choice affected by organizational interests.

Second, we overcome the much criticized instrumental rationality of Oliver's model (Goodrick & Salancik, 1996; Lounsbury, 2008; Scott, 2001; Seo & Creed, 2002) by incorporating the role of institutional logics in examining the scope conditions under which organizations are willing to respond to institutional pressures. In doing so, we extend theoretical knowledge by considering the institutional logics that constrain organizational decision making.

Third, we extend prior research empirically. Little is known about the institutional conditions that motivate voluntary adoption of IFRS, and how companies respond to those conditions. Despite many arguments advanced to explain voluntary adoption of IFRS, there has been little exploration of the influence of institutional environments on the choice and diffusion of IFRS. Oliver's model is useful in fostering analysis of the predictive institutional factors that influenced the purposive action of large Portuguese unlisted companies in exercising their discretion to select between different regimes of accounting standards. The analysis conducted here should enhance knowledge of the scope conditions that underpin voluntary adoption of IFRS.