Broad vs. narrow sample research in accounting

Discussion of “The Informational Effects of Tightening Oil and Gas Disclosure Rules”
How does this paper fit into the broader literature?

• Main finding: Tighter disclosure rules increase information content

• Similar takeaway from prior papers
  – E.g., Accounting standards (e.g., IFRS over local GAAP), SOX, Regulation Fair Disclosure, Enforcement, etc.

• The sample (setting) in this paper is narrower than most prior studies:
  – Oil and Gas
  – One change in accounting standards
  – Canada and the US (vs. large international sample)
Is this a case study?

• Yes. But that is true for all applied economics studies on the effects of regulation
  • Including EU IFRS, SOX, Reg. FD, and Securities Acts of 1933/34
  • Almost all regulatory changes are unique in some way that prevents us from generalizing to other settings
• We hope there is a broader takeaway from the joint evidence
  • Only true if we use different settings
  • Although we have hundreds of IFRS studies with broadly same takeaway, we are all estimating the effect from the same variation
  • Not clear we learn more from continuing to use the same settings (and therefore the same variation)
The Case for Narrow Samples

• In accounting research we often use broad (sometimes global) samples
  – Arguments are often generalizability or that idiosyncrasies cancel out in large samples
    • This is probably an unrealistic assumption in most broad sample studies
    • How generalizable is IFRS adoption in the EU?
    • Does Euro adoption cancel out because we have 28 EU countries?
  – In narrow samples/settings we can often dig deeper into the institutional details and therefore:
    1. Speak to the role of specific features of regulation (or mechanisms)
    2. Improve identification more generally (often higher internal validity)
Does this paper tell us more about why effects occur?

- The informational effects of bright-line probability thresholds
  - Contrast that to IFRS adoption or SOX (bundles of many changes)

- Policy debate on principles vs. rules
  - Arguments for rules: Less discretion and are easier to enforce
  - Arguments against rules: Easier to circumvent and may limit managers’ ability to convey private information

- Open question: is the net informational effect positive or negative?
  - Of course, results are likely setting specific
  - Is there something special about this setting? Could allow a broader point or limit generalizability
  - This is a baseline result that future researchers can compare to when looking at same question in other settings
    - One paper is rarely enough to settle an important debate
Does this paper have a better identification strategy?

- Main concern in regulatory studies is almost always that regulation is not randomly assigned
  - Parallel trends assumption
- Regulation is often motivated by corporate scandals or other major events
  - E.g., SOX was enacted partly as a response to audit failures
  - Difficult to empirically assess the effect of SOX on audit quality
  - Presumable quality would have improved even without regulation in response to the audit failures
- Is the documented effects caused by the disclosure regulation or what gave rise to the regulatory changes?
  - E.g., Royal Dutch/Shell in January 2004 and the subsequent press coverage

“The business press began questioning the rules on how O&G companies estimated reserves, echoing concerns by industry leaders...”
Arguments in paper

• Argue that staggered implementation helps them and perform several randomizations (dates/firms)
  – Approaches often used in broad sample studies

• But the key question is whether the implementation in Canada (in 2003) and the US (in 2009) are exogenous
  – Staggered implementation does not help if the dates are endogenously selected
  – Randomization of dates does not address the issue because it is the actual dates that are potentially endogenous (not the counterfactual dates)

• We don’t know for sure if this is a valid concern (or how big the issue is)
  – Institutional knowledge can help address it
  – Often easier to address in a narrow sample study than in a broad sample study
How could the authors address this issue?

• Use institutional knowledge to argue and develop tests that provide evidence on this issue.

• Two ways to assess whether it affects the estimates:
  1. Can the authors identify the events that motivated the regulation (e.g., large accounting scandals)?
  2. Is something observable correlated with what we are concerned about but cannot directly observe?

• In narrow sample studies we can dig into the institutional details and often do a better job on this issue than in broad sample studies.
Operationalizing these methods

• Identify key events (e.g., corporate scandals)
  – Separated in time? E.g., 2004 vs. 2009
  – Map out the effect and show us whether they occur at the events that triggered regulation rather than when regulation became effective (tell us what explains the time in between)

• Use observables to gauge selection on unobservables
  – Is something observable correlated with the unobservable concern? Perhaps media coverage or firm size
  – Control for (or match on) observables and see how much the estimated treatment effect changes. Similar to Table 8 (but compare to coefficient without controls)
  – You can potentially quantify the effect as suggested by Oster (2017)

• Ultimately, parallel trends assumption is an assumption
  – Tests based on institutional details can support its validity but never prove it
Main takeaways

• Narrower sample than most prior work: one industry, one major accounting standard change, two countries
  – Advantages:
    • Can speak to why tightening rules have an effect (i.e., clear thresholds)
    • Potentially better identification because we can at relatively low costs gain a good understanding of the institutions

• I hope that more researchers will do narrow sample studies in the future (and that editors will accept them)
  – Single country (not just US)
  – Single industries
  – Non-bundled rule changes