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## **Towards Paradigmatic Pluralism in Applied Accounting Research**

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### **ABSTRACT**

The prevalence of a single paradigm in mainstream accounting research has contributed to the steady accumulation of knowledge; however, we argue that this development has come at the cost of theoretical and empirical narrowness which in turn has kept the accounting discipline and profession blinded from some very important problems. In particular, we consider the impact of this shortcoming with respect to hybrid securities in financial statements. Lastly, we suggest ways to address this shortcoming with greater openness and tolerance to a more synergistic approach to applied accounting research.

**Key Words:** accounting theory, financial reporting, hybrid securities, liability and equity, paradigms, positive theory.

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## 1. Introduction

Up to the 1960s, major trends in accounting research, especially in accounting theory, have had a strong normative focus. With the emergence of the deductivist capital market-based research during the late 1960s, however, the normative disposition has given way to a more positivist or what Burrell and Morgan (1979) refer to as the functionalist paradigm. While there are significant benefits deriving from the continuity of a single dominant paradigm, the lack of pluralism and richness in accounting research presents a unique challenge to its study and practice.

Critics such as Merchant(2010) laments the gradual isolation and eventual exclusion of certain subfields, while Modell(2010) and Malmi(2010) point out the lack of theoretical and empirical sophistication arising from methodological and paradigmatic bias. Lukka(2010) claims that the unidimensionality of accounting research has contributed to a lack of breakthroughs and intellectual diversity, which can only be remedied by greater openness. We would also like to add that the lack of tolerance to new approaches has kept the discipline and the profession blinded from some serious problems.

This is especially true with respect to hybrid securities such as redeemable or trust preferred securities. The lack of a clear classification rule has pushed numerous issuing firms to report these products in the “mezzanine” section, between debt and equity. Such treatment (and the variation in the dividend) not only reduces the usefulness of the financial statement but it violates the traditional dichotomous classification between liability and equity. While firms which engage in these types of practices along with the Financial Accounting Standard Board (FASB, 1984) are partly to blame, we cannot downplay the importance of the epistemic community in this dilemma. The failure to identify problems in accounting practices such as these results in the absence of a clear norm and best practice. What we argue is that this predicament in the accounting profession is due in part to the lack of paradigmatic pluralism in accounting research.

Our discussion begins with the description of the sociological paradigms developed by Burrell and Morgan. We explore how these paradigms inform and relate to accounting research. We will then consider contemporary reporting research and practices with respect to hybrid securities. We suggest how other paradigms can be applied to the representation issues in financial statements. We argue that a more synergistic approach derived from greater tolerance

for intellectual pluralism can provide unique insights about accounting practices with respect to hybrid securities.

## **2. Paradigms From the Difference of the Philosophy of Science and the Theory of Social Science**

Burrell and Morgan (1979) argue that all organizational theories are based on both a philosophy of science and a theory of society. More generally, we can identify four sets of philosophical inquiries, which underwrite different approaches to social science: ontology, epistemology, human nature, and methodology (See Table 1).

Ontology is the assumption about the very essence of the phenomena under investigation. It concerns such questions as whether the ‘reality’ being investigated is external or internal (i.e. cognition) to the individual. Epistemology is the assumption about the grounds of knowledge - how one might begin to understand the world and communicate this understanding as knowledge to fellow human beings. It concerns such questions as what forms of knowledge can be obtained and how one can sort out what is to be regarded as ‘true’ from ‘false’. Notions such as whether the nature of knowledge is hard or soft, real or spiritual, deterministic or existential, and objective or subjective all fall under this heading. Assumptions about human nature is focused on the relationship between human beings and their environment. Human life is the subject and object of inquiry. There are two views with respect to this dimension. The deterministic view suggests that human beings and their experiences are products of the environment (i.e., human beings respond in a deterministic fashion to their environment). Voluntarism puts determinism on its head and suggests that human beings are creators of their environment.

These assumptions have direct methodological implications. Nomothetic methodology treats social science like the sciences of the natural world. Therefore, this methodology is ‘scientific’ (i.e., general and universal laws). Idiographic methodology sees social science as being of a much softer, personal, and more subjective nature. Therefore, this methodology is relatively ‘un-scientific’ (i.e., relative, personal and unique).

**Table 1. The Subjective - Objective Dimension.**

<b>The subjective approach to social science</b>	<b>Underlying assumptions</b>	<b>The objective approach to social science</b>
Nominalism	<b>Ontology</b>	<b>Realism</b>
Anti-positivism	<b>Epistemology</b>	Positivism
Voluntarism	<b>Human nature</b>	Determinism
Idiographic	<b>Methodology</b>	Nomothetic

Another central theme in organization theory is the assumption about the *nature of society*. We have at one end a concern about the underlying unity and cohesiveness of society. At the other end is a concern about modes of domination and structural contradictions in modern society. This view focuses on what is possible rather than what is, and attempts to find alternatives to the status quo through radical change. Table 2 shows the regulation–radical change dimension based on different theories of society.

**Table 2. The Regulation – Radical Change Dimension.**

<b>The sociology of regulation is concerned with</b>	<b>The sociology of radical change is concerned with</b>
The status quo	Radical change
Social order	Structural conflict
Consensus (voluntary & spontaneous)	Modes of domination
Social integration and cohesion	Contradiction
Solidarity	Emancipation
Need satisfaction	Deprivation
Actuality	Potentiality

The above dimensions give way to the four paradigms or views about the social world. For our intents and purposes, paradigms reflect the mode of theorizing in social science. At the most fundamental level, it separates the group of theorists in one paradigm from theorists in other paradigms. Burrell and Morgan (1979) regard the four paradigms as being defined by the very basic

‘meta-theoretical’ assumptions that underwrite the frame of reference (or the mode of theorizing about the subject matter or one’s view of social world). Figure 1 shows four paradigms based on the dichotomy of the two-by-two dimension, that is, the dimension of state of nature and approach to social science.

**Figure1. Four Paradigms for the Analysis of Social Theory.**

*Approach to Social Science*

		Subjective	Objective
<b>State of</b>	Radical Change	<b>Radical Humanist</b>	<b>Radical Structuralist</b>
	Regulation	Interpretive German Idealism	<i>Functionalist</i>

Functionalist paradigm has been the dominant paradigm in mainstream social science and the study of organizations. It is firmly rooted in the sociology of regulation and it approaches the subject matter from an objectivist point of view. The approach applies the models and methods of natural sciences to the study of human affairs under the assumption that the social world is composed of relatively concrete empirical artifacts and relationships which can be identified, studied and measured through approaches derived from the natural sciences. Most importantly, it also assumes that the social facts exist outside of human consciousness and restrain people in their everyday activities.

The interpretive paradigm concerns the understanding of the fundamental nature of the social world at the level of subjective experience within the realm of individual consciousness and subjectivity. The key assumption here is that the social world is an emergent social process. Theorists in this paradigm often delve into the depths of human consciousness and subjectivity in search of meanings that underlie social life. Thus, their standpoint is based on the assumption that the world of human affairs is cohesive, ordered, and integrated. This paradigm is more oriented towards obtaining an understanding of the subjectively created social world ‘as it is.’

The radical humanist paradigm perceives the sociology of radical change from a subjectivist standpoint. It is similar to the interpretive paradigm but it views "change" as necessarily a revolutionary process within an individual's consciousness. Rooted in German idealism, it sees man dominated by ideological superstructures, which create 'false consciousness.' Hence, releasing man from these exploitive structural constraints would require changes in modes of individual cognition and consciousness.

Theorists in the radical structuralist paradigm advocate the sociology of radical change from an objectivist standpoint. It shares the same approach to science as functionalism but towards a different end -- one that is committed to radical change, emancipation and potentiality through an analysis which emphasizes structural conflict, modes of domination, contradiction and deprivation. Radical structuralists, like radical humanists, are preoccupied with the critique of society, but they are not as concerned with 'consciousness.' Instead, they are mostly concerned with the structural relationships within the social world. Some structuralists focus on the deep-seated internal contradictions of social forces, while others focus on the structure and analysis of power relationships. All structuralists believe that society is characterized by fundamental conflicts, which generate radical change through political and economic crises.

### 3. Accounting Theories and Thoughts with Respect to the Paradigms

The four paradigms present vastly different yet broad range of useful approaches to applied accounting research. 'Inter-paradigmatic' journeys are difficult (though not impossible) because paradigm switching calls for a change in 'meta-theoretical' assumptions. Nonetheless, we maintain that a varied approach sheds light on important problems that otherwise would have largely gone ignored. Hence, we hold that it is worthwhile considering the unique contributions of each individual paradigm.

The radical humanists view accounting as a vehicle for human emancipation. To them, accounting should reveal the limitations of existing social arrangements within the capitalist society. Chua (1986-1), for instance, points out that theorists in this tradition see "accounting information" as a form of "social control and as a mediator of conflict" that "has often been obscured (mystified) by powerful, ideological ideas embedded in mainstream thought". This mainstream thought is "false-conscious" in the way accounting is a "neutral" service of accountants who have the "professional" and value-neutral knowledge.

The "New Interpretation" approach can be an illustrative example (Dumenil, 1983/4; Foley, 1986, 2000; Bryer, 2008). We know, for instance, that traditional accounting principles are derived from Irving Fisher's notion of capital as one of the key ingredients of production - the other two being labor (i.e. human capital) and material. A radical humanist, who is sympathetic to the Marxist notion of labor theory of value (LTV), is likely to argue that value is created only through human labor. If we follow this line of reasoning, the current practice of valuing and categorizing assets, liabilities, and equity would have to be rethought and reconstituted in such a way that labor takes precedence over material and capital. Marx has already planted the seed for this work, but there are some interesting contemporary development of this idea, which defines price as the aggregate rate of money value added per hour of productive labor (Dumenil, 1983/4; Foley, 1986, 2000; Bryer, 2008).

In our view, the viability of the New Interpretationist approach depends on the acceptability of the LTV which in turn is conditioned by the general perception of capitalism. To the extent that reality is socially constructed, the question remains as to when and how the perceived notion of the "best" accounting practice can change within the accounting community. Much work remains in this regard, but we believe that the answer to this question may lie in a more interdisciplinary approach to accounting research which takes its cue from the postmodern philosophical traditions of the New Left.

The radical structuralist approach is similar to that of the radical humanist in its pursuit of revolutionary change; however, the former views society and human behavior objectively. An example of this type of approach is historical materialism. Tinker, Merino, and Neimark (1982) insist that "historical materialism shows that theories emerge and decline, not merely in the context of social struggles but as inextricable parts of them".<sup>1</sup> The advocates of this paradigm use accounting to explain the structural relationship between the bourgeoisie and the proletariats. The goal is to reveal fundamental conflicts among class interests which generate radical change through political and economic crises.

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<sup>1</sup> Tinker, Merino, and Neimark (1982) argue that materialism or historical materialism differs fundamentally from realism "in that it recognizes that "theory" may come to form part of the reality that the theory purports to describe". Hopper and Powell (1985) and Chua (1986-1) point out that "the separation of the radical structuralist from the radical humanist paradigm is not well supported within sociology itself, being based on a contentious reading of Marx's argument". Here, materialism and/or historical materialism is classified as radical structuralism, based on the Marx's emphasis of its realistic and scientific characteristics.

While it may be difficult to find accounting theories that belong to this camp, one illustrative example is the set of works explaining the historical transformation leading up to the emergence of capitalism in England during the mid-18th century (Bryer, 2004, 2005; Thompson, 1978). The historical narrative traces the accounting practices of pre-industrial English landlords leading up to, during, and after this period, which suggests that the financial revolution of the 17th and early 18th century set the stage for these landlords to adopt the rate of return on capital mentality. Subsequent outcome was the establishment of the parliamentary enclosure and a sharp hike in rents, which in turn, led to the perpetuation of the capitalist mentality.

Unlike the radical structuralists but similar to the radical humanists, interpretivists see accounting as a construct of human society. For this paradigm, “materiality” in the Conceptual Framework for Financial Reporting (FASB, 1980) is a subjective notion, and “usefulness for decision making” is a relative concept. Chua (1986-1) discusses accounting as the product of language, interpretation, and understanding in social science. Chua (1986-2) also points out that “accounting theories do not just emerge in a natural, rational process of greater development”. Instead, she argues that “there are specific interests, accidents and localized objectives,” which are conducive to “the acceptance of particular constructions” of the accounting model.

There are a number of exemplary works adhering to the principles of interpretivist paradigm in accounting research. Cooper, Hayes, and Wolf (1981), for instance, argue that accounting can be interpreted as language and as legitimization. When “traditional prohibitions in choice behavior against imitation, coercion and rationalization” are relaxed, “accounting systems might be understood both in terms of their impact on sustaining and influencing an organization’s culture and language and in terms of their ideological and legitimizing influence in maintaining systems of power and control in organizations” (Ibid.). Others, like that of Boland (1989) and Shapiro (1997, 1998), also stand to illustrate what we consider to be good examples of research utilizing the interpretive approach.

Until the 1960s, both the interpretive and normative paradigms were quite prevalent in accounting research. However, mounting criticisms have raised some serious questions about these approaches. Mattessich (1995) points out that “the major criticism directed against normative accounting theories, and the reason for their dismissal by many leading accounting researchers during the past decades, lies in the claim that such theories are subjective, hence “unscientific””. He argues, furthermore, that “value judgments, underlying every normative accounting theory, are neither objective nor accessible to empirical refutation or verification”.

Proponents of the alternative functionalist paradigm such as Watts and Zimmerman (1979) also criticize normative accounting theories “because they are used as excuses for political actions.” They posit that the “diversity” of political “positions” and the need for accounting standards to address political needs “prevents general agreement” on a normative “theory of accounting”. Finally, they argue that “the political process creates a demand for accounting theories” which “prescribe[s] rather than describe[s] the world”. Therefore, the normative accounting theories can never explain or “justify all accounting standards” because they lack generality.

The panacea for this endemic was a new mode of research that is more objective, deterministic, and nomothetic. The quick uptake in capital market-based research as well as research focused on the value relevance of accounting information and earnings management have coincided with the emergence of the functionalist paradigm.<sup>2</sup> The impact of this shift was also reflected in the Conceptual Framework as stated in the Concepts Statements No. 2 (FASB,

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<sup>2</sup> Currently, most accounting journals, except for that of “Accounting, Organizations and Society”, do not publish interpretive accounting theories and thoughts.

1980).<sup>3</sup> The Framework spells out the primary accounting qualities of reliability and relevance. The former requires that the accounting information be verifiable, representationally faithful, and neutral. The latter emphasizes the importance of predictive value, feedback value, and timeliness. Together, these qualities embody the foundational principles of the functionalist paradigm which holds that human knowledge should explain and predict outcomes.

The majority of financial accounting research grounded in the functionalist paradigm are quantitative in nature. That is, they use various statistical techniques to test the empirical validity and reliability of existing theories. The philosophical basis of this paradigmatic approach is the Popperian notion of science and falsification. One example of this type of research is positive accounting theory, which is often associated with Watts and Zimmerman.<sup>4</sup> Watts and Zimmerman(1978, 1979, 1990) state that positive accounting theory emphasizes “accounting theory’s role” in explaining and predicting “accounting practice”.<sup>5</sup> They “adopted the label “positive” from economics where it was used to distinguish research aimed at explanation and prediction from research whose objective was prescription”, i.e., various normative theories of accounting (Watts and Zimmerman, 1990).

Positivism is not without critics of its own. Cristenson (1983), for instance, points out that logical positivism is already refuted by the majority of contemporary philosophy. Watts and Zimmerman's (1979, 1990) response is that they used the term “positive” in order to distinguish positive propositions from extant normative propositions in the literature. Therefore,

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<sup>3</sup> The point here is that the FASB adopted these measures when the functionalism emerged as the dominant paradigm in accounting research. FASB issued Concept Statements No. 8 (2010) which revised the aforementioned qualities in the Conceptual Framework as follows: fundamental qualitative characteristics are relevance and faithful representation. In order to be relevant, information should have qualities of predictive value, confirmatory (feedback) value, and materiality. In order to be faithful representation, information should be complete, free from material error, and neutral. FASB categorize verifiability and timeliness as enhancing qualitative characteristics.

<sup>4</sup> Watts and Zimmerman (1978, 1979, 1990) point out that before the publication of their 1978, 1979 papers, positive accounting theory was early introduced by others such as Gordon (1964) and Gordon et al. (1966).

<sup>5</sup> As Watts and Zimmerman (1990) point out, positive accounting theory has two mutually exclusive sets: one “concerning research methods” and the other “concerning methodology (including philosophy of science)”. Their 1978 paper mainly focus on methods, whereas their 1979 focus on methodology. This paper excludes the issues that are related to their methods.

their positive accounting theory does not mean to represent the philosophy of obsolete logical positivism (Jensen, 1983). Chambers (1993) argues that the movement of “positive accounting” toward “scientific, empirical, economics based” researches or studies is a “cult”. He points out each component of the movements has problems which conflict with the directions or pursuits of positivist accounting, which cannot be easily solved. Chambers (1993) and Tinker et al. (1982) also point out that positive accounting theory is value-laden, i.e., it cannot be neutral. Watts and Zimmerman's (1990) response is that “the usefulness of positive accounting theories depends on their predictive and explanatory power and on the user’s preference or objective function” to the extent that the “researcher’s values” do not “interfere with the theory’s ability to predict and explain.”

As they predicted, current accounting research is dominated by scientific, empirical, and economics-based theory and methods. A broad survey of the literature related to capital markets research in accounting (Kothari, 2001), valuation-based accounting (Barth, 2000) and value relevance for financial accounting standard setting (Holthausen and Watts, 2001), all suggest similar trends. However, some questions remain: is Watts and Zimmerman (1990) correct? Is positive accounting theory most useful with respect to its ability to predict and explain outcomes? Can we do one better than the positive accounting theories? If so, what kind of approach is preferable to the existing mainstream accounting research programs which strictly adheres to the principles of functionalism?

First and foremost, we would like to point out that the application of the scientific method in mainstream accounting research (or any social scientific inquiry) does not require extensive overdependence on large-n quantitative data. In fact, there is ample evidence to suggest that a carefully designed small-n qualitative analyses can follow the same logic and yield similar results as large-n quantitative research (King, Keohane, and Verba, 1994). Conversely, we do not argue in favor of small-n qualitative research for the sake of this approach. Instead, what we propose is that the research be driven by the nature of the inquiry rather than the availability of data. Hence, if the nature of the inquiry is such that it requires large-n analysis, then we propose that it be supported by such analysis; if not, then thick, rich, descriptive studies would be more appropriate. In an ideal world, we should be able to address the inquiry using the full arsenal of the methods available to the researcher at hand.

Secondly, strict adherence to the deductivist logic can be detrimental to theoretical development in the sense that it distances the theory from the data. While the two criteria to judge the theory's "usefulness" may be explanation and prediction, we cannot ignore the

importance of the theory's accuracy in describing the real world (i.e. external validity). This, we argue, is largely due to the fact that the theory exists within the real world context. That is, the failure to consider the connection between the theory and the real world can potentially result in wrongful application. Hence, we would like to propose that future accounting research also move to not only be "useful" but also be an accurate depiction of the real world.

Most importantly, we maintain that Burrell and Morgan's (1979) typology of paradigms need not be mutually exclusive. Instead, we propose a more pragmatic approach which considers the possibility for synergy among two or more paradigms. Take for instance Cooper and Sherer's (1984) "political economy of accounting" approach. According to Cooper and Sherer (1984), the political economy approach is "normative, descriptive, and critical" thereby potentially embodying all four of Burrell and Morgan's (1979) paradigms. Another example can be found in the application of behavioral economics in accounting. In general, behavioral economics problematizes one of the crucial assumptions in neoclassical economics about the rationality of individuals in the marketplace. This research program has yielded some fascinating results which shows how and when individuals may deviate from the neoclassical assumptions. While the experimental accounting approach does not completely discount the role of rationality in economic decision-making, it does leave the door open for the possibility that subjectivity and individual perception can influence outcomes in the marketplace. In this sense, we consider experimental accounting research as a mixture of the functionalist and interpretivist paradigms.

While experimental accounting has many promises as an emerging subfield, we are not rooting for a particular type of synergy or combinations of paradigms. Instead, what we are proposing is a greater degree of paradigmatic pluralism in accounting research. We are most certainly arguing against the limiting influence that each paradigm has with respect to the kinds of inquiry we can have. The limitations can be found in the assumptions or the method that each paradigm espouses. In the next section, we consider how the synergistic approach to hybrid securities can shed light on important problems that otherwise would not have been possible without a broader inter-paradigmatic approach.

#### **4. Representation Issues for Hybrid Securities in Financial Statements**

With the introduction of hybrid securities, the distinction between equity and debt has been complicated. Firms have issued mandatory redeemable preferred securities with a

determinable maturity. Companies have also issued convertible bonds with conversion features that allow bond investors to convert their bonds into stocks. Some firms represent these in the “mezzanine” section of the balance sheet, between debt and equity. Others report these as debt, or as equity. Utility industries even report these as unclassified under the heading of capitalization. In cases for which we cannot give a clear classification criterion with respect to the debt and equity dichotomy, we lose the quality of comparability due to the lack of unified classification.

Furthermore, one can either treat the payments to investors as expenses before (or net of) tax, or classify it as dividend after tax. Earnings estimate will be different under these two treatments. This may create some ambiguity in income determination. Alternatively, mezzanine treatment may serve a useful purpose, in that it provides a category that distinguishes hybrid securities from those that are pure equity or debt.

There are many possible explanations as to why firms might resort to issuing hybrid securities. Most explanations are based on the functionalist basis about the deterministic nature of rational individuals in the marketplace driven largely by the profit-maximizing motive. For instance, corporate entities are able to minimize their cost of capital by making debt securities more attractive with an equity feature. Financial reporting is another possible explanation. Firms could make their capital structure look sound since they do not have to report preferred securities as debt in the financial statements. Firms may use hybrid securities as an indirect form of equity financing when the conventional stock issue is unattractive due to adverse-selection under informational asymmetry (Stein, 1992). Nair, Rittenberg, and Weygandt (1990) recommend that preferred stocks with debt features such as mandatory redemption be treated as a liability and that the payments be treated as expenses. The logical basis for this treatment rests on the belief that trust preferred stocks are debts and payments are interest expenses.

Tax deductibility provides another motivation in that periodic payments can be treated as interest expenses. Frischmann, Kimmel and Warfield (1999) find that financial reporting, tax and regulatory incentives are motivations for issuing trust preferred stock. They investigate trust preferred stock, with respect to the reporting effects of three different types of trends. A brief description of the structure of trust preferred stock issuance is as follows: a parent company sets up a subsidiary that issues trust preferred stocks to investors. Then proceeds from the issue are loaned to the parent company. The interest paid to the subsidiary is tax-deductible. The loan from the subsidiary to the parent is not shown in the balance sheet and only the preferred stocks issued to the investors are reported.

Engel, Erickson, and Maydew (1999) exploit the features of trust preferred stock to examine the extent to which firms will incur costs to manage the balance sheet classification of a security, to which investor-level taxation imposes implicit taxes on securities, and study the magnitude of net tax benefits, if any, associated with leverage-increasing capital structure decisions. They argue that favorable capital structure associated with issuing trust preferred stocks and retiring debt, and the tax advantages associated with these actions are important to issuing firms.

Fooladi, McGraw, and Roberts (1991) also show that preferred stock is not necessarily a bond with a tax disadvantage. As long as a corporate tax rate is not too high, firms are willing to issue preferred stocks since there is a strong demand. This demand is caused by the fact that firms can get tax advantages on the dividends received from domestic corporations. Thomas and Sellers (1992) summarize the impact of the classification of hybrid securities on corporate taxation and suggest many alternative methods (factor approach, market value appraisal, present value, and statistical analysis) for implementing bifurcation.

Classification of the hybrid securities is critical for relevance and reliability of the accounting information. This in turn, impacts the user's decision making. The most important users will be investors, because of the effect that the accounting information will have on the stock market. Therefore, it is important to examine how stock markets respond to the different reporting classification of the hybrid securities. Barh (2000) suggests two primary reasons why accounting research often uses a valuation approach to address financial reporting questions. One of the reasons is that the “investors are primarily interested in information that can help them assess the value of the firm for the purposes of making informed choices”, thus, “valuation is the key input to and a key output of investors’ decisions”. Several studies examine the relevance and reliability of issued financial instruments fair value estimates, including the investor’s response to the issuance the reporting of hybrid securities. Value relevance can be explained by stating that if accounting information is value-relevant, the accounting information users can get aid in their decision-making.

Hopkins (1996) reports that a lower stock price for the issuing firm is predicted when firms offer mandatory redeemable preferred stocks classified as equity compared to debt. However, the analyst judgments may not necessarily be reflected in a real market setting. Lee, Jin, and Jung (2010) provide the empirical study that shows the stock market’s response in terms of the stock price to the issue of the redeemable and trust preferred securities. Their study shows that the announcement return for firms issuing redeemable or

trust preferred stock with the classification of debt or mezzanine is greater than those firms with equity classification. Market investors also value the tax advantage from issuing preferred stocks. Irvine and Rosenfeld (2000) find that replacing outstanding preferred stocks with monthly income preferred stocks (MIPS) has a positive impact on the value of the firm. Since MIPS is equity with a tax advantage, issuing MIPS increases the present value of tax savings without affecting the firm's capital structure.

Negative stock price reactions around announcement dates of equity issuance can be explained in the context of models using adverse selection. Myers and Majluf (1984) provide a rationale for this adverse-selection problem, arguing that managers, who know more than outside investors, use their superior information to benefit existing shareholders at the expense of new shareholders. Therefore, the announcement of an equity offering is regarded as less favorable than the announcement of a debt offering.

Mikkelson and Partch(1986) document that the announcements of equity offerings convey the message that the firm is overvalued. Many studies that examine announcement-period reactions surrounding equity offerings provide support for these hypotheses. Mikkelson and Partch (1986) report significantly negative event-window returns to equity offering announcements. Asquith and Mullins (1986) report negative two-day announcement period return to equity offering announcements. In addition, Mikkelson and Partch (1986) and Eckbo (1986) also report negative but insignificant abnormal market reaction to the announcement of straight debt offerings.

Preferred stocks have characteristics of both equity and debt and firms may issue preferred stocks to circumvent the negative effect of equity issue to the firm value. Mikkelson and Partch (1986) also report insignificant event-window returns to preferred stock offering announcements. Considering that preferred stocks are a relative compromise between equity and straight debt, it is understandable that the announcement-window stock price reaction to preferred stock offerings is less negative when compared to equity offerings. Kimmel and Warfield (1995) also report that the extent to which redeemable preferred stocks affect the financial risk of the firm (in turn, the systematic risk of common stocks) is not the same as debt. They further find that the preferred stocks without voting rights and convertibility features do not exhibit the systematic risk in the manner common stocks do.

All the studies above with respect to preferred stocks or hybrid securities try to show the relationships among the organizational or human behavior, as well as other factors such as capital markets, price movement, etc. They see these things as existing outside of human

consciousness, and people's intentions and/or interactions can be explained and reasonably expected. In effect, they seek to find universal laws that explain the relations of the human behavior in the accounting or finance area. In particular, all of these studies work under the assumption of the general principle that the individual firms or investors are motivated by the rational calculus of profit maximization. While this may be true of some individuals in the marketplace, there is mounting evidence to question this belief.

In particular, findings from behavioral economics or experimental methods suggest that factors unrelated to profit-motive, such as psychological outlook or culture play a critical role in influencing individual behavior in the marketplace with respect to securities (Rode, Fischhoff and Fischhbeck, 2000; Shiller, 2005; Lee, O'Brien and Sivaramakrishnan, 2008). This obviously does not mean that we should discount the notion of rational decision-making in the marketplace altogether; however, it does suggest a strong need for problematizing or even loosening this assumption to encompass other possible explanations about how individuals interact with the environment that they are in. Most importantly, it also suggests an approach that considers the possibility of allowing the explanation to emerge from the observed data (i.e. induction) rather than simply confirming the logically reasoned desk-explanation be falsified by the data (i.e. deduction). However, studies that utilize this type of approach are rare in research associated with hybrid securities.

This is not to suggest a complete absence of all alternatives to functionalism in research about hybrid securities. Take Nair, Larry, and Weygandt (1990) for instance, which integrates a more normative approach to their work grounded in functionalism. They make a strong recommendation to the effect that standard setters in regulating hybrid securities "should" classify mandatorily redeemable preferred stocks which have debt features as a liability and that the payments be treated as interest expenses, when practitioners follow the Generally Accepted Accounting Principles (GAAP). While Weygandt et al. (1993) and Nair, et al. (1990) are responding to various standard setters (i.e. FASB and SEC) who are concerned about the general social welfare, what these examples show is the direct recognition that social scientific inquiry need not necessarily be restricted to simple explanation and prediction but also be expanded to accurate description and application.

## **5. Concluding Remarks**

Burrell and Morgan (1979) have suggested four paradigms in the study of society and organizations. Their typology seems to work well in depicting the different approaches to accounting research. However, our survey of the mainstream accounting literature has shown a strong disposition for only one of the four paradigms (i.e. functionalism). We have suggested a need for moving beyond this trend. What our discussion has shown is a possible way forward for the future of accounting research that tries to take the thinking outside of the proverbial "box". In particular, what we suggest is a more synergistic approach between two or more of these paradigms. While this may be difficult in theory, what our discussion has shown is that it is possible and could already be well under way in other areas of accounting research (e.g. management accounting research). We have also shown through our discussion of research and findings on hybrid securitization some evidence and possibilities for the materialization of this synergy. In effect, what we propose is a need for greater degree of pluralism in the paradigmatic approaches to accounting research that will allow for greater theoretical breakthroughs and empirical developments.

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