A Comparison of the Financial Characteristics of U.S. and U.K. Manufacturing Firms

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In this paper, we compare the financial characteristics of U.S. and U.K. manufacturing firms with the MANOVA (Multivariate Analysis of Variance) methodology using data from the Research Insight/Global Vintage database. Our findings indicate that U.S. firms have more liquidity compared with U.K. firms. This implies that U.S. firms have less technical insolvency risk compared with their U.K. counterparts. We find that U.K. firms have more efficient use of inventories and fixed assets compared with U.S. firms. However, U.S. firms have more efficient collection of accounts receivable compared with U.K. firms. Net profit margin is higher in U.S. firms than in U.K. firms. Since firms cannot raise prices to increase the profit margin in competitive markets, this finding implies that U.S. firms have lower manufacturing costs compared with their U.K. counterparts.

Introduction

Comparing the financial characteristics of different groups of firms has long been a popular research methodology in finance. A popular research topic has been predicting bankruptcy by comparing the financial characteristics of bankrupt and non-bankrupt firms. Altman (1968), Deakin (1972), Moyer (1977), Dambolena and Khoury (1980) and Zhang et al. (2014) find significant differences in the financial characteristics of bankrupt and non-bankrupt firms. Bankrupt firms tend to have poorer liquidity, lower turnover ratios, lower profitability and higher financial leverage compared with non-bankrupt firms prior to bankruptcy.

Stevens (1973), Belkaoui (1978), Rege (1984) and Meric et al. (1991) identify the financial characteristics of firms that have been takeover targets by comparing them with firms that have not been takeover targets. They find significant differences in the financial characteristics of target and non-target firms. Target firms have poorer asset management and lower profitability and leverage ratios compared with non-target firms. Additionally, target firms have an active market for corporate assets and close to 7% of plants change ownership annually. Maximovic and Phillips (2001) find that the probability of assets sales and whole-firm transactions is related to firm organization and ex ante efficiency of buyers and sellers. Masulis et al. (2007) examine whether corporate governance mechanisms affect the profitability of firm acquisitions. They find that acquirers with more antitakeover provisions experience significantly lower announcement-period abnormal stock returns.

Hutchinson et al. (1988) identify the financial characteristics of small firms that achieve stock market quotation by comparing them with similar size firms that do not have stock market quotation in the U.K. stock market. They find that small firms that achieve stock market quotation have higher growth rates, they use more debt financing and they invest less in liquid assets compared with similar size firms that do not have stock market quotation. In a recent study, Uygur et al. (2015) compare the financial characteristics of firms with most and least losses in the 1987 and 2008 stock market crashes. They find that firms with high debt ratios (high bankruptcy risk) and those with a high stock beta (higher market risk) lost most value in these stock market crashes.

A number of studies compare the financial characteristics of firms in different countries. Kester (1986) compares the capital structure of U.S. and Japanese corporations. He finds that, while a significant country difference exists when leverage is measured on book value basis, there is no significant country difference in market-value leverage between U.S. and Japanese manufacturing corporations after controlling for characteristics such as growth, profitability, risk, size and industry classification. Wald (1999) examines the factors correlated with capital structure in France, Germany, Japan, the U.K. and the U.S. He finds differences in the correlation between long-term debt/assets ratios and the firms' riskiness, profitability, size and growth.

Meric and Meric (1994) compare the financial characteristics of U.S. and Japanese manufacturing firms. They find that Japanese manufacturing firms have significantly higher accounts receivable turnover, inventory turnover and fixed assets turnover ratios compared with U.S. manufacturing firms. However, U.S. manufacturing firms have significantly higher cash turnover, market-value return on equity ratios and interest cost/total debt ratios compared with Japanese manufacturing firms. In a recent study, Folkinsteyn et al. (2014) find significant differences between the financial characteristics of U.K. and German manufacturing firms. They find that U.S. manufacturing firms have higher liquidity and profitability ratios and lower debt and total assets turnover ratios compared with their German counterparts.

After Germany, the U.K. is the second largest economy and the second largest trading partner of the U.S. in the EU. However, there are no studies that compare the financial characteristics of U.S. and U.K. manufacturing firms. The objective of this paper is to undertake such a study. Comparing the financial characteristics of U.S. and U.K. manufacturing firms can provide valuable insights for the financial managers in these countries and for the global investors who invest in these countries.

Meric and Meric (1994) find that Japanese manufacturing firms have significantly higher inventory turnover ratios compared with U.S. manufacturing firms. In this study, we also find that U.K. manufacturing firms have significantly higher inventory turnover ratios compared with U.S. manufacturing firms. These results imply that U.S. financial managers

could improve their inventory management efficiency to become more competitive vis-à-vis their Japanese and U.K. counterparts. On the other hand, Meric and Meric (1994) find that Japanese manufacturing firms have lower returns-on-equity, and in this study we find that U.K. firms have lower net profit margins compared with U.S. manufacturing firms. These results indicate that U.S. manufacturing firms are more profitable. Further, they may be better investment prospects for global investors compared with Japanese and U.K. manufacturing firms given the fact that financial risk is not significantly different in U.S. manufacturing firms versus Japanese and U.K. manufacturing firms because Japanese and U.K. have similar debt ratios.

A Comparison of U.S. and U.K. Economies

The CIA World Factbook (2015) describes the U.S. "as the most technologically powerful economy in the world with a per capita GDP of $54,800."[1] Yet, in this same year, 2014, China's economy gained the top spot when evaluated on a purchasing power basis. This change illustrates the economic evolution and challenges facing established economies such as the U.S. and U.K. and the need to examine some of the underlying factors that contribute to economic success. Francis, Huang, Khurana and Pereira (2009) studied 37 manufacturing industries in 37 countries and found "contemporaneous correlations in industry growth rates across country pairs are higher when there is a greater level of corporate transparency in the country pairs, after controlling for country-level economic and financial development" (abstract, paragraph one). They also found stronger correlations for country pairs with similar levels of economic development. The paper noted the reasonably high correlation in industry growth rates between the U.S. and U.K., which is explained by their similar level of economic and financial development. The decline in manufacturing and movement toward other economic sectors over an extended period of time has been impacting the nature of work, educational needs of these countries and the relative wealth of their populations as globalization begins to change the world economic order. With significant manufacturing now spread

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[1] Data source: https://www.cia.gov/library/publications/the-world-factbook/ . All yearly numbers above are based on 2014 estimates.

throughout Asia and emerging countries, U.S. and U.K. manufacturers should be seeking a better understanding of the characteristics of their firms with the hope of identifying new ways to better succeed.

The relationship between the U.S. and U.K. is well developed from the foundations of their social and economic systems. The U.S. economy of almost $17.5 trillion is substantially higher than that of the roughly $2.5 trillion U.K. economy. U.K. per capita of $37,700 is well below the U.S. figure noted previously ($54,800). High household consumption as well as similar government consumption and investment in fixed capital are indicative of overall GDP composition. U.S. exports of goods and services at 13.4% are less than half the U.K. 28.4%. Imports of the U.S. at -16.4% are well below the -30.3% for the U.K. As a trading partner with the U.S., the U.K. exports and imports 8.8% and 5.6%, respectively.

Both the U.S. and U.K. are world financial centers. The U.K. is the third largest economy in Europe. Real U.K. GDP growth is expected to be 3.2% in 2014, substantially above the 1.7% in 2013. U.S. GDP growth is expected at 2.4%, slightly above the 2.2% from the previous year.

A Comparison of U.S. and U.K. Accounting Systems

Although the U.S. Securities and Exchange Commission (SEC) has the legal authority, via the Securities Act of 1934, to determine U.S. accounting rules, much of their development has been delegated to the private sector Financial Accounting Standards Board (FASB). These standards, better known in the U.S. as Generally Accepted Accounting Principles (GAAP), are recognized as high quality and satisfy the needs of many stakeholders, including investors and creditors. Still, the foundations of accounting structured in accordance with the FASB's conceptual framework and a due process set of procedures ensure that accounting meets the objectives of financial reporting. Bushman and Smith (2003) note that financial accounting systems supply information about investment opportunities that managers and others rely upon for acquisitions or strategic innovations. The use of measures, such as profit margins, are cited within this context as well as the overall value that accounting systems and related governance bring to the credibility and accountability necessary for fully functioning securities markets. They cite Guenther and Young's

(2000) findings of an association between aggregate return on assets and growth in GDP, which were high in both the U.S. and U.K. Bushman, Piotroski and Smith (2004), in studying corporate transparency, found the governance transparency factor most related to a country's legal/judicial regime while financial transparency related most to their political economy. The authors noted these results varied across countries and that governance transparency was higher in countries with a common law legal origin and high judicial efficiency. Also of note was the higher financial transparency in countries with low state ownership of enterprises and banks and a low risk of state expropriation of firm assets. The close historical relationship of U.S. and U.K. legal and economic systems signifies the high levels of governance and financial transparency of each country's financial systems. Business scandals in the early 2000s brought needed regulatory reforms to the U.S. in the form of the Sarbanes-Oxley Act. In general the size and scope of the U.S. financial system influences world markets, and high quality accounting is instrumental in that status.

U.K. accounting standards are now the responsibility of the Financial Reporting Council. U.K. accounting generally follows the principles developed by the International Accounting Standards Board (IASB), with some specific differences. Those standards, known as International Financial Reporting Standards (IFRS), are principles based and have been required by U.K. firms and other members of the European Union since 2005. IFRS reflect the efforts for the EU, as well as a significant portion of the world, to use high quality accounting principles and are sometimes contrasted with U.S. GAAP, which are more rules based. The trend toward one set of worldwide accounting principles has been embraced by many in finance. That goal for a time was leading to a convergence of U.S. and IFRS, with both the FASB and IASB jointly developing new accounting principles. At one point it looked like U.S. firms would be adopting IFRS in their U.S. securities filings. This movement stalled before that objective was met, and it now looks far less likely to occur. However, U.S. policymakers still seeking improvements in their financial reporting and, with a respect for the IASB and their opinions, continue to develop U.S. GAAP with an eye toward worldwide reporting needs. Evidence of U.S. acceptance of IFRS is reflected by the fact that since 2007 foreign firms listing on U.S. exchanges are not required to provide reconciliations with U.S. GAAP if they followed

IFRS in their financial statement preparation. While differences between U.S. GAAP and IFRS exist, these have been lessened to a degree by the period of convergence of many accounting issues. The fact that both U.S. and U.K. standards involve professional judgment, and even firms within each respective country have some alternative choices of assumptions and principles, makes comparisons less than perfect for analysts. However, while the potential exists for differences in some reporting areas, a research report by Smith (2014) prepared for the Institute of Management Accountants (IMA) notes that "while there are some notable differences between IFRS and U.S. GAAP, differences between these two sets of accounting standards do not lead to significant overall differences"(2).[2] References to one of these differences, the use of Last In First Out (LIFO) for inventory valuation, is addressed in the results in our study noted later in this paper. While other often cited differences, such as the treatment of research and development, may seem potentially significant because U.S. GAAP (which requires immediate expensing for all of R&D with the exception of software development costs) differs from IFRS (which allows capitalization for development costs if certain conditions are met), Danielson and Press (2005) studied potential R&D adjustments and found that "unadjusted ROA and adjusted ROA typically rank firm profitability in a similar order. Thus, unadjusted ROA is a reasonable proxy for a firm's underlying economic profitability in many research applications, and complex adjustment procedures are often unnecessary" (90). This is consistent with Smith's findings noted earlier.

New U.K. accounting standards continuing to be based primarily on IFRS and emphasizing reduced disclosures and more flexibility were scheduled for implementation in 2015.

Methodology and Data

Multiple Discriminant Analysis (MDA) (see Altman 1968, Stevens 1973 and Belkaoui 1978) and Multivariate Analysis of Variance-MANOVA

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[2] For a more detailed discussion than above of U.S. and international financial reporting, please see *Financial Reporting and Analysis* by Revsine et al, 2015. For a discussion of the conceptual frameworks for U.S. and international accounting as well as differences between U.S. and U.K. accounting standards, please see *International Accounting* by Doupnik and Perera, 2015.

(see Hutchinson et al. 1988, Meric et al., 1991, Folkishteyn et al. 2014 and Uygur et al. 2015) are two multivariate techniques most commonly used in previous studies to compare the financial characteristics of different groups of firms. In this study, we use the MANOVA technique to compare the financial characteristics of U.S. and U.K. manufacturing firms. Detailed information about the MANOVA methodology can be found in Marascuilo and Levin (1983) and Johnson and Wichern (2007).

In general, financial ratios are used in empirical studies to compare the financial characteristics of different groups of firms. The financial ratios used in this study were obtained from the Research Insight/Global Vintage database. The ratios were computed with data taken from the 2013 year-end financial statements of the firms. Manufacturing industries with SIC codes 2000-3999 are included in the study. Our research sample consists of 782 U.S. and 241 U.K. manufacturing firms. We use the financial ratios presented in Table 1 for the comparisons of the financial characteristics of U.S. and U.K. manufacturing firms.

TABLE 1

Financial Ratios Used in the Study as Measures of Firm Financial Characteristics

Financial Ratio Name	Financial Ratio Definition
Liquidity	
Current Ratio (CR)	Current Assets / Current Liabilities
Quick Ratio (QR)	(Current Assets - Inventories) / Current Liabilities
Asset Management (Turnover) Ratios	
Average Collection Period (ACP)	Average Number of Days to Collect Accounts Receivable
Inventory Turnover (INT)	Sales / Inventory
Fixed Assets Turnover (FAT)	Sales / Net Fixed Assets
Total Assets Turnover (TAT)	Sales / Total Assets
Financial Leverage	
Equity Ratio (ER)	Common Equity/Total Liabilities
Profitability	
Net Profit Margin (NPM)	Net Income / Sales
Operating Profit Margin (OPM)	Operating Income / Sales
Return on Assets (ROA)	Net Income / Total Assets
Return on Equity (ROE)	Net Income / Common Equity

Empirical Findings

Our MANOVA test results are presented in Table 2. The multivariate test statistics in the table indicate that the overall financial characteristics of U.S. and U.K manufacturing firms are significantly different at the 1% level. The univariate test statistics indicate that the liquidity and asset management (turnover) ratios of U.S. and U.K. manufacturing firms are significantly different.

TABLE 2
MANOVA Statistics: U.S. vs. U.K.
† The figures in parentheses are the standard deviations.
**, * indicate that the difference is significant at the 1% and 5% levels, respectively.

Financial Ratios	Means and Standard Deviations †		Univariate Statistics	
	U.S.	U.K.	F Value	P Value
Liquidity				
Current Ratio (CR)	3.099	2.207	42.942**	0.000
	(1.867)	(1.777)		
Quick Ratio (QR)	2.016	1.507	20.128**	0.000
	(1.531)	(1.576)		
Asset Management (Turnover) Ratios				
Average Collect. Period (ACP)	52.27	69.58	87.286**	0.000
	(20.32)	(36.67)		
Inventory Turnover (INT)	5.236	7.415	22.306**	0.000
	(3.715)	(11.040)		
Fixed Assets Turnover (FAT)	7.745	14.36	33.318**	0.000
	(6.488)	(29.88)		
Total Assets Turnover (TAT)	1.054	1.047	0.035	0.852
	(0.522)	(0.501)		
Financial Leverage				
Equity Ratio (ER)	2.004	1.881	0.674	0.412
	(2.105)	(1.805)		
Profitability				
Net Profit Margin (NPM)	5.533%	3.890%	5.009*	0.025
	(9.094%)	(12.37%)		
Return on Assets (ROA)	4.857%	4.072%	1.861	0.173
	(7.564%)	(8.552%)		
Return on Equity (ROE)	9.758%	8.295%	1.650	0.199
	(15.04%)	(16.72%)		
Multivariate Statistics:			**23.419****	**0.000**

LIQUIDITY

Both liquidity ratios are significantly higher in U.S. manufacturing firms than in U.K. manufacturing firms at the 1% level. These results indicate that U.S. firms have less technical insolvency risk (i.e., U.S. firms are better able to meet their maturing obligations) compared with U.K. firms.

The LIFO inventory method is prohibited in the U.K. under IFRS. However, U.S. firms are allowed to use LIFO under U.S. GAAP. Therefore, the use of LIFO understates balance sheet inventory figures and the current ratio in U.S. firms that use LIFO. Despite this, we find the mean current ratio figure to be significantly higher in U.S. firms than in U.K. firms (i.e., the fact that U.K. firms cannot use LIFO but U.S. firms can strengthens our empirical finding regarding liquidity as measured by the current ratio).

ASSET MANAGEMENT

The inventory turnover and fixed asset turnover ratios are significantly higher in U.K. manufacturing firms than in U.S. manufacturing firms at the 1% level. This implies that U.K. firms have more efficient use of inventories and fixed assets compared with U.S. firms. However, U.S. firms appear to be more efficient in the collection of accounts receivable compared with U.K. firms. U.S. average collection period is significantly shorter than U.K. average collection period at the 1% level. The U.S. and U.K total assets turnover ratios are not significantly different.

Our inventory turnover statistics for U.S. and U.K. firms are taken from the Research Insight/Global Vintage database. This database calculates inventory turnover as the ratio of sales (rather than cost of sales) to inventories. Our finding regarding inventory turnover can be considered to be even more significant given the fact that the use of LIFO is allowed for U.S. firms and produces a lower ending inventory and higher cost of goods sold than that provided under First in First Out (FIFO). Despite the fact that U.S. firms using LIFO would tend to have higher inventory turnover, we find that the mean inventory turnover ratio is significantly higher in U.K. firms than in U.S. firms.

FINANCIAL LEVERAGE SUB, SUB-TITLE FONT

The univariate test statistics indicate that U.S. and U.K. total equity/total liabilities ratios are not significantly different. This implies that manufacturing firms in the two countries have similar financial risk (i.e., bankruptcy risk).

PROFITABILITY

The univariate test statistics indicate that the net profit margin ratio is significantly higher in U.S. manufacturing firms than in U.K. manufacturing firms. In competitive markets, it is difficult for firms to charge higher prices to their customers to increase their profit margin. Therefore, the higher net profit margin in U.S. firms is likely to be the result of lower manufacturing costs in U.S. firms compared with U.K. firms.

The use of LIFO in some U.S. firms would tend to raise the cost of goods sold and lower the profit margin in those firms whereas the use of FIFO in U.K. firms would tend to understate the cost of goods sold and overstate the profit margin. However, despite that, we find the mean profit margin to be significantly higher in U.S. manufacturing firms than in U.K. manufacturing firms (i.e., the fact that some U.S. firms use LIFO and U.K. firms use FIFO strengthens our empirical finding in this study regarding the profit margin).

Summary and Conclusion

Comparing the financial characteristics of firms in different countries has been a popular research topic in finance. However, financial characteristics of U.S. and U.K. manufacturing firms have not been compared in previous studies. In this paper, we undertake such a study. Our MANOVA test statistics indicate that the overall financial characteristics of U.S. and U.K. manufacturing firms are significantly different. Most significant differences are in terms of liquidity and asset management ratios.

U.S. manufacturing firms have significantly higher liquidity levels compared with U.K. manufacturing firms. This finding implies that U.S. firms have less technical insolvency risk (i.e., U.S. firms are better able to meet their maturing obligations) compared with U.K. firms. However, our finding related to financial leverage indicates that U.S. and U.K. manufacturing firms have similar financial risk (i.e., bankruptcy risk).

Our finding related to inventory turnover indicates that U.K. manufacturing firms have more efficient use of inventories compared with their U.S. counterparts. This finding may be the result of greater adherence to JIT (Just-in-Time) inventory methods in U.K. manufacturing firms as

well as greater efficiencies in supply chain management, which allows for less reliance on inventory buildup relative to sales. We also find that U.K. manufacturing firms have a significantly higher fixed assets turnover compared with U.S. manufacturing firms.

U.S. manufacturing firms appear to have more efficient collection of their accounts receivable compared with U.K. manufacturing firms. Net profit margin is also significantly higher in U.S. manufacturing firms than in U.K. manufacturing firms. In competitive markets, it is difficult for firms to charge higher prices to their customers for their products to increase their profit margin. Therefore, the higher net profit margin in U.S. manufacturing firms is likely to be the result of U.S. firms' achieving lower manufacturing costs compared with their U.K. counterparts. One reason for that may be higher labor costs due to stronger labor unions in the U.K.

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Company Board and Earnings Quality Pre- and Post-IFRS: Evidence from France and the U.K.

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This paper studies whether mandatory International Financial Reporting Standards (IFRS) adoption affects the effectiveness of a company board. We opt for board independence, audit committee and remuneration committee as characteristics of company board. The sample includes France, which had national accounting standards divergent from IFRS, and the U.K., which had national accounting standards close to IFRS. We expect that corporate board is more effective in limiting earnings management and in improving earnings relevance following IFRS adoption in France and not in the U.K. The results of the research confirm our prediction, revealing that IFRS increases the effectiveness of corporate board, measured by its ability to improve earnings quality, in the French context. However, in the U.K. context, no significant difference is observed in company board's effectiveness between IFRS and the U.K. Generally Accepted Accounting Principles (UK-GAAP).

Introduction

Capital markets have become increasingly integrated. Thus, to achieve comparability and harmonization of their accounting standards, and even to adopt a common set of reporting standards, all listed companies

in the European Union (EU) have been required to prepare their financial statements in accordance with International Financial Reporting Standards (IFRS) as of 2005. The mandatory adoption of IFRS in the EU represents one of the largest regulatory experiments ever undertaken (Christensen, Lee and Walker 2007). Since then, IFRS have become the most widely accepted financial accounting guidelines in major capital markets of the world, and many countries have adopted them, have permitted their use or have initiated an IFRS harmonization program (Liang and Shan 2013). The degree and timing of the adoption of IFRS vary due to countries' differences in culture, technology and natural resources (Ramanna and Sletten 2009).

As high-quality accounting standards, IFRS require a high level of disclosure, which reduces informational asymmetry and ensures greater transparency (Barth, Konchitchki and Landsman 2013). Several accounting studies have examined the consequences of IFRS adoption, but the results remain inconclusive. Many of these studies have reported an improvement on earnings quality after moving toward IFRS. They find that IFRS firms exhibit less earnings management, less earnings smoothness, more timely recognition of losses and greater value relevance. (See Chua, Cheong and Gould 2012; Liang and Shan 2013; Nouri and Abaoub 2014 and Daske 2006). Landsman, Maydew and Thornock (2012) confirm that IFRS adoption increases information content through reducing reporting lag. Other researchers also document many capital market benefits of IFRS adoption. They have concluded that IFRS reduce the cost of capital, improve market liquidity and equity valuations, encourage international investments, increase analyst following and reduce analyst forecast dispersion. (See Daske, Hail, Leuz and Verdi 2008; Cormier 2014 and Landsman et al. 2012). In contrast, other researchers argue that IFRS adoption has no effect on earnings quality or that it even decreases earnings quality (Atwood, Drake, Myers and Myers 2011; Tsalavoutas, André and Evans 2012 and Devalle, Onali and Magarini 2010).

Most researchers studying IFRS application confirm that IFRS enhance earnings quality, but only for firms with good governance (Cormier 2014 and Zéghal, Chtourou and Sellami 2011). Chen and Rezaee (2012) provide empirical evidence that corporate governance helps companies to be more aligned with IFRS and thus provide high quality financial information.