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Management accounting and corporate governance: An institutional interpretation of the agency problem

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Abstract

Challenging the dominant economic agency theory of corporate governance with a new discourse drawn from institutional theory, the paper analyses how management accounting is implicated in corporate governance. The proposed institutional theory of agency links the micro-institutions of the organization that are informed by the practices of management accounting with external institutional players and stakeholders. The paper identifies emerging narratives in which the management accounting profession has recognised a distinctive, post-Enron set of sensibilities. Although techniques drawn from strategic management accounting can be adapted to embed better corporate governance practices, the institutional theory of agency identifies tensions between the heroic CEO narrative and the routinization of strategy implicit in strategic management accounting.

Keywords: Management accounting; Corporate governance; Agency; Institutional theory

1. Introduction

A relatively obscure concept with narrow legalistic connotations even a few years ago, *corporate governance* is now being applied to a whole range of areas such as economic organization, corporate strategy, information technology and corporate social responsibility. But what are the disciplines that should be concerned with corporate governance? In the case of Enron, issues of financial reporting and auditing were clearly in the spotlight. But as the scandal unfolded, it became clear that bankers and investment analysts were also implicated in the scam. Enron and other scandals challenged academics in financial accounting, finance and banking to re-examine their own roles in advocating theories that seemed

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to be part of the deception. Effective corporate governance seemed to be based on myths propagated by practitioners and academics—the myth of auditor independence; the myth of "Chinese walls" in corporate banks and, especially, the myth of "efficient" capital markets (Gordon, 2002).

More unusually, this paper contends that many practices commonly associated with *management accounting* are, and certainly should be, implicated in corporate governance. The paper will argue that, without absolving auditors and regulators of their responsibilities as *external* monitors, good corporate governance additionally requires that appropriate internal reporting and monitoring practices are embedded in organizations. Secondly, whilst the customary sharp distinction between financial and management accounting has a useful pedagogical and academic role, it cannot always be maintained in the practice of organizational accounting. Thirdly, the paper will argue that many of the anxieties about a loss of professional control over the techniques of management accounting (Scapens et al., 2003) may be countered if the profession responds by emphasising its independence rather than subservience to senior management.

In advocating an institutional approach to corporate governance, the paper is arguably truer to the tradition of Berle and Means (1932) than the managerialist and agency theories which trace their origins to that seminal work. For although they famously pointed out that the control of the corporation is in the hands of senior managers while ownership is dispersed among thousands, even millions of shareholders, Berle and Means (1932) seemed more concerned about *potential* rather than *established* abuses. For example, in the case of potential abuses, such as the 'routing of income', Berle and Means argued that 'both the investment market, the business community, and the good sense of those in control will demand conformity to a reasonable standard in this regard' (1932, p. 204). With their emphasis on conformance to reasonable norms, Berle and Means implicitly adopted an essentially *institutionalist* approach to corporate governance which has got lost in the subsequent development of managerialist and economic agency theories (see, e.g., Baumol, 1959; Marris, 1964; Williamson, 1964; Williamson, 1975, 1985; Jensen and Meckling, 1976; Dowd, 1992; Shleifer and Vishny, 1997).

Returning to the original spirit of Berle and Means (1932), the paper proposes an institutional theory of agency[1] (ITA). The ITA may be defined as the analysis of managerial behaviour in giant, widely owned corporations where managerial action is influenced by institutionalized practices that affect share valuation, corporate reporting and, as an integral feature of internal governance, management accounting. The ITA accepts that managers are agents with delegated decision-making powers but rejects the realist ontologies that underpin economic agency theory (EAT). From an institutionalist perspective, EAT is under-socialized (Granovetter, 1985, 1992; Pollitt, 1993) because it assumes an inherent human nature typified by Homo Oeconomicus, a self-regarding, individual utility maximizer. In sociologically informed institutional theory, by contrast, humans are characterized by an organic "world-openness" where human nature is socially constructed and shaped by routines and shared typifications (Berger and Luckmann, 1967). Thus, in contrast to EAT, the ITA does not assume that the managers' actions are determined by a combination of human nature and natural economic forces but rather that managerial behaviour has been influenced and legitimized by the dominant discourse of corporate governance—neoclassical agency theory (Shleifer and Vishny, 1997). In the ITA, managers are agents with authority delegated from the legal owners of the corporations but their intentions are influenced by legitimacy, routines, scripts and

[1] The term 'agency' has different meanings. In the ITA proposed in this paper, the primary meaning is taken from the *economic* agency where the agent is someone who has been given delegated decision-making responsibility. But as economic agency theory is a theory of interests, the ITA also has to address the more *sociologically informed*, 'structure/agency' issue.