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.

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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 (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

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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.
other cognitive phenomena. Crucially, as Powell and DiMaggio put it, ‘(I)nstitutions do not just constrain options; they establish the very criteria by which people discover their preferences (1991, p. 11).

The ITA addresses a number of theoretical and ontological deficiencies in the corporate governance and management accounting literatures. In particular, the ITA avoids both the under-socialization of EAT and the under-developed theory of motivation that can be seen with over-socialized approaches (Granovetter, 1992; Mouritsen et al., 2002). Furthermore, building on the recent institutional theories in the management accounting literature (see, e.g., Scapens, 1994; Burns and Scapens, 2000; Dillard et al., 2004), the ITA links the taken-for-granted, routine character of organizational accounting with external institutional influences.

The paper develops the analysis of agency relationships through a variation of institutional theory informed by a narrative perspective (Czarniawska, 1997; Barry and Elmes, 1997; Llewellyn, 1999; Elliot, 2005). To Czarniawska, narrative is ‘the constitutive action mode, a type of action constituting actors, fields, and action nets’ (1997, p. 180, original emphasis). Well-known institutionalist concepts, such as the organizational field, are delineated by their typical genres (combinations of characters, modes of narration, and rhetorical conventions) which consequently limit the possible repertoire and the plots’ (Czarniawska, 1997, p. 180, original emphasis). The great advantage of this translation from physical to cultural artefact is that it enables an analysis of the ‘interplay between intentionality and field forces’ (Czarniawska, 1997, p. 188) that are at the core of the ITA. An analysis of the narratives told in particular organizational fields fosters an understanding of institutionalization ‘…whereby practices expected in various social settings are developed and learned’ (Dillard et al., 2004, p. 508).

Although as pessimistic as others (see, e.g., Erturk et al., 2003) about current attempts to regulate corporate governance, the paper argues that, since they are socially constructed, institutionalized practices in and around the giant corporation may be influenced through the production of alternative discourses. The paper identifies an emerging narrative in which the management accounting profession has recognised a distinctive, post-Enron set of sensibilities.2 This narrative does not propose new techniques but suggests that practices commonly associated with strategic management accounting can be adapted to improve board governance.

The paper proceeds as follows. In the next section, the ITA is developed through adapting a narrative approach to institutional theory. The approach is then applied to critically review two narratives; the corporate governance narrative and the relevance lost and found narrative. The concluding sections of the paper argue that a post-Enron convergence between these two narratives has potential implications for future developments in management accounting and corporate governance.

2. Institutions, routines and the production of local narratives

The ITA accepts the basic insight of EAT that in large corporations with dispersed shareholdings, the owners have an agency relationship with their managers characterized by conflicts of interest and asymmetries in information (Ricketts, 1987, p. 40). In the ITA, the problem is seen as “how can the managers be controlled?” rather than the more usual one in managing accounting, “how can managers control their subordinates?” While EAT proposes that managers may be controlled by aligning managers’

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2 As will be argued later, some of these sensibilities are themselves informed by fresh regulatory initiatives such as the Sarbanes–Oxley Act.
interests with those of shareholders through appropriate contractual arrangements, from an ITA perspective, contract is but one approach to the agency issue. Thus, although the ITA acknowledges that the contractual model based on EAT is a discourse that has affected corporate governance practice in areas such as the design of long term incentive packages (Zajac and Westphal, 1995), it rejects the naturalizing tendencies of EAT. Adopting a constructivist stance, the ITA is informed by New Institutional Sociology (NIS). Powell and DiMaggio argue that NIS draws on Garfinkel’s theory of how ‘social order . . . does not derive automatically from shared patterns of evaluation and social roles, but is constituted, as practical activity, in the course of everyday interaction’ (1991, p. 20). Actors draw on tacit background knowledge and cognitive typifications to help them establish ‘a mutual impression of intersubjectivity’ (Powell and DiMaggio, 1991, p. 20).

In the specific context of corporate governance, an ITA discourse can only successfully challenge EAT if it can match the latter’s “theory of interests” (shareholder versus managers, managers versus debtholders and so on). One way that an ITA can remain true to the basic tenets of NIS but also accommodate issues of motivation is to extend NIS by adopting a narrative approach. Hinchman and Hinchman define narratives as ‘discourses with a clear sequential order that connects events in a meaningful way for a definite audience and thus offer insights about the world and/or people’s experiences of it.’ (Hinchman and Hinchman, 1997, p. xvi). According to Elliot (2005), narratives are chronological, meaningful and social, that is, produced for a specific audience. The significance of the narrative version of institutionalism is that it introduces ‘the role of emotions and aesthetic experiences, not as complementary processes but as inseparable aspects of any act of cognition . . .’ (Czarniawska, 1997, p. 194). According to Czarniawska (1997), conflicts of interest give meaning to narratives by providing both actors and researchers with plots. Similarly, goals are portrayed as devices that organize narratives. Fig. 1 shows how a narrative perspective extends NIS to accommodate the intentionality of EAT without reverting to the more political perspective of the “old institutionalism” (Powell and DiMaggio, 1991).

2.1. Institutional and rational theories in the construction of a persuasive narrative

What role does narrative play in institutionalization? Or putting the issue more generally, what is the relationship between discourse and institutions? Phillips et al. (2004) propose the following step-by-step approach:

We first investigate the discursive effects of action. If actions affect discourse through the production of texts, then the critical questions are which types of actions are more likely to produce texts that leave meaningful traces, and which texts are more likely to influence discourses? We then assess the institutional effects of discourse. If discourses affect action through the production of institutions, then the critical question becomes which forms of discourse are most likely to produce institutions? (2004, p. 640).

In narrative thinking, the discourses most likely to produce institutions in domains such as corporate governance and management accounting will have distinctive literary qualities (Czarniawska, 1997; Barry

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3 As will be shown later, another way of accommodating power and interests in a social version of agency theory is to adopt a structurationist perspective (Armstrong, 1991). See also the discussion in Seo and Creed (2002).

4 Given the emphasis on aesthetics in narrative approaches, the adjective “persuasive” is probably more suitable than the adjective “convincing”. See Norreklit (2003) for an interesting analysis of the two adjectives in the context of the balanced scorecard literature.
Successful narratives, whether produced by researchers or by organizational actors, have coherent plots where temporal events are linked by causality and communicated to specific audiences via a collaboratively produced process of evaluation (Elliot, 2005). For example, Barry and Elmes argue that, given the interplay between text, author and reader, corporate strategists employ a range of devices such as ‘(M)ateriality, voice, perspective, ordering, setting and readership targeting...’ (1997, p. 435). Readership targeting is based around the identification and construction of “Model Readers”. For example, as a consequence of professionalization and education, managers are exposed to a range of models and coded techniques with their familiar three letter acronyms (TQM, ABC, EVA, and so on).

Elliot distinguishes between second-order narratives which are ‘accounts we may construct as researchers to make sense of the social world’ and first-order narratives which are ‘stories that individuals tell about themselves and their own experiences’ (2005, p. 12). Yet the distinction between first and second order narratives becomes less clear with the decline of the grand narrative and the rise of the local narrative (Lyotard, 1984). Alvesson and Deetz argue that ‘the loss of grand integrative narratives has not been missed by management groups’ and suggest that ‘corporate “visions” and “cultures” are strategic local narrative constructions...’ (Alvesson and Deetz, 2005, p. 91).

In the ITA, strategic local narratives are constructed by actors such as senior managers, consultants and academics who draw on meanings and causal relationships already supplied by rationalist and institutional theories. In some respects, rational and institutional perspectives produce contrasting local narratives with respect to change and strategizing. According to Czarniawska, the ‘rational model promotes change, promotes the illusion of controllability’... whilst the ‘institutional response is that the change only

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### Table: Different approaches to common themes in institutional theory

<table>
<thead>
<tr>
<th>Theme</th>
<th>Old</th>
<th>New</th>
<th>Narrative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conflict of interest</td>
<td>Central</td>
<td>Peripheral</td>
<td>Important type of plot</td>
</tr>
<tr>
<td>Organization embedded in</td>
<td>Local community</td>
<td>Field, sector, society</td>
<td>Field/ institutional thought structure</td>
</tr>
<tr>
<td>Locus of institutionalization</td>
<td>Organization</td>
<td>Field, sector or society</td>
<td>Action nets</td>
</tr>
<tr>
<td>Key forms of cognition</td>
<td>Values, norms, attitudes</td>
<td>Classifications, routines, scripts</td>
<td>Narratives</td>
</tr>
<tr>
<td>Cognitive basis of order</td>
<td>Commitment</td>
<td>Habit, practical action</td>
<td>Accessible repertoire of textual strategies</td>
</tr>
<tr>
<td>Goals</td>
<td>Displaced</td>
<td>Ambiguous</td>
<td>Devices organizing narratives</td>
</tr>
</tbody>
</table>

Fig. 1. Different approaches to common themes in institutional theory (adapted from Czarniawska, 1997, pp. 193–194).
happens within frames permitted by the institutionalist thought structure. . . ’ (1997, p. 192). Yet although institutions are usually identified as negating change, some researchers have pointed out that strategic action is only possible because of the prior existence of institutions. For example, Beckert argues that, given the chronic uncertainty of market capitalism, ‘(I)nstitutions reduce uncertainty by creating expectations in the behaviour of others’ (1999, p. 782).

2.2. The CEO as destroyer and creator of institutions

In the ITA, the paradoxical relationship between institutionalization and rationalist arguments may be illustrated through an analysis of an important local narrative—the CEO as destroyer and creator of institutions. In the EAT discourse, the CEO is portrayed as an over mighty actor who may at worst be corrupt, possibly reckless and, more systematically, overpaid (Erturk et al., 2003) who needs to contained by the other members of the board (Dailly et al., 2003). Yet in the popular business literature, there is an alternative discourse which has created a more positive image of the CEO through the skilful construction of a CEO narrative.

From a literary perspective, a good narrative favours leadership stories with the CEO portrayed as having unique, even heroic qualities. But how can an heroic CEO hero be constructed when, as Schumpeter (1943) recognised, ‘...capitalist civilization is rationalistic and “anti-heroic” (p. 127)? In his account of what he called ‘plausible capitalism’, Schumpeter identified a capitalist hero in the character of the entrepreneur. Schumpeter described the special qualities of the entrepreneur as follows:

To act with confidence beyond the range of familiar beacons and to overcome that resistance requires aptitudes that are present in only a small faction of the population and that define the entrepreneurial type as well as the entrepreneurial function. This function does not consist in either inventing anything or otherwise creating the conditions which the enterprise exploits. It consists of getting things done’ (1943, p. 132).

As an entrepreneur, the CEO battles against resistance to change. Yet as a manager, the CEO sets up new routines and institutionalized practices (Beckert, 1999) offering at least an illusion of control. The ideal CEO narrative thus constructs an exceptional, hyper-active individual who struggles against the odds as both a creator and a destroyer of institutions and routines.5 The dual entrepreneur/manager narrative possesses additional aesthetic appeal because it can combine familiarity with the novelty. Routines are, by definition, expected but dull while novelties, also by definition, are exciting but possibly unrealistic (Barry and Elmes, 1997; Llewellyn, 1999).

An excellent example of a good business story may be found in the story of the transformation of Sears which depended on the determination of CEO Martinez to push through a new performance management system (Rucci et al., 1998). Although it has been criticised from a narrative perspective (Gabriel, 2000; Boje, 2001; Collins and Rainwater, 2003), the Sears story has the successful qualities highlighted by Llewellyn who argues that:

In accounting and management research the goal-directed romantic plot holds immediate appeal, it depicts steady progression towards a pre-defined objective, hence, it has lots of scope for heroes (or managers) who make decisive and successful interventions and it has a happy ending (1999, p.226).

5 Schumpeter coined the memorable phrase to describe capitalist change as ‘creative destruction’ (1943, p. 83).
From an ITA perspective, the heroic CEO narrative is probably most important in terms of legitimizing, the huge multiples of CEO pay relative to average employees (Erturk et al., 2003). The repetition of CEO narratives in the business and popular press operate at an almost subliminal level by naturalizing the notion that CEOs are rare individuals. At a more direct level, the myth of the exceptional individual may be mobilized to inform proxy statements made by companies seeking to justify the notion that high remuneration is required to ‘attract and retain scarce managerial talent...’ (Zajac and Westphal, 1995, p. 285).

In the ITA, the narrative of the CEO offers a particular type of discursive closure by legitimating ‘dominant forms of organizational reality...’ (Mumby, 1987, p. 113). Mumby (1987) illustrates this political/ideological aspect of narrative through a story about an occasion when Thomas Watson Jr., the then chairman of IBM, was challenged by a very junior employee for not wearing the required badge for security purposes. Surrounded by an entourage of “white-shirted” men and apparently too grand to personally respond to the challenge, Watson nevertheless demonstrates that he is as subject to the organization rules as any other member of IBM. As Mumby points out, the detail about the employee (physically small, a “bride” separated from her husband who is serving overseas) is contrasted with the lack of detail about Watson which enhances ‘his status as an almost mythical character’ (1987, p. 123). Mumby argues that the IBM story does not just reify Watson-as-hero but demonstrates ‘rules as having an importance all their own, independent of the function that they perform within the organization’ (1987, p. 123).

In contrast to the CEO narrative, management accounting offers a far more prosaic narrative of rational, calculating and, above all, routinized behaviour. Applying the logic of the organizational narrative to the ITA, the CEO as the agent of shareholders is both enabled and constrained by the rule systems of management accounting. The constraining effect of management accounting can operate at different levels of the organization. As will be argued later, although the CEO narrative may sit cosily with some aspects of management accounting routine such as budgeting and product costing, it may be in conflict with attempts to routinize (and thus de-mythologize) the production of corporate strategy.

To summarize thus far, the interdependencies between institutional theory, narrative methods and rationalist theories are illustrated in Fig. 2 as a circular flow of relations. The persuasive CEO narrative claims the heroic mantle of the Schumpeterian entrepreneur as well as offering a least an imitation of control via the espousal of new managerial routines. In the next section, an examination of some key narrative themes in the management accounting and corporate governance literatures demonstrates how an ITA can be developed. The ITA can then be mobilized to inform and evaluate the possibilities of new roles and practices for management accounting in corporate governance.

3. The convergence of the relevance lost and found and the accounting and governability narratives

This section analyses the convergence between two historical narratives, relevance lost and found and accounting and governability. Until quite recently, these two narratives progressed along separate, parallel paths. But building on the notion that changing historical contingencies can lead to the production of new text (Boje, 2001), it is argued that the political and regulatory fall-out from some high profile corporate narratives...
scandals has disrupted the parallel progress of the two narratives and prompted fresh narratives based on a resurgent governance role for management accounting. The narratives discussed are mainly secondary narratives that impact at the level of the organizational field and as such are concerned not with the new regulations *per se* but with how players at this level, such as consultants, academics and professional accounting bodies ‘develop positions, guidelines and interpretations as to how the regulations should and/or could be implemented within certain industries and by certain types of companies’ (Dillard et al., 2004, p. 516).

3.1. Narrative one: relevance lost and found

The first narrative, *relevance lost and found*, requires only a brief description as not only is it very familiar to management accounting readers but it has already been analysed from a narrative perspective (Llewellyn, 1999). Introducing the four main types of plot (the *romance*; the *comedy*; the *tragedy*; and the *satire*), Llewellyn (1999) argues that much of the mainstream accounting and management literatures are romantic stories about heroic quests for better cost control or “Searches for excellence”.

Thus, *relevance lost* (Johnson and Kaplan, 1987) is a combination of tragic and comic plots with some possibilities for a happy ending realised in later publications such as *relevance regained* (Johnson, 1992) and *cost and effect* (Kaplan and Cooper, 1998).

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7 *The goal* (Goldratt and Fox, 1993) is a particularly famous and overt example of the use of the narrative in the management literature. The theory of constraints is explained and espoused though the medium of a novel written in the style of a “business thriller”.
The “relevance” lost and regained in the narrative clearly relates to value creation. By evading the tricky question of the *appropriation of value*, the narrative avoids confronting alternative views on relevance which might vary between managers, shareholders and other stakeholders. However, by arguing that, after 1900, the development of cost accounting had been driven by financial reporting imperatives (at the expense of decision relevance), J&K implicitly recognise the important role of accounting in corporate governance. But they also seem to hope that capital market efficiency will resolve conflicts between the goal of shareholder wealth maximisation and the goal of good financial stewardship. For example, J&K argue that ‘it is hard to believe that a focus on creating wealth by clever financing and rearrangement of ownership claims will help companies survive in the global competition of the 1980s and beyond’ (1987, p. 201). Yet their faith in capital markets seems less robust when they lament that ‘recent emphasis on achieving short-term earnings performance is occurring just at the time when such performance has become a far less valid indicator of changes in the company’s long-term competitive position’ (1987, p. 202).

While the strengths and weaknesses of J&K thesis may be a matter for academic debate, the sheer size of the academic and practitioner response to the relevance lost and found theme suggests that they have produced a highly influential narrative. Indeed, as will be argued below, their fundamental argument that management accounting is primarily concerned with wealth creation has until recently almost completely dominated the mainstream management accounting discourse.

### 3.2. Narrative two: accounting and governability

When governability is discussed in the management accounting literature, it is usually associated with a Foucauldian perspective with an emphasis on the control of junior managers and workers (see, e.g., Miller and O’Leary, 1987). Indeed, the Foucauldian view of accounting seems either to neglect, or to exaggerate, the governability of senior managers. If managers are disciplined by the all-pervasive power of accounting, then how can accounting researchers explain corporate scandals such as Enron and Shell? Even more problematically, how can accounting apparently be both the source of, and the solution to, corporate governance problems? The social constructivist interpretation of accounting’s governance role can sometimes seem to be contradictory. On the one hand, accounting is implicated in the construction of the free-wheeling, self-regarding model of economic man that is taken as a given state of nature in EAT. Indeed, some accounting academics argue that as an important institutional mechanism by which economic man is constructed, accounting is ‘influential in defining positions, reporting exchanges, allocating resources, and thus shaping actors’ identification of their interests’ (Jones and Dugdale, 2001, p. 38). Others have argued that management accounting contributes to the process of individualization within the organization (Roberts, 2001; Scapens et al., 2003; Lambert and Sponem, 2005).

On the other hand, individuals in organizations are deemed to be governed through the disciplinary effects of accounting, which ‘are to be discerned in those who are ‘subject’ to the visibility that it creates and the constant surveillance that it makes possible’ (Roberts, 2001, p. 1553). Management accounting information provides a long range visibility where ‘its representations of organizational activity in the form of departmental budgets and cost and profit centres, organizes the content and process of routine

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8 For example, in a recent review of Foucauldian research in management accounting, Cowton and Dopson (2002) argue that subordinate managerial work is made visible to top management but they do not claim that the latter are made visible to external suppliers of capital.
accountability through comparisons of individual performance with budget, one department with another, and one accounting period with another’ (Roberts, 2001, p. 1553). In this disciplinary view of accounting, ‘(W)hilst the occasional sacking or take-over reinforces this for everyone, most of the disciplinary effects are realised, in anticipation, within the self’ (Roberts, 2001, p. 1530).

Paradoxically for a mainstream theoretical approach, EAT can generate a far more sceptical, even critical, view of the motivation and controllability of senior corporate management. Given the logic of the rational self-interested individual, it is perhaps not surprising that the EAT literature focuses less on the heroic CEO than on designing mechanisms to reduce “shirking” (Zajac and Westphal, 1995), managerial discretion (Williamson, 1964) or the appropriation corporate surpluses (Dowd, 1992). Modelling the managerially controlled firm using neoclassical micro-theory has produced theories where managers pursue sales growth (Baumol, 1959), asset growth (Marris, 1964), and managerial discretion and perks (Williamson, 1964). Even though later work argued that proprietorial influence can still be strong (Nyman and Silberston, 1978); that shares are now held by institutional investors who could also exert an ownership interest; or that there is a market for control (Manne, 1965), orthodox economic theory has coalesced around the agency interpretation of corporate governance posing the following questions:

...How do the suppliers of finance get managers to return some of the profits to them? How do they make sure that managers do not steal the capital they supply or invest in bad projects? How do suppliers of finance control managers? (Shleifer and Vishny, 1997, p. 737).

In the agency literature (Holmstrom, 1979), corporate governance is seen as an issue of optimal contracts and the interaction between incentives and monitoring (such as accounting and auditing). But as Shleifer and Vishny (1997) show in their review of the corporate governance literature (supplemented with their own consultancy experiences in Russia), the opportunities for managers to misbehave seem immense when set against the various mechanisms suggested for controlling them. In particular, the proposed solution to agency problems based on incentive compatible contracts seems unconvincing, both theoretically and empirically.

Although the potential literature and number of narratives relating to corporate governance is vast, Armstrong’s (1991) paper is especially pertinent as it offers both an appreciation and a critique of EAT and the governance role of accounting. Armstrong dismisses the contracting solution proposed by EAT, arguing that ‘...there is no method of constructing reliable agency relationships out of the building blocks of self-interest... Whatever ingenious pattern of self-interest is set up within the agency relationship, agents and monitors can always increase their utilities by conspiring to defraud or otherwise dispossess the principal, and share out the proceeds’ (1991, p. 13). Yet he is also critical of social theories of control that seem to suggest that top management can be made governable in the same way as lower level employees arguing that:

It is difficult to see how any theory which sees capitalist priorities imported into organizations solely through the thought processes of managers could adequately theorize the limits which are placed on these, and on the policies arising from them...it is necessary to take account of the manner in which managerial interests are structured (Armstrong, 1991, p. 7).

Developing a social version of agency theory that builds on the motivational model of EAT but broadens agency costs to include a dividend of control, Armstrong argues that owners accept that high levels managerial compensation and perquisites are the inevitable costs of delegated decision-making because it enables the ‘deliberate cultivation of trust as a means of controlling the employment relationship’ (1991,
p. 14). In narrative terms, Armstrong’s social theory of agency has a surprisingly romantic plot where the solution to governance problems lies in the cultivation of trust between senior managers and the suppliers of capital. Less happily, more that a decade on from the publication of his paper, not only do US and UK CEOs receive 50, 100 or even 400 times the pay of their lowest paid worker but the inequality between executive and ordinary worker pay is increasing (Erturk et al., 2003).

Such an observation is not intended to belittle Armstrong’s contribution but rather it emphasises that historical narratives, unlike fictional narratives, are inevitably “open-ended” (Elliot, 2005). It also suggests that the field of corporate governance can host a number of narratives. One puzzle is that although EAT dominates the corporate governance discourse, the full logic of the approach has only partly affected practice. For example, although there is evidence that companies have drawn on EAT to justify the form of long term incentive plans (Zajac and Westphal, 1995), the substance of the compensation packages is easier to relate to the CEO myth.

3.3. The convergence of narratives

On the premise that actions and changing historical contingencies affect discourse and the production of text (Boje, 2001; Phillips et al., 2004), the two parallel narratives are shown in Fig. 3 as converging

<table>
<thead>
<tr>
<th>Corporate governance narratives</th>
<th>Relevant lost and found narratives (Johnson &amp; Kaplan, 1987)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Berle &amp; Means - separation of ownership and control published in 1932- some institutional restraints on abuses</td>
<td>Main management accounting techniques established by 1925</td>
</tr>
<tr>
<td>Baumol (1959) - beginning of managerialist theory of the firm</td>
<td>Economics of information</td>
</tr>
<tr>
<td>Morris (1964)</td>
<td>Agency theory</td>
</tr>
<tr>
<td>Williamson (1964)</td>
<td>Cost management to cost accounting</td>
</tr>
<tr>
<td>Agency theory</td>
<td>Publication of Relevance Lost (1987)</td>
</tr>
<tr>
<td>Increasing need for monitoring</td>
<td>ABC, BSC, TQM, BPR, EVA...</td>
</tr>
<tr>
<td>Publication of Sathe’s works (1982; 1983)</td>
<td>Relevance regained?</td>
</tr>
<tr>
<td>Armstrong (1991)</td>
<td>Strategic management accounting</td>
</tr>
<tr>
<td>CEO as hero</td>
<td>Board performance measurement/ Strategic management accounting</td>
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Fig. 3. The two narrative model.
around the time of the end of millennium stock market crash. The disruption of orthodoxy is captured by Gordon’s interpretation of the Enron case as follows:

...the Enron situation challenges some of the core beliefs and practices that have underpinned academic analysis of corporate law and governance, including mergers and acquisitions, since the 1980s. These amount to an interlocking set of institutions that constitute “shareholder capitalism,” American style, 2001, that we have seen aggressively promoted throughout the world. We come to rely on a particular set of assumptions about the connection between stock market prices and underlying economic realities; the reliability of independent auditors, financial standards and copious disclosure in protecting the integrity of financial reporting; the efficacy of corporate governance in monitoring managerial performance; the utility of stock options in aligning managerial and shareholder interests, and the value of employee ownership as both an incentive device as well as a retirement planning tool (2002, p. 1234–1235).

Gordon’s sceptical view of stock market efficiency demonstrates an important point of convergence between the relevance lost and corporate governance narratives. J&K’s critique of the influence of financial reporting conventions on management accounting is based on a finance model of the firm as essentially a “bundle of projects”. In this view, which is implicitly underpinned by stock market efficiency, short term profit measurement such as quarterly earnings are practically meaningless since the value of the company is determined by the discounted value of the cash flows. Yet the finance model seems at odds with the Enron case where senior executives were desperate to demonstrate continuous rises in earnings-per-share and, for at least a short time, were able to fool the financial markets through accounting manipulations.

As long as the share values of their companies kept on rising then Enron’s Ken Lay, WorldCom’s Bernie Ebbers and Tyco’s Dennis Kozlowski could build and preserve their hero status. However, as the bubble threatened to burst, not only were desperate measures adopted, but personal bailouts were arranged before the edifice collapsed. Public outrage at such gross examples of corporate malfeasance quickly led to regulatory responses. While in the US, the emphasis has been on increased judicial enforcement of financial reporting standards in the Sarbanes–Oxley Act (2002), the corporate governance problem in the UK has been seen more as an issue of inadequate performance by boards of directors rather than outright criminality (Higgs, 2003).

The stock market collapse, associated scandals and new regulations have led to the emergence of fresh narratives and new “conversations” (Czarniawska, 1997). The new narratives are concerned with exploring the links between internal and external governance or, in the terminology of EAT, the links between internal and external agency. The convergence between the two narratives is illustrated in Fig. 3 through the visual and conceptual notion of a new action net, which unites the different strands and new plots of the post-Enron era. The next section develops the ITA by showing how a convergence of narratives delineates a new organizational field in which management accounting can play an important role in corporate governance.

4. Regulatory responses and management accounting: an institutional theory of agency interpretation

Whilst EAT does help to define some issues in corporate governance (especially the possible role of contract and financial incentives), its reductionist approach can prematurely closedown and confine. In
contrast, a strength of the ITA is its openness about human behaviour and organizational practices. A further strength of the ITA is that it offers a way of linking the institutionally informed management accounting research that has been increasingly adopted at the organizational level to the wider political, legal and social processes associated with corporate governance and professionalization. From an ITA perspective, the application of management accounting practices, from the local business unit to the highest board level, will be influenced by a variety of competing narratives that inform the organizational field of corporate governance. It is argued that the competing narratives reflect an underlying tension between the institutionalized routines of management accounting (Scapens, 1994) and a desire by senior managers, as agents, to resist the institutionalization of their role.

4.1. Corporate governance regulation, professionalization and the stewardship role of management accounting

The multiple roles ascribed to management accounting in textbooks (see, e.g., Drury, 2004; Seal et al., 2005) may be related to different narratives. Whilst the routine, taken-for-granted aspects of the controlling role resonates very well with institutionalist insights and the more normative treatment of decision-making has conventionally been derived from neoclassical economics (Scapens, 1994), the stewardship role of management accounting has been neglected. In this section, the stewardship role is analysed through the theoretical lens of the ITA via an examination of the interaction between external regulation and management accounting practices. Focusing particularly on the proposals from CIMA that call for the mobilization of strategic management accounting in an Enterprise Governance Framework [International Federation of Accounts (IFAC, 2004)], the ITA is used not only to trace the likely impact of regulation but also to identify possible resistance to new applications of strategic management accounting.

The ITA does not see the influence of regulations and laws in terms of a simple compliance model. In institutional theory, the significance of legislation such as Sarbanes–Oxley in the US and the production of the Combined Code (2003) in the UK is their effect on collectively sanctioned norms rather than just straightforward compliance. Indeed, from a specifically NIS perspective, possible changes in norms will be less noteworthy than cognitive developments for, as Powell and DiMaggio put it, ‘(N)ot norms and values but taken for granted scripts, rules, and classifications are the stuff of which institutions are made’ (1991, p. 15).

Regulations as one type of external influence on internal organizational practices may also be related to another external influence, namely, professional developments. Given that institutions are also made through discourse (Czarniawska, 1997; Phillips et al., 2004), an emerging narrative on compliance and corporate responsibility seems to suggest a new professional mobility project for management accountants. In particular, the internal governance narrative emphasises a need for management accountants who are formally certified and subject to an ethical code rather than just management accounting as a heterogeneous body of techniques. More specifically, management accountants may use the corporate governance narrative to counter the threat to their profession posed by the de-centring of management accounting knowledge (Scapens et al., 2003). Indeed, with respect to the accreditation process, it is already possible to observe a new emphasis on ethics and risk management in recent changes in the CIMA syllabus.

Other professions have also seen opportunities to influence board selection and other areas of corporate governance. CEO narratives are beginning to emphasise the importance of trust rather than the more
flamboyant and esoteric qualities of the pre-Enron CEO narrative. These latter developments do not necessarily draw on management accounting directly but may generate a demand not for a straight reversal of the relevance lost narrative but a new emphasis on boundary rather than belief systems (Simons, 1995). Furthermore, instead of posing an opposition between branches of accounting as suggested in the relevance lost narrative, accountants are re-discovering that the power of accounting is based not on particular practices but on the inter-connectedness of practices (Jones and Dugdale, 2001).

In the ITA, if management accounting is to play a role in improving corporate governance, then the establishment and reproduction of appropriate institutionalized practices and routines is crucial (Burns and Scapens, 2000; Roberts, 2001). Whilst we might expect to find robust routines such as budgeting, standard costing and performance measurement, these systems focus on the control of subordinates by senior executives. In an institutional reading, the problem of corporate governance is an absence of similar controlling routines for CEOs and other senior managers whose behaviour consequently seems under-socialized. Indeed, it could even be argued that some CEO routines that emerged prior to Enron were a contributory rather than controlling factor in the subsequent debacle. For example, the “earnings management game”, which involved collusion not just between senior managers but with analysts and auditors, was not just a “one-off” event since the whole point of the exercise was to meet or beat Wall Street earnings projections on a consistent basis (Macintosh et al., 2000).

4.2. A governance role for strategic management accounting?

Given that a key theme in the narrative of the CEO is one of strategizing then strategic management accounting (SMA) offers a set of practices that could help to institutionalize the boardroom. This possibility for SMA is illustrated in Fig. 3, as SMA is shown as being at the end of both the corporate governance and the relevance lost and found narratives.

The potentially enhanced role for SMA in the corporate governance narrative is a relatively underdeveloped theme that requires more elaboration. Recent cases of corporate underperformance in the UK have opened up the role of non-executive directors as a target for regulatory review (Higgs, 2003). Yet such reviews pose the question: how can non-executive directors be expected to make a difference if they do not know what is going on in the company? From this perspective, it is a short step to see a potential role for management accounting in providing non-executives with information with which to assess risk, check on strategy and monitor the behaviour of executive board members. Indeed, many of the criticisms of conventional financial reporting and the proposed remedies will be unsurprising to academic management accountants. If conventional transaction-based financial accounting data is too late and too backward looking, then many of the key trends and performance drivers could be provided by models such as the balanced score card (Kaplan and Norton, 2004). At a more popular level, calls for better-informed directors have also been made in newspaper articles. For example, Brittlestone argues in connection with the Marconi that:

In the case of Marconi there was a latent assumption that the demand for telecom equipment would continue to grow at a very high rate more or less indefinitely. Marconi’s board might have been in

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9 See, for example, the website of the Institute of Chartered Secretaries (http://www.icsa.org.uk) and of head hunters, Russell Reynolds (http://www.russrey.com).

10 Part of the problem is that the dynamics of board behaviour and the role of non-executives in strategising is an under-researched and little understood area (see McNulty and Pettigrew, 1999).
a better position to challenge the proposed billion-dollar investments in US internet infrastructure suppliers if they had been provided with a single clear chart showing the managers’ forecasts with sales line disappearing into the stratosphere (2003, p. 11).

The response from the management accounting profession to the corporate governance debate has been articulated in a CIMA technical report (Starovic, 2002). Drawing on previous reports on governance such as the Cadbury report, Starovic (2002) builds on the Combined Code for corporate governance. The CIMA approach seems to advocate a sort of “reverse takeover” of corporate reporting by management accounting. Thus, although there is a proposal for a single database to run business and communicate with stakeholders, it captures far more information than can be gleaned from even the best prepared and audited financial accounts.

CIMA have also been involved in the *Enterprise Governance framework* [International Federation of Accountants (IFAC, 2004)] which is particularly pertinent because it has resonance with the two narrative model described earlier. In implicit sympathy with the parallel path model, the proponents of the Enterprise Governance framework note that ‘(T)here is a gulf between the corporate governance agenda and the “business success” literature and a framework is required to bring the two together’ (IFAC, 2004, p. 9). The Enterprise Governance concept recognises the tensions between governance and value creation, between conformance and performance and the multiple roles of the accountant. Suggestions for implementing the Enterprise Governance Framework include the formation of a strategy committee and the development of a *Strategic Scorecard* which balances strategic position, strategic options, strategic risks and strategic implementation.

Although the proposals on SMA and Enterprise Governance may seem laudable to an academic accounting audience, the take-up of SMA techniques has been disappointing. Guilding et al. (2000) found that respondents scored SMA higher on *merit* than in actual usage. Such evidence seems to beg two questions. First, why should non-executive directors be interested in strategic management accounting data when even senior accounting officials seem reluctant to collect such information (Guilding et al., 2000)? Second, is there an ITA interpretation for this lukewarm reception?

From the point of view of economic rationality, SMA techniques should enable managers develop a *unique* company strategy based on an appraisal of actual and potential competitors. A unique strategy is advocated as the way to competitive advantage and thus a higher return (Porter, 1980). If a company just does what all its competitors are doing, then, at best, the company will just match the industry return. At worst, as in the Marconi case, if all companies try to expand, then a huge surplus of capacity and low or even negative returns are likely.11 Although following Beckert (1999), it has been argued that a certain level of institutionalization enables strategizing, the paradox is that institutional theory is better at explaining *mimetic* rather than unique strategies. Indeed, the main fear for executives seems to be that they might be caught adopting strategies that are *different* rather than strategies that *fail*. For example, senior executives at Marconi defended themselves (*ex post!*!) by claiming that not only did they do what everyone else in the telecoms sector was doing but they were also responding to City pressures to move away from the conglomerate structure of the old GEC (Seal, 2001; Mayo, 2001).

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11 In such eventuality, the ultimate winners are the players with the biggest capital. I am grateful to an anonymous referee for this observation.
4.3. The CEO narrative revisited: resisting the routinization of strategy

Although the mimetic nature of corporate decision-making reveals a degree of institutionalization, CEO narratives seem reluctant to admit (ex ante) that the strategizing role can be systematized through the techniques of SMA. If corporate strategizing can be codified\textsuperscript{12} and formalized, as SMA suggests, then it becomes a bureaucratic rather than an entrepreneurial narrative. The idea of routinizing strategy clashes with the myth of the manager as hero, risk taker and innovator. Indeed, SMA may actually suffer from being too logical for CEO narratives that thrive on mystification rather than rationality. Barry and Elmes argue that ‘the successful strategy story may depend less on tools such as comprehensive scanning, objective planning, of meticulous control/feedback systems and more on whether it stands out from other organizational stories, is persuasive, and invokes retelling’ (1997, p. 433).

One of Schumpeter’s predictions about the demise of capitalism was that the economic change that used to be provided by the entrepreneur can become routinized. But perhaps rather more threatening to the CEO narrative, Schumpeter’s thesis suggests that economic change is produced by committees and analysis rather than heroic individuals following hunches. In particular, although the enabling of non-executive directors with improved strategic information may project a more positive and less constraining identity (Dailly et al., 2003), a more pro-active image for the board threatens the heroic image espoused in the CEO myth.

From an ITA perspective, we need not decide whether we agree with Schumpeter’s grand narrative on economic change. The really interesting aspect of his argument is his insight on the rhetorical value of the entrepreneurial myth in the political defence of the bourgeoisie. In the local narrative of the corporate governance, the special character of the entrepreneur is now a rhetorical device that is used to defend a particular view of the CEO in large mature corporations. In particular, an emphasis on the unique character of the CEO implies that practices such as SMA will be resisted because they seem designed to diminish, or at least commodify, the role of the CEO.

Although dramatic tensions between routine and novelty may play well in the CEO-as-hero genre, many narratives in the popular business literature tend to be more linear (Llewellyn, 1999). We may, for example, compare the runaway success of the relevance lost and found narrative with the relative obscurity of more complex arguments about conflicting roles for management accounting. For example, at about the same time that US managers and business academics were constructing the “managing our way to decline” narrative, an alternative (and from a corporate governance point of view, more nuanced) narrative was available (Sathe, 1982, 1983). Sathe explicitly explored the tension between the accountant as a member of a management team and the management accountant (or controller) as the guardian of the integrity of the externally reported financial information. In the latter role, Sathe (1982, 1983) argued that the controller must exhibit a degree of independence from the business decision-making process.\textsuperscript{13} Despite its potentially seminal contribution to the internal governance role of management accounting, Sathe’s work was buried by an avalanche of articles and books on the relevance lost narrative that was emerging at the same time (see, for example, Kaplan, 1983, 1984). Whilst stories about heroic CEOs resolving organizational tensions may make good narratives, conflicting roles in management control systems seem less compelling (Llewellyn, 1999).

\textsuperscript{12} Unlike ABC, EVA and BSC, SMA has not become “packaged” by management consultants.

\textsuperscript{13} A governance role for management accounting was recently mooted by Becker and Messner (2005) who argues that German controllers have distanced themselves from management by constructing a hyper-rational role within the organization.
4.4. Some reflections on the generalizability of the ITA

The ITA is a branch of a wider institutional framework that ‘encourages us to take seriously the study of accounting as a practice rather than comparing accounting practice with some ideal...’ (Scapens, 1994, p. 303). Because its basic premises are institutionalist, the ITA can accommodate recent institutionalist approaches to management accounting research. Indeed, the most generalizable aspects of the ITA are also those features that are most generic in institutional approaches such as the expectation that much behaviour by those in organizations who practice management accounting can be explained by habits, routines and taken-for-granted rules (Scapens, 1994; Burns and Scapens, 2000). Similarly, the analysis of delegated decision-making to senior managers is also generic in the ITA. Senior managers may not be the maximising, ultra-rational individuals envisioned in EAT, but they do have intentionality and they can reflexively monitor organizational routines. As agents with delegated authority, senior managers selectively adopt some management accounting routines which apparently offer them organizational control but reject other routines which seem to threaten their personal power and esteem.

The ITA recognises that particular institutional configurations of the agency relationship and the role of organizational practices such as management accounting are subject to varying political and cultural influences. There is no grand narrative. As we have seen, what constitutes a persuasive narrative in one time period may not be persuasive in another. Not only may narratives vary between different time periods (e.g., pre-Enron and post-Enron) but they also vary geographically (e.g., Japanese capitalism and US capitalism). Thus, somewhat paradoxically, the other generic characteristic of the ITA, the recognition that human nature and organizational practices are open to historical and cultural contingencies, suggests a diversity of interpretations. In particular, as was shown with the political mobilization of the CEO myth, agents such as senior managers can construct persuasive local narratives that draw on wider culturally based aesthetics (Scheytt et al., 2003).

5. Conclusions

The ITA offers a way to synthesise management accounting routines, agency and NIS into a single conceptual framework. Such a synthesis depends on adopting common ontological assumptions on the socially constructed nature of individuals, organizations, states and markets. The ITA is based on a narrative version of institutional theory, whereby conflicts of interests are important plots. The paper identifies two major twentieth century narratives on corporate governance and on the development of management accounting. It argues that with the collapse of stock markets in the US and UK and subsequent exposure of corporate malfeasance and reckless strategies, these two narratives have begun to converge in the new millennium. More rigorous regulation of financial reporting has led to a change of emphasis in organizational accounting practices with a renewed focus on the integrity of financial and non-financial information. A new narrative is emerging that puts greater stress on the multiple roles of management accounting in which “relevance” includes issues such as financial integrity. But since corporate governance problems is also concerned with the creation as well as the distribution of surplus, management accounting can provide key information for non-executive directors on issues such as the strategic direction of the firm. In particular, the paper explored a possible role for strategic management accounting in establishing a stronger and more institutionalized form of strategizing which is more systemic and strengthens the input of non-executive directors and other actors who may wish to hold senior executives to account.
The recent CIMA/IFAC proposals for corporate governance are vulnerable to EAT-informed criticisms that they ignore issues of senior executive motivation in the mature, widely owned, corporation. In an EAT interpretation, good governance and effective intervention by non-executive directors do require extra information but they also require that the watchdogs are appropriately motivated to search for and use the proposed information. By exposing the socially constructed character of corporate governance and the disciplines that traditionally inform the governance discourse, the ITA can accommodate an emerging discourse of reforms that include a more prominent role for management accounting and a more positive role for non-executive directors. Although the ITA aims to contribute to the reform discourse by establishing a new cognitive model of corporate governance, current narratives on the nature of business leadership are unhelpful. It is perhaps to be expected that recent corporate governance narratives have not read as romantic successes of heroic victories against the forces of darkness. With researchers in corporate governance expressing “disappointment” and referring to “insoluble problems”, the stories seem more likely to be tragic or, at best, comic. From a narrative perspective, any corporate governance story with a happy ending may actually be rather boring with tales of able, trustworthy, honest people, “doing the right thing” good governance, perhaps, but hardly the stuff of epics.

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References


