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Corporate Governance Development: New or Old Concept?

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Abstract:
Previous studies that dealt with Corporate Governance have concentrated on its importance and the necessity of its application. This paper has focused on the history of corporate governance and its roots in the time that the audience and the majority of researchers believed that its existence and principles came by the rules of Sarbanes–Oxley Act and legislation in the United States of 2002. The experience of the auther over the years in accounting and management and particularly in the discipline of corporate governance, in addition to depth literature review, all have been used to develop this research. It is concluded that despite common beliefs and debate for the period of corporate governance emergence in 2000s, corporate governance's begining arose before a hundred of years. This study is important for investors and organizations as well to be aware of the necessity to apply corporate governance principles and mechanisms in all contries, being an ancient and precise system that has deep roots. This paper therefore provides useful information and clear picture to the researchers and practitioners about the reality of corporate governance' history and roots.
Keywords: Corporate governance, Agency theory, History

1. Introduction

In recent years, corporate governance has developed rapidly, and its importance has increased throughout the world and even those countries that couldn't employ corporate governance in their firms, they look forward eagerly to employing it when possible.The reason for that global interest in corporate governance lies in the idea and essence for corporate governance; in that it is concerned, using its mechanisms, with organizing and controlling the firm's operating framework. Consequently, this will lead to maximize interests of the owners, and being committed to using principles and mechanisms of corporate governance by which owners, in the widest meaning, can effectively monitor the activities of the firm throughout the information that governance provides when implementing the transparency and disclosure principles. Thus, this will positively affect the investment decision of current and potential investors, on one hand, and the firm value on the other (Nicolo at el ,2008; Shi, 2007; Brennan and Solomon, 2008; Hebble and Ramaswamy, 2005; Berglöf and Thadden, 1999).

The collapse and bankruptcy for largest corporations in the US such as Enron, Worldcom , and Adolphia led to increased awareness of investors and their interest towards the corporations characterized by having distinguished control systems ; in other words , these investors have had an obvious orientation towards the companies applying rules and literature of governance . Moreover, decisions are being assessed daily by owners (stockholders), in addition to the great deal of assessments by analyzers and investors (Coles at el., 2008; Kim et al, 2007; Chen et al., 2007; Maher and Andersson 2000).

2. Literature Review

2.1. Corporate governance developement

Future business in general, and in accounting discipline particularly, might have a wide and clear understanding of Corporate governance has witnessed a widespread debate among a variety of parties including international organizations, academics, regulators, and the business world. On the other hand, till now there is no unique definition to describe the specific meaning of corporate governance taking in place the consideration of giving the comprehensive characteristics of corporate governance system. So, the Definition of corporate governance stays a substance of confusion and argument (Brickley and Zimmerman, 2010; Windsor, 2009).

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Nonetheless, the common, traditional and general definition of corporate governance is that by the Organization of Economic Cooperation and Development ((OECD, April 1999) which defines corporate governance (Hebble and Ramaswamy, 2005) as: *"Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs"*.

Moreover, various definitions on corporate governance found in academic literature; for instance Cadbury (1992) explain corporate governance as a system with the purpose of directing and controlling the firms. Another definition of corporate governance by (Shleifer & Vishny, 1997) is as the process in which the financiers of corporations might be certain in gaining back their investments.

2.2. History and Roots of Corporate Governance

The first and big debate on corporate governance arose in 1602 in Netherlands having the oldest stock market in the world. Managers at that time insisted on continuing the firm's work which was eventually profitable. Similarly, the obvious surprise that drew the route of corporate governance in France was represented by the implosion of the Mississippi Company in 1720 (Morck and Steier, 2005).The origins of corporate governance in U.S. appeared in the 19^{th} century in the first enterprises namely Canal Companies. The development in the processing of financial reporting and corporate governance, in the case of the Canal Companies, was really influenced by the stockholder review committee (Russ et al., 2006). However, (Giroud and Mueller, 2010; Bai et al., 2004; Farinha, 2003; Denis, 2001) believe that the initial beginnings of corporate governance might have come from Adam Smith's theses over three centuries ago as part of his book titled "The Wealth of Nations" in which he warned of the potential problems of the corporate absent ownership when he raised the issue of separation between ownership and stewardship in the joint-stock corporations, mentioning that managers of other people's money cannot be expected to give as good watch over it with the same anxious care, since then, there was an inevitable need for effective mechanisms to resolve conflict of interests between owners and managers. Economists have long seen that managerial slack is first and foremost an issue for firms in non-competitive industries.

On the other hand, there is an explicit demand by the economists Berle and Means (1932) for the necessity of imposing control on the potential gap between shareholders and managers due to the latter's negative practices and misuse of the firm's resources for the sake of maximizing their own interest at the expense of shareholders' interests (Brennan and Solomon, 2008).

Meanwhile, a common work by Berle and Means assures the above argument by pointing out that the managers of a firm seek their own interests rather than the shareholders' (Bai et al., 2004). Since the early days of Berle and Means, a famous debate was started regarding the call for recovery of shareholder – centered governance amid separation of ownership and control (Yuka, 2010).

The early perception of the pioneers of management theory is that the responsibility of firm's management is not only on shareholders, but on all interested parties (Junsen and Meckling,1976). Nevertheless, among the most outstanding and driving factors for the corporate governance and its mechanisms to emerge are the increased concern on the part of the firm's stakeholders, lack of strategic vision and wide influence the senior managers are characterized by, the high amounts of money they obtain as rewards, outbreak of administrative corruption, and involvement of big audit and review companies in occupational conduct issues leaving negative impact on auditors' reputation, such as the conviction of Arthur Andersen, the great account auditing company in the US in relation to the issue of Enron, the nation's 7th largest corporation and six-time winner of Fortune Magazine's most innovative company award (Luo, 2005; Nelson at el., 2008) on one hand, and the conflict of interests between managers and stockholders because of separation between ownership and control causing the problems of Agency on the other hand (Collins and Huang , 2010)**.** As much as the Enron's issue is concerned and in relation to the adoption of corporate governance, Enron's collapse, together with other failures meanwhile, provided the ground for numerous corporate governance reforms including the Sarbanes–Oxley Act of 2002 (SOX) (Stigliano 2011).

3. Agency theory and corporate governance

According to Jensen and Meckling (1976) and with the assent of (Bang and Jensen, 2004; Jensen, 2004; Tate et al., 2009), they explain that agency theory refers to such an existing relationship arising between two parties: the owners (principals e.g. corporation's shareholders) from one hand, and the management (agents, e.g. corporation's executives) from the other. They argue that this relationship is determined in accordance with contractual explicit and implicit conditions for the purpose of obligating the parties to operate pretty efficiently as per which the owners assign the management certain activities for their sake to maximize their own wealth, in addition to delegating them the authority of decision making since the owners are not skillful to manage and carry out the tasks.

Corporate Governance appeared and was affected by the agency theory and its hypotheses (Roberts et al., 2006). In support of this opinion, (Bushman & Smith, 2001; Tirole, 2010) demonstrate that the widespread prevalence of research and academic thinking on corporate governance studies came from the core idea of agency theory that concentrated on the problem that appeared due to the fact that the separation matter between ownership and management, mentioned by Berle and Means on 1932 in the United states, leads to creation of wide divergence in motivations and interests between owners and managers. It is, as (Nisa and Warsi, 2008) and (Cramton & Ayres, 1994) have shown, widely accepted to say that corporate governance is to reduce the agency cost and protect interests of shareholders.

4. Conclusions

Despite the great and increased interest in corporate governance, which appeared at the beginning of 2000s, specifically when the principles and mechanisms of corporate governance were applied in 2002 by U.S. Sarbanes–Oxley Act (SOX), nevertheless, corporate governance has ancient roots back to hundreds of years though it had not been applied directly at that time nor had a special name or even a specific law or legistration that led to apply this concept in the companies. Corporate governance principles had implicit presence and its roots back to hundreds of years. Thus, for the significant importance represented by application of principles and mechanisms brought by corporate governance as one of its main goals is an extension of the goal of agency theory which lies in resolving the eternal conflict between management and shareholders, awareness, perception and real desire to apply corporate governance by external stakeholders (customers, competitors, suppliers, society) and internal stakeholders (shareholders, human resources) have been increasing. It has become a source of interest for many countries in the world as a weapon to be used in mitigating or reducing the crises when they occur from one hand, and as a building block for the companies in order to create a competitive advantage, maximize their value and enhance their performance and thus upgrade the whole economy from the other hand.

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