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Rethinking of Corporate Governance

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Abstract

Corporate governance is regarded as an acceptable mechanism to prevent fraud in companies. However, corporation scandals still occur from year to year. This article tries to describe corporate governance from the emergence, the implementation and the underlying theories. As a result, the concept of corporate governance works stably in the framework of capitalism. This article gives predecessor analysis for further research to insert other fields such as philosophy and psychology in corporate governance
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Keywords: Corporate governance; fraud; capitalism; agency theory; stakeholder theory.

1. Historical Background of Corporate Governance

Simple corporate governance is a system to direct and control a corporation (OECD, 2004). Meanwhile, good corporate governance has long been seen as the ‘holy trinity’; they are rights of shareholder, transparency, and board accountability (Calder, 2008: 2). The term of corporate governance did not appear suddenly.

The downfall of the Roman Empire, until the beginning of age of enlightenment, marked the rise of entrepreneurialism, which was practiced more by baronial marauders and the Church than by commercially private business people (Calder, 2008:6). Their trading activity was carried out in a simple manner. However, it has already shown separation between the members and the Church. This fact was the reason behind the longer survival of the church through wealth development, an essential precursor to corporation nowadays. Since then, companies operating in fields with higher risks, which was impossible for individuals to do it, started to emerge.

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One of the early modern corporations is The Dutch East India Company. It was established in 1601 by the States General of the Netherlands (VOC). This company has the monopoly right to exploit Asia for 21 years. This company was successful, and it survived for some 200 years paying routine annual dividend[1]. This form of colonialism was imitated by Hudson Bay Company in the form of joint stock companies, which survived for about 100 years. In the 18th - 19th century, trading and financial expansion developed industrialization. There were many companies operating without a strong legal basis. This made the relationship between businesses owners become more complicated and more difficult. This condition led them to make rules. One of which was the Joint Stock Companies Act of 1844 in the UK. The regulation did not have the ability to protect the wealth of shareholders. There were many events where the bankruptcy of the company was followed by the bankruptcy of the owner. This condition continued until the liability of shareholders was limited, formally by the Limited Liability Act of 1855. Meanwhile, new companies only started to emerge in the United States in 1813. However, the companies grew more rapidly compared to those in the UK and Europe (Calder, 2008).

However, this improvement in economy was coupled by several downturns. Pergamon Press, Robert Maxwell as CEO, recorded higher earning when Pergamon was sold to Saul Steinberg (Leasco-US) in 1971 (Wearing, 2005). Rolls-Roys accumulated research expense made its assets overstated massively in 1971[2]. London and County Securities Bank (L&C) in 1973[3] did financial manipulation by Gerald Caplan, as CEO. This triggered Bob Tricker wrote an article, 'Perspective on Corporate Governance: Intellectual Influences in The Exercise of Corporate Governance' in 1983. He described corporate governance as relationship between top management, owners and other interested in the company (Calder, 2008: 10). Tricker then developed the idea of corporate governance in a book, 'Corporate Governance' in 1984, which got response from business, related to scandals that emerged continually in the 1980s. Michael Milken at Drexel Burnham (1976-1990) created competitive and aggressive culture that allowed employees to do unethical and illegal conduct. Securities violations, including insider trading and junk bond involved Milken and their employees (Meulbroek, 1992: 1666). Brian Burke, the prime minister of Western Australian, involved dealing business with Alan Bond and Laurie Connell, CEO WA Inc. in Australia (Brueckner, et.al. 2014). This suggested that there was something wrong with management. Businessmen began to concern in corporate governance for controlling company.

2. Corporate Governance Practices

2.1 Corporate Governance in US

The structure of the management of companies uses one board system, consisting executive director (company leader) and non-executive director (company supervisor). In one board system, according Daniri (2014: 24), there were many cases where non-executive director was not able to work independently and objectively in overseeing the company. This happened because his duties were often mixed up with managerial tasks of executive director. In addition, members of the non-executive director were dominated by parties from the outside of the company. Chief Executive Officer has a duty to lead executive director and non-executive director. Thus, CEO fulfils his responsibilities as the head of management and the supervisor at once. It means that the CEO has a tremendous influence and authority. Thus, deviations in the interest of certain parties (agency problem) are very likely to arise. One reason for the use of one-board system is adjustment to the goal of rapid economic growth (the need for quick investment decisions) so that companies can become multinational firms in different countries. However, the introduction of one board system that gives full powers to the CEO leads to corporate scandals, such as WorldCom and Enron.

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[1] Over period of some twenty years experiences (1602-1623), VOC had two key features of Modern Corporation, split between ownership-management and transferable shares. Inversely, the EIC (English East India Company) did not have it (Gelderblom, 20012: 29).

[2] This scandal affected accounting regulation to forbid the capitalisation and government policy to make Rolls-Royce Limited, privatisation under Margaret Thatcher government (Lazonick and Prencipe, 2005: 4).

[3] This scandal indicated the weaknesses of banking auditor, Department of Trade, and subsequent changes in regulatory (Matthews, 2005).

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