استكشاف تطور نظرية الوكالة في حوكمة الشركات: مراجعة للنظرية

Exploring the Development of Agency Theory: Review of theory

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الملخص:

يقدم هذا المقال نظرة شاملة على نظرية الوكالة، من أسسها النظرية. يتناول في البداية المفاهيم الرئيسية والمنظور والتحديات والمشاكل المرتبطة بنظرية الوكالة، مع الاستناد إلى استعراض شامل للأدبيات الموجودة. يستكشف المناقشة بعد ذلك الأسس النظرية لها، ويدرس مفاهيم وقضايا مختلفة متعلقة بها. يوثق المقال أيضا النتائج التجريبية التي تسلط الضوء على الآليات التي تهدف إلى التخفيف من تكاليف الوكالة. يحدد المقال أيضًا عدة عوامل يمكن أن تؤدي إلى تعارض المصالح وتكاليف الوكالة، بما في ذلك الفصل بين الملكية والتحكم، وتفاوت تفضيلات المخاطر، وعدم المعرفة المعلوماتية، والمخاطر الأخلاقية. يسلط الضوء بعد ذلك على العديد من الحلول التي اقترحت في الأدبيات، مثل التحكم القوي في الملكية، والملكية الإدارية، وتضمين أعضاء مجلس مستقلين، وإنشاء لجان متنوعة. يتم اقتراح هذه الاستراتيجيات كوسيلة فعالة للتعامل مع صراعات الوكالة والتكاليف المرتبطة بها. نحن نؤكد أن هذا الاستعراض الأدبي سيعزز فهم الممارسين والباحثين، ويساعد في تحليل وتخفيف مشكلة الوكالة. تساهم الإشارات المستمدة من هذا المراجعة في فهم أكثر تعقيدًا للموضوع والاستراتيجيات المحتملة للتعامل مع التحديات المتعلقة بالوكالة في إعدادات المنظمات.

الكلمات المفتاحية :نظرية الوكالة، حوكمة الشركات، تكلفة الوكالة.

Abstract:

This article provides a comprehensive overview of agency theory, from its theoretical foundations. It first delves into the key concepts, perspectives, challenges, and problems associated with agency theory, drawing on an extensive review of existing literature. The discussion then explores the theoretical underpinnings of agency theory, scrutinizing a range of interconnected concepts and associated challenges. The article documents empirical findings that shed light on the mechanisms aimed at mitigating agency costs. The article also highlights several elements that can give rise to a conflict of interest and agency expenses, such as the division between ownership and management control, varying risk preferences, information imbalances, and ethical risks. Subsequently, it underscores several solutions that have been suggested in scholarly works. These include strengthening ownership control, promoting managerial ownership, incorporating independent board members, and establishing diverse

committees, among others. These strategies are proposed as effective means of addressing agency conflicts and their associated costs. We argue that This review of the literature will improve the understanding of both practitioners and researchers, assisting in the examination and alleviation of the agency issue.

Keywords: Agency theory, corporate governance, agency cost.

Introduction:

At the core of agency theory lies the examination of the agency's predicament and its potential resolutions (Jensen & Meckling, 1976). The roots of the agency issue can be traced back to the period when early human civilizations engaged in business endeavors and sought to optimize their self-interest. It became particularly important with the evolution of joint stock companies and has persisted across time, taking on diverse manifestations. As eras shifted, the agency predicament assumed various forms, leaving a trail of evidence in scholarly works. A comprehensive exploration of the literature on agency theory is imperative to grasp the nuances of the agency challenge, its myriad forms, and the associated costs, all of which demand mitigation strategies (Panda & Leepsa, 2017).

The presence of agency challenges spans multiple academic domains, of management, economics, politics, and sociology (Panda & Leepsa, 2017). The ubiquity of the agency issue across diverse organizational structures has elevated it to a pivotal position within financial and economic literature. This article's central aim is to delve into both the theoretical and empirical aspects of agency theory, unraveling key inquiries. These questions encompass the definition of agency theory, its significance, the nature of the agency challenge, its forms, causal factors, potential remedies, the concept of agency cost, its constituents, and strategies for controlling it. These inquiries have dominated the financial discourse for decades.

Authors such as (Gedajlovic & Shapiro, 2002) have undertaken comprehensive surveys of the multifaceted agency literature due to its widespread prominence. In alignment with their objectives, this article embarks on a comprehensive examination of both theoretical and empirical reviews, shedding light on differents aspects of agency theory. By maintaining an equilibrium between theoretical underpinnings and empirical findings, this article contributes to the understanding of this influential theory.

Research Design

The main purpose of this investigation is to explore the practical aspects of agency theory including its perspectives and empirical models. This thorough literature review serves as a resource to gain insights, into the questions addressed. The structure of this manuscript focuses on the different aspects of literature covering the agency theory. To achieve this goal an extensive search was conducted across databases such as, Google Scholar, Web of Sciences and others, to compile a comprehensive collection of literature, on agency theory.

In order to conduct this study we have extensively searched for manuscript, using some keywords in relation with the agency theory, from online databases. The exploration of agency theory dates back, to the century with the research conducted by Berle & Means (1932) and since then numerous studies have been carried out in this field. This article serves as a survey starting from Berle and Means work in 1932. Continuing through the most significant contributions made over the past four decades. Our focus primarily lies on works published between 1968 up until years.

Agency Theory

In management and economics literature, the agency model is a well-established theory that has been around for a long time (Wasserman, 2006). It addresses the problem of owners and managers being separated in firms and emphasizes the need to reduce this problem. This theory can help put in place governance mechanisms to oversee the actions of agents within collectively owned corporations. Berle & Means (1932) identified that the contemporary establishments in the United States exhibited diffuse ownership, resulting in the parting of possession and dominance. In other type of companies, individuals or groups possess stock ownership, and these stockholders, referred to as principals, entrust managerial authority to agents. These agents are responsible for managing the company on behalf of the principals (Jensen & Meckling, 1976). The central concern revolves around whether these agents act in the best interests of the owners or prioritize their own interests (Panda & Leepsa, 2017).

Agency theory: Origin and evolution

In his article "The Wealth of Nations" (1793), Smith was one of the authors to raise concerns about the presence of an agency problem. This concern has since prompted economists to explore aspects of agency theory (Zogning, 2017). Smith's insights suggested that when individuals or a group who do not truly own an organization are in charge there is a possibility that their actions may not align with the interests of the owners. Berle and Means (1932) further developed this idea by examining ownership structures within companies in the United States. Their analysis revealed that individuals appointed by owners have control, over these corporations and manage their operations. They argued that these agents could potentially exploit the company's assets for personal gain, potentially engendering a clash of interests between principals and agents (Gwala & Mashau, 2023).

The agency problem within organizations during the 1960s and 1970s was discussed in financial literature. This problem centered on the challenge of distributing risk among the collaborating parties (Arrow, 1974) who were part of these organizations. Within the firm, various individuals and groups exhibited differing levels of comfort with risk, leading to divergent actions. Those in the role of principals or owners invested their capital and assumed risk to attain economic advantages. Conversely, the agents responsible for managing the firm displayed risk aversion and prioritized their gains. With contrasting risk preferences between principals and agents, the issue of sharing risk led to conflicts known as agency conflicts, a concept extensively explored within agency theory (Panda & Leepsa, 2017).

Mitnick (1973) was made contributions, for development of this theory through their approaches. Ross viewed the agency problem as a matter of incentives while Mitnick attributed it to structures. Despite their differing perspectives, their theories share a foundation. Ross identified the principal-agent problem as originating from compensation decisions. Emphasized its relevance not only within firms but also in society as a whole. Mitnick's institutional approach played a role in shaping the concepts of agency theory aiming to provide insights into real-world behaviors. According to his theory institutions emerge around the idea of agency (Panda & Leepsa, 2017).

Alchian (1972) characterized firms as networks of conventions among production elements. They explained that firms although artificial constructs embody relationships among individuals involved. The agency relationship can also be seen as a type of contract, between principals and agents where both parties pursue self-interests that inevitably lead to conflicts. For that condition, principals engage in managing actions to control agents and manage agency costs. In the principal agent relationship the way incentives are structured, how the labor market operates and the existence of information all play roles. These factors work together to shape the theory of ownership structure (Panda & Leepsa, 2017).

According to Jensen & Meckling, (1976), the firm is described as an entity that aims to maximize its value and profitability. To achieve the level

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of wealth it is crucial, for all parties involved to coordinate and collaborate effectively within the firm.

Nonetheless, conflicts arise due, to interests. They can be resolved by implementing managerial ownership and control. These self-interested parties understand that the firm's survival is essential, for their benefits so they are motivated to contribute towards the success of the company for its existence. Similarly, Fama (1980) proposed that external entities should compete with firms to keep them in check. This competitive force monitors both team and individual performance ensuring accountability throughout the organization.

Types of Agency Problems:

Alchian & Demsetz (1972) suggest that the success of a company depends on the relationship, between two parties, known as the principal and agent. The principal is the owner of the firm while agents are responsible for managing the firm's operations on behalf of the principal. Although they work together within the organization they often have goals and interests leading to a conflict called the agency problem. Over time this problem has expanded to include stakeholders, like, shareholders and the Board (Gwala & Mashau, 2023).

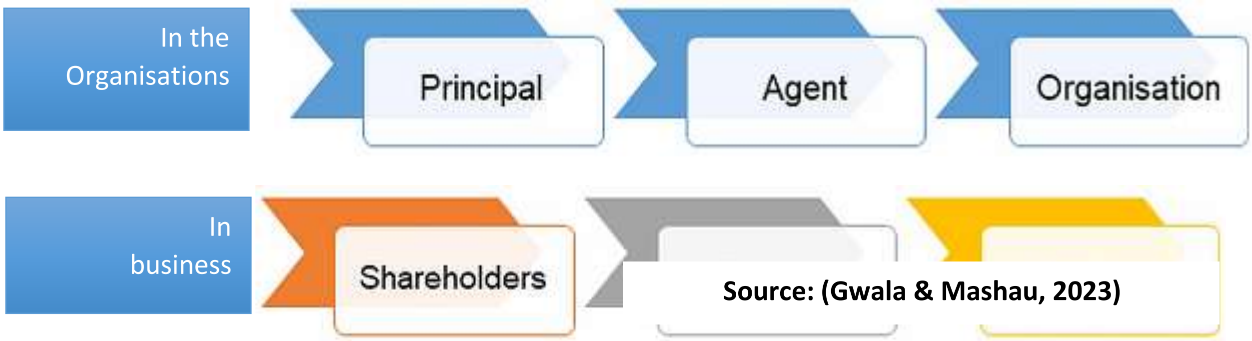

Figure 1 : Type of agency relations

Economists and financial experts have categorized the agency problem into three groups as shown in Figure 1. The first group focuses on the connection, between principals and agents which arises due to differences, in information and risk-sharing preferences (Jensen & Meckling, 1976; S. Ross, 1973). The second group deals with conflicts that arise between shareholders and the board (Gilson & Gordon, 2003; Shleifer & Vishny, 1997), and arises when major shareholders make decisions that primarily benefit themselves at the expense of minority shareholders. Another aspect of the agency problem occurs between owners and creditors where conflicts arise when owners make investment choices, against the preferences of the creditors (Panda & Leepsa, 2017).

Causes of Agency Problem:

An agency problem is when there’s a conflict of interest, in a relationship where one party is expected to act in the interests of another (Abdelkarim & Zuriqi, 2020). Researchers have extensively studied the hazard conflict between shareholders and managers (Zhang et al., 2023). According to Berle & Means (1932), when monitoring agents is expensive and some actions are not fully observable managers may put in the effort or allocate resources, towards activities that don't maximize shareholder value like building their empires (Gwala & Mashau, 2023).

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Separation of Ownership from Control

In companies the separation of ownership and control often leads to supervision, from owners, towards managers. This scenario enables managers to use company resources for benefits giving priority to their well being.

Risk Preference

Different entities , within organizations have viewpoints on risk. Face difficulties when trying to align their decisions. This tension emerges amidst the interests of proprietors and managers, as well as between proprietors and creditors.

Limited Earnings

Managers and creditors play roles as stakeholders, in the company. Their financial benefits are limited. Managers focus on their compensation while creditors are primarily concerned, with receiving interest payments.

Information Asymmetry

Managers are responsible, for supervising the company. Have an understanding of how it operates. On the hand owners depend on managers to communicate this information to them. As a result the exchange of information, between managers and owners may not happen consistently.

Figure 2: Causes of agency relation

Source: (Panda & Leepsa, 2017)

In Figure 2, we can find a summary of some factors that lead to conflicts, within organizations and how they relate to specific types of issues. Researchers have been exploring the causes and possible solutions to these agency problems. Ange et al. (2000) proposed that effective management, by owner-managers could be one way to address the agency problem. However, when ownership and control are separated this problem tends to continue.

Controlling of the Agency Problem (Boshkoska, 2014)

To avoid managers from exploiting their position and power while safeguarding their interests stockholders can employ mechanisms. In the text, these measures are categorized into two groups. Subsequently analyzed as external and internal approaches.

Internal measures:

Conducting an audit is crucial, for maintaining the company's operations and promoting its growth. It helps evaluate the efficiency of company processes identify and address any inefficiency and protect the company's assets and financial resources (Jovanova, 2014).

Another way to tackle the agency problem is, by implementing a strategy that involves compensating managers. The effective approach is to calculate their bonuses based on a percentage of the company's profits. This kind of incentive will motivate managers to make decisions and take actions that are in line to maximize company profitability for shareholders. Another practiced method is to offer managers the opportunity to purchase shares and become stakeholders themselves. This approach helps align the interests of managers with long-term growth, sustainability, and the increase, in share value (Boshkoska, 2014).

According to Resnick (2004), concentrated ownership is considered a way to address the agency problem. They suggest that when managers own a portion of the company their interests align with those of shareholders. This alignment motivates managers to make decisions that benefit the shareholders by increasing the value of their investments.

A functioning corporate governance system is incredibly important, for ensuring oversight of companies enhancing their performance, and enabling them to easily obtain external funding. Corporate governance covers the relationships and obligations of all parties with a vested interest in the company (Boshkoska, 2014).

External measures:

To effectively manage the company's operations and address any conflicts of interest it is crucial to establish a system of external oversight, for managerial activities. An effective method in this regard is to engage auditors who will consistently evaluate the accuracy and fairness of the company's financial statements. Ensuring reporting is essential, for verifying that financial results are presented fairly and that management has not manipulated them for personal gain (Larcker & Tayan, 2011).

The value of a company's market share is a factor, in assessing its performance. When a company is being managed by an executive whose decisions negatively impact its efficiency shareholders may choose to sell their shares. This increase in the supply of shares can cause the share price to decrease, which serves as an indication to the board of directors that changes within the management team are necessary. However, it's important to note that in some cases a thorough analysis is required to determine whether the declining price is due, to management or external factors influencing the situation (Boshkoska, 2014).

Agency Cost Measures: (Panda & Leepsa, 2017, p. 85)

According to Miller (2005), there are solutions but none of them are perfect. Therefore it is crucial to monitor the activities and ensure that the company complies with both domestic and international financial regulations in order to tackle or even anticipate this problem effectively.

Building on the ideas put forward by Jensen and Meckling in 1976 several authors have proposed approaches, for measuring agency costs resulting in two methodologies. The first approach involves measurements of agency costs. Scholars like Ang et al. (2000) and Firth et al. (2008)have used metrics such as the asset utilization ratio and expenses ratio. On the other hand, the second approach uses performance as an indirect indicator of agency costs. Pioneers in this line of thinking include Morck et al. (1988)

and Agrawal & Knoeber (1996) who used Tobins Q as an indicator of agency costs. Moreover, Xu et al. (2005) employed return, on assets (ROA) and return on equity (ROE) respectively to assess agency costs (Panda & Leepsa, 2017).

Criticism of the Agency theory:

Hence the approach is based on making assumptions, about motivation, such as self-interest or maximizing personal gain. It creates structures within organizations by establishing decision-making hierarchies delegating tasks and implementing procedures. This helps to simplify the aspects of institutions. As a result, there has been some criticism directed towards the agency approach although certain critiques are only applicable to modeling efforts, within the realm of agency theory (Mitnick, 2015).

Several authors conflate older issues of agency control with "agency problems" specific to agency theory itself. However, it should be noted that agency theory did not exist before 1973 (Dalton et al., 2007). No citations are listed in the literature, Ross (1973) first coined the term "Agency problem", independently named thereafter "Agency theory" by Mitnick (1973).

Albanese et al.(1997) present a criticism of some authors focusing on their claimed misinterpretation of agency theory particularly regarding the conflicting interests, between agents and principals (James H. Davis, 2014). While Albanese and colleagues recognize that there are perspectives within the proponents and versions of agency theory they argue that these critics primarily base their characterization on the trailblazers and influential figures in the field, like Jensen & Meckling (1976).

Conclusion

This article thoroughly discusses the collection of literature that explores the concepts of agency theory. This review of literature explores the concepts of agency theory diving into its beginnings and the influential researchers who played a role, in its development. Additionally, it investigates the underlying assumptions that give rise to the issue of agency. In business settings, this theory suggests that individuals acting as agents often prioritize their interests, which can lead to conflicts with those, in positions of authority and result in costs associated with agency. Based on this examination of the existing research, on agency theory, it is clear that the theory holds value and finds application, in academic fields. Its foundations are rooted in disciplines and its significance and usefulness are widely recognized.

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