



Mitigating Agency Conflict: A Systematic Review of Literature on Governance Mechanisms

Agyemang Badu Ebenezer

Department of Business Administration, School of Business and Economics, Presbyterian University College, Abetifi, Ghana

Email address:

ebagyemang@presbyuniversity.edu.gh

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Abstract: The concern of this paper is to systematically review prior literature and to contribute significantly to the understanding of governance mechanisms in resolving agency conflict between shareholders and managers. Using systematic literature approach, this study presents 123 articles published within 1978-2014 in scholarly articles. The review modified the procedure adopted by [1] and [19]. The results observe that significant body of knowledge on mechanisms to resolve agency conflict exists from different theoretical perspectives. However, combinations of mechanisms and circumstances under which they become effective are yet to be thoroughly explored. This paper attempts to fully understand systematically the effectiveness of governance mechanisms from different theoretical perspectives geared towards resolving agency conflict.

Keywords: Systematic Literature, Positivist Stream, Principal Agent Stream, Internal Mechanism, External Mechanism

1. Introduction

The importance of controlling all forms of agency conflict in modern corporations is evident by the considerable number of both theoretical and empirical studies in various disciplines, all geared towards developing models that effectively control agency problem. Following [6] who carried out systematic analysis and research on separation of ownership from control as early as 1934, since then, many researchers try as much as possible to find answer as to how the various forms of agency conflict can be controlled. Key features that permeate through the vast literature are independence of boards, equity, market for corporate control, regulations, mergers and acquisitions are capable of mitigating agency conflict. Different strands address the role of monitoring and supervision by boards, ownership structure and the market for corporate control, and executive compensation in mitigating these agency problems (see, e.g., [18], [30] and [17]). It is also evident in literature that ‘all fit all’ approach exists in the application of the above mechanisms in the view of agency conflict mitigation. One major drawback of these models in these empirical studies is the ad hoc selection of various variables, measurement and the lack of theoretical basis for the selection of the variables.

Similarly, prior reviews are limited in scope and outdated

for example [14]. More importantly up to date, to the best of researcher understanding, there is no systematic literature review that contribute to better understanding of agency conflict issues through two different research streams namely positivist approach and principal agent preposition. This study therefore attempts to fill this gap.

Motivated by the structure of [14] and following the approach of [7] the objective of this study is to accomplish a systematic literature review (SLR) and presents the current literature on agency conflict mitigation models.

This paper proceeds as follows: section 2 considers the planning and the design of the SLR. Section 3 looks at results and discussions whereas section 4 outlines the limitations of the review. Section 5 concludes the review with recommendations for further review.

2. Planning the Systematic Literature Review

We follow [7] and [24] review protocol in this SLR. Accordingly, section 2.1 presents the scope. Section 2.2 outlines the research questions that guide the SLR. Section 2.3 states the planning of the search process. Section 2.4 reports the inclusion and exclusion criteria. Section 2.5 describes the data collected from the selected studies, and

finally, the data analysis is the focus of section 2.6

2.1. Scope of the SLR

The aim of the SLR is stated in section 1.0. Nonetheless, the SLR is limited to reviewing scholarly studies on mitigating agency conflict from two broad namely: Positivist stream and principal agent preposition.

Most theoretical works on agency falls into two main stream which have evolved over time. These are the positivist agency theory and the principal agency theory [18] and [33]

These two streams are similar in that they identify a principal and an agent focusing on the contract between the two [33]. However, they display certain differences. The positivist focuses on external labour market, capital market and compensation systems [15], [2]. [14] Concludes that the common approach to the positivist is to identify a policy or a behavior in which stockholder and manager interest diverge and then demonstrate that outcome based incentive can solve the agency problem. They focus on identifying situations in which the principal and agent are likely to have conflicting goals and then describe the governance mechanisms that limit the agent's self-serving behavior. They opine that when the contract between the principal and agent is outcome

based, the agent is more likely to behave in the interests of the principal. The argument is that such contracts coalign the preferences of agents with those of the principal because the rewards for both depend on the same actions and, therefore, the conflicts of self-interest between principal and agent are reduced. They indicate that when the principal has information to verify agent behavior, the agent is more likely to behave in the interests of the principal. The argument here is that, since information systems inform the principal about what the agent is actually doing, they are likely to curb agent opportunism because the agent will realize that he or she cannot deceive the principal.

Whereas the focus of the positivist stream set the pace by indicating that agency problem exist and that various contract options are available in resolving the conflict, principal agent stream focus on the most efficient contract options. The most common approach underlying such studies is to use the agency variables to predict whether contract based or outcome based is effective in resolving agency conflict. They believe that both principal and agent will select the most efficient contract.

The table below shows an overview of related methods of the two research paradigms discussed in the previous section.

Table 1. Summary of Landmarks Studies.

| DIMENSION | Research Stream | Description | Specific mechanism | Internal/ External |
|-------------------------------|-----------------|--|---|--------------------|
| 1.0 Konik(1987) | Positivist | information mechanism for managerial opportunism | Proportion of outside directors, Equity by outside directors, Outside directors with executive experience | Internal |
| 2.0 Barney (1988) | Positivist | Whether employees stockownership reduces cost of equity | Employee stock ownership | Internal |
| 3.0 Sigh & Harrianto | Positivist | If golden parachute align executive interest with stockholders | Takeover threat, Managerial stock ownership | Mixed |
| 4.0 Amihud& Lev(1981) | Positivist | Why firms engage in conglomerate merger | Manager vrs owner controlled | External |
| 5.0 Argawal& Mandelker(1981) | Positivist | Whether executive holdings reduces agency problem | Executive stock holdings | Internal |
| 6.0 Walking & Long (1984) | Positivist | Why managers resist takeover | Management equity ownership | Internal |
| 7.0 Eisenhardt (1985) | Principal agent | The choice between commission and salary | Job programmability, Span of control and outcome uncertainty | Internal |
| 8.0 Eisenhardt (1988) | Principal agent | Same as 7.0 | Same | Internal |
| 9.0 Colon and Parks (1988) | Principal agent | Agency and institutional prediction | Monitoring | Mixed |
| 10.0 Fama & Jensen | Positivist | Same as 9.0 | Board relationship | Internal |
| 11. 0 colon & Park (1990) | Positivist | Same as 5.0 | Compensation system | Internal |
| 12.0 Jensen & Meckling | Positivist | Same as 6.0 | Ownership structure and financing | External |
| 13.0 Amit & Wernerfelt (1990) | Positivist | Same as 5.0 | Diversification & Acquisition | External |

Table 1 is structured into four main columns. First, column one reports the respective author(s) who initiated the landmark studies in the agency conflict. Column, two outlines the research stream. A brief description of the study is presented in column three. The specific mechanism studied is also found in column four. Whether the mechanism is internal or external is captured in column 5.

2.2. Research Questions of the SLR

The SLR seeks to answer the four main research questions:

RQ1. What trend can be drawn in literature concerning resolving agency conflict?

RQ2. What are the various mechanisms that have been employed in resolving agency conflict?

RQ3. What are the methodological issues in the literature?

RQ4. What is the main research gap in the literature?

2.3. Search Procedure of the SLR

In searching for the literature we use five main search engines to perform the SLR. These are: (1) Google Scholar (2) Emerald (3) Taylor and Francis (4) Ebscohost and (5) Science direct specifically, the researcher searched scholarly reviewed articles of agency conflict from these sources. During the search it was identified that many researchers use

agency problem, agency cost to represent agency conflict, therefore the search string was extended in the various search engines for other articles using a search framework that encapsulates all the terms identified.

2.4. Selection Criteria

Articles to be considered in the SLR are first read to ensure that it is appropriate. In all cases the abstract of the article is read to ensure that it touches the subject matter. In some cases the introduction of the article which sets the tone of the paper is read. All articles included must be in English language and the full text of the article must be available in electronic format.

In other to ensure that quality articles are selected for the SRL, some exclusion criteria are considered. In other to avoid quality biasness of SRL, PhD thesis, conference proceedings, working papers, technical reports are excluded. All the articles are examined critically to ensure that they are peer reviewed in quality journal. Using Association Business School Academic (ABS) Journal Quality GuideVersion 4 2010Edition (hereafter the Guide) only articles that are published in at least grade two journals are considered for inclusion.

2.5. Data Collection of the SLR

Following prior reviewers, such as [4] and [5] an integrated template is designed and filled for each selected article. The form consists of the research attributes. These include results (RQ1), technique used (RQ2), and methodological issues (RQ3 and RQ4). The methodological issues comprise purpose, sample, variables, matching, origin, and operational definition among others.

2.6. Data Analysis of the SLR

The articles data collected are analyzed to depict following:

- Author(s) references, origin and the year of publication
- The structure of the of the study using the classification guide described in section 3
- The theoretical perspectives of prior researchers
- The research techniques and methods adopted for the various studies

Consistent with [4] and [12] reviews, studies that used two or more governance mechanisms are counted as more than one empirical investigation.

3. Results and Discussion of the SLR

3.1. Search Results and Deviations from Protocol

The search string is used in the search engines of the five main sources. Table 2 reports a summary of the number of papers identified per source, candidates and selected studies. Thus, the inclusion and exclusion criteria are used to identify the candidate and selected studies, respectively.

Table 2. Search Results.

| Source | Studies found | Candidate Studies | Selected Studies |
|------------------|---------------|-------------------|------------------|
| Google Scholar | 138 | 78 | 30 |
| Science Direct | 7381 | 32 | 21 |
| Emerald | 148 | 32 | 31 |
| EBSCO Host | 197 | 45 | 19 |
| Taylor & Francis | 8143 | 73 | 22 |
| Total | 12471 | 140 | 123 |

Note: identical studies from different sources are yet to be eliminated

The search process also results in 123 scholarly reviewed articles these are read with a critical eye for the following reasons: (1) to generate a representation of the state of the art about the SLR subject. For this reason, we read these prior carefully. First, to familiarizes our ourselves with prior authors, and second, improve our knowledge on the field under study.

Consequently, the present SLR covers 123 articles reporting over 40 different mechanisms in resolving agency conflict published in scholarly reviewed journals different disciplines. These are as follows: finance, management, accountancy, economics, marketing, entrepreneurship, politics and international business, and public administration. From this, there is clear indication that agency conflict is a multi-disciplinary field. Furthermore, selected studies originate from 12 countries. 53%, 14%and 10% of the studies used dataset from the US, Korea and UK, respectively. In addition, Australia, Belgium and Canada account for 4% each, whereas the rest of the world accounts for the remaining (i.e. Finland 3%, France 3%, Greece 2%, Italy 2%, Brazil 1% and Spain 1%). These disclosures pave the way for an in-depth discussion of the methodological issues in the extant literature, in the next sub-section. The rest of the paper will be structured as follows discussion of the results of the search, mechanisms for resolving agency conflict, research gaps, limitations of the SLR, conclusions and recommendations for policy making and further research.

3.2. Synthesis of the Proposals

This section provides a synthesis vision of the field of knowledge address by the SLR. In particular, this section answers the research question three (R3) what are the methodological issues in literature. In this direction, the attributes of the selected papers are considered. These attributes are the measurement of independent and dependent variables, data collection issues and empirical results. From this point taxonomy is proposed for the papers selected in this SLR based on the three areas of prior studies and these include;

- (1) Theoretical perspectives;
- (2) Governances mechanisms used and the measurement of agency conflict; and
- (3) Dataset

Each of these is discussed as follows:

3.2.1. Theoretical Perspectives

From the articles studied, two main theoretical perspectives are identified. These include agency theory and

resource dependency in mitigating agency conflict. From the articles reviewed, 72% is covered by the former and the latter accounts for 28%. Few studies (see Hillman et al. 2003) consider the role of integrating agency and resource dependency perspectives in mitigating agency conflict. This suggests that further research is expected to consider the integration of these perspectives in mitigating agency perspective.

3.2.2. *Issues Associated with Governances Mechanisms*

We observe from the landmark studies that prior studies employed the principal agent mechanism whereas 73% employed the positivist approach. This implies that many corporations prefer using the positivist approach in controlling agency conflict. [14] describes positivist stream as theoretically concerned with describing the governance mechanism that solve the agency conflict. There is therefore a general agreement that the positivist approach provides the best approach in resolving agency problem.

However, there is little agreement on the appropriate combination of the mechanism of the positivist approach. For instance, [11] considers Board of Directors and audit committee in resolving agency conflict. However, [9] look at Venture Capitalist and financing arrangement. From these conflicting combinations of positivist stream it is evident that there is no appropriate mix of mechanism to resolve agency conflict. It is therefore not surprising the conclusion made by [10] that mechanisms proposed to mitigate agency problem remains contentious even after 75 years of conceptualization and development of empirical research in agency conflict. Future studies are expected to consider circumstances under which these mechanisms become effective.

i. Neglect of external mechanisms in controlling agency conflict

From the SLR about 90% of the mechanism used is internal mechanism. The only external mechanism captured was external audit whereas market for corporate control and regulation is neglected. [10] confirm that the market for corporate control was largely ineffective and is likely it will no longer active. Thus, it has done little to truly mitigate agency problems, and in fact, may have encouraged agency problems. It is also becoming clear that those that include external mechanism also prefer the mixed where the external mechanism is supported by internal mechanism. The neglect is particularly due to the cost associated with the use of external mechanism and the complicated nature of it usage.

ii. Measurement of agency conflict

From the various studies in the SLR, ten different measurement of agency conflict are identified. These include agency cost [3] and [10]. Performance [34] demand for audit quality [27], Debt usage [32], [16] monetary cost [23], Earnings management [31], and dividend policy [20]. The above demonstrate that agency conflict covers a wider spectrum. The SLR also shows that the measurements of the above definitions are also different. For instance, [11] uses seven different proxies to capture agency conflict. From the above, there is a general agreement that agency cost and firm

performance provide the best definition and measurement of the level of agency conflict. However there is little agreement of their measurement. For instance, [3] and [29] use asset turnover and selling, general administrative expenses to total sales

3.2.3. *Dataset*

The dataset stage shows four different issues namely the data source of prior studies and industry, period of study and arbitrarily sample period.

i. Data source of Prior Studies

Out of the studies considered in the SLR 57.7% used North America data. This is followed by Europe with 22.84% and Asia data with 15.34% each. Only one African study was captured. This could imply that there is concentration of the studies in the North America where the capital market is developed than the emerging market like Africa where both legal enforcement and corporate governance are weak [20]. Many empirical studies document that institutional, legal and cultural systems may account for the level of agency conflict and the mechanisms used to mitigate it. For instance, [20] document that UK and US usually have similar character in terms of common law, however, their market bears significant distinguishing features. It is therefore argued that several of these characteristics may contribute to a more significant degree to the approach in resolving agency conflict. It must be noted for instance, in the UK there is UK Corporate Code (2014) and in the US Sarbanes Oxley Act (2002). It is therefore common to understand that the code of the country is likely to affect the adoption of mechanisms in controlling agency conflict. Another interesting observation about the sample studies is they are country specific studies. None of these studies considered in this review combines different countries therefore the findings may not providing holistic model for improving corporate governance in regional or continental basis.

ii. Sampled Industry

From the literature review, all the prior studies consider companies listed on the stock exchange. However there are some disagreements on the industry considered for the study. Many of the studies poll data from various industries neglecting industrial sensitivity. The exceptions were [8] and [32]. [8] for example considers non financial companies with the reason that they are highly regulated. The study by [32] examine only considered only manufacturing companies. The implication of the above is that industries that are highly regulated such as financial and mining have been neglected on the basis that agency issues in such companies are minimal.

iii. Period of study

Majority of the literature is filled with limited period of study. For example [8] studies Taiwan listed companies within 2000-2001. To overcome the limitations associated with the use of limited period of study, previous empirical studies adopted large sample size pooled from mix of industries neglect the impact of industrial sensitivity of the results of the study. Another issue worth mentioning is the

use of panel data which also increases number of the observations. [17] argue that panel data have advantage over cross sectional and time series data highlighting the former can control effects of mutual affection of corporate governance findings.

iv. Arbitral Sample Period

The bulk of the literature is filled with arbitrary sample period. This implies that there is no uniformity sample year of the prior studies. The sample period of the prior studies ranges from one to five years with majority falling within one to two years. Though the governance mechanisms used to resolve agency conflict are not theoretical to a certain chosen year or period, the interdependent nature of the governance variables requires that the sample year exceeds one year. This is to ensure model reliability which is influenced by data stability and stationarity [1] and [35]. Stationarity refers to stable relationship, within the independent variables [13] and between the dependent and independent variables [20] and [19]. The data stability requires no change in macroeconomic environment [21].

4. Limitations of the Systematic Literature Review

The limitations of the SLR are as follows: first, the study defined agency conflict different using different proxies. Therefore in searching for articles, the SLR used different synonyms such as agency problem agency conflict, agency cost and earning management. We cannot guarantee that relevant papers falling within the scope of agency conflict are captured in the SLR. Secondly, the SLR considered only papers that were published in journals classified by the ABS guide (2010) at least grade two papers. However there are five papers that were directly included in the SLR which deviated from protocol. These papers are included because it was considered as important studies in the area in other studies.

5. Conclusion and Recommendation for Further Studies

This paper adopts SLR approach and considers papers from 1984-2014 using the positivist and agent principal approach the as well internal and external mechanisms in resolving agency conflict. It tries to answer three main questions. First, what are the trends in the adoption of governance mechanisms in resolving agency conflict? Second, what are the methodological issues and finally what are the research gaps in the study of mechanism in resolving agency conflict in literature. In searching for appropriate papers for the review, various search engines namely Google Scholar, Science Direct, Ebschost, Taylor and Francis and Emerald were considered. The papers from these peer referred journals were systematically reviewed.

Following [5] study, we propose a synthesis of the proposal to discuss the methodological issues in the

literature. Third, the objective behind research and operational definition of agency conflict are extracted and discussed. Finally, we discussed the significant contributions of each paper in the relevant section and concluded the review with suggestions to shift the focus from the recent mechanism to control agency conflict to innovative ways of resolving agency conflict and enhance our understanding in the agency theory literature. From all these studies, the question as to what mechanism or combinations of mechanisms are effective in resolving agency conflict remains unanswered. For this reason, future studies should examine the role of those mechanisms in resolving agency conflict particular from the positive accounting theories perspective.

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