Agency theory: Review of Theory and Evidence on Problems and Perspectives

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Abstract

This article intends to review the theoretical aspects and empirical evidences made on agency theory. It is aimed to explore the main ideas, perspectives, problems and issues related to the agency theory through a literature survey. It discusses the theoretical aspects of agency theory and the various concepts and issues related to it and documents empirical evidences on the mechanisms that diminish the agency cost. The conflict of interest and agency cost arises due to the separation of ownership from control, different risk preferences, information asymmetry and moral hazards. The literatures have cited many solutions like strong ownership control, managerial ownership, independent board members and different committees can be useful in controlling the agency conflict and its cost. This literature survey will enlighten the practitioners and researchers in understanding, analysing the agency problem and will be helpful in mitigating the agency problem.

Keywords

Agency theory, contractual relationship, conflict of interest, agency issues, agency cost, literature survey

Introduction

Agency theory revolves around the issue of the agency problem and its solution (Jensen & Meckling, 1976; Ross, 1973). The history of agency problem dates back to the time when human civilisation practiced business and tried to maximise

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their interest. Agency problem is one of the age-old problems that persisted since the evolution of the joint stock companies. It cannot be ignored since every organisation possibly suffered from this problem in different forms. With the change in the time, the agency problem has taken different shapes and the literature has evidence about it. The discussion on the literature of agency theory is very much in need to understand the agency problem, its various forms and the various costs involved in it to minimise the problem.

The presence of agency issues has been widely witnessed in different academic fields. The evidences found in different fields like accounting (Ronen & Balachandran, 1995; Watts & Zimmerman, 1983) finance (Fama, 1980; Fama & Jensen, 1983; Jensen, 1986), economics (Jensen & Meckling, 1976; Ross, 1973; Spence & Zeckhauser, 1971), political science (Hammond & Knott, 1996; Weingast & Moran, 1983), sociology (Adams, 1996; Kiser & Tong, 1992), organisational behaviour (Kosnik & Bittenhausen, 1992) and marketing (Bergen, Dutta, & Walker, 1992; Logan, 2000; Tate et al., 2010). The wide existence of the agency problem in different types of organisations has made this theory as one of the most important theory in the finance and economic literature.

The central idea of this article is to inspect and analyse the theoretical and empirical literature on agency theory to find out the answers to certain important questions. These questions are like: What is agency theory? Why does it matter? What is agency problem? What are the types of agency problem? Which factors cause the agency problem? What are the remedies for the problem? What is agency cost? What are the elements of agency cost? and How the agency cost can be controlled? These issues have dominated the finance literature since last many decades. Earlier authors like Eisenhardt (1989), Kiser (1999) and Shapiro (2005) have surveyed and captured the different facets of the agency literature due to its wide popularity. This article is developed in the same line with an extensive work on the theoretical and empirical literature on the various aspects of the agency theory. This article strikes a balance between the theoretical aspects and the empirical evidence in the popular areas of agency theory.

Research Design

The basic idea of this study is to explore the theoretical and empirical works done on agency theory, its various perspectives and empirical models. This literature survey will aid in finding certain answers to the major issues raised in this article. The design of this literature survey article is based on two approaches. The first approach discusses the theoretical aspects of the concepts, definitions, limitations and issues related to agency theory. The second approach deals with empirical works made on the factors that reduce the agency cost. For this purpose, we have explored various journals, books and chapters available in the online databases like JSTOR, Wiley, Scopus, Science Direct, Springer, SAGE, Taylor & Francis and Emerald to gather the literature on agency theory.

This article has searched the articles, working papers and chapters by the keywords such as agency theory, principal–agent problem, agency relationship, ownership structure, managerial ownership, board structure, governance mechanisms and agency cost from the online databases. Out of these, we have only selected those articles which are from reputed journals in order to improve the quality of the literature study. Berle and Means (1932) found the research on agency theory in the early 19th century and since then many researches have been done. This article has started the literature survey with Berle and Means (1932) and covered the most prominent works done in the last four decades. Mostly, this article includes articles from 1968 to the recent works in 2015 (Figure 1).

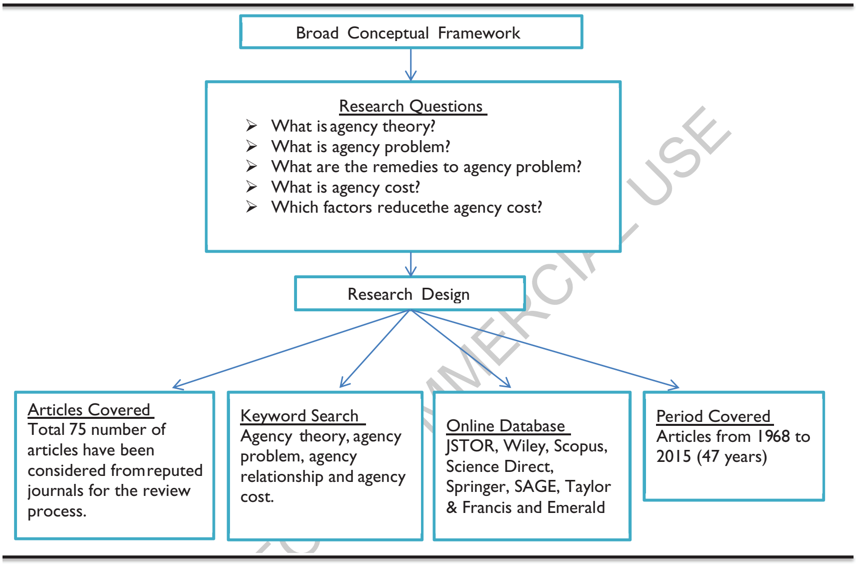

Figure 1. Summary of Broad Research Framework

Source: Developed by the authors.

Agency Theory

Agency model is considered as one of the oldest theory in the literature of the management and economics (Daily, Dalton, & Rajagopalan, 2003; Wasserman, 2006). Agency theory discusses the problems that surface in the firms due to the separation of owners and managers and emphasises on the reduction of this problem. This theory helps in implementing the various governance mechanisms to control the agents' action in the jointly held corporations. Berle and Means (1932) in their thesis found that the modern corporation of the USA was having dispersed ownership, and it leads to the separation of ownership from control. In a joint stock company, the ownership is held by individuals or groups in the form of stock and these shareholders (principals) delegates the authority to the managers (agents) to run the business on their behalf (Jensen & Meckling, 1976; Ross, 1973), but the major issue is whether these managers are performing for the owners or themselves.

Evolution of Agency Theory

Adam Smith (1937[1776]) is perhaps the first author to suspect the presence of agency problem and since then it has been a motivating factor for the economists to cultivate the aspects of agency theory. Smith forecasted in his work *The Wealth of Nations* that if an organisation is managed by a person or group of persons who are not the real owners, then there is a chance that they may not work for the owners' benefit. Berle and Means (1932) later fostered this concern in their thesis, where they analysed the ownership structure of the large firms of the USA and obtained that agents appointed by the owners control large firms and carry the business operations. They argued that the agents might use the property of the firm for their own end, which will create the conflict between the principals and agents.

The financial literature in the 1960s and 1970s described the agency problem in the organisations through the problem of risk-sharing among the cooperating parties (Arrow, 1971; Wilson, 1968) involved in the organisations. There are individuals and groups in the firm having different risk tolerance and their action differs, accordingly. The principal or the owners, who invest their capital and take the risk to acquire the economic benefits, whereas the agents, who manage the firm are risk averse and concerned in maximising their private benefits. Both the principal and agent are having opposite risk preferences and their problem in risk-sharing creates the agency conflict, which is broadly covered under the agency theory.

Ross (1973) and Mitnick (1975) have shaped the theory of agency and came up with two different approaches in their respective works. Ross regarded the agency problem as the problem of incentives, while Mitnick considered the problem occurs due to the institutional structure, but the central idea behind their theories is similar. Ross identified the principal–agent problem as the consequence of the compensation decision and opined that the problem does not confine only in the firm, rather it prevails in the society as well. The institutional approach of Mitnick helped in developing the logics of the core agency theory and it was possibly designed to understand the behaviour of the real world. His theory propagated that institutions are built around agency and grow to reconcile with the agency.

Alchian and Demsetz (1972) and Jensen and Meckling (1976) defined a firm as a 'set of contracts between the factors of production'. They described that firms are the legal fictions, where some contractual relationships exist among the persons involved in the firm. Agency relationship is also a kind of contract between the principal and agent, where both the party work for their self-interest that leads to the agency conflict. In this context, principals exercise various monitoring activities to curb the actions of the agents to control the agency cost. In the principal–agent contract, the incentive structure, labour market and information asymmetry plays a crucial role and these elements helped in building the theory of ownership structure.

Jensen and Meckling (1976) portrayed the firm as a black box, which operates to maximise its value and profitability. The maximisation of the wealth can be achieved through a proper coordination and teamwork among the parties involved in the firm. However, the interest of the parties differs, the conflict of interest arises, and it can only be relegated through managerial ownership and control. The self-interested parties also knew that their interest can only be satisfied if the firm exists. Hence, they perform well for the survival of the firm. Same way, Fama (1980) advocated that the firms can be disciplined by the competition from the other players, which monitors the performance of the entire team and the individual persons.

Fama and Jensen (1983) made a study on the decision-making process and the residual claimants. They segregated the firm's decision process into two categories such as decision management and decision control, where agents are the key players in the process. In the non-complex firms, the decision management and decision control are the same but in complex firms, both exists. In those complex firms, the agency problem arises in the management decision process because the decision-makers who initiate and implement the decisions of the firm are not the real bearer of the wealth effects of their choices. They inferred that these agency problems are necessary to be controlled for the survival of the firm.

Grossman and Hart (1983) made an interesting tale on the divergence of risk preference between the principal and agents. They explained that the consumption of the principal gets affected by the agent's output. The agent's level of effort affects the firms' output, where the principals desire for the higher level of effort from agents. Hence, the principal should trade-off the agent's behaviour with a proper payment structure, for which they used an algorithmic model to figure out an optimal incentive structure. The incentive structure is affected by the agents' attitude towards the risk and information quality possessed by the principals and no incentive problem arise if the agent is risk neutral.

Eisenhardt (1989) categorised the agency theory into two models such as the positivist agency model and principal–agent model (Harris & Raviv, 1978). Both of these models are based upon the contractual relationship between the principal and agent but principal–agent model is more mathematical. Principal–agent model explains that principals are risk-neutral and profit seekers, while agents are risk averse and rent seekers. Positive agency theory explains the causes of agency problem and the cost involved in it. This theory proposes two propositions. First proposition explains that if the outcome of the contract is incentive based, then the agents act in the favour of principal. Second, if the principal is having information about the agents, then the action of the agents will be disciplined.

Criticism of Agency Theory

Perrow (1986) criticised that positivist agency researchers have only concentrated on the agent side of the 'principal and agent problem', and opined that the problem may also happen from the principal side. He observed that this theory is unconcerned about the principals, who deceive, shirk and exploit the agents. Furthermore, he added that the agents are unknowingly dragged into work with the perilous working environment and without any scope for encroachment, where principals act as opportunistic. He believed in another way that humans are noble and work ethically for the betterment of the firm. This argument persisted in the finance literature and has become a prominent theory known as stewardship theory (Donaldson, 1990).

Many authors like Wiseman and Gomez-Mejia (1998), Sanders and Carpenter (2003) and Pepper and Gore (2012) have criticised the positive agency theory (Eisenhardt, 1989) on various grounds and they propounded a different agency theory called behavioural agency theory. These behavioural agency theorists argued that standard agency theory only emphasises on the principal and agent conflict, agency cost and the realignment of both the parties' interest to minimise the agency problem. The behavioural agency model recommended some modifications like agent's motivation, risk averseness, time preference and equitable compensation. The argument was that the agents are the main component of the principal–agent relationship and their performance mostly depends upon their ability, motivation and perfect opportunity.

Behavioural agency model (Wiseman & Gomez-Mejia, 1998) is essentially different from the positive agency model (Eisenhardt, 1989) by three aspects. The first difference is that the behavioural agency model assesses the association between the agency cost and agent's performance, while the positive agency model emphasises on the principal and agent relationship and the cost incurred due to it. Second, the behavioural agency model theorises the agents as the boundedly rational, anti-risk/loss takers and they trade-off between the internal and external benefits, while the positive agency model assumes the agents as logical and reward seekers. Third, behavioural agency model finds a linear relationship between the agent's performance and motivation, while agency model focuses on the principal's objective and agency cost.

Limitation of Agency Theory

Though agency theory is very pragmatic and popular, it still suffers from various limitations and this has been documented by many authors like Eisenhardt (1989), Shleifer and Vishny (1997) and Daily et al. (2003). The theory assumes a contractual agreement between the principal and agent for a limited or unlimited future period, where the future is uncertain. The theory assumes that contracting can eliminate the agency problem, but practically it faces many hindrances like information asymmetry, rationality, fraud and transaction cost. Shareholders' interest in the firm is only to maximise their return, but their role is limited in the firm. The roles of directors are only limited to monitor the managers and their further role is not clearly defined. The theory considers the managers as opportunistic and ignores the competence of the managers.

Types of Agency Problem

The firm is based on the limited or unlimited contractual relationship (Alchian & Demsetz, 1972) between the two interested parties and they are known as the principal and agent. The principal is the person who owns the firm, while agents manage the business of the firm on behalf of the principal. These two parties reside under one firm but have different and opposite goals and interest, so there exists a conflict and this conflict is termed as the agency problem. With the changes of time, the agency problem is not only limited to the principal and agent, rather it has gone beyond and covered other parties like creditors, major shareholders and minor shareholders.

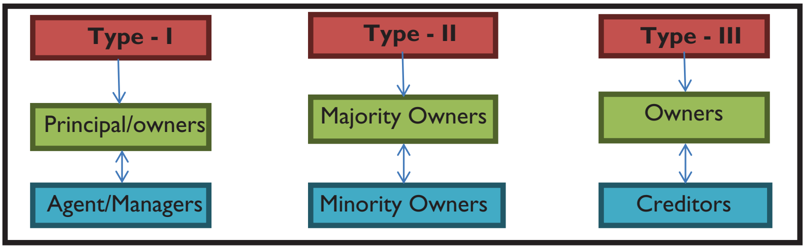

Figure 2. Types of Agency Problem

Source: Authors' research.

The economic and finance researchers have categorised the agency problem into three types, which are depicted in the figure 2. The first type is between the principal and agents, which arises due to the information asymmetry and variances in risk-sharing attitudes (Jensen & Meckling, 1976; Ross, 1973). The second type of conflict occurs between the major and minor shareholders (Gilson & Gordon, 2003; Shleifer & Vishny, 1997) and it arises because major owners take decisions for their benefit at the expense of the minor shareholders. The third type of the agency problem happens between the owners and creditors; this conflict awakes when the owners take more risky investment decision against the will of the creditors.

Type—1: Principal–Agent Problem

The problem of agency between owners and managers in the organisations due to the separation of ownership from control was found since the birth of large corporations (Berle & Means, 1932). The owners assign the task to the managers to manage the firm with a hope that managers will work for the benefit of the owners. However, managers are more interested in their compensation maximisation. The argument on the agent's self-satisfying behaviour is based on the rationality of human behaviour (Sen, 1987; Williamson, 1985), which states that human actions are rational and motivated to maximise their own ends. The misalignment of interest between principal and agent and the lack of proper monitoring due to diffused ownership structure leads to the conflict, which is known as principal–agent conflict.

Type—2: Principal–Principal Problem

The underlying assumption of this type of agency problem is the conflict of interest between the major and minor owners. Major owners are termed as a person or group of person holding the majority of the shares of a firm, while minor owners are those persons holding a very less portion of the firm's share. The majority owners or blockholders are having higher voting power and can take any decision in favour of their benefit, which hampers the interests of the minor shareholders (Fama & Jensen, 1983). This kind of agency problem prevails in a country or company, where the ownership is concentrated in the hands of few persons or with the family owners, then the minority shareholders find it difficult to protect their interests or wealth (Demsetz & Lehn, 1985).

Type–3: Principal–Creditor Problem

The conflict between the owners and creditors arise due to the projects undertaken and the financing decision taken by the shareholders (Damodaran, 1997). The shareholders try to invest in the risky projects, where they expect higher return. The risk involved in the projects raise the cost of the finance and decreases the value of the outstanding debt, which affects the creditors. If the project is successful, then the owners will enjoy the huge profits, while the interest of the creditors is limited as they get only a fixed rate of interest. On the other hand, if the project fails, then the creditors will be enforced to share some of the losses and generally this problem persists in these kinds of circumstances.

Causes of Agency Problem

The agency problem between the principal and agent in the firms has certain causes and these are described by Chowdhury (2004) in his study. He has pointed out several reasons for the occurrence of the agency problem like separation of the ownership from control, differences in risk attitudes between the principal and agents, short period involvement of the agents in the organisation, unsatisfactory incentive plans for the agents and the prevalence of information asymmetry within the firm. These causes of the agency problem are often found in the listed firms between the principal and agent, major owners and minor owners, and owners and creditors (Barnea, Haugen, & Senbet, 1985).

Table 1. Different Causes of the Agency Problem

Causes of Agency Problem	Explanation	Type of Agency Problem
Separation of Ownership from Control	The separation of ownership from control in the large organisations leads to loss of proper monitoring by the owners on the managers, where managers use the business property for their private purpose to maximise their welfare.	Type-I
Risk Preference	The parties involved in the organisations are having different risk perceptions and struggle to reconcile with their decisions. This conflict arises between the owners and managers and owners and creditors.	Type-I and III
Duration of Involvement	The managers work for the organisations for a limited period, whereas the owners are the inseparable part of the firms. Hence, the agents try to maximise their benefit within their limited stay and then flow to another firm.	Type-I

(Table 1 Continued)

(Table 1 Continued)

Causes of Agency Problem	Explanation	Type of Agency Problem
Limited Earnings	Both the managers and creditors of the firm are the significant stakeholders of the firm, but they are having only limited earnings as managers are concerned for their compensation, while creditors look for the interest amount only.	Type-I and III
Decision-making	Mostly, the majority shareholders take the decision in the firms due to high voting rights, while the minority shareholders only follow it.	Type-II
Information Asymmetry	Managers look after the firm and are aware about all the information related to the business, while owners depend upon the managers to get the information. So the information may not reach to the owners exactly in the same manner.	Type-I
Moral Hazard	Managers work for the owners in good faith, where the owners utilise their knowledge and skill in the risky projects, which the managers are not aware of the risk attached to the investment decision for which they suffer.	Type-I
Retention of Earnings	The majority owners take the decision to retain the earnings of the firm for future profitable risky projects instead of distributing the profits as dividends to all the shareholders. Due to which the minority shareholders lose their earnings.	Type-II

Source: Authors' research.

Table 1 describes the different causes behind the agency conflict and the relation between the cause and the type of the agency problem. The persistence of the agency problem in every organisation has made the researchers find out the real causes and its remedies. Jensen and Meckling (1976) opined that the agency problem can be mitigated if the owner–manager will manage the firm, otherwise this problem will persist as ownership and control differs (Ang, Cole, & Lin, 2000).

Remedies to Agency Problem

The study of agency problem and its remedies is an ongoing research in both the corporate and academic world. Eisenhardt (1989) highlighted that a proper governance system can relegate the agency conflict. He recommended two proposals to minimise the agency problem. The first one is to have an outcome-based contract, where the action of the agents' can be checked. Second, the principal needs to form a strong information structure, where the principal is aware of all the information about the agents' action and they cannot misrepresent the principals.

Several researchers have documented certain remedies to the agency problem, which are cited below:

Managerial ownership: Granting of stocks to the agents increases their affiliation to the firm. Jensen and Meckling (1976) described that managerial ownership makes the manager work as the owner in the organisation and concentrate on the firm performance. By this, the interest of the owners' and managers' interest aligns.

Executive compensation: An inadequate compensation package may force the managers to use the owners' property for their private benefit. A periodic compensation revision and proper incentive package can motivate the managers to work harder for the better performance of the firm (Core, Holthausen, & Larcker, 1999) and by which the owners can maximise their wealth.

Debt: Increase in the debt level in the firm discipline the managers. The periodic payment of the debt service charges and principal amount to the creditors can make the managers more cautious regarding taking inefficient decisions that may hamper the profitability of the firm (Frierman & Viswanath, 1994).

Labour market: The effective managers always aspire for better opportunity and remuneration from the market and the market estimate the manager's ability by their previous performance (Fama, 1980). For this reason, the managers have to prove their worth in the firm by maximising the value of the firm and this increases the effectiveness and efficiency of the managers.

Board of directors: The inclusion of more outside and independent directors in the board (Rosenstein & Wyatt, 1990) may diligently watch the actions of the managers and help in making the alignment of the interest among the owners and managers.

Blockholders: A strong owner or concentrated ownership or the blockholders can closely monitor the behaviours of the managers and can control their activities to improvise the value of the firm (Burkart, Gromb, & Panunzi, 1997).

Dividends: The profit distribution as dividends leads to decline in the agency conflict (Park, 2009). Dividend distribution decreases the internal funds, so the firm has to attract external funds to finance. For which, the managers need to make the firm perform better in order to allure the market participants. Dividend payout also resolves the agency conflict between the inside and outside shareholders (Jensen, 1986; Myers, 2000).

Market for corporate control: The poor performing firm may be taken over by an efficient firm and the acquiring firm may eradicate the inefficient management (Kini, Kracaw, & Mian, 2004), which penetrates the managers to perform efficiently.

Agency Cost

Agency theory has brought forward the concept of agency conflict and the cost that arises out of it (Jensen & Meckling, 1976). Agency costs are one of the internal costs attached with the agents that occur due to the misalignment of the interest between the agent and principal. It embraces the cost of examining and picking up a suitable agent, collecting of information to fix performance benchmarks, watching to control the agent's action, bonding costs and the loss due to the inefficient decisions of the agents. Jensen and Meckling (1976) described the agency cost as the aggregate of the monitoring cost, bonding cost and residual loss (Figure 3). These elements of the agency cost are described below.

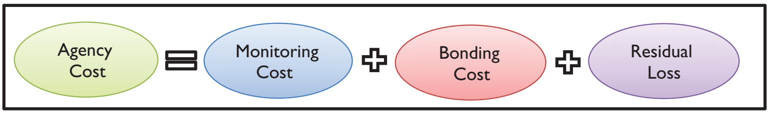

Figure 3: Elements of Agency Cost

Source: Jensen and Meckling (1976).

Monitoring Cost

Monitoring cost involves the cost associated with the monitoring and assessing of the agent's performance in the firm. The various expenditures covered under the monitoring cost are the payment for watching, compensating and evaluating the agent's behaviour. Owners appoint boards to monitor the managers; hence the cost of maintaining a board is also considered as a monitoring cost. The monitoring cost also includes the recruitment and training and development expenses made for the executives. These costs are incurred by the shareholders in the initial stage but in the later stage, it is borne by the managers because they are compensated to cover these expenses (Fama & Jensen, 1983).

Bonding Cost

The close monitoring by the owners on the managers makes them work according to the interest of the owners, otherwise the managers have to bear the monitoring cost. Basically, the cost incurred to set up and operate according to the defined system of the firm is known as the bonding cost (Jensen & Meckling, 1976). The bonding costs are attached to the managers, where the managers of a firm are committed to their contractual obligations that limit their activity. Monitoring cost and bonding cost go in the opposite way, where the bonding cost increases with the decline in monitoring costs.

Residual Loss

The conflict of interest between the shareholders and managers results in another problem, where the decision taken by the managers are not aligned to maximise the wealth of the owners. These inefficient managerial decisions lead to a loss known as the residual loss. Williamson (1988) elucidated that the residual loss is the key component of the agency cost, which should have to be reduced by the principals.

To reduce the residual loss, the owners incur monitoring cost and bonding cost. Hence, these costs have become the whole of the irreducible agency cost.

Agency Cost Measures

Based on the discussion of Jensen and Meckling (1976), many authors have defined the different measures for the agency cost and there are two thoughts of measuring agency cost. The first school of thought uses the direct measures of agency cost. Ang et al. (2000), Singh and Davidson (2003), and Firth, Fung and Rui (2006) used the asset utilisation ratio and expenses ratio. While the second school of thought used the firm performance as the reverse measure of the agency cost, Morch, Shleifer and Vishny (1988) and Agrawal and Knoeber (1996) used the Tobin's Q as the measure of agency cost. While Xu, Zhu and Lin (2005) and Li and Cui (2003) used return on assets (ROA) and return on equity (ROE), respectively, as the measure of agency cost (Table 2).

Table 2. Details of Agency Cost Measures

Agency Cost—Measures	Authors	Type of Agency Problem
Asset Utilisation Ratio or Asset Turnover Ratio	Ang et al. (2000); Singh and Davidson (2003); Fleming, Heaney and McCosker (2005); Florackis and Ozkan (2009); and Rashid (2013).	Principal–Agent Problem
Expense Ratio	Ang et al. (2000); McKnight and Weir (2009); and Wellalage and Locke (2012).	Principal–Agent Problem
Tobin's Q—Free Cash Flow Interaction	Doukas, Kim and Pantzalis (2000); Mcknight and Weir (2009); Henry (2010); and Rashid (2016)	Principal–Agent Problem
Dividend Pay-out Ratio	Faccio, Lang and Young (2001) and Wellalage and Locke (2011).	Principal–Principal Problem
Board Compensation	Zajac and Westphal (1994) and Su, Xu and Phan (2008).	Principal–Principal Problem
Tobin's Q	Morch, Shleifer and Vishny (1988) and Agrawal and Knoeber (1996).	Principal–Agent Problem
ROA and ROE	Li and Cui (2003) and Xu, Zhu and Lin (2005).	Principal–Agent Problem

Source: Authors' research.

The first measure, that is, the asset utilisation ratio, explains how efficiently the assets are utilised by the managers and better utilisation indicates low agency cost. The second measure expense ratio describes the effectiveness of the managers in controlling the operating expenses and a lower expense ratio is desirable. The third measure elucidates the cash flow growth opportunities of the firm. The fourth measure delineates the dividend paid to the owners and a better pay-out minimises the cost. The fifth measure describes a better board compensation can minimise the agency cost. The last three measures mostly discuss the firm value and return gained by the owners on their investments and used as the reverse measure of agency cost.

Empirical Evidence on Agency Cost

Previously, the researchers have documented certain mechanisms like ownership structure, managerial ownership, board size, independent board members, different committees and CEO (Chief Executive Officer) duality to monitor the agency cost. Based on the previous empirical evidence, we have segregated this section into three subsections. The first subsection deals with empirical work on the impact of ownership structure on the agency cost. The second section demonstrates the empirical evidence on the effect of managerial ownership on the agency cost. The third section throws light on the empirical literature on the relationship between the governance variables and agency cost.

Agency Cost and Ownership Structure

Agency theory advocates that ownership structure plays a significant role in reducing the agency cost. Some authors like Zeckhauser and Pound (1990) and Shleifer and Vishny (1997) opine that ownership concentration could possibly monitor the manager's behaviour very closely in order to reduce the agency cost. Table 3 shows the recent empirical studies done by the eminent researchers and their findings. The below studies have used the ownership concentration/blockholders, outside ownership, family ownership and institutional ownership as the ownership structure variables.

Table 3. Influence of Ownership Structure Variables on the Agency Cost

Sl. No.	Author	Year	Country	Sample	Findings
1	Hastori, Siregar, Sembel and Maulana	2015	Indonesia	54 Agro-companies from 2010 to 2013.	Ownership concentration does not affect the agency cost significantly.
2	Rashid	2015	Bangladesh	110 non-financial firms from 2001 to 2011.	Tobin's Q—Free Cash Flow measure is positively affected by the institutional ownership.

(Table 3 Continued)

(Table 3 Continued)

Sl. No.	Author	Year	Country	Sample	Findings
3	Songini and Gnan	2015	Italy	146 manufacturing SMEs in the Milan province of Italy.	Family involvement in governance has a negative and significant effect, while family involvement in management has a positive and significant effect on agency cost.
4	Yegon, Sang and Kirui	2014	Kenya	9 service firms from 2008 to 2012.	Institutional ownership affects the agency cost while the external ownership does not affect.

Source: Authors' compilation.

In Table 3, it can be found that the findings are diversified. The majority of the authors have concluded that institutional ownership affects the agency cost positively. Florackis (2008) found that ownership concentration is effective in the UK, while Hastori et al. (2015) found that it is not effective in Indonesia. Family ownership (Ang et al., 2000) helps in controlling the agency cost while outside blockholders do not have any effect on the agency cost.

Agency Cost and Managerial Ownership

Jensen and Meckling (1976) opined that in the owner-manager firms, the agency cost is zero. But this argument does not prevail in case of the publicly traded firms as the ownership is separated from the control and mostly outsiders manage the firm. Hence, managerial ownership can align the interest of the owners and managers. The misuse of the assets by the employees' declines as their ownership increases because the employees get the share in the firm's profit and their compensations remain fixed (Ang et al., 2000). Table 4 shows some recent empirical work done on managerial ownership and agency cost.

Table 4. Impact of Managerial Ownership on the Agency Cost

Sl. No.	Author	Year	Country	Sample	Findings
1	Rashid	2015	Bangladesh	110 non-financial firms from 2001 to 2011.	Managerial ownership reduces the asset utilisation ratio under agency cost.
2	Mustapha and Ahmad	2011	Malaysia	235 companies for the financial year 2006.	Managerial ownership has an inverse relationship with the monitoring cost.

(Table 4 Continued)

(Table 4 Continued)

Sl. No.	Author	Year	Country	Sample	Findings
3	Wellalage and Locke	2011	New Zealand	100 unlisted small firms in New Zealand.	Very high and very low managerial ownership increases the agency cost.
4	Ahmed	2009	Malaysia	100 blue-chip companies from 1997 to 2001.	Higher level of managerial ownership reduces the agency conflict.
5	McKnight and Weir	2009	UK	128 UK non-financial firms from 1996 to 2000.	Increase in board ownership helps in reducing the agency cost.
6	Jelinek and Stuerke	2009	USA	15,186 firm year observation.	The effect of managerial equity ownership on asset utilisation ratio is positively non-linear, while non-linearly and negatively associated with the expense ratio.
7	Florackis	2008	UK	897 UK-listed firms from 1999 to 2003.	Executive ownership decreases the agency cost.
8	Fleming et al.	2005	Australia	3,800 Australian SMEs from 1996 to 1998.	The manager's equity holding has a significant inverse relationship with the agency cost.
9	Davidson, Bouresli and Singh	2006	USA	293 IPO firms from 1995 to 1998.	CEO ownership positively increases the asset utilisation ratio and decreases the expense ratio.
10	Singh and Davidson	2003	USA	118 US-listed firms.	Managerial ownership is positively associated with the asset utilisation ratio.
11	Ang et al.	2000	USA	1,708 small corporations	Managerial ownership affects the agency cost significantly and there exists an inverse relationship.

Source: Authors' compilation.

Here, we have considered the CEO ownership, director's ownership and executive's ownership under the managerial ownership category. The findings shown in Table 4 are unanimously indicating that managerial ownership helps in reducing the agency cost. These results are very much proving the hypothesis of agency theory in the entire context.

Agency Cost and Governance Variables

Agency theorists opine that good governance mechanisms can help in reducing the agency conflict. Pearce and Zahra (1991) found that large and powerful boards as a governance mechanism are helpful, while Lipton and Lorsch (1992) found that smaller boards are more useful for the firms. There are different types of governance mechanisms used in mitigating the agency problem and in this section, we have taken into consideration the board structure, different committees and CEO duality as the governance mechanisms. Table 5 shows the empirical work on the impact of these variables on the agency cost.

Table 5. Impact of Governance Variables on Agency Cost

Sl. No.	Author	Year	Country	Sample	Findings
1	Hastori et al.	2015	Indonesia	54 Agro-companies from year 2010 to 2013.	Large board size reduces the agency cost.
2	Cai, Hiller, Tian and Wu	2015	China	1,126 listed companies for the period between 2002 and 2004.	Presence of audit committees reduces the agency cost.
3	Rashid	2015	Bangladesh	118 non-financial firms from 2006 to 2011.	Independent board members positively improve the asset utilisation ratio and board size positively affects expense ratio.
4	Rashid	2013	Bangladesh	94 non-financial firms from 2000 to 2009.	No significant relationship between CEO duality and agency costs.
5	Siddiqui, Razzaq, Malik and Gul	2013	Pakistan	120 listed firms from 2003 to 2010.	Size of the board affects the agency cost positively.
6	Sanjaya and Christianti	2012	Indonesia	377 listed manufacturing companies from 2008 to 2010.	Increase in numbers of board commissioners and proportion of independent commissioners reduce the agency cost.

(Table 5 Continued)

(Table 5 Continued)

Sl. No.	Author	Year	Country	Sample	Findings
7	Gul, Sajid, Razzaq and Afzal	2012	Pakistan	50 firms from 2003 to 2006.	Smaller board size and independent board members help in lowering the agency cost.
8	Fauzi and Locke	2012	New Zealand	79 New Zealand-listed firms	Higher board size, presence of the nomination committee and remuneration committee reduce the agency cost.
9	Miller	2009	USA	95 companies from 2001 to 2002	Independent board members positively affect the asset utilisation ratio.
10	McKnight and Weir	2009	UK	128 UK non-financial firms from 1996 to 2000.	Nomination committee reduces the agency cost.
11	Singh and Davidson	2003	USA	118 US-listed firms	Smaller board size increases the asset utilisation ratio.

Source: Authors' research.

Mostly, the research results shown in Table 5 are in support of the hypothesis that governance tools are helpful in mitigating the agency cost. Hastori et al. (2015) and Fauzi and Locke (2012) have found that larger board size reduces the agency cost. The Gul et al. (2012) and Singh and Davidson (2003) have discovered that smaller board size helps in curtailing the agency cost. Rashid (2015), Gul et al. (2012) and Miller (2009) have noticed that independent board members positively affect the agency costs. Cai et al. (2015) observed that audit committee helps in improving the manager's efficiency and reducing the agency costs. Fauzi and Locke (2012), Sanjaya and Christianti (2012), and McKnight and Weir (2009) found that the presence of remuneration and nomination committees positively affect the agency cost.

Summary and Conclusion

This article has widely covered the vast literature on the key aspects of agency theory for a period of 47 years. The discussion on agency relationship and its conflict was started with the early work of Smith (1937[1776]) and continues till date. The fascinating work of the classic agency theorists, by whom the agency problem was theorised, has narrated the principal–agent problem in various formats.

This enriched piece of literatures has guided us to demonstrate the various concepts and issues attached to the agency theory. This also helps in resolving the questions that revolved around the agency theory.

Through this literature survey on agency theory, it can be summarised that this is a very pragmatic and applied theory. It has roots in many different academic fields and its usefulness is very extensive and prominent. Many authors have opined that agency problem prevails in every kind of organisation except owner-managed firms. Hence, many authors from different countries have made extensive surveys on the agency problem and its cost to find the remedies. Many authors have found that separations of ownership from control, conflict of interest, risk averseness, information asymmetry are the leading causes for agency problem; while it was found that ownership structure, executive ownership and governance mechanism like board structure can minimise the agency cost.

There are certain gaps found through this literature survey and these may be dealt in the future studies on agency theory. First, we found that the literature works have mostly focused on the principal–agent problem and there is a dearth of studies on the types of agency problem like principal–principal problem and principal–creditor problem. Second, it was found that there are few studies done on the agency cost and the factors that reduce the agency cost. Third, research on 'agent–agent problem' was not found and it can be an emerging area for the future study in the agency theory. Fourth, more or less, most of the studies on agency theory were concentrated in developed economies like the USA, the UK and few developed countries. Though there are some studies done in emerging countries, it is very insufficient in comparison to the developed countries.

Though this article has done some immense work to capture the literary works on the agency theory, it still has some limitations. The literary works of the authors were taken in this article might not cover the entire population of the agency theory literature. Rather these were most of the major works done in the field of agency theory and limited to the availability in the online databases. The issues that were discussed in this article might not be the whole issue of the agency theory. Hence, there may be some other issues which can be captured in the future works. Despite these limitations, this literature survey will help the research world in analysing the agency problem, finding the solutions to the various types of the agency problem and forming empirical models in their future studies.

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