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Application of Agency Theory on Top Management Team Towards Organisational Thinking.

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Abstract

Within pure water companies this quantitative research study examined how agency theory affects Top Management Teams (TMTs) specifically by analysing agency conflict and intervention behaviour. A structured questionnaire was given to 125 employees and SPSS version 23.0 analysed the collected data. The research method adopted for this study was quantitative and it used primary data from the questionnaire. The study investigated the agency conflict and intervention using descriptive statistics, ANOVA and regression analysis to analyse the relationship between the two variables. The results show a strong positive correlation (r = 0.850) among agency conflict predictors of earnings retention, moral hazards, effort level, risk aversion and time horizon; a moderate positive correlation (r = 0.462) among agency intervention predictors of internal audit system, managerial compensation, concentrated ownership, threat of dismissal, effective monitoring, ownership structure and managerial shareholding. The findings of this study provide empirical evidence to support the application of agency theory to explain the behaviour of TMTs, and the results highlight the importance of mitigating agency conflict and the use of effective interventions mechanisms. The findings of this study also have implications for strategic decisions regarding the composition, compensation, and monitoring of TMTs that can lead to improved organizational performance. It was suggested that future research should incorporate qualitative approaches to gain a deeper understanding of the implications of agency theory.

***Keywords**: Agency Theory, organizational thinking, Top Management Team, Application.*

1. Introduction

The agency theory as propounded by Williamson (1998) is based on a three-armed principle-agent relationship, risk aversion, goal conflicts, and information asymmetry. It has been used to analyze many various aspects of relations and conflicts of principals as well as management in organizations (Kivistö & Zalyevska, 2015). However, an important characteristic of agency theory is that managers will devise self-serving actions that frequently result in shareholders misappropriate use of borrowed funders' net worth as a consequence of having appointed the manager to represent their interests.

The classical agency perspective, introduced by Jensen & Mackling (1976), lays emphasis on the significant conflict between self-interested managers and shareholders particularly when managers control the company and owners bear all the wealth fluctuations (Kivisto, 2008). Agency cost, like moral hazard, effort level, wealth retention, risk aversion, and time horizon, makes the conflict even distrustful (Mutuku, 2012). However, according to Yusuf, et al. (2018), the study of agency problems between principal and managers as proposed by the classical agency perspective is necessary for developing countries.

Moral hazard is characterized by the priorities of managers who emerged from the risk situation, favouring personal benefit above what may be the best for their employ (Jensen & Mackling, 1976). Employees may also tend to underperform about the contributions of owners; that is, employees will work less vigorously than what would have been the case with owners, resulting in lower profits and share prices. On top of that, retained earnings and risk averse will push them to prefer the organization growth and, of course, seeing those shareholders' returns, while time horizon differences will lead to a conflicting priority of interests between managers and shareholders.

To mitigate agency problems, various control mechanisms have been proposed, including ownership structure, managerial shareholding, concentrated ownership, equity-

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based managerial compensation and managerial labour market arts (Jensen & Mackling, 1976). Individual termination of employment from the company, as well as combining performance-based incentive plans, direct shareholder interventions, dismissal threats such as that of a potential takeover-bid, and performance shares can also align manager incentives with that of owners or limit managerial discretion.

Agency theory states that the agency problems are arising from the fact that interests of shareholders and managers are not in accordance with each other (Jenson & Mackling, 1976). Thus, it becomes necessary to deploy different control mechanisms into practice to align managers' interests with those of shareholders or limit their discretion. Those include internal control mechanisms such as ownership structure, managerial shareholding, equity-based managerial compensation, and internal audit systems ((Shleifer & Vishny, 1986; Morck et al., 1988; Core & Guay, 1999; Mutchler, 2003). External control mechanisms that include direct intervention by shareholders, the threat of dismissal, and the threat of a takeover bid ((Hermalin & Weisbach, 1991; Fama, 1980; Manne, 1965) may also be effective. Furthermore, performance-based incentive plans, such as performance shares and bonus plans, can motivate managers to prioritize shareholder value (Murphy, 2000; Lazear, 2000).

2. Literature Review

The contract arrangement of agency theory according to Bouckova (2015) means that one party-the principal-assigns work to another-the agent-to act on its behalf. The theory examines and explores several different agency relations, which have one distinct feature of delegation from a principal to an agent. Agency theory considers two main issues regarding agency interactions: (1) Conflicting interests-The agents and principals often have different interests, making it difficult and costly for principals to monitor their agents. This information asymmetry can also lead to moral hazards, in which the agents act in their interest rather than the interest of the principals (Eisenhardt, 1989). (2) Risk Sharing-The principal and agent can differ in their acceptance of risks and thus differ in their preferences for taking risks. This difference can lead to agency problems because the agents may become risk-averse against the level of risk preferred by the principal (Eisenhardt, 1989). These agency problems stressed the necessity for an adequate design of contracts and visible means of control to align the interests of principals and agents.

2.1 Critique of Agency Theory

Numerous critiques are directed at the application of the agency theory due to its oversimplification of highly complex organizational dynamics. Several challenges arise that obstruct the theory's application.

Under the Assumptions of Self-Interest and Individuality, agency assumes that social relations are irrelevant to the working of the market and that all actors are motivated by self-interest and indivisible ends (Hirsch et al., 1990) even though behavioral research shows that such individuals are swayed by diverse factors, including social prestige, personal fulfilment, and non-monetary incentives (Davis et al., 1997).

The Oversimplification of Human Motivation also concentrates on monetary rewards and information asymmetries, which obscures the real complexity of human motivation (Pink, 2009). Note that prestigious awards and non-monetary motivations could powerfully resolve agency problems, which illustrates the necessity of a more nuanced understanding of human motivation (Gagné, & Deci, 2005).

Challenging the Agency Theory, Ignores Institutional Context specifies that Agency Theory generally ignores the relevance of institutional context-institutions formal or informal, in determining ownership and organizational behavior (Van-Essen, 2011). The concentration of ownership and corporate strategies and performance is dictated by the institutional environment; agency theory ignores that as well.

The Information Asymmetry and Communication Breakdowns also made a challenge to the Agency Theory and opine that where agents possesses information that are not foreclosed to principals, misapprehension and ineffective communication are likely to arise (Nchukwe & Adejuwon, 2013)-affecting the organizations and public services from successful operation.

Such sort of criticism brings up the need for a clearer understanding of organizational dynamics and the motivational aspects of man. Agency theory's oversimplification of such complex phenomena ignores diversity in institutional context with an assumption of information symmetry in the organization and also lack of any non-monetary incentive in any organization.

2.2 Application of Agency Theory

With application of agency theory there are better organizational relationships between the principals and agents, making the delivery of public services better; therefore, less optimal use of agents reasonably would diminish the value of public services. It also reminds us that agencies work outside of government bureaucracies under more professional circumstances (Oloruntoba & Ghemigun, 2019).

This theory shows strength in analyzing regulatory frameworks, compensations, ownership structures, innovations, and vertical integration, as any form of organizational activity could be analyzed using the agency theory (Schillemans, 2013). Vargas-Hernandez & Cruz (2018) emphasize that agency theory is a broad framework that can be applied in many situations.

The applicability of agency theory to accountability studies has contributed to the formulation of hypotheses concerning the conduct of the stakeholders in accountability processes (Oloruntoba & Ghemigun, 2019). The agency theory focuses on exercising rights of decision to enhance the management and control of organizations (Iyowuna & Davies, 2021). In the field of public administration, agency theory acknowledges the role of accountability in ensuring effective delivery of public services. Through protecting and nurturing

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organizational assets, agency theory creates motivation among stakeholders, especially agents or directors, to exceed expectations (Oloruntoba & Ghemigun, 2019).

The agency theory is a tool for increasing work relationships at the principal-agent level, thereby enhancing organizational outcomes (Iyowuna & Davices, 2021). The theoretical stipulation reminds us poignantly that agencies function without reference to the parent organization, being structurally and professionally distinct entities.

Agency theory operates on a wider institutional or organizational canvas, where it promises, depending on the application, the explanation of a lot of events from macro to micro levels (Oloruntoba & Ghemigun, 2019). By drawing an intelligent distinction about the principal-agent relation, organizational strategies can then proceed in an effective manner.

On the other hand, agency theory initiates a reward and sanction system across the organization while promoting an accountability and performance culture (Schillemans, 2013). Agency theory thus improves efficiency, productivity, and overall effectiveness by harmonizing the interests of principals and agents in the organization.

2.3 Assumptions of Agency Theory

Such assumptions will enable observing the motivation or inducements, behavior, and interaction occurrences that will help in the understanding of how to understand these people above principal definitions. Agency theory is built on a variety of critical assumptions for the agency or principal-agent relationship. In the first instance, in the agent's view, the control mechanism of the principal is supposed to prevent opportunistic behavior (Schillemans, 2013) by the agent; therefore it indicates a negative relationship between the principal and agent. Secondly, Goal Congruence Assumption posited both principal's and agent's objectives are along together (Eisenhardt, 1989). In contrast, Self-interest assumption states that agents always rate their interests higher than those of the principal (Jensen & Mackling, 1976). The Information Asymmetry assumption accepts that agents have more information than their principals do (Akerlof, 1970). The Risk Aversion assumption claims that agents are more risk-averse and are likely to prefer lower-risk ones (Arrow, 1965). The Rationality assumption assumes that principals and agents both act under full and perfect information (Simon, 1957).

Lastly, the separation of ownership and control assumption underscores the distinction between owners (principals) and managers (agents) in modern corporations (Berle &Means, 1932).

2.4 Agency Theory and Top Management Teams

The action theory basically describes some of the rudiments and evolves organizational theory. Haughty of Jenson and Mackling (1976) is the study discussed in this study. The agency theory has great relevance to TMTs because they influence the overall organizational strategy and performance (Guohui & Eppler, 2008). Thus, this would be linking top management teams to agency theory because TMT would fit in this area. Top Management Teams to Agency Theory, Top management teams (TMTs) play a critical role in agency theory, as they are responsible for making strategic decisions on behalf of the organization (Hambrick &Mason, 1984). TMT is a collection of high-level executives who are concerned with shaping the overall organizational strategy and performance. TMT is captivated in strategic process of making of decisions which influenced by the interpretations and perceptions of the managers therefore reflecting their 'cognitive base (Wasike, 2015). TMT become more relevant when they are stable with mission, visions, competitive environment and resources of the organization.

TMTs, in the sense of agency theory, may be touted as agents with a duty to serve the principal, which is the shareholder. But because of the self-interest assumption, the TMTs put their interests first over those of the share- holders leading to agency problems (Jensen & Mackling, 1976). Some of the ways that can minimize such an agency problem include:

1. **Executive** Compensation: Efficiently linking executive compensation to performance of the organization has proved to align interest of TMTs with that of all the shareholders (Murply, 1985).
2. Board of Directors: A strengthen and independent board of directors would provide oversight and monitoring of the TMTs to help avoid agency problems (Fama & Jensen, 1986).
3. Corporate Governance: Strong corporate governance such as audit committees and internal controls help minimize or prevent agency problems that ensure TMTs always in the optimum best of shareholders' expectations (Jensen & Mackling, 1976).

3. Methodology

This study made use of a quantitative methodology in order to analyze primary data collected through a structured questionnaire administered to 125 employees of pure water companies. The data was analyzed using SPSS version 23.0 and presented ANOVA as well as regression analyses for both agency conflict and intervention.

4. Results and Discussions

The following section shows the results and discussion with regards to the application of agency theory in relation to top management team.

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Tabe 1: **Agency Conflict Model Summary[b]**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig.
1	.850[a]	.723	.713	.169	.723	78.198	4	120	.000

a. Predictors: (Constant), Time Horizon, Risk aversion, Moral Hazard, Effort level

b. Dependent Variable: Earning Retention

Table 1 shows the strong correlation of 0.850 between the predictors of agency conflict Time Horizon, Risk aversion, Moral Hazard, Effort level were found to be satisfactory variables in explaining dependent variable This was supported by coefficient of determination also known as the R square of 72.3%. The results further meant that the model applied to link the relationship of the variables was satisfactory. In statistics significance testing the p-value indicates the level of relation of the independent variable to the dependent variable. If the significance number found is less than the critical value also known as the probability value (p) which is statistically set at 0.05, then the conclusion would be that the model is significant in explaining the relationship; else the model would be regarded as non-significant

Table 2: **Agency Intervention Model Summary[b]**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig.
1	.462[a]	.213	.166	.284	.213	4.527	7	117	.000

a. Predictors: (Constant), Internal Audit System, Managerial Compensation, Concentrated Ownership, Threat of Dismissal, Effective Monitoring, Ownership Structure, Managerial Shareholding

b. Dependent Variable: Performance Share

Table 2 shows the week correlation 0f of 0.462 between the predictors of agency intervention advantage: Internal Audit System, Managerial Compensation, Concentrated Ownership, Threat of Dismissal, Effective Monitoring, Ownership Structure, Managerial Shareholding Increase were found to be satisfactory variables in explaining dependent variable This was supported by coefficient of determination also known as the R square of 16.6%. The results further meant that the model applied to link the relationship of the variables was satisfactory.

Table 3: **Agency Conflict ANOVA[a]**

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	8.985	4	2.246	78.198	.000[b]
	Residual	3.447	120	.029		
	Total	12.432	124			

a. Dependent Variable: Earning Retention

b. Predictors: (Constant), Time Horizon, Risk aversion, Moral Hazard, Effort level

The results indicate that the overall model was statistically significant. Further, the results imply that the independent variables are good predictors of the customer service. This is supported by an F (4,120) statistic of 78.198 and p value (0.000) which is less than the conventional probability of 0.05significant level. The critical F (4,120) statistic from the table (2.31) is also much less compared to the calculated F statistic

Table 4: **Agency Intervention ANOVA[a]**

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	2.557	7	.365	4.527	.000[b]
	Residual	9.443	117	.081		
	Total	12.000	124			

a. Dependent Variable: Performance Share

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b. Predictors: (Constant), Internal Audit System, Managerial Compensation, Concentrated Ownership, Threat of Dismissal, Effective Monitoring, Ownership Structure, Managerial Shareholding

The results indicate that the overall model was statistically significant. Further, the results imply that the independent variables are good predictors of the customer service. This is supported by an F (7,117) statistic of 4.527 and p value (0.000) which is less than the conventional probability of 0.05significant level. The critical F (7,117) statistic from the table (2.31) is also much less compared to the calculated F statistic

Table 5: **Agency Conflict Coefficients**[a]

Model	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	T	Sig.
1 (Constant)	6.746	.187		36.143	.000
Moral Hazard	.152	.024	.327	6.390	.000
Effort level	-.630	.050	-.807	-12.604	.000
Risk aversion	.029	.030	.062	.962	.338
Time Horizon	.014	.012	.063	1.243	.216

a. Dependent Variable: Earning Retention

The above table shows the multiple regression coefficient for both standardized and unstandardized of agency conflict, The model is shown as

Earning Retention = 6.746 $+0.152$ moral hazards – 0.630 effort level $+ 0.029$ Risk aversion $+0.014$ Time horizon

The model explained that a unit increase of the independent variables will increase the dependent variable by the amount of the coefficients of the predictors except effort level which will decrease earning retention by 0,063 respectively

Table 6: **Agency Intervention Coefficients**[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.563	.774		3.312	.001
	Ownership Structure	.230	.069	.403	-3.355	.001
	Managerial Shareholding	.306	.097	.407	3.166	.002
	Concentrated Ownership	.124	.078	.199	1.593	.114
	Managerial Compensation	-094	.054	.191	-1.745	.084
	Effective Monitoring	.005	.021	.021	-.244	.808
	Threat of Dismissal	.249	.098	.216	2.552	.012
	Internal Audit System	.033	.048	-.062	-.691	.491

a. Dependent Variable: Performance Share

The above table shows the multiple regression coefficient for both standardized and unstandardized of agency intervention. The model is shown as

Performance Share= 2.563 $+0.230$ Ownership Structure $+$ 0.306 Managerial Shareholding $+0.124$ Concentrated Ownership - 0.094 Managerial Compensation $+0.005+$ 0.249 Threat of Dismissal $+0.033$ Internal Audit System

The model explained that a unit increase of the predictors will increase the performance share by the amount of the coefficients of the predictors except managerial compensation which will decrease the response variable by 0.094 respectively. Again, ownership structure and managerial shareholding were the highest contributing variables with regards to the beta coefficients.

5. Conclusion

This study investigated the application of agency theory stating the agency conflict and the mechanism for controlling agency challenges. Agency theorists often ignore the expense of protecting against opportunistic behaviour, which can hinder business initiatives, entrepreneurship, creativity, and innovation. The challenge of agency theory, considers the different formal as well as informal institutional that are present in different contexts when examining the function of ownership. Agency theory relating to shareholders are concerned about the long-term financial success of their company, because the value of their shares depends on expectations for the long-term future. In contrast, managers might only be interested in the short-term. Managers might therefore have an incentive to increase accounting return on capital employed (or return on investment), whereas shareholders have a greater interest in long term value as measured by net present value.

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6. Recommendation and Future Work

Organisation and companies are encouraged to apply the concepts of agency theory and its challenges to further address the challenges between the principal and the mangers for efficiency. Further research is to consider the impact of agency theory in tertiary institutions in Ghana.

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