Agency Theory: An Assessment and Review  
(Katheleen M. Eisenhardt, 1988)

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Agency Theory – Organizational Research

1. What is Agency Theory?

2. What does Agency Theory contribute to organizational theory?

3. Is Agency Theory empirically valid?

4. What topics and contexts are fruitful for organizational researchers who use Agency Theory?
1. Agency Theory

- One party, the principal, delegates work (with a contract) to another, the agent, who performs that work

- Agency Cost
  - Desires or goals conflict; principal supervision
  - Different attitudes toward risk

- Unit analysis – question of the most efficient contract
  - Behavior oriented vs. Outcome oriented

- Positivist vs. Principal - Agent
Positivist Agency Theory

- Focus: conflict of Principal-Agent and the governance mechanism to overcome the agent’s self-serving behavior (agency problem) → large and public corporation.

- Proposition 1: When the contract is outcome based, the agent is more likely to behave in the interest of the principal.

- Proposition 2: When the principal has information to verify agent behavior, the agent is more likely to behave in the interest of the principal.
Principal - Agent Theory

- Focus: a general theory of P-A relationships, theoretical implications $\rightarrow$ specific assumption, logical deduction and mathematical proof (more abstract and mathematical)
- Together with Positivist $\rightarrow$ complementary.
- Proposition 3: Information systems are positively related to behavior-based contracts and negatively related to outcome-based contracts.
- Proposition 4: Outcome uncertainty is positively related to behavior-based contracts and negatively related to outcome-based contracts.
Principal - Agent Theory

- Proposition 5: The risk aversion of the agent is positively related to behavior-based contracts and negatively related to outcome-based contracts.
- Proposition 6: The risk aversion of the principal is negatively related to behavior-based contracts and positively related to outcome-based contracts.
- Proposition 7: The goal conflict between principal and agent is negatively related to behavior-based contracts and positively related to outcome-based contracts.
Principal - Agent Theory

- Proposition 8: Task programmability is positively related to behavior-based contracts and negatively related to outcome-based contracts.
- Proposition 9: The outcome measurability is negatively related to behavior-based contracts and positively related to outcome-based contracts.
- Proposition 10: The length of the agency relationship is positively related to behavior-based contracts and negatively related to outcome-based contracts.
2. Contributions to Organizational Theory

1. The treatment of information
   - Organizations can invest in information systems (budgeting, MBO, board of directors, managerial supervision) in order to control agent opportunism. → executive compensation

2. Risk implication
   - Uncertainty future of an organization must be seen as risk/reward trade-offs → vertical integration (make or buy), risk-averse executive will buy (outcome-based contract)
3. Supported by Empirical Results

1. Positivist Agency Theory
   - Proposition 1: When the contract is outcome based, the agent is more likely to behave in the interest of the principal → supported
   - Proposition 2: When the principal has information to verify agent behavior, the agent is more likely to behave in the interest of the principal → supported

2. Principal Agent Theory
   - Proposition 3 – 10 are supported
   - Linking the contract form with: information systems, outcome uncertainty, outcome measurability, time & task programmability.
4. Recommendations for AT Research

1. Focus on IS, Outcome Uncertainty, and Risk
   • Unique variables but less attention

2. Key on Theory – Relevant Contexts
   • In the situations where: substantial goal conflict, sufficient outcome uncertainty, evaluation of behavior is difficult → technology-based firm

3. Expand to Richer Contexts
   • Info asymmetry (deception) & broader spectrum of possible contract (beyond behavior-outcome)

4. Use Multiple Theories → complexity of organization

5. Look Beyond Economics