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Conflicts of Interest in Agency Theory: A Theoretical Overview

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Keywords: *agency theory, principal, agent, asymmetry of information.*

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Conflicts of Interest in Agency Theory: A Theoretical Overview

Hounaida Daly

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I. Introduction

According to Shleifer A. and Vishny R. W. "the corporate governance relates to the means by which the suppliers of capital of the company can ensure themselves of the return on their investment ". Thus, the objective of the government of company, according to these authors is limited to the maximization of the richness of the shareholders. However, such a definition fits in a current with dominant Anglo-Saxon which is founded on the prevalence of the shareholder. Other definitions dispute this design of the government of the company.

Thus, for G Charreaux (1997, p. 1)" the government of the companies covers the unit with the organizational mechanisms which cause to delimit the capacities and to influence the decisions of the leaders, in other words which controls their discretionary space." The author specifies (Charreaux, 1997, p. 1) that this definition," centered on the role determining of the leaders "

Aims at exceeding the analysis, often privileged, of the only relations between leaders and shareholders. It "replaces the problem of the government of the companies in the whole of the contracts and relations which maintains the company (and its leaders) with its multiple partners ".This definition widens the government of company to the fascinating parts like the employees, the lenders, the customers, the authorities, etc. It thus relates to all the relations between the leaders and the whole of the fascinating parts.

For O Pastré (1994, p. 18), the government of company is consisted " the whole of the rules of operation and control which govern, within a historical and geographical framework given, the life of the companies." It refers to a legal and organizational device (rules of operation and control) which aims at framing the relations of the leaders of the company and the various fascinating parts and in particular those holders of " rights on the company ".

The need for setting up a system of government of company is due to the divergences of interests between the various parts and, in particular the owners and the leaders. Such is the case when the firm is directed by paid managers (or holders of a weak share of its capital).

It results a relation from it from agency, in which, one of the parts, indicated like agent, acts in the name of the other part, called the main thing. The main thing and the agent can have divergences of interest. To lead them to conform to their engagements, and especially to align the behavior of the agent on that of the main thing, of the costs known as costs of agency must be committed.

Thus, in the current state of the literature, three principal designs as for the connection between the performance and the structure of property seem to clash[1]: the thesis of the " convergence of the interests ", the thesis of neutrality and finally the thesis of " the rooting ". According to the first thesis, constant initially by Berle and Means and in particular taken again by Jensen and Meckling [1976], plus the percentage of capital held by the leaders is significant, plus the variation compared to the traditional objective of maximization of the value is weak. 1er page

The thesis of neutrality in its purest form is that of Demsetz [1983], according to which the structure of detention of the capital constitutes an endogenous response of the process of maximization of the profit, function of the characteristics of exploitation of the firm and pressures exerted by the environment (external markets); in other words, all the structures are equivalent.

Lastly, the thesis of the rooting supports on the contrary that the leaders who have a solid majority of the capital, escape any control and can thus manage from a contrary point of view with the maximization of the value.

The object of this research is to show that, within the framework of the current debate on the

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[1] Charreaux, G(1991) « property structure , agency relation, and financial performance »Economic review, flight 42, 1991.

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government of company, the starting point of the theory of agency is the divergence of interests between the owners and the leaders. Thus, our discussion thread throughout this research is the answer to the question:

How presents the conflicts of interests in the theory of agency?

The paper is organized as follows: Section 2 reviews the origin of the interest conflicts. Section 3 analyzes the divergence of the interests between leaders and shareholders. Section 4 presents effects of the conflicts of interests and in the end we have concluding remarks.

II. Origin of the Interest Conflicts

The need for setting up a system of government of company is due to the divergences of interests between the various parts and, in particular the owners and the leaders. Such is the case when the firm is directed by paid managers (or holders of a weak share of its capital).

It results a relation from it from agency, in which, one of the parts, indicated like agent, acts in the name of the other part, called the main thing. The main thing and the agent can have divergences of interest. To lead them to conform to their engagements, and especially to align the behavior of the agent on that of the main thing, of the costs known as costs of agency must be committed.

Thus, the theory of the agency, developed in particular by Jensen and Meckling, concentrates on the relation between the main thing, agent of an authority, and an agent to which is deputy the realization of a task. This delegation, in a context of asymmetry of information, generates conflicts of interests which should be channeled.

Jensen and Meckling (1976) and Fama (1980) reconnect three sources of conflicts. First of all, the leaders tend to misuse the free cash-flow in kind by granting advantages which harm the performance of the company (Jensen, 1986.) Thereafter, and contrary to the leaders who invest in human capital, the shareholders bring into play their financial capital. Consequently, the behavior of the shareholders and the leaders with respect to the risk differs (Amihud and lev, 1981). Finally, the conflicts can result owing to the fact that the leaders privilege the short-term investments considering their presence within the company is at limited horizon (Fama and Jensen, 1983).

a) The Separation between the property and capacity

Jensen and Meckling (1976) defined the relation of agency thus “as a contract for which one or more people (the principal) urges another person (the agent) to carry out on her behalf an unspecified spot which implies a delegation of some decision-making power to the agent”.

The theory of the agency, developed in particular by Jensen and Meckling, concentrates on the relation between the main thing, agent of an authority, and an agent to which the realization of a task is deputy. This delegation, in a context of asymmetry of information, generates conflicts of interests which should be channeled.

If S.A. Ross is the first speaking about agency theory, the concept is already present in the theory of the insurances. It gave rise to two currents distinguished by Jensen and Meckling:

- *The positive theory of the agency* which approaches management, milked in priority mechanisms actually implemented to treat relation of agency and to solve the conflicts. Jensen and Meckling are the founders.
- *The normative theory of the agency* is prescriptive. It is attached to the problems of economic modeling in imperfect information.

The starting report of the theory of the agency is simple: the individuals have divergent interests which make that the relations of collaboration do not go without conflicts. The cost of these conflicts reduced of as much the benefit drawn from the common action and draws aside the balance of the economic optimum.

The theory then aims either at explaining the organizational forms as mode of reduction of the costs of agency (positive theory), or to propose mechanisms of control and incentive aiming at reducing these costs (normative theory).

b) The relation of agency

Jensen and Meckling (1976) define " a relation of agency like a contract in which one (or several people) has recourse to the services of another person to achieve on her behalf an unspecified task, which implies a delegation of decisional nature to the agent ".

The relation between the principal and the agent includes several characteristics:

- It rests on a relation of authority. The agent accepts, realising remuneration, to yield part of its decisional rights to achieve the mission which was entrusted to him, by taking account of the objectives of the main thing.
- The relation of agency is asymmetrical. The main thing is not able to evaluate exactly the effort implemented by the agent. It is vis-a-vis a moral risk.
- It brings into play rights of propriété16. The main thing transfers to the agent, in a provisional way, part of its right of ownership on the credits implied in the deputy mission.

In this context of asymmetry of information and impossibility of writing complete contracts because of limited rationality and of dubious, the conflicts of agency can occur at the same time at the pre and post-

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contractual stages. This analysis joined the study of opportunism by Williamson.

Nicolas Curien summarizes in a sentence all the difficulty of the relation of agency: "[...] the actor in position of principal controls the rule of the game, without holding all useful information, while the actor in position of agent yields with the rule while controlling the margin of uncertainty which its advantage in term of information confers to him."

The relation of agency constitutes a standard elementary relation between two agents. The concept can be extended and gives place to rich developments.

c) Extensions of the relation of agency

i. *The dyadic relation of agency or collaboration*

Since 1976, Jensen and Meckling establish a widening with the relation of agency by considering that the relation of authority is not necessary. Their reasoning can more generally apply to any relation of co-operation:

" Let us notice, also, that the efforts of costs of agency appear in all the situations which imply an effort of co-operation [...] by two or more than two people even if there is no clearly definite relation main thing-agent ".

This vision makes it possible to not take into account the utility of the only main thing, but the interest of the two partners. The stake is not limited any more to reduce the conflicts, but to find the conditions of an advantageous co-operation.

ii. *The taking into account of the whole of the fascinating parts: the organization like node of contracts*

The interests concerned are not only summarized with those of contracting. Taking into account the externalities, the fascinating parts with the contract are much more numerous. For example, the relation shareholder-leaders has impacts on the employees or the consumers. This crossing between multiple interests leads to an explanation of the existence of the organizations.

The organizational forms can be explained by considering that they result from a minimization of the whole of the conflict costs, rising from the superposition of various relations of collaboration between the whole of the fascinating parts. Thus, part of the externalities can be internalisée by the constitution of a firm. The firm then becomes a "contracting nexus".

Jensen and Meckling deduce a theory from it from the organizational architecture, with which two significant dimensions are associated:

– The allowance of the decisional rights inside the organization, by distinguishing the rights related to management of the decision and those related to control from the decision;
– The systems design of control, which associates the system of evaluation and measurement of the performance and the system of incentive which, according to the measured performance, founds sanctions or rewards.

III. The Divergence of the Interests Between Leaders and Shareholders

The need for setting up a system of government of company is due to the divergences of interests between the various parts and, in particular the owners and the leaders. Such is the case when the firm is directed by paid managers (or holders of a weak share of its capital).

a) The nature of the divergences

The nature and the importance of the conflicts between the parts are an in particular function of the structure of the rights of ownership of the firm (Couret, 1987 and Fama, Jensen, 1983)[2]. The right of ownership of the shareholder supposes at the same time his appropriation of the profits released by the firm and the free transfer of its right of ownership.

However, the exercise of this right differs according to whether the company is of type "shareholder" (the leaders are the principal shareholders), from "controlled" type (the company is subsidiary of a group), of type "managérial" (the shareholding is dispersed), "mutuality or co-operative" (the shareholding is non-existent), "public" (the State exerts, sometimes with difficulty, its role of owner). In the case of the “firms managériales” - controlled by their leaders the right of ownership of the shareholders is attenuated and their limited supervisory powers.

b) The origin of the divergences

These divergences have three principal origins (Charreaux, 1999)[3].

Firstly, the shareholders wish to maximize the return on their financial investment, while the leaders are inclined to benefit from their position to perceive no pecuniary benefit of the control which they exert on the entrepreneurial resources. The seconds tend to seek the growth of the sales turnover to the detriment of the profitability of capital invested: that enables them to obtain a higher social status, a larger immunity compared to the shareholders, a stronger remuneration and a more significant satisfaction of the personnel since the prospects for promotion are more numerous.

Secondly, the shareholders can diversify their wealth of distributing it on various credits, whereas most of that of the leaders (their human capital and their remuneration in particular) is dependent on the evolution of the company. The leaders thus will test an aversion with the risk more significant than the shareholders,

[2] Quoted by Pluchartm J-J and Hamza, T(1994) « from the agency relation to the corporate governance »P. 304.
[3] City by Poulin-Rehm, T « corporate governance and employee ownership » financial review.

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which generates deviating behaviors: they can be encouraged to follow a policy of diversification in contradiction with the interest of the shareholders or to refuse a beneficial project because of the personal risks perceived like too high. Considering his increase in richness insufficient to compensate for the personal costs inherent in the realization of new investments, the leader adopts a position with tendency attentist.

Thirdly, the leaders have a decisional horizon limited to their presence in the company. However, the quoted value of a company takes account of the whole of the flows generated by each project and this, whatever their horizon. The richness of the shareholders is affected by all foreseeable flows of the company, whereas the leaders privilege the evaluation of the projects according to their contribution to the results in the short or medium term remaining and of the duration to run.

This opportunist behavior of the leaders and the divergence of interests with the shareholders which results is not the only condition to see being born a relation from agency. The second condition posed relates to the existence of a situation of informational asymmetry. Any conflict, to be proven, implies an imperfect absorbability of the efforts of the agent. The divergence of interests is not sufficient because, in a universe without uncertainty, it would be possible to draw up a contract making it possible to encourage the agent to act in accordance with the wishes of mandant. In all the cases, the existence of relations of agency is not without consequence on the value of the company.

c) Asymmetry in the distribution of information, the problem of opportunism

Asymmetry in the distribution of information associated with a divergence with the interests give rise to the problem of agency. Indeed, if there is not divergence in the preferences of the actors, informational asymmetry will not pose problems insofar as the agent chooses its action in agreement with the main thing. In the same way, in the absence of problem of informational asymmetry, the possible conflicts of interest will be easily overcome insofar as the main thing immediately detects any opportunist behavior on behalf of the agent. However, the relation of agency exists only because the principal one considers the agent placed better than him to manage its good. It recognizes capacities and knowledge private individuals to him. The asymmetry of information is thus at the origin of the contractual relation (P.Y.Gomez, 1996)[4].

The problems of agency are related the 2nd time to uncertainty, with the imperfect absorbability of the efforts of the agent like at the costs of establishment and execution of the contracts. The complexity of work managerial which cannot be the subject of a precise specification, the shareholder is exposed, consequently, with the opportunism of the leader. Thus, more the environment will be dubious, asymmetrical information and the measurement of the problematic individual effort, more will be the risk of negligence's prejudicial to the interests of the shareholders.

The relations of agency thus let foresee with new the problems of moral risk, unfavorable selection and opportunism. Indeed, the leaders who have the load of the business management have information privileged on its operation. Moreover, the shareholder always does not have necessary competences allowing him to know if a transaction serves its own interests or those of the leaders. It is then possible to the manager to adopt an opportunist behavior by handling the information of which it has management, communicating only what serves its interest. The opportunism of the manager can lead it to divert for its personal profit decreasing by as much the residual profit of the owner. The main thing will have to thus set up a system of incentive and mechanisms of control if it wishes to limit the losses caused by a divergence of interests (Mr. Jensen and W Meckling, 1976; E Fama, 1980). The installation of techniques of control and systems of incentive to ensure the good unfolding of the contracts will generate costs of agency. Those can be included like costs of organization and represent symmetrical costs of transaction.

IV. Effects of the Conflicts of Interests

The need for setting up a system of government of company is due to the divergences of interests between the various parts and, in particular the owners and the leaders.

These "divergences of interests" and the "asymmetry of information "between shareholders and managers, involve "costs of transaction" (Williamson, 1965) where" costs of agency " (Jensen, Meckling, 1967).

a) Costs of agency

The costs of agency are born in any situation which causes a co-operative effort between two or several people, even if it does not have there clear relations principal/agent. As previously established, it is impossible for "the principal" to ensure null cost that the agent will make optimal decisions from the point of view of the main thing.

In the majority of the relations of agency, the main thing and the agent will undergo costs of monitoring and obligation. Mr. Jensen and W Meckling (1976) distinguish three types of costs:

- Costs of monitoring supported by the main thing to limit the opportunist behavior of the agent and costs of incentive (systems of profit-sharing) engaged by the main thing to direct the behavior of the agent.

[4] City by Demsetz, H « confidence and governance », 6 march 2005.

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- Costs of obligation or costs of engagement which the agent can itself have incurred to put the main thing in confidence (cost of motivation). *" the costs of engagement result from the drafting by the firm of financial reports/ratios and from the realization of audits by experts external at the firm "* H. Gabrié and J.L. Jacquier (2001, p.248).
- The third type of cost is an opportunity cost, called " residual loss ", which is assimilated to the loss of utility undergone by the main thing in consequence of a divergence of interest with the agent, like the cost undergone by the main thing following a management by the unfavorable agent with the interests of this one. Thus, in spite of control and engagement, there will always remain a certain divergence between the decisions taken by the agent and those which would maximize the wellbeing of the main thing.

This definition of the costs of agency is connected with the problem of the cheating and the monitoring of a production line team. The costs of agency vary according to the firm, they depend on the tastes of the managers, the costs of monitoring of the performance of the manager and finally of the cost of the design and the application of an index to compensate the manager who satisfies the wellbeing of the owner.

In order to fight against these deviations, the governance of company brings into play levers of alignment of the behavior of the leaders. Since the theory of the agency regards the firm as a legal fiction being used as nodes for a whole of contractual relations inter individual (Mr. Jensen and W Meckling, 1976), one can apprehend it as a system of incentive where the direction plays a hinge role.

b) The performance of company

The study of the problems involved in the relation of agency originates in the interrogations of Adam Smith (1776) on the inefficiency of the companies whose direction was entrusted to an agent not-owner. *" the directors of these kinds of companies (joint stock companies) being the managers of the money of others rather than of their own money, one can hardly expect that they bring this exact and concerned vigilance there that associates often bring in the handling of their funds. The intendants of a particular rich person, they are carried to believe that the attention on the small things would not be appropriate for the honor of their Masters and they are very easily exempted to have it. Thus, the negligence and the profusion must always more or less dominate in the administration of the businesses of company "* A. Smith(1776, p.401).

Berle and G Means (1932) will prolong the reflexion by showing that separation between the property and the control led to a situation where the divergence of the interests between owners and leaders is problematic. Indeed, the large modern companies would be directed by managers who would not have any reason to have the same objectives as the owners of the capital. The relation actionnaire/dirigeant is then presented as a particular case of the relation of agency

The design of the firm according to the theory of the agency is connected with that proposed by the theory of the rights of ownership which represents the firm like a form of organization of the production in team (A. Alchian and A. Demsetz, 1972). Mr. Jensen and W Meckling (1976) will do nothing but widen the design of A. Alchian and H. Demsetz (1972) by including in their analysis the whole of the contracts drawn up between the organization and his environment, and not only the contracts related to the function of production. Complementary to the economy of the rights of ownership, the theory of the agency constitutes today the framework dominating of analysis of the firm (Mr. Jensen and W Meckling, 1976). *" the firm is designed there like a whole of contracts which, in a universe of imperfect information, ensure the management of the individual conflicts and channel the behaviors through the installation of suitable incentives "* P. Cohendet and P. Llenéra (1999, p.211).

This current proposes to regard the organizations as a node of contracts. The gasoline of the firm is in the contractual relations (employed, suppliers, customers). This one is not assimilated to an individual; it is a fiction which is used as hearth with a complex process in which the conflict objectives of the agents are brought to balance through a whole of contractual relations. Its starting point is thus the analysis of the relation.

V. Conclusions

This research constitutes an attempt at analysis of the divergences of interests in the theory of the agency in the light of the theoretical and empirical basic elements.

Our objective consisted in studying the conflicts of interests in the theory of agency. In a first stage, we were concerned with analyze the theoretical framework of the conflicts of interests. In a second stage we tried to bring some remedies suggested for the relation of agency. Lastly, we primarily treat the divergences of interests in the agricultural cooperatives by taking account of the co-operative mechanisms contributing to reduce where to solve these conflicts.

Indeed, the theory of the agency, through the model "shareholder" is useful to describe the contractual relations between all the speakers and to explain the government of the agricultural cooperatives. However, the agricultural cooperative is a "contracting nexus" which is the place of crossing of several fascinating parts, whose interests can diverge.

Thereafter, the economic theories of the contract contribute to characterize the relations between these fascinating parts and to propose an interpretation of it.

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So some problems arising from the conflicts of interest within the framework of these relations can be to regulate by the bodies of government of the co-operative: the general meeting of associated and the board of directors.

Thus, it is deduced that the conflicts between the associated owners and leaders are limited in the agricultural cooperative:

Initially, the conflicts between associated co-operators and administrators (including the president) are of a weak range because of the low divergence of interest between the parts (economic identity of situation, even professional culture and homogeneous group).

Then, the conflicts between owners and director (or top executives), the strategies of rooting of the leaders are difficult to implement, for several reasons. Initially, the participation, with the daily newspaper, of associated the activity and the operation of the co-operative, which enables them to supervise the business management. Then, the activity of monitoring of the administrators and the president, who are also decision makers. Lastly, the director incarne not the function of contractor which returns to associated and with their elected officials.

Lastly, as for the conflicts of interest with the lenders, the latter often belong to the co-operative movement (co-operative banks in particular) and finalize the contracts with the president of the co-operative. In addition, the practices of these organizations and the values shared contribute to reduce the costs of agency.

The theoretical examination of the operation of the agricultural cooperatives makes it possible to conclude temporarily that their specificities and their operation make it possible to reduce the conflicts of interest and the problems of governance.

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