WWW.IJRPR.COM

International Journal of Research Publication and Reviews

Journal homepage: www.ijrpr.com ISSN 2582-7421

How Agency Theory Can Be Used to Improve Financial Management

Mounesh

PES University, Bangalore

ABSTRACT

The primary principal of this article is to describe how organisational accounting evolved and to what extent we think the model of agency may be used to expand the idea of executive accounting. The opening section of the essay discusses variables that have influenced governance management advancement. The description of the three main areas of the belief in agency and their effects on the sciences are given special attention. The general potential approach towards employing the organisation theory inside organisational budgeting is also discussed in the article. In order provide the spotlight on agency issues impacting Australian finances managing and financial preparation, we enhance a significant addition to the body of research on the concept of agency. We subsequently employ this addition in combination with various additional conceptual developments. The rationale for actively controlled pure charge for-service pricing

Key points

• The interaction amongst owners (like clients) and agency (like directors) in the handling of finances is examined using the conceptual structure of the concept of agency. •Acknowledging the disputes among interests that might occur involving the owner actors the agent is one of the primary consequences of agency philosophy application for the handling of finances.

• Info inequality in in relationship between the principal and an agent, because agencies may have greater insight than principles, might cause issues with representation. Agency theory implications for financial management

• Differences between interest groups give a boost to responsibility expenses, which could encompass monitor expenses; bonded expenses and remaining loss.

• In order to alleviate agency issues and lower agency expenses, accounting procedures must concentrate on coordinating the desires of the owner and agent.

I. INTRODUCTION

Strategies and money turn prove to be insufficient. Particularly in the event of clients close to the future, a manager who is engaged should not expose additional funds to risk over the consumer's whole investable capital. Constantly controlled institutions' asset-based expenses ought to have an upright element. It is essential to adopt adaptable techniques and strategies in this increasingly chaotic time due to the constantly changing financial climate. Strong demands for cost cutting and effectiveness improvement that came from the battle for economy were mirrored in managerial approaches used by various businesses. These factors deserve to be considered when conducting finances, which prompts us to reconsider and expand upon this idea in the way it started. The application of some basic theory concepts to executive bookkeeping might lead to fresh perspectives and, eventually, the resolution of several of the most pressing problems of the moment. The purpose of the study is to use the concepts of agency in order to clarify what organisational for managers developed along with where we believe there is room for additional advancement of the idea.

II. REVIEW OF LITERATURE

A popular hypothesis in finances and business that looks at the interactions among principal and their clients is called the concept of agency. The primary figure in the overall picture of money oversight is the organization's the proprietor, while the intermediary is the one in charge. According to the argument of agency, there exists an inevitable dispute that arises involving the two parties since agencies may be more motivated to behave in the interest of themselves than in the most beneficial intentions. of the principal. The resulting difference of interests may result in issues related to agency, who might harm the company's bottom line. Samples of the manner in which the idea of agency can be used in managing finances are given below:

- The dichotomy of authority and governance can result in problems for agencies, as Jensen & Meckling in 1976, have shown through the development of an agency's expense theory.
- The advent of the corporate company, according to the research of Berle and Means (1932), caused the division of owner from management, which ultimately resulted in agency issues.

- In their 1983 financial planning theory, Fama, as well as Jensen, demonstrated how the usage of equity, debt, the shares other forms of financing might be used to reduce agency concerns.
- Eisenhardt, who died in 1989, created an explanation of strategic planning that illustrated ways the exercise of management flexibility might be used to address agent concerns.

III. METHODOLOGY

The manifestation of agency issues in the handling of money can take many different forms. For instance, agents might invest excessive amounts of money on privileges and bonuses, take on a great deal of risk, or create choices that are in their best interests rather than those of the organisation. Communication asymmetry—where the intermediary knows a greater deal about the organisation than its principal—can also result from agency difficulties. Because of this, it could be challenging for the person in charge to keep an eye on the representative's conduct to be confident that they function for the greater good of the business.

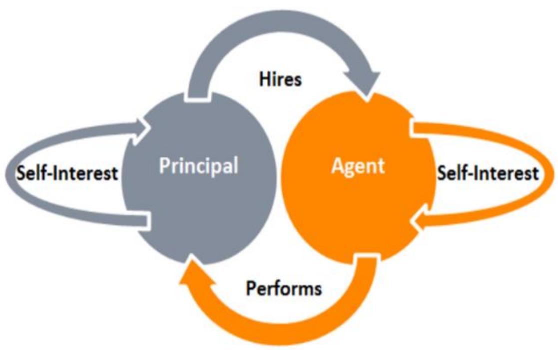
To reduce difficulties with regard to cash administration, a variety of approaches can be implemented. These consist of:

- **Rewards:** Agents may get rewards for acting in a principal's finest pursuits, which might include options on stocks or bonus based on the success of the business.
- **Tracking:** The principle can keep an eye on the actions taken by the agent to make ensure there are taking their orders into consideration. Audits, assessments of achievement, and other methods may be used to accomplish this. Agency theory implications for financial management
- **Organisational control**: To assist reduce agency issues, the main entity might set up a structure of corporate oversight. This may entail establishing a committee of executives that is separate from managers and an assortment of rules and regulations that control how the business is run.

IV. THE AGENCY THEORY

For the last 25 years, the concept of agency has served as regarded as among the oldest and most significant conceptual structures in management accounts. Given the perspective of principal-age, this idea offers an extensive intellectual foundation for analysing organisational activities. According to Jensen's definition from 2000, an agency connection is one during which two or a few individuals are parties to an agreement.

Figure 1:



To undertake an activity in his favour, (the principle) hires one and multiple individuals (agents), which necessitates granting them some decision-making authority. According to agencies theory of agencies, this is a commercial connection between each of them, and one of them can be regarded as the principle, directorship or the manager, while one of them is considered to be a broker. The owner will provide each agent the right to make decisions.

First, exists an arrangement involving both principals & the agents that outlines the requirements for Performance of the agent will be assessed.

Figure:2

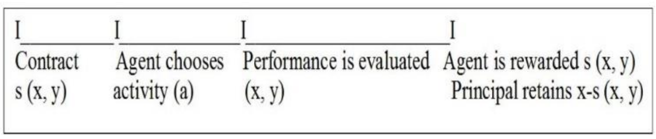


Fig. 1. Agency theory, source: Author, adapted from Lambert (2001)

"s" stands for the corresponding function, "x" stands for the firm's bottom line, & "y" stands for a vector.

used to assess how well the arrangement is performing Agent chooses the "a" scalar hustle and bustle, which might be either in effect, money. or investment-related. Endogenous agents along with other elements that have an impact on how the organization's outcomes are implemented. The agent gets compensated in accordance with the deal after we mutually examined our business's outcomes. When critical presumptions are maintained, this series events proceeds without incident.

The business's success can be quantified and may also be legally enforceable. Additionally, it is thought that "x" may become profitable and apply to a single time. Senior fails to fully watch this alternative and the agent is free to take his or her own actions / stages. Events outside of the agents authority may be influenced by the outcome. Both the client and the middleman incur some degree of risk; within all, the more the intermediary's assumed risk, the greater the representative's remuneration. The theory of agency is able to be seen from a standards or beneficial viewpoint (Jensen, 1983).

Since Friedman, among others the phrase has been applied to accounting and stems from beneficial attitude. Control techniques that prevent self-serving are described by optimistic theory. The relationship of entrepreneurs and business owners is mostly the focus (Eisenhardt, 1989). According to Eisenhardt, who (1989), norm notion of agency emphasises on creating a more comprehensive framework that may be used to explain a variety of interactions, including employees and employers and buyer-supplier ones. An economy' complete narrative viewpoint of the organisation may be enhanced by adopting an optimistic model agency perspective. We might characterise prescriptive notions of agent as a broader strategy with a larger emphasis and an attempt to put forth the best answer to the issue.

V. PROBLEM OF AGENCY THEORY

The main issue with an agency arrangement as we've defined it above has to do with the conduct of the agent including his need to maximise one's and utility role, and could prove to be in keeping with the goals that constitute the primary. The issue of agencies is brought up by this, wherein a representative might not operate in their principal's finest interests. Communication imbalances, ethical risks, and selection bias, as described by Akerlof (1970), characterise the notion of agency theory.

A particular kind of shareholder-manager connection as has drawn investigation's notice in the subject matter of corporate budgeting is also connected to the matter of agency. Regarding the shareholder-manager interaction, it is essential that the with and managers of the organisation be kept separate. A circumstance in which one of the shareholders fails to watch the manger's behaviour may result from the decoupling. This might increase the danger that the management won't operate in the best benefit of the stakeholders and instead start acting opportunistically. They might envisage a variety of opportunism behaviours emanating from the substance including but not limited to fraud, ineptitude, excessive drinking, and apathy.

The most well-known type of this deceit is likely tunnelling, in which an accomplice tries to covertly syphon money from the business he manages. We define inappropriate use of a servant as any use of it that has no immediate relationship to the accomplishment of its duties within the organisation. Whenever an agent approaches the job lazily, it also affects how well it performs what it does. When a contact is unqualified, we encounter shortcomings in the fundamental managerial abilities that are related to the role. The everyday activities of the organisation are compromised by this kind of agent behaviour. That shareholder-manager partnership is subjected to a risk as a result.

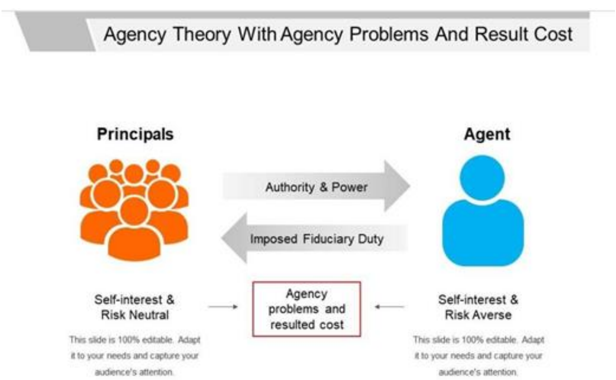
Baiman (1990) conducted a thorough investigation of the notion of agency concept, which offers examination of the key academic tenets and practical challenges that emerge when modelling business finance concerns using action hypothesis's point of view. The three fundamental sections of the idea of agency that may be used in the field of executive accounting study are identified by the writers.

- the principal-agent theory
- Model of transaction costs in economics
- Rochester-style

We briefly address the fundamental advantages of such designs in this section. Once the hypotheses are applied to the field of business finances, we also draw attention to their limitations.

- **The principal-agent theory**

Figure:3

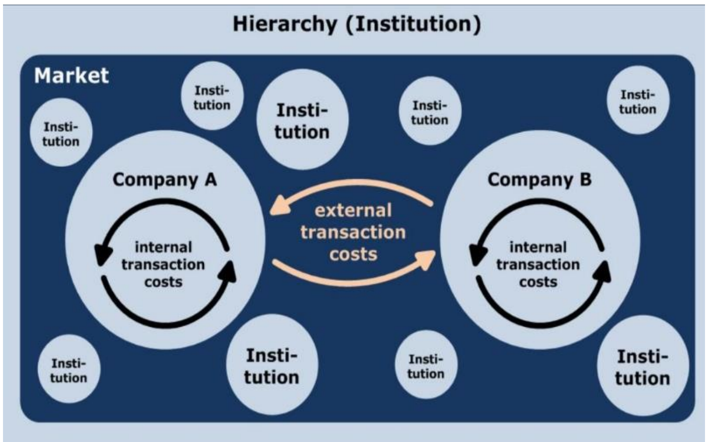


We concentrate on the selection of beforehand contractual along with data systems compatible that follow the principal-agent concept. The theory depends on the reasonable behaviour of people and makes the assumption that people are ability to foresee and assess the likelihood of foreseeable occurrences. Depending by their stated interests and views, people in the system internally originate their behaviours. We anticipate that people will behave precisely as per their particular inclinations. Partnerships are full in the way in which they specify the activities the two sides are to perform in response to any given event. The framework anticipates that obligations under contracts will be completely justiciable. There is a general expectation of information inequalities for principal-agent frameworks. Agent possesses knowledge that the owner of the business cannot easily get for free. The individual is also thought to be cautious about risk, bringing it all together. According to Baiman (1990), the principal-agent paradigm in management the discipline's primary benefit is to assure

A clear and practical approach that allows us to demonstrate executive accounting and envision leadership accountancy issues. The principal-agent framework may be found in accounting for management literature, such as Kaplan (1982).

- **Model of transaction costs in economics**

Figure 4:



The model makes the assumption that people are doing what's in their personally best interests. This is an example of opportunism behaviour, in which people prioritise their personal interests before following the laws. Here, as opposed to the principal-agent paradigm, we believe that people have restricted rational. Because of constrained reason. As a result, it is impossible for anybody to predict every potential future occurrence, and as a result, it is also impossible to explicitly ex ante include unanticipated occurrences in labour agreements. In contrast to the principal-agent method, this approach makes the assumption that deals are not fully formed.

The concept explains anomalous interactions between businesses that are actively attempting to acquire or exercise monopolistic power. In accordance with modelling, it was determined that a portion of these interactions may exist in order to reduce the price of transactions. Unlike effective principal-agent method, that emphasises on greater commercial connections in the organisation, the one presented here concentrates on resolving of agreements on contracts amongst businesses. The paper "Relevance Lost" by Johnson had & Kaplan (1987) provides a template economic the fees for transactions in managerial accounts in possibly its best-known use. According to the writers, the organisation offers a competitor to economic growth coordination through the economy. A critical component of business accounting as business setting that offers organising data and keeping track help.

- **Rochester-style**

The 1976 study by Jensen and Meckling research provides the foundation of the Rochester concept. This framework and the purchase cost-economy framework, which also takes into account impulsive actions & the expenditures, of transactions, are quite similar. But according to the research of Watts and Zimmerman (1986), the model rests on favourable budgeting hypothesis. The Farmington model's application to agency problems with the goal of comprehending where the organization's difficulty arises and how the system of organisation might lessen it. Studies centred around the advantages of the Rochester framework has a propensity to pinpoint instances where it is clear that the principle and agency have different values and analyses regarding value for money in the context of controls measures (Hoque, 2006).

The three approaches offer a comparable structure for examining how people behave in a monetary setting in order to comprehend the decreased efficiency brought on by People's different tastes as well as a discussion of the effects of different controls designed to reduce the loss of productivity brought on through the challenge of agency. The governmental problem's loss of efficiency has presently rendered management finance more necessary in the organisation.

VI. Application of the agency theory to financial management

According to Roirdan (1987), the importance and function of administrative accounts is going to depend upon if we believe that the agreement reached completion under the hypothesis of responsibility. It must be also recognised that, in addition to substances, owners can also act impulsively if given the chance. Nevertheless, the majority of the theory's studies makes the assumption that because the principal's judgements are transparent and contractable, thereby they cannot be vulnerable to moral risk.

We discovered can there has been a rising need for technologies that track the supervisor's behaviour by fusing the idea of agency with management budgeting. methods. It is also necessary to regulate and keep the expense oversight under limit. The firm must weigh the advantages and disadvantages of inspection. The importance provided by data in business accounting is directly impacted by manager behaviour, which is described by the principle of agency. Given this viewpoint, we must take into consideration when this knowledge is employed and how much is their worth for the organisation. Acquiring data from leadership for management does not come without expense. The gathered data ought to expose an organization's gratifying management or agent.

We pinpoint issues with business accounting, these are further explored throughout the study on the idea of agency. The motives and repercussions of the split of administration and leadership, which is a feature of modern enterprises, are covered in the first section. Agency's expenses and their effects on company value are discussed in the next section. When attempting to establish the framework of contract interactions wherein the middleman would protect the rights of the basic principle, a third issue relates towards the economic connection that exists between both the principle and the agent. The favourable theory may be applied to the initial two attempts, whereas the theory of norms is more appropriate for the third one.

VII. CONCLUSION

Although there have been considerable advancements in administration accounting over the past 200 years, there is still a long way to go before administration accounting is fully developed and can concentrate more on meeting the demands of businesses according to business theory. We have developed an arrangement for comprehending and analysing interactions inside the organisation when a single party delegated decision-making responsibilities to different parties by fusing accounting management with the idea of agency. Identifying the interactions amongst agents and the owners in managing finances may be done with the help of the concept of agency. It may be useful in identifying solutions to agency issues and methods to enhance the the business's profitability as well as in explaining why certain businesses do more well than competitors.

BIBLIOGRAPHY

1. Aljifri, Khaled, and Sunil Kumar Khandelwal. "FINANCIAL CONTRACTS IN CONVENTIONAL AND ISLAMIC FINANCIAL INSTITUTIONS: AN AGENCY THEORY PERSPECTIVE" 4, no. 2 (2013).
2. Boučková, Markéta. "Management Accounting and Agency Theory." *Procedia Economics and Finance* 25 (2015): 5–13. https://doi.org/10.1016/S22125671(15)00707-8.
3. Bricker, Robert, and Nandini Chandar. "On Applying Agency Theory in Historical Accounting Research," n.d.
4. "EmeraldInsight_citations_20230610125730.Ris," n.d.
5. Jassim, Amir, Carolyn R. Dexter, and Aman Sidhu. "AGENCY THEORY:" *Managerial Finance* 14, no. 4 (January 1, 1988): 1–5. https://doi.org/10.1108/eb013600.
6. Javaid, Hafiz Mustansar, and Snober Javid. "Determining Agency Theory Framework through Financial Leverage & Insider Ownership: Evidence from Pakistan." *International Journal of Economics and Finance* 9, no. 3 (January 30, 2017): 21. https://doi.org/10.5539/ijef.v9n3p21.
7. Kingston, Geoffrey, and Haijie Weng. "Agency Theory and Financial Planning Practice: Agency Theory and Financial Planning Practice." *Australian Economic Review* 47, no. 3 (September 2014): 290–303. https://doi.org/10.1111/14678462.12053.
8. Naz, Muhammad Azeem, Rizwan Ali, Ramiz Ur Rehman, and Collins G. Ntim. "Corporate Governance, Working Capital Management, and Firm Performance: Some New Insights from Agency Theory." *Managerial and Decision Economics* 43, no. 5 (July 2022): 1448–61. https://doi.org/10.1002/mde.3466.
9. Seal, Will. "Management Accounting and Corporate Governance: An Institutional Interpretation of the Agency Problem." *Management Accounting Research* 17, no. 4 (December 2006): 389–408. https://doi.org/10.1016/j.mar.2006.05.001.
10. Shapiro, Susan P. "Agency Theory." *Annual Review of Sociology* 31, no. 1 (August 1, 2005): 263–84. https://doi.org/10.1146/annurev.soc.31.041304.122159.

---

1. Shapiro, "Agency Theory."
2. Kingston and Weng, "Agency Theory and Financial Planning Practice."
3. Jassim, Dexter, and Sidhu, "AGENCY THEORY:"
4. Naz et al., "Corporate Governance, Working Capital Management, and Firm Performance."

5. Javaid and Javid, “Determining Agency Theory Framework through Financial Leverage & Insider Ownership.”
6. “EmeraldInsight_citations_20230610125730.Ris.”
7. Aljifri and Khandelwal, “FINANCIAL CONTRACTS IN CONVENTIONAL AND ISLAMIC FINANCIAL INSTITUTIONS: AN AGENCY THEORY PERSPECTIVE.”

1. Boučková, “Management Accounting and Agency Theory.”
2. Seal, “Management Accounting and Corporate Governance.”
3. Bricker and Chandar, “On Applying Agency Theory in Historical Accounting Research.”