THE PROBLEM OF INCENTIVES IN BUILDING CORPORATE GOVERNANCE MODELS

Joaquim Rubens Fontes Filho*, Moisés Balassiano**

Abstract

The attempt to align interests of executives with those of shareholders has been addressed in the corporate governance context from a predominantly economic outlook based on the agency theory. The models that combine monitoring and control systems in association with financial incentive mechanisms, such as profit and income sharing, stock options, bonds and other benefits, consider an individual to be individualist, opportunist and self-interested, diverging from the assumptions of other theories and contemporary ideas in the area of human resources management. Based on the criticism related to the agency theory, particularly when drawing up incentive schemes, this article aims to look at alternative theories to build corporate governance practices that include considerations on extrinsic and intrinsic motivation of agents.

Keywords: corporate governance, agency costs, stock options

*Professor of corporate governance and strategy, Brazilian School of Public and Business Administration, Getulio Vargas Foundation (FGV/EBAPE), Rio de Janeiro, Brazil. Joaquim.rubens@fgv.br
** Professor of quantitative methods and career management, Brazilian School of Public and Business Administration, Getulio Vargas Foundation (FGV/EBAPE), Rio de Janeiro, Brazil. Moises@fgv.br

1. Corporate governance as an agency problem

Discussions on corporate governance have intensified in the business environment, affecting many different countries. Quite a few explanations justify this interest, such as the need to improve capital structure, facilitate access to investor resources, the need for further corporate social responsibility, or even to prevent problems such as recent events in the Enron, WorldCom and Parmalat cases.

The interest in corporate governance issues may have originated in the 1930s with the analysis by Berle and Means (1932) on fragmentation of ownership of the modern corporation among its multiple shareholders, according to a study on the North American context. This fragmentation dilutes the interests of monitoring the owners, permitting executives to assume ample voting rights at shareholders’ meetings based on proxy votes. The so-called “good practices” of corporate governance are now pursued and demanded primarily by institutional investors, considered to be a way for the investor to recover its power in the organization. Later studies, which showed a higher market value for businesses that adopted these practices, contributed significantly to multiplying adoption of governance (Shleifer and Vishny 1997).

The definition of good corporate governance practices considers the basic guidelines to be disclosure, fairness, accountability, compliance and ethics. The locus for implementing these practices, par excellence, is the board of directors and its committees.

The question that has driven most studies on corporate governance is the separation between ownership and control and agency problems caused by this separation (Denis 2001). The result is then that the prime objective of corporate governance is how to assure that executives pursue the objectives determined by the shareholders and board of directors: the so-called agency problem. Although in most countries ownership is not very scattered and, in fact, on the contrary, where control block holders emerge with economic benefits in the effective accompaniment of the administration, the agency problem is also apparent, but located in the relationship between control and minority holdings.

The idea of agency theory is precisely to address problems arising from this separation between ownership and management, or control and minority shareholdings, caused by differences in motivation and objectives between owners and managers, asymmetry of information and risk references. It is the prevailing theoretical view applied to corporate governance studies (Daily, Dalton and Cannella 2003; Shleifer and Vishny 1997, Aguilera and Jackson 2003, Lynall, Golden and Hillman 2003).

The basic premise of agency theory is that, if both parties in a principal-agent relationship seek to maximize their utility function, the agent will not always act in the best interest of the principal. The principal can restrict interests other than its own by setting appropriate incentives for the agent and
incurring monitoring costs estimated to restrain the agent’s extravagances or anomalous activities.

However, in contexts where there is no evident effort required by the agent, or when there are multiple owners with non-converging interests, the references based on agency theory may be of little use in understanding the pressures on administration and to model suitable incentive solutions. In such situations, when failing to define clear results comparable to the market, the major concern of those executives is to seek legitimacy of the organization and its activities as administrator (Nilakant and Rao 1994), reducing the explanatory capacity of agency theory and validity of its proposals.

Particularly in the Brazilian business environment where governance structures concentrate considerable power in the principal, agency problems are reduced by greater capacity and interest of the owner in accompanying administrative activities. Monitoring and control are more direct in virtue of the controlling group’s interest in proceeding to follow up, reducing what is called the free rider effect occurring in situations of scattered ownership, when the accompaniment by small owners is not economically justifiable.

The evalulative assumptions of agency theory originating from the proposed new institutional economy are based on an economic, opportunist and egoistic view of humankind, which is why it needs to be controlled and monitored. Within corporate governance theories, although it is the prevailing outlook, this approach is not unanimous (Eisenhardt 1989). Other theories offer alternative references based on assumptions of participation or willful behavior of the agent, such as the stakeholder-agency theory (Hill and Jones 1992) and stewardship theory (Davis, Schoorman and Donaldson 1997).

This article adopts the people-management viewpoint to discuss the potential negative effects that improper use of monitoring, control and incentive instruments can cause to the agent’s motivation and best efforts, with side effects exactly on those that agency theory aims to minimize. Although the agency problem spreads throughout the organization (Eisenhardt 1989), the focus of this study is on the relationship of owners and administrators and the negative impacts that the acritical inclusion of corporate governance models, without due considerations of trade-offs in specific environments, can cause this relationship and the executives’ performance.

2. Executives and their motivation: are incentive plans the solution?

While economic prospects, and particularly agency theory, direct their objectives to align interests between a principal and administrators and incentive mechanisms, the currents of human relations have built another benchmark to address these issues, based on motivation of the administrators. In fact, the so-called motivation crisis has attracted special attention from scholars and practitioners, associated largely with the new meaning of labor today. However, given the vast literature on motivation and consolidation achieved by its theoretical reference, it is worth investigating the reasons for this crisis.

Since the rise of what is called the school of human relations, administrative theories are concerned with the individual’s relationship with the organization of labor, assuming the feasible integration between individual and organizational objectives.

Motta (1991) classifies the theories on motivation in three currents, according to which the driving forces for behavior would be requirements, intentions and expectations, and external stimuli. The first, represented by the theory of needs, is based on the logic that the individual always has a need to be satisfied, and is found mainly in the writings of Abraham Maslow. These needs will never be fully satisfied and their relative weight is particular to each individual. Moreover, social and cultural factors introduce variations to individual needs, imposing restraints on the simple transfer of uniform systems to improve work satisfaction.

The second of these currents is based on the fact that the individual’s intention drives his behavior and it is built on his beliefs and attitudes. Motivation develops from idealizing an objective, namely, individual acts in accordance with the expected results and degree of job satisfaction is associated with the achieved result. The outcome of this current for application in the organizational environment, particularly with regard to incentive schemes, is that any kind of incentive, whether financial, recognition or awards, only influences the individual’s job motivation and has some influence on his intentions to act.

The third current, based on external stimuli, is represented by the theory of learning. It explains human behavior only by external causes, by what is based on the mechanisms of stimuli and reinforcements, with examples found in Skinner’s behaviorist studies. The expected consequence of a certain behavior may increase or reduce the possibility of an action occurring, depending on whether the consequence is associated with a benefit or punishment, respectively.

These stimulus-response relations are at the base of compensation systems, mainly in North American businesses. As Carrel, Elbert and Hatfield (2000) said, American workers hope that their performance is related to the awards received from the organization. The variable performance-related portion is far more significant in the executives’ remuneration relations, consisting generally of the base-salary, annual bonus, stock options and long-term incentives, besides other benefits and perks, such as the use of a company car, differentiated health plans, club membership and restaurant expenses reimbursement.
The farther diffusion of motivation proposals centered on incentives, reinforcements, objectives, intent and expectations occurred not only because of the much stricter methodology of the studies in this field, but mainly because, when focusing on the individual’s external dimensions, they are more applicable through the use of management tools. Nevertheless, in order to express motivated behavior, the individual has to aspire to objectives and rewards (Motta, 1991).

Moreover, contrary to what would be expected as a way to reduce agency problems in the corporate governance context, the rewards may contribute to discouraging administrators from taking risks. Whenever people are encouraged to think of what they will achieve by engaging in the task, they are less inclined to take risks or explore possibilities, or to risk giving suggestions or considering causal stimuli (Kohn, 1995).

3. Theoretical basis of corporate governance: the agency theory

Agency theory addresses the problems arising from the owner’s delegating the organization’s management by the owner to a professional, for which agreements are drawn up to maximize the owner’s end return, after monitoring costs, accounts rendered and residual losses. It focuses on these and other problems arising from the separation between ownership and management, called agency problems, and risk sharing between these groups, since various propensities to risk can also lead to diversity of objectives. These problems are not restricted to those in the owner-administrator relationship, but extend to a larger group of relations, permeating the day-to-day activities of organizations. An agency relationship occurs whenever an individual depends on another’s action, the agent being the person who takes the action and the affected party is the principal (Pratt and Zeckhauser 1985). Jensen and Meckling (1976:308) define an agency relationship as “a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent.”

The bases of agency theory lie in the premises of neoclassic economics (Banks 1995) of gains in specialization, deriving from the scale economy or different capacities. Through restrictions of its referential, however, this economic perspective does not consider variations in the interest of stakeholders in the firm’s sphere, which are necessary when addressing governance mechanisms. Although these issues can be addressed through contracts, the impossibility of defining a complete contract implies the need for control structures and incentives for them to function.

The scope of agency theory is not restricted to the relationship between owners and administrators, permeating all the various relations in organizations, principally cooperative actions where there is a hierarchic component: “the domain of agency theory is relationships that mirror the basic agency structure of a principal and agent who are engaged in cooperative behavior, but have differing goals and differing attitudes toward risk” (Eisenhardt 1989:59).

Arrow (1985) points out that the theory presents both descriptive – by offering support in defining more efficient contracts for the relations between principal and agent – and regulatory characteristics – by representing an attempt to explain phenomena found in fact, principally exchange relations unexplained by the conventional economic theories.

This ubiquity permitted deeper studies in two different fields or situations, namely directly either involving the separation between owners and administrators, or analyzing more broadly all agency relations within the organizations or between external agencies. Eisenhardt (1989) classifies the development of the studies on the theory in two lines: positivist and principal-agent. Both lines share the premises about people, organizations and information, but differ mainly with regard to the mathematical treatment and coverage of the application. In the principal-agent current there is more concern with the development of empirically verifiable models and a wider focus on agency relations in general, not only between shareholders and CEOs of large corporations. The descriptive positivist line seeks to investigate the behavioral consequences of the dispute between owners and administrators, while principal-agent based studies of a prescriptive nature examine control mechanisms that induce administrators to strive for maximum profits.

The analytical unit of the theory is the contract between principal and agent and how to make it more efficient from the principal’s viewpoint, and not only the explicit but also the implicit contract may be considered. In the light of its premises – about people, organizations and information – and impediments against an excellent contract – moral hazard (lack of effort by the agent) and adverse selection (misrepresentation of ability by the agent) – agency theory seeks to define the nature of a contract that will reduce agency costs, expressed in monitoring and motivation, and assure the agent’s commitment.

Using control modes based on behavior (e.g. wages) or results-based contracts (commission or bonus payments), agency theory looks to equate the design of a contract that reconciles maximum utility for the agent with maximum wealth for the principal. When the agent’s behavior is visible, the hiring by the behavior is the first-best solution, since this may be considered a negotiable product, characterizing a case of complete information (Eisenhardt 1985).

When only the agent knows about his behavior then this is an incomplete information situation, since the principal cannot determine whether the agent is acting appropriately. In this situation, either the principal “buys” information about the agent’s
behavior, using monitoring and supervision mechanisms, or may reward the agent for the result. In this case, the agent is penalized for incurring risks in the process, beyond his control, which may alter the results. This is the second-best solution.

Jensen and Meckling (1976) classify the mechanisms designed to minimize problems of an agency relationship in three kinds: (a) monitoring costs, which are those incurred by the principal to monitor the agent’s work, such as the audits, for example; (b) bonding costs, incurred by the agent and generated in the company, so that the principal can check whether the agent acts in its interests, such as reports and specialized opinions (Hill and Jones 1992); and (c) residual loss, resulting from non-excellent choices inherent to diverging interests.

Fama and Jensen (1983) argue that agency problems can be controlled by decision-making systems that separate the control management at the various levels of organization. The forms used for this separation function for ratifying and monitoring; boards of directors, which not only ratify and monitor the most important decisions for the organization, are responsible for hiring, dismissing and fixing the remuneration and compensation levels of the executives; and incentive structures encouraging mutual monitoring between agents. However, implantation and maintenance costs of these mechanisms reduce the gain available to the principal.

Nilakant and Rao (1994) claim that agency theory is normally considered to be a theory of human behavior, but which must be considered also as a theory on guidance for the agent’s results. In consequence of that prevailing view, literature includes little discussion on the use and capacity of generalizing the theory. They highlight two requirements that act as restraints on the theory: unity in defining the organizational objectives, and clarity concerning the efforts required to achieve them. The authors say that the theory’s applicability is restricted to contexts in which the performance standards are precise and efforts to achieve the results are known (first-best solution), or when the performance standards are known but the information on the efforts required is incomplete (second-best solution).

In situations where it is up to the agent to define objectives, in virtue, for example, of multiple principals or sparse information about the environment, the agents may consider it necessary to engage in activities that lend legitimacy and political support to their choices. In such cases, contractual solutions offer limited solutions to the agency problems, because the uncertainty of the results cannot be mitigated by contract designs, since this is beyond the agency relationship. Dispute settlement and seeking consensus can be shown to be more important in such situations than individual rewards and monitoring.

This model is a consequence of an earlier proposal by Thompson (1967) about the decision-making process in organizations, and who believes that the decisions always involve two main dimensions related to the beliefs about cause and effect relations, and the preferences regarding possible results, which together create a matrix with four types of decision-making problems. In practice, it often occurs in situations of diffuse ownership and little activism of investors, associated with environments with a high rate of innovation or change. It is also present in the reality of not-for-profit organizations, such as pension funds, cooperatives, associations and non-governmental organizations, when the difficulty of agents in proposing objectives or assessing the situation of these organizations may make it more important for the administrators to prioritize the search for legitimacy in their role.

4. Evaluative bases and restraints of agency theory

A theory is a statement of relations between concepts within a limited set of assumptions and restraints. It may be defined as a statement of a relationship between observed (variables empirically operationalized by measures) or approximate (constructs) units in the empirical world. Its prime objective is to answer how, where and why questions, in contrast to the description objective, which is to answer what questions (Bacharach 1989). The concept of boundaries based on assumptions is crucial because it defines the limitations in applying the theory, which include implicit values of theoreticians – a reflection of their ideological leanings and life experiences – and often explicit restraints regarding time and space.

A theory may be assessed by “forgeability” or utility criteria. A theory is useful if it can explain and predict, and the explanatory capacities of theories can be compared on the basis of specificity of its assumptions regarding the objects under analysis, causal connections between before and after, and scope and parsimony of its proposals.

The predictive adaptation of a theoretical system must be judged in terms of its skill in making predictions according to a space and time frame. This scope represents the conditions that establish the validity of the theory, whether with regard to the units of analysis for the spatial boundary or in the historic context and its time contingences, according to the time frame (Bacharach 1989).

Every theory is formed by postulates, premises and proposals, which define its positive side and present its recommendations to act. To question its premises or refute its proposals, in a specific context, does not mean rejecting a theory but contributing to better define and explain it, although at a distance from a grand theory. A bibliographic investigation helps identify a representative group of criticisms about this theory, which achieve not only their objectives but mainly the implicit values of their
assumptions. Eisenhardt (1989) mentions that her critics consider her to be trivial, dehumanizing and even dangerous.

Arrow (1985) identifies communication costs, variety and vagueness in monitoring, and the social reward mediation as elements that restrict agency theory. This mediation may be related to the importance of the institutional factors in mediating this theory.

The theory is based on the premise of risk preference, assuming the principal’s neutrality, which can diversify its investments, but to which the agent is adverse, which cannot reduce his employment-related risks. Wright, Mukherji and Kroll (2001) question this approach to the agent’s risk, arguing that in various situations this cannot be confirmed, which could occur in the case of younger agents, where dissatisfied, or when influenced by earlier successes in similar risk conditions. In such situations, agents who are not adverse to risk may be attracted by participating in agency relationships in more dynamic structures.

Along the same line, Arthurs and Busenitz (2003) point out that the theory is “silent” when there is consistency of objectives between agent and principal, for which a prior theoretical reasoning is required to explain the existence of this discrepancy before applying the theory to behaviors. They resort to regulatory – of a prescriptive nature – and positivist – of an explanatory nature - elements of the theory to point out that together these two elements provide clarity in relation to the boundary problems for a given set of research questions, but consider that many of the regulatory premises of agency theory were considered as data and thus applied to a certain set of problems. If these premises cannot be applied to the situation under study, this does not mean that they are false, but that it should be explained when they apply and make the observations in such a situation. Although this restricts the generalization of the theory, it increases its accuracy.

To assume the premises of diverging interests can lead to preparing more complex contracts and the need for stronger monitoring mechanisms, implying higher agency costs and other negative effects. Arthurs and Busenitz (2003) point to the possibility of Type I error occurring since, in the absence of different objectives between principal and agent, to consider the perception of the agent would not confirm the regulatory premises of agency theory nor be unable to explain their behavior, resulting in a wrong specification of results.

Agency theory is most criticized however in the values supporting its premises. The human model considered in the theory, its motivation regarded as eminently directed to personal rather than collective gains, the egoistic view and need for external controls to condition behavior are criticized by a number of authors (Davis, Schoorman and Donaldson (1997), Shankman (1999), Donaldson and Preston (1995)). Perrow (1986) writes that the theory is over-focused on the players’ self-interested attitude, while Donaldson (1990) questions the premises of individualism assumed in the theory.

Both Shankman (1999) and Hill and Jones (1992) and Buck, Filatotchev and Wright (1998) suggest that agency theory can be perceived as a particularity of a more comprehensive theory in which the various interests about the organization are perceived and incorporated, along the line of the stakeholders’ theory. Perrow (1986) also adopts this line when considering the validity of the theory’s assumptions as a particularity in the organizational life.

The restraints and assumptions of agency theory are discussed by Hill and Jones (1992), who suggest that a firm can be perceived as a connection of contracts between resource holders, but both the explicit and implicit contractual relations between the stakeholders must be considered. They consider that administrators are the only group of stakeholders with contractual relations with everyone else and, accordingly, their role must be perceived as an agent of the others.

The economic models of organization are also questioned by Nilakant and Rao (1994) for neglecting altruism and power and exaggerating the importance of self-interest and efficiency in the evolution of organizations, as well as reflecting a negative moral characterization and individualist methodological bias of economic theories. They also criticize the theory, even in contexts where it is applicable, because they assume that the performance of organizations results solely from an individual’s job, exaggerates the degree to which individuals dislike work, and emphasizes the quantity of efforts at the expense of quality and type of effort.

The implicit dimension of contracts is used by Hill and Jones (1992) when extending the condition of principal in an agency relationship to the group of the organization’s stakeholders, stating that the latter provide the resources in accordance with the implicit understanding that their intentions will be fulfilled. A set of organizational structures referred in the agency theory as governance structures, are then conceived to perform the role of monitoring and inspecting not only explicit but also implicit contracts. These authors advance in an institutional outlook of corporate governance when they categorize governance structures as a particularity that they call institutional structures, in which they include the traditional categories of councils, corporate control market and legal structure, the institutions representing and promoting the interests of a group of stakeholders, such as trade unions and consumer associations.

This approach, called stakeholder-agency theory (SAT) by the authors, partly recovers the initial draft of agency theory as proposed by Jensen and Meckling (1976), according to the perception of the firm as legal fiction, acting as a connection of contractual relationships. Referring to this initial dimension of the theory, Hill and Jones (1992) recall that other
contracts must be considered to be covered by the theory in addition to those between shareholders and administrators, namely, those who include the firm’s administrators and different stakeholder groups. Buck et al (1998), adopting the stakeholder-agent theory, analyze the characteristics of corporate governance in the USA and UK, concluding that its characteristics suggest a hybrid structure where stakeholders play a leading role, rather than the pure model attributed to the corporation by agency theory, based on free coming and going of their participation in the company. Their arguments are backed by the widespread sharing of the employees and executives in American company ownership, and the emergence of block holders, who have a share in the corporate control.

SAT contradicts the premise of agency theory concerning market efficiency, which would create power differentials between the parties in the contract. The market balance mechanisms would imply considering that the players, principal and agent, are free to come and go in the relationship should the contractual terms or conditions of the governance structure fail to suit them. From the SAT viewpoint, however, these obstacles contain friction sources, which inhibit rapid adjustment and thereby produce power differentials. Organizational inertia may also mean another source of friction, increasing the imbalance between the parties. Hill and Jones (1992:136) say that “Pressures such as sunk costs, political coalitions, the tendency to consider precedents as normative standards, and a simple lack of imagination all limit the degree to which incentive, monitoring, and enforcement structures respond quickly to new circumstances.”

On reviewing the economic perspective adopted by agency theory, Davis, Schoorman and Donaldson (1997) propose another theory relating to agency problems, which they call the stewardship theory. They use this to introduce a new human model, based on psychology and sociology, acting as the agent. In contrast to the economic view, they propose that the agent does not act in his own but in the interests of the collective, in a pro-organizational direction based on mutual trust.

Arthurs and Busenitz (2003), comparing agency theory to stewardship theory, stress the latter’s roots in sociology and psychology, when characterizing the human being as having strong needs for self-esteem, self-achievement, growth, fulfillment and belonging, contrasting with the view of man in agency theory as opportunist, untrustworthy and pursuing limited financial objectives. Davis et al (1997) compare the differences between the two theories to the human models proposed in the classic work by McGregor on the X and Y theory that, in the opinion of those authors, would support agency and stewardship theories, respectively. Along the same line, Sundaramurthy and Lewis (2003) analyze that the control approach adopted by agency theory stresses discipline, while the collaborative approach of stewardship theory emphasizes helpfulness, trust and partnership.

The following table 1 shows the main differences between the two theories:

<table>
<thead>
<tr>
<th></th>
<th>Agency Theory</th>
<th>Stewardship Theory</th>
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<tbody>
<tr>
<td>Human model</td>
<td>Economic human</td>
<td>Self-achievement</td>
</tr>
<tr>
<td>Behavior</td>
<td>Serving oneself</td>
<td>Serving the collective</td>
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<tr>
<td>Psychological mechanisms</td>
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<tr>
<td>Motivation</td>
<td>Extrinsic</td>
<td>Intrinsic</td>
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<td></td>
<td>Low order / economic needs (psychological, safety, economic)</td>
<td>High order needs (growth, self-achievement)</td>
</tr>
<tr>
<td>Social comparison</td>
<td>Other executives</td>
<td>Leader (principal) (inner values)</td>
</tr>
<tr>
<td>Power</td>
<td>Institutional (legitimated, coercive, reward)</td>
<td>Personal (knowledge, competence)</td>
</tr>
<tr>
<td>Situational mechanisms</td>
<td></td>
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<tr>
<td>Administration philosophy</td>
<td>Control-driven</td>
<td>Involvement-driven</td>
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<tr>
<td>Risk-driven</td>
<td>Control mechanisms</td>
<td>Trust</td>
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<tr>
<td>Time</td>
<td>Short term</td>
<td>Long term</td>
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<tr>
<td>Objective</td>
<td>Cost control</td>
<td>Improved performance</td>
</tr>
<tr>
<td>Cultural differences</td>
<td>Individualism</td>
<td>Collectivism</td>
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<td></td>
<td>High power distance</td>
<td>Low power distance</td>
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Source: Adapted from Davis, Schoorman, Donaldson (1997)

Critics of stewardship theory restrict its application to stating that it confuses agency theory with the agency problem, and focuses more on the relationship between the parties than on the task to be performed. Moreover, its proposals are not enough to address the problems of aligning interests (Albanese, Dacin and Harris 1997) or considering non-hierarchic relations between principal and agent (Arthurs and Busenitz 2003).

Agency theory assumes that the agent will seek to maximize his personal interest, his own function-utility, if not duly monitored by the principal.
However, Davis, Schoorman and Donaldson (1997) find that when the assumptions of agency theory are not confirmed, as occurs, for example, in situations where the agent fails to adopt opportunist but collaborative behavior, monitoring and control proposals of the theory can contribute to cause frustration and prevent development of cooperative relations with the principal. Another problem that may arise is that the intensive use of instruments to shape the agent’s action may contribute to also restricting his competence in achieving the objectives of the principal (Hendry 2002).

5. New views on the agency problem

The importance in the people-management area to participate in building corporate governance models lies, principally, in the possible introduction of other evaluative assumptions and extending of the scope of the agent’s control mechanisms beyond the limited economic perspective. The alignment of interests between principal and agent, as recognized by the motivation theories, cannot be restricted to providing incentive plans or other financial benefits aligned to performance targets, associated or not with punishment mechanisms.

Hendry (2002) adds to earlier criticisms about agency theory the consideration that, even in the case of honest or effectively controlled administrators, it must be foreseen that there is a limited capacity for achieving the objective defined by the principal. He suggests that, although a precise determination of objectives and monitoring can reduce the agent’s behavioral problems, this also restricts the space for initiatives that could benefit the principal, and that situations may arise in which it would be more important for the principal to invest in the administrator’s accompaniment and counseling.

On this subject, and seeking to contribute to building corporate governance models more in tune with a more comprehensive human view, Shen (2003) proposes that the choice of monitoring mechanisms and control used by the principal must vary during the time of the administrator’s position, in which he affirms that it permits integrating the proposed agency and stewardship theories.

When assuming a director’s position, the agent takes some time to find his way around and fully accomplish his leadership role, a time that would require support and collaboration from the principal for his development. This first moment, where the job itself is a challenge to overcome plus this new activity, may be the fulfillment of the administrator’s aspirations, intrinsically presents the main characteristics that create the motivated drive. The principal’s role, represented in the daily relationship by the board, is to assist in the administrator’s adaptation and development of his leadership skills in the organization.

Over time, his motivation tends to decrease now that he is adapted to the organization and facing day-to-day routine. Frustrations increase, the risks of specialization on the job increase, and motivation decreases in the absence of new challenges. This is time when the opportunist view or passive behavior may increase and it is, therefore, more necessary to reinforce monitoring and control instruments.

Shen (2003) therefore introduces the need for an inverse association between the use of monitoring and control mechanisms and the time of the administrators in the job, bringing a relationship between the motivation ideas and corporate governance.

Use of these mechanisms with the same intensity over time may cause two problems for the organization. The first refers to the costs of deploying these mechanisms, which unnecessarily increase agency costs. The second is directly linked to the administrator’s feeling of discouragement when failing to find support in the board, and at the same time having to face the challenges of becoming a leader in the organization and meeting the then excessive demands of the board.

6. Conclusion

This article is based on the people management view to discuss potential negative effects that improper use of control, incentive and monitoring instruments may give rise to the agent’s motivation and best efforts, causing precisely side effects to those that agency theory aims to minimize. Although the agency problem underlies the entire organization (Eisenhardt, 1989), this study focuses on the owner-administrator relationship and negative impacts that acritical inclusion of corporate governance models, without duly considering trade-offs in specific environments, can bring to this relationship and executives’ performance.

The prime objective of this article was to discuss the restriction of the theoretical reference used to define corporate governance practices, predominantly based on agency theory, and the negative impacts of this use in the CEO’s motivation and performance. While various theoretical approaches are available today to propose solutions for the governance issue (Clarke 2004), the models proceed to be built around the agency problem, neglecting in fact proposed uses of multi-theoretical structures for addressing them (Eisenhardt 1988).

While Shen’s (2003) proposals are recent, corporate governance practices are not, and they are being consolidated in the margin of comments about values and expectations of those who will be subject to them. If the main problem they hope to solve is the agency relationship resulting from separating the beneficiary from his executor, it is argued that this discussion cannot be restricted to the economic dimension or the latter’s particular theory.

If agents are in fact opportunist, why are they? Why do they have different interests from the owners,
if they have at all? These are certainly not economically based issues. They relate to people, the way they behave and set their expectations. It is not necessary to invest funds in line with parties’ interests, if they do not diverge; nor is it necessary for costly monitoring processes, if assumed, contrary to agency theory, that individuals are honest and willing when motivated.

Therefore, based on the criticism related to the agency theory, as presented in this article, it is important to observe that the incentive models proposed by agency theory do not comprise some key dimensions of the agency problem. Alternatives to increase the effectiveness of the deal with this problem have been proposed in the present article, based mainly on the principle of extrinsic and intrinsic motivation. After all, according to Kohn (1995), the extrinsic award may cause the intrinsic motivation to evaporate.

References