Quarterly Journal
OeconomiA
copernicana

2016 Volume 7 Issue 4, December

p-ISSN 2083-1277, e-ISSN 2353-1827
www.oeconomia.pl

Kultys, J. (2016). Controversies about Agency Theory as Theoretical Basis for Corporate Governance. *Oeconomia Copernicana*, 7(4), 613-634. DOI: http://dx.doi.org/10.12775/OeC.2016.034

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Controversies about Agency Theory as Theoretical Basis for Corporate Governance

JEL Classification: *D23; G34*

Keywords: *corporate governance; agency theory; stewardship theory; team production theory; shareholder primacy model; director primacy model*

Abstract: *The issue of corporate governance is being taken up by different branches of science. Particular views on the nature and goals of a firm, as well as on corporate law, determine various approaches to the issue. The ongoing debate on corporate governance is being stimulated by notorious scandals and economic crises. The agency theory (prevailing today), which assumes egoism and pursuit of one's own interests, forms the basis for shareholder primacy model, while team production theory forms the basis for director primacy model. Stewardship theory, which assumes convergence of management's and stakeholders' interests, may be competing or complementary towards the agency theory, depending on situation. According to management theory, efficient management requires law regulation of managers' status.*

This paper is aimed at presenting controversies about traditional agency theory as theoretical basis for corporate governance, as well as at discussing other perspectives on the issue, which are extensions of the traditional theory or are based

Date of submission: April 9, 2015; date of acceptance: September 12, 2016
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on substantially different premises. The analysis shows that going beyond agency theory allows for better understanding of the whole range of models of corporate governance as well as of the changes that are being proposed in the area. The method utilized in this paper is descriptive and comparative in character.

Introduction

The issue of corporate governance is being taken up by different branches of science, such as economics, finance, management studies, sociology, psychology or ethics. Various approaches to the issue are connected with particular views on the nature and goals of a firm, as well as with the way the corporate law is being interpreted (Jordi, 2010, p. 195; Zollo & Freeman, 2010, p. 191; Rajan & Zingales, 2001, p. 209; Segrestin & Hatchuel, 2011; Lan & Heracleous, 2010).

Debate on patterns of corporate governance has a long history (Sundarum & Inkpen, 2004,). In recent years it was being stimulated by notorious scandals and economic crises. Some authors suggest, that the most recent crisis had characteristics not only of economic or financial crisis, but in large measure it was also a crisis of management (Zollo & Freeman, 2010, p. 191; Segrestin & Hatchuel, 2011, p. 485). As far as corporate governance is concerned (in the context of the prevailing today agency theory), managers are being treated as agents of shareholders (principals). In most cases corporate governance is focused on devices reducing agency costs in the relationships between managers and shareholders, which results in substantially limiting managers' autonomy, whereas management theory perceives autonomy as a key factor in the processes of creation of value and development of the firm. Both of them – development and creation of value for all the stakeholders – require managers of considerable standing, innovative and with leadership skills – features which can be obtained exclusively in the context of substantial autonomy in carrying out business projects (Segrestin & Hatchuel, 2011, p. 485, 489, 491). According to those authors, the most recent crisis has revealed that managers forced to act as shareholders' agents neglected both interests of other stakeholders and long-term development of their firms. In the aftermath of corporate scandals and particularly during the most recent crisis, the opinion became widespread that managers have excessive power, which resulted in reforms in the area of corporate governance, oriented towards strengthening mechanisms of control over managers. This trend does not always seem to be favourable, particularly if we take into account implications of the broader view of corporate goals, not restricted to gaining value for shareholders, and if we assume a model of firm other than contractual agency theory (e.g. team production theory) as a basis for understanding corporate law. We can also come to disparate conclusions concerning corporate governance, if we assume that functions which should be performed by managers are not sufficiently protected by the rules of corporate law and therefore some changes are required, oriented towards protection of managers' autonomy necessary for them to perform management function properly.

Sections two and three of the paper present basic elements of agency theory as well as limitations of its applications to the issues of corporate governance. Section four discusses stewardship theory, which – depending on situation – may be competing or complementary towards agency theory. Section five presents differences between agency theory and stewardship theory. Section six discusses social agency theory, which is an extension of the traditional agency theory, formulated in response to unrealistic premises of the traditional theory. Section seven presents agency theory as revised from a legal perspective, and suggests director primacy model instead of shareholder primacy model. Section eight discusses the issue of legal regulation of managers' status, allowing them to perform management function efficiently, which may require establishing business law and introducing rules for supervision of a firm. The last section contains some final remarks.

The method utilized in this paper is descriptive and comparative in character. It presents various models of corporate governance depending on (i) particular views on nature of a firm, on its goals as well as on legal solutions, and (ii) premises concerning behaviour of people involved in structures of corporate governance.

Agency Theory

Agency theory is a prevailing theoretical framework in studies on corporate governance. Its popularity results from two features (Daily *et al*., 2003, p. 372). Firstly, it is simple, because it reduces large corporations to two groups of participants – managers and shareholders – whose divergent interests are clearly defined. Secondly, it makes a very common assumption that a man is an intrinsic egoist, and therefore every rational individual pursue his or her own interests. In most studies corporate governance mechanisms are considered devices that restrict managers' own interests and make them pursue shareholders' interests. Internal mechanisms of control over managers include: appropriately structured board of directors (supervisory board), structure of salaries that orients managers at shareholders' interests and ownership concentration enabling active monitoring. External mechanisms include capital market and job market for managers.

Appropriate salary packages are an important factor adjusting managers' goals to shareholders' goals in the situation when managers have substantial informational advantage over shareholders and direct control over managers' actions is impossible. A very important function is also performed by a board of directors (supervisory board), which theoretically represents shareholders' interests, communicates them to the managers, and exercises control over the latter in order to reduce agency costs. Though shareholders' and managers' interests may vary to a various extent, depending on situation, agency theory assumes that in case of lack of control mechanisms there is a possibility of opportunistic behaviours in every situation. Total control would mean that managers would be completely deprived of any form of autonomy, and practically a firm would be managed by its owners. Introducing control mechanisms into agency relationships does not necessarily mean that all the decisions will result in increased owners' benefit. It only means that managers will spare no effort to achieve results advantageous for the owners. Apart from wrong (opportunistic) motivation, there are also other factors which can lower the outcomes of managers' actions, which include (among other things) lack of necessary skills, knowledge or information (Davis *et al*., 1997, p. 23-24), however proponents of agency theory give their attention mainly to the issue of incentives.

Limitations of Agency Theory

Critics of agency theory and its applications to the issues of corporate governance focus on such problems as unrealistic premises concerning managers' motivations and actions, ineffective recommendations inferred from the theory and dubious legal interpretations of corporate governance being made on its basis (Segrestin & Hatchuel, 2011, pp. 487-488).

Limits of applicability of agency theory are determined mainly by the premises assumed in modelling various agency relationships. Simplistic premises concerning nature of actions involved in relationships between subjects (opportunism, homo oeconomicus, pursuit of one's own interests exclusively), do not cover all the complexities of human actions. Simplistic premises are very convenient for mathematical modelling, but unrealistic when it comes to description of human behaviour. We have a trade-off here: agreement with reality versus formal precision and elegance. Relying exclusively on the premises of agency theory may lead to superficial descriptions of relationships involved in corporate governance and consequently to inadequate practical solutions. It means, that premises of agency theory restrict its universality (Davis *et al*., 1997, p. 24) and make it applicable only in the situations, when there is divergence between shareholders' and managers' interests, which can be restricted by adequate monitoring systems and appropriate salary packages. This theory is one-sided (Mesjasz, 2007, p. 39), emphasizing some economic factors, and not including (among other things) political factors, internal problems of governance or the roles of other stakeholders. Numerous authors offer different approaches that allow for explaining managers' behaviour. Davis *et al.* (1997, pp. 24-42) propose stewardship theory, and Blair and Stout (1999a, 1999 b) draw on team production theory in their analyses of legal aspects of corporate governance.

Critics of agency theory have noticed as well that control mechanisms suggested on the basis of agency theory are not only expensive, but also economically ineffective, because mechanisms protecting shareholders' interests may interfere with realization of strategic decisions, may restrict collective actions, distort investment plans and ignore interests of other stakeholders, which may lead to decreasing their commitment to creation of economic value (Segrestin & Hatchuel, 2011, p. 487).

Other authors express numerous legal doubts concerning ways of presenting relationships between shareholders and managers on the basis of agency theory. For instance, shareholders are not the only group that bear the risk. Other stakeholders involved in creation of value contribute their resources vital for the firm and bear risk arising from its activities. In this context we can mention: stakeholder theory (Donaldson & Preston, 1995; Freeman & Evan, 1990), stakeholder-agency theory (Hil & Jones, 1992), years long debate between proponents of shareholders' primacy and those, who opt for taking into account other stakeholders (Daily *et al*., 2003; Mamun *et al.*, 2013; Freeman *et al*., 2004; Sundaram & Inkpen, 2004a, 2004b), or finally proposal for settling the argument on the basis of property rights theory (Blair, 2005; Asher *et al*., 2005; Grandori, 2005).

Another doubt concerns ownership of a firm. From the legal point of view, shareholders are owners not of a firm, but only of its shares, and therefore they should not be considered the only residual claimants. Shareholders' exclusive rights modify risk undertaken by various stakeholders, because managers controlled by shareholders will opt for strategies leading to relatively safe financial returns, even at the expense of lack of innovative development or of ignoring other goals vital for the firm. Risk may therefore be transferred from shareholders to other groups, e.g. employees. What is more, managers are not shareholders' agents, and they get their mandate not from them, but from the board of directors, which in turn acts as an autonomous fiduciary. Those interpretations of law, which favour primacy of directors and not of shareholders, will be discussed in section seven, dealing with rethinking of agency theory from a legal perspective.

Stewardship Theory

Some attention has been also received by stewardship theory, which may be competing or complementary towards agency theory (Daily *et al*., 2003, p. 372; Davis *et al*., 1997, p. 26). It draws on psychological and sociological arguments. Relying exclusively on the premises of agency theory, one cannot do the justice to all the organizational complexities. Contrary to the premises of agency theory (directors' and managers' opportunism), this approach views both directors and managers as having the same interests as shareholders. It does not mean that they are altruists. This view on managers is based on the assumption that in numerous situations managers are convinced that pursuing shareholders' interests, they accomplish their own goals as well. Managers and directors build and protect their reputation, when firms managed by them achieve maximal financial results, which includes also a value for shareholders. Financial results of a firm, a value for shareholders and goals of both managers and directors should not diverge.

Initially, the proponents of this approach contrasted it with agency theory, which they considered false. Later studies recognized complementary character of both perspectives and suggested that the choice of any of them should depend on particular circumstances (Davis *et al*., 1997). Analyses of corporate governance usually emphasize conflicts of interest between particular groups of stakeholders. In fact, divergence of goals can appear both between various groups of stakeholders and inside each of them (Carney *et al*., 2011, pp. 485-486). According to stewardship theory, in such situations managers' behaviour is focused on the goals of the organization as a whole. Even with substantial divergence of goals, we may assume that most stakeholders are interested in the success of a firm, therefore if a manager (steward) pursues interests of a firm as a whole, in fact he acts for the benefit of majority of interested parties. It is also assumed that acting for the benefit of the organization as a whole leads to fulfilling manager's needs as well, and that managers' interests are interconnected with the goals of the whole organization and of its owners' (Davis *et al*., 1997, p. 25).

Manager's actions are also influenced by structural conditions. If managers' motivations are in accordance with the premises of this theory, it is appropriate to increase the scope of managers' authorizations and their autonomy in governance structures and mechanisms. It results in saving resources, which in case of a manager-agent would have been allotted for guaranteeing his or her pro-organizational behaviour. Mechanisms of control can contribute to the decrease of motivation in pursuing interests of the organization.

During the early development of stewardship theory, its proponents focused mainly on analyses of structures facilitating actions of chief managers and formulated recommendations to the effect that appropriate governance structures should ensure managers' authority and autonomy, which usually is the case, when CEO chairs the board of directors as well (Davis *et al*., 1997, p. 26). Such person is then unambiguously responsible for the results of the organization and able to determine a strategy of a firm, with no fear of opposition or dismissal from the post by a board of directors. One can thus conclude that stewardship theory (contrary to agency theory) recommends governance structures enhancing autonomy and not control of managers.

We may ask why – in spite of substantial benefits that managers' stewardship could bring to their principals – in many cases we have agency relations. According to the authors cited above, the answer depends on how much risk principals want to take. Owners disliking risk will view managers as individuals pursuing their own interests, and in shaping relationships with them they will follow recommendations of agency theory. They will be willing to incur all the resulting costs, as necessary hedging against manager's opportunism.

Empirical studies cited by Davis *et al.* (1997, p. 26) do not decide unequivocally in favour of application any of the theories. It means that none of them is the only correct view, and that is why the authors suggest that those approaches should be meshed together.

Differences between Agency Theory and Stewardship Theory

Differences between agency theory and stewardship theory concern mainly situational and psychological factors (Davis *et al*., 1997, p. 27; Mamun *et al*., 2013, p. 43). As far as psychological factors are concerned, model of human conduct is the main issue. Agency theory is based on the concept of economic rationality. Model of self-actualizing man, which serves as the basis for stewardship theory, is more complex and humane. It appeared in studies by McGregor, Maslow and Argyris (McGregor, 1960; Maslow, 1970; Argyris, 1973, as cited in Davis *et al*., 1997, p. 27). It rests on the conviction that humans aspire to exceed their current accomplishments, and that the assumptions economics makes regarding a human person, may restrict possibilities of developing human potential. A human person situated in the environment built on economic assumptions may stifle his or her higher aspirations or become frustrated.

Major differences concerning psychological factors between agency theory and stewardship theory occur in the premises concerning (i) stimuli (motivation), (ii) identification and (iii) types of power exercised in the context of hierarchical relationships (Davis *et al.*, 1997, pp. 27-29). Agency theory focuses on motivation and such external stimuli as tangible, exchangeable and saleable values having measurable market value. They form a basis for both remuneration system and control mechanisms. Stewardship theory, by contrast, focuses on such internal values, hardly measurable in money, as potential for development, accomplishments, affiliation and fulfillment. The theory draws on various concepts of motivation leading to increased sense of significance of one's work and increased sense of responsibility for the outcomes of one's actions. These internal values, which motivate pursuing interests of organization, enhance the relationships of submission. One can therefore expect, that it is individuals who are guided by higher internal motives, will act as stewards in principal-manager relations.

The factor of identification appears when managers define themselves in terms of membership of particular organization, accept its mission, vision and goals, as well as establish appropriate relations with it. They view successes and failures of the firm as their own. In case of failure, managers who look for the causes of problems on the outside, do not identify themselves with the firm, and in order to escape responsibility, pursuing their own interests, they can increase problems of the firm, refraining from any repair actions (Davis *et al*., 1997, p. 29). The concept of identification with an organization is closely related to the concepts of organizational commitment and value commitment. In agency theory, while considering manager-principal relations, such features as commitment and identification may be ignored as lacking any economic utility. Therefore, there's a real chance that it is individuals who are committed to the firm and identify with it who will act as stewards in principal-manager relations.

Nature of power understood as "psychological need to influence others toward the accomplishment" of important and approved goals is of a great significance in principal-manager relationships (Davis *et al*., 1997, p. 31). The authors draw on the division into two types of power: institutional (organizational) and personal. Organizational power comes from the position of particular individual in the organization. Expiring of membership leads to a loss of power. This type of power is a basis for reciprocal influences between the parties involved in agency relationships. Remuneration systems and principal's establishment according to the law are important elements of control systems involved in those relationships. Personal power does not come from the role which a particular individual plays in an organization. It develops in time, in the context of particular relationship. It is a basis for reciprocal influences between the parties involved in stewardship relationships. Which type of power prevails in particular principal-manager relation, is a function of personal features of particular individuals and of organizational culture.

Organizational culture and philosophy of management are situational factors shaping principal-manager relations. Which types of relations and management systems are emphasized in debates on philosophy of management, depends on assumptions concerning human nature. One can distinguish two approaches to the issue. The first one, philosophy of high-commitment, assumes substantial participation related to open communication, empowerment of workers and mutual confidence. The antipodal philosophy of management emphasizes control systems.

The philosophies mentioned above differ in ways they response to risk and uncertainty. High-commitment approach may turn out more efficient in unstable and uncertain environment, and control-oriented management – in more stable environment. In response to increased risk and uncertainty control-oriented philosophy will recommend additional control activities. High-commitment approach, by contrast, in response to increased instability will increase competence (training courses), empowerment and confidence in members of an organization. Concept of confidence understood as "a willingness to be vulnerable" while involved in relationship, is very important in high-commitment approach, contrary to control-oriented approach, in which "willingness to be vulnerable" (and therefore confidence) is of no significance. Furthermore, the issue of confidence appears in the context of relationships resting on personal power (e.g. resulting from being an expert or from wide recognition). Relationships being part of control-oriented management rest mainly on institutional power and are of transactional nature. Therefore, it is philosophy of management, which is a context in which particular type of relationship between principal and manager (agency or stewardship) is chosen and shaped. That is why individuals situated in the environment with high level of commitment are apt to become stewards in principal-manager relationships, but not individuals operating in control-oriented environment.

Organizational culture mentioned above can also influence the choice between agency and stewardship. The analyses draw on the distinction between individualism and collectivism. Individualism means that individual (personal) goals prevail over collective ones. Collectivists appreciate harmony in groups they belong to, they avoid conflicts and confrontations, they prefer long-term relationships, they devote a lot of time and effort to prior acquaintance of the other party of business transaction. Individualists, by contrast, may consider confrontation an opportunity for working things out and for direct communication. They will be short-term-oriented, in business relations they will emphasize costs and benefits analyses, and will insist on contracts in order to minimize business risk. It thus seems that collectivist culture favours stewardship relationships and individualism is a more appropriate environment for agency relationships.

Description of the diversity of cultures made by Hofstede (1980, 1991, as cited in Davis *et al*., 1997, p. 34) introduces an important concept of "power distance". It is defined as the extent, to which less powerful members of organizations in particular country are willing to accept unequal distribution of power. In cultures with substantial power distance (e.g. in class or caste societies) large inequalities in power and privileges are accepted. In societies with small power distance inequalities are being minimized, independence of individuals having less power is of a great importance, diversification is unwelcome. Similar diversity occurs in organizations. In cultures with large power distance, organizations are centralized, with considerable differences in authority, salaries and privileges between various levels of hierarchy. Therefore, cultures with large power distance favour agency, because they support and legitimize inequality between an agent and a principal. Cultures with small power distance, by contrast, favour stewardship, because participants of the relationships attach much weight to equality of the parties involved.

Cultural dimensions of individualism, collectivism and power distance are not perfectly correlated, therefore forecasting which type of the relations will occur on the basis of these factors is problematic. Furthermore, various psychological factors and philosophies of management discussed above make any such forecasting even more difficult.

The choice between agency and stewardship relationships may resemble to some extent prisoner's dilemma discussed in the game theory. It is shown in Figure 1.

Figure. 1. Principal-Manager Choice Model

		Principal's Choice	
		Agent	***Steward***
Manager's Choice	*Agent*	Minimize potential costs Mutual Agency relationship	Agent act opportunistically Principal is angry Principal is betrayed
	steward	principal acts opportunistically Manager is frustrated Manager is betrayed	Maximize potential performance Mutual stewardship relationship

Source: Davis *et al.* (1997, p. 39).

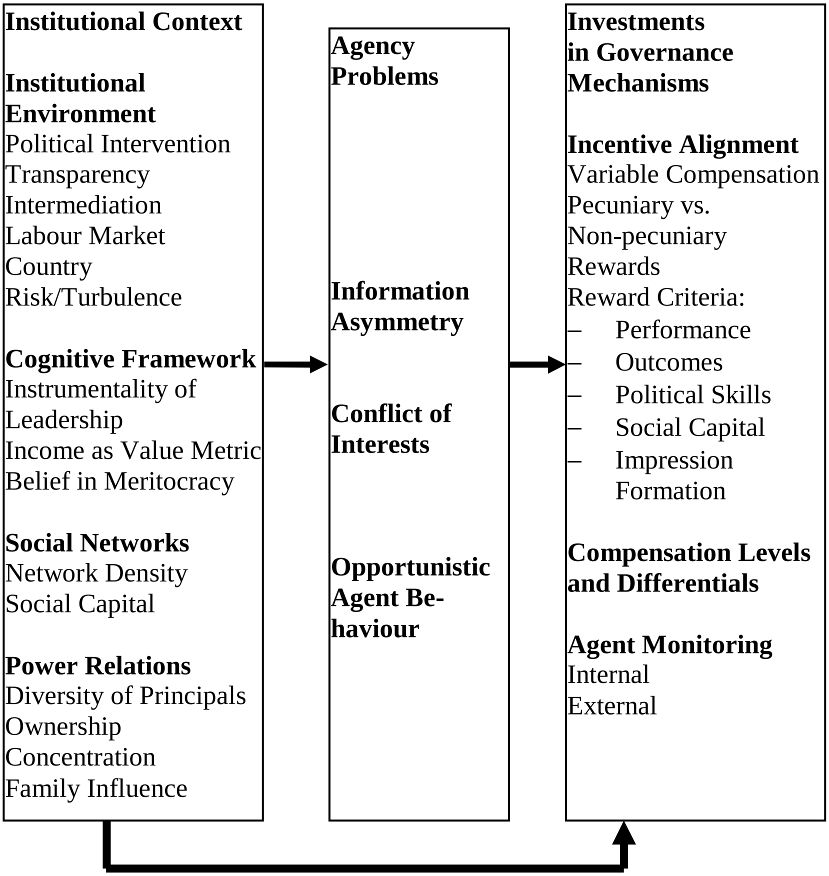
So, if there are reciprocal relationships of stewardship, it leads to maximizing potential financial results of a firm. If, on the other hand, there are reciprocal relationships of agency, it leads to minimizing potential costs; and in the environment consisting of various relationships, then the party choosing stewardship will be exploited, and the second party will act opportunistically.

Social Agency Theory – Extension of the Traditional Theory

Some of the objections levelled against agency theory concern the fact that some social factors not included in contracts regulating principal-agent relationships may restrict opportunism assumed by the theory and influence control mechanisms included in contracts between principal and agent. It means that the nature and forms of corporate governance are determined by institutional context and this is the reason why there is such a large diversity of forms of governance both between various countries and inside particular countries. This has given rise to criticism. Critics of the agency theory point out the need for alternative models of corporate governance, appropriate for particular institutional and social contexts. Wiseman *et al*. (2012), by contrast, instead of alternative models of corporate governance put forward "social agency theory", which is an extended version of the traditional agency theory. They argue that this extended theory is applicable in various institutional contexts. They admit that simplistic premises of the agency theory were indeed assumed by neoclassical economics on account of mathematical formalization of the models. They claim, however, that such limiting assumptions are not necessary in studies on corporate governance in various institutional environments, and that with extended and more flexible premises this theory is still a very important device for analyzes in situations of delegation of rights. Extension of the premises comes down to assuming that conflict of interest between parties involved in the relationships is always possible, because parties may differ in their views on favourable goals as well as on connections between actions and results. Convergence or divergence of views and interests is a dynamic process, because parties may understand differently the key issues involved in their relationships. Furthermore, limited access to information and specificity of the goals of the parties involved in relationships may generate opportunistic behaviours of agents including moral hazard and negative selection. Assumption of egoism in pursuing one's own interests is replaced by the statement that the interests of the parties involved in relationships are socially conditioned, convergent or not, and they do not have to be maximized. One has only to assume the possibility of diversification of parties' interests. The important thing is that because of information asymmetry and of the fact that in a long-term perspective, the nature of relationship changes, a principal thus may have problems with identifying when divergence of interests occurs. That makes it necessary to introduce some governance mechanisms – not because all the managers are always egoistic, but because principals may not know when egoistic behaviours occur, and that managers may have opposite (if compared with principals) views as to which solutions are the most favourable to the firm.

Critics of agency theory emphasize as well that numerous studies drawing on it focus on the issue of efficiency of various forms of contracts so designed as to minimize effects of moral hazard, and because of the fact that they do not take into account possibility of institutional impact on its nature and scope. According to the authors cited above, a proper response to this situation should be extending agency theory through inclusion of the lacking premises. It will be important then to grasp how those contextual factors added to the model will affect the ways problems of agency will emerge, and why governance structures are so different in various social contexts. Drawing on various authors Wiseman *et al.* (2012, p. 206) formulate social agency theory including such factors as institutions, cognitive factors, social networks and factors of power, which allow to explain, how the roles of principal and agent, their interests, problems originating from their interactions and mechanisms designed for controlling all those issues are understood in various contexts (Figure 2).

Figure 2. Institutional contexts and their effect on agency problems and investments in governance mechanisms



Source: Wiseman *et al.* (2012, p. 206).

Contrary to the sociologists, Wiseman, Cuevas-Rodrigues and Gomez-Mejia (2012) draw on deductive approach, quite common in economics, which allows to generalize governance theory in such a way that it is not a simple description of particular situation in the given context. The basic idea is that each time we deal with delegation of rights, problems of agency occur (information asymmetry, divergence of interests and opportunism of agents' behaviour), even if the ways they occur and can be solved, may be different in various institutional environments.

Revised Agency Theory – Legal Perspective

Lan and Heracleous (2010) expressed doubts concerning the effectiveness of devices recommended by agency theory, aimed at minimizing agency problems. Those devices are not adequate for cooperative behaviours nor behaviours of substantial complexity. Therefore, they suggest revision of agency theory resting on a legal doctrine. The authors point out that, according to legal regulations, it is not shareholders but corporation that is a principal. According to traditional agency theory, board of directors acts as shareholders' first-order agent. Lan and Heracleous (2010, p. 295) argue, however, that the board is an autonomous fiduciary – a body having authority to act on behalf and for the benefit of a beneficiary. Directors' autonomy comes from the fact that they are not agents of any of the parties involved (stakeholders), nor are they controlled by them. The role of a board of directors is another issue. According to classical agency theory, it consists in control of managers' actions aimed at securing that their behaviours will be oriented towards maximizing the value for shareholders. According to the authors, board of directors should act as a mediating hierarch with the objective of balancing interests (often competing ones) of various groups substantially contributing to the process of team production, deciding on allocation of the surplus gained by the team, controlling (by force of law) corporate resources and strategic decisions. This new understanding of the role of board of directors is based on team production theory (Alchian & Demsetz, 1972; Blair & Stout, 1999a; 1999b).

This new view on the relationships involved in corporate governance is based on the fact that from the legal point of view a corporation is an independent legal person, which results in its having rights to control common property of its participants, as well as in a state protection of these rights.

In legal sciences, on the ground of contractual theory of the firm, two models of corporate governance have emerged: shareholder primacy model which supports agency theory, and director primacy model which demands revision of agency theory (Lan & Heracleous, 2010, p. 295). The authors argue that in spite of the fact that shareholder primacy model became widespread in theory and in practice, both judicial precedents and corporate law weigh in favour of director primacy model.

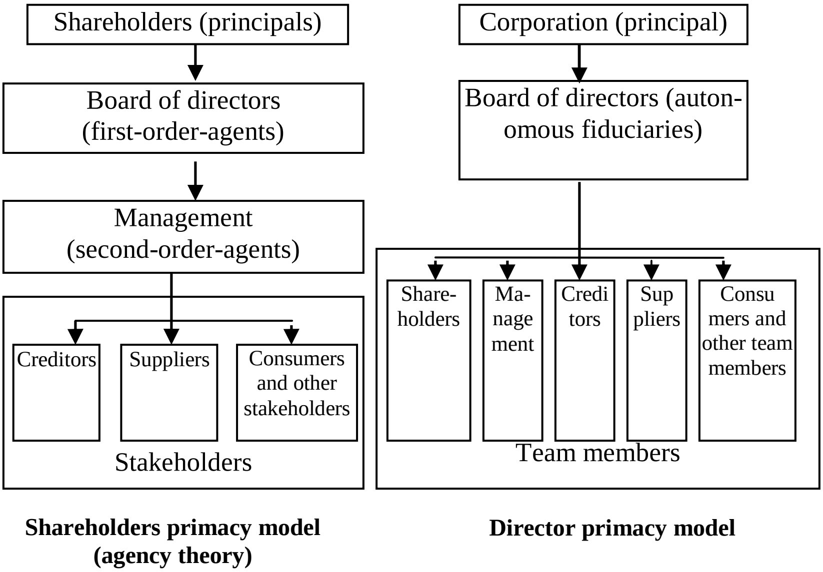
Shareholder primacy model rests on the idea that a firm is a legal fiction, a bundle of contracts, and shareholders should have decisive authority as contractual principals. Managers are agents answerable to shareholders, and should pursue maximization of value for shareholders. In this model a board of directors controls managers on behalf of shareholders. Since the board of directors is viewed as shareholders' agent, in this relationship problems and costs of agency may emerge. In order to minimize these effects, the following are proposed (among other things): board's independence from managers, participation in ownership, and corporate control market is being utilized as a mechanism imposing discipline on directors and managers.

In director primacy model a firm is viewed as production team carrying out complex production process, in which numerous parties are involved, and it is impossible to distinguish unequivocally their particular contributions to its outcome. Shareholders are only one of the parties contributing to the final results and should not be the only residual claimants. Other groups bring in assets vital for production process, specific for a firm, which if once involved in a team production, cannot be withdrawn and sold somewhere else for their full value. Therefore, the rights of the parties bringing in specific assets cannot be properly protected by the contracts, and thus they cannot provide appropriate stimuli for optimal commitment to the work of a team. The problem can be solved by delegation (by team members) of the authority over allocation of a surplus to some independent, mediatory body having form of a board of directors. It would monitor commitment of particular parties to the production process, remunerate properly for former involvement, motivate to future commitment and counteracting mutual opportunism in relationships between the parties involved. In this model, corporate governance is oriented towards creating a structure which would maximize the sum of returns adjusted to the risk of all the parties involved in a firm. The board of directors is placed on the top of structural hierarchy, as a mediator in possible arguments between the parties. In this model, the board of directors decides on such vital issues as employing and remunerating chief managers, fusions and takeovers, division of dividends, control over strategic decisions and securing that those decisions are in the corporation's best interest, as well as provides schemes for numerous managers' decisions.

Figure 3 compares shareholder primacy model and director primacy model.

Proponents of director primacy model emphasize the peculiar character of relationship between directors and corporation. It differs substantially from typical principal-agent relationships; it is a peculiar legal relationship. Directors' power is original and undelegated. Directors, who are legally obliged to act for the benefit of corporation, are not subordinate to any of the stakeholders. In spite of the fact that they are designated by shareholders, they should enjoy freedom of taking business decisions within the limits of justified risk (as they define it), without fear that their decisions will be revised persistently. Usually, any shareholders' actions against directors taken on the suspicion that they fail to carry out their responsibilities require court permission, because it is the corporation and not shareholders who have right to take such actions. Pointing out that directors should enjoy freedom to exercise their judgments independently, even if it could rank shareholders interests below those of other stakeholders, emphasizes the role of directors as autonomous fiduciaries of the corporation.

Figure 3. Comparison of shareholder primacy and director primacy models



Source: Lan and Heracleous (2010, p. 302).

In the director primacy model, their actions are motivated not only by salary packages, but also by the values linked to their high status and the confidence given to them. In this respect, the model is in keeping with the stewardship theory, which assumes confidence, internal motivation, need for fulfillment, collectivism, self-control and high level of commitment. One has also to assume that confidence given to directors and managers, may be abused, so some governance mechanism is required – it is the legal system.

From Corporate Law to Business Law

Segrestin and Hatchuel (2011, p. 485) while recapitulating the debate on various concepts of corporate governance, come to the conclusion that the most recent global financial crisis revealed a management crisis as well, in the fields of both theoretical analysis and managerial practice (corporate governance). It is „a fundamental, structural crisis of management, as managers are deprived of their freedom to decide on their actions". Origins of this situation are of a legal nature, because the law does not protect managers' autonomy and neutrality towards shareholders' interests. According to the authors, management is based on such concepts as: authority, creative competence and leadership. In fact, they cannot be carried out, because they are not protected by law, as managers are viewed as agents. It is a result of increasing dominance of the agency theory in the area of corporate governance. Therefore, a new interpretation of law alone, which occurs for instance in director primacy model, is not enough, because it does not secure protection of managers' autonomy.

Crucial function of management is coordination and management of key assets of a firm in the context of uncertainty, diversified knowledge and various group interests present in the firm. Efficient performance of this function requires managers having authority, which is in danger when shareholders have the right to control them.

Creative skills and abilities of managers are the next important feature that emphasizes entrepreneurial character of management. Manager-entrepreneur carries out projects and strategies, organizes resources and develops competence, which is not only a response to internal and external factors, rational choice or adaptative learning, but also a creative organizing of resources, combining learning analysis with creative and inventive forecasting, designing new options for team actions, reaching beyond known ways of operating. The managers' objective is therefore creating and implementing projects unknown to the investors *a priori*. When it is the shareholders (investors) who ultimately exercise control, managers are forced to realize projects determined by their principals, and their competence may not be utilized properly. Similarly, the structure of agency relationship may weaken the leadership function of managers consisting in winning support for various projects from all other groups having various interests. Leadership function is also connected with confidence that enables supporting of the realized projects, in spite of uncertainty accompanying them. But according to Segrestin and Hatchuel (2011, pp. 492-493), law does not provide devices for building trust and solidarism in teams which may curb investments of various groups involved in firm's operations and limit creation of value.

Segrestin and Hatchuel (2011, p. 494) are convinced that the most recent crisis revealed the lack of specific business law or law concerning a firm. It is also very important not to confuse corporate law with business law, because the former was not designed for a modern firm. In numerous jurisdictions, corporation does not include employees, while business includes all the stakeholders. Emergence of modern firm has not resulted in emergence of "firm law", but only of labour law, and corporate law has not changed. Manager's status got divided into two categories. On the one hand, manager occurs as a representative of a corporation (corporate law) and on the other hand as employer (labour law). Thus, the law does not integrate the concept of modern management, and a manager found himself in a gap between two systems of law. According to the authors, this is the reason why there is no legal concept of a firm, and the firm itself is not protected and supported.

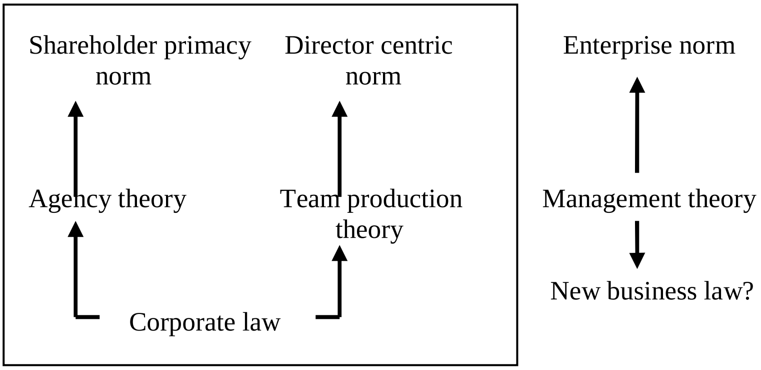
In this context, Segrestin and Hatchuel (2011, pp. 495-496) suggest some principles for legal regulations concerning management. The first one concerns the right to vote and to appoint managers. In the process of appointing managers having authority, stakeholders should be divided into two groups: those recognizing and accepting manager's authority and the rest. The former entrust manager with the task of managing their capital on their behalf and should be given the right to appoint managers. Thus managers would be appointed as well as dismissed by those groups which recognize the manager's authority. A charge may be levelled that if we provide many parties with the right to appoint managers, chaos and decision paralysis may occur. However, we should distinguish the right to appoint managers from managers' right to decide. Those who appoint managers, accept their authority, and thus agree not to interfere with their decisions. This principle is also different from stakeholders theory and shareholders' primacy, because according to this principle the right to appoint and dismiss managers would be given only to those who recognize their authority and are involved in the operations of firm in the medium or long term (it concerns some employees and some shareholders).

In order for managers to efficiently utilize their innovative capabilities and realize business ideas, their actions should not be hindered but legitimized. Corporate governance and directors should find ways to justify and legitimize managers' decisions through questioning, inquiring, testing, discussing, explaining, encouraging etc. Systems of stimuli of any sorts are not recommended, because they may distort business judgements.

More complete legitimization of managers' decisions may be obtained through mechanism of solidarism. Managers' actions (e.g. particular strategy) have a positive or negative impact on particular members of a team. In case of shareholders, it will be an increase or decrease of share prices, in case of employees – an increase or decrease of competence which translates into ability to work. Usually, those effects do not cumulate nor are they divided. It seems, however, that when individuals agree to have their assets utilized and managed for joint projects, the results should also be jointly allocated. Appropriate rules of solidarism would probably ease mutual commitment of various individuals and would strengthen mutual confidence. For instance, when shareholders gain profits or suffer losses, compensation of some sort would be paid by them to the firm or vice versa. Employees who leave a firm, which had covered costs of their professional training, could partially pay them back. On the other hand, employees dismissed as redundant, should receive some compensation, if at their expense the firm will be able to bring in a profit again.

To sum up, Segrestin and Hatchuel (2011, pp. 496-497) call for a revision of corporate law oriented towards business law and firm law, which would be in greater accord with the theory of management, which would protect managers' authority and support their innovative competence and leadership features. Those proposals are shown in Figure 4.

Figure 4. The alternative views of corporate governance based on corporate law and the view from management research



Source: Segrestin and Hatchuel (2011, p. 497).

Conclusions

Above discussion shows that the controversies about the agency theory as theoretical basis for corporate governance may have many various sources.

Simplistic and unrealistic premises which constitute the basis of the theory. Therefore, it is suggested that numerous additional factors should be taken into account – socio-institutional, psychological, cultural and organizational – that shape relationships between subjects, influencing the structure of corporate governance and forming basis for alternative views on the issue of governance. This paper discusses two of them: stewardship theory and social agency theory. The first one, contrary to agency theory, assumes that managers act pro-organizationally, and in this way they accomplish goals of all the stakeholders – including their own. Proponents of this approach at first rejected agency theory as wrong, but later they came to the conclusion that both theories may be complementary. Social agency theory is an extended version of the traditional one, which replaces the assumption of egoistic attitude of managers with extended premise of possible conflicts of interest, not necessarily originating from opportunism, but from different perspectives on goals of the firm, on actions and their results, or from unequal access to vital information. It takes into account institutional factors as well, which together enables analyzing various models of corporate governance.

Understanding of the nature of a firm and interpretation of corporate law. Instead of contractual view of the firm, theory of team production is being proposed, in which shareholder primacy model is replaced by director primacy model in the area of corporate governance. Agency theory is revised on the basis of reinterpretation of corporate law, according to which a board of directors has its powers not through delegation by shareholders (agency relationship), but by force of law it is a corporation that is its principal. The role of the board is not in the first place control over managers, but the function of a mediatory body in the structural hierarchy of the firm. The firm is understood as a production team with various stakeholders as its members, who contribute their specific assets. According to other authors, a new interpretation of the law alone in favour of director primacy model is not enough, because the law does not support nor sufficiently protects managers' vital attributes: authority, innovative skills and leadership features. Therefore they suggest formulation of business law and appropriate rules of corporate governance, which would be in greater accord with theory of management.

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