



Addis Ababa University

College of Business and Economics

School of Graduate Studies

**The Effect of Incentive Schemes in reducing agency cost of
an organization in Ethiopia**

By:

Sebsiba Kiros Beyene

**A Thesis Submitted to School of Graduate Studies of Addis
Ababa University In partial Fulfillment for the Requirement
of The Degree of Masters in Business Administration**

(MBA).

December, 2023

Addis Ababa, Ethiopia

**The Effect of Incentive Schemes in reducing agency cost of
an organization in Ethiopia**

By:

Sebsiba Kiros Beyene

Advisor:

Temesgen Worku (PhD)

Addis Ababa University

December, 2023

Addis Ababa, Ethiopia

Declaration

I declare that this research work entitled “The effect of incentive scheme in reducing agency cost of an organization” is my own original work. I have carried out it independently with the guidance and suggestions of the research advisor. And it has not been presented in Addis Ababa University or any other University.

Sebsiba Kiros Beyene

Signature _____

Date _____

ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS POST
GRADUATE PROGRAM
DEPARTMENT OF MANAGEMENT

This is to certify that the thesis prepared by **Sebsiba Kiros Beyene** entitled The Effect of Incentive Schemes in reducing agency cost of an organization: which submitted in partial Fulfillment of the Requirements for the Degree of masters in Management. Complies with the regulations of University and meets the accepted standards with respect to originality and quality.

Signed by the Examining Committee:

Advisor

Signature

Date

Examiner (Internal)

Signature

Date

Examiner (External)

Signature

Date

Chair of Department of Graduate Program Coordinator

Acknowledgment

I extend my heartfelt appreciation to my advisor, Dr. Temesgen Worku, for his invaluable guidance and motivation throughout the preparation and completion of this study.

I am deeply grateful to my family for their unwavering moral support and encouragement in all my academic endeavors. I extend special thanks to my wife and daughter for their constant encouragement.

I also wish to express my gratitude to all the managers and employees of the organizations who generously participated in filling out and promptly responding to my questionnaires. Their sincere cooperation and assistance in facilitating the data collection process are greatly appreciated.

Table of Contents

<i>Content</i>	<i>Page</i>
Declaration.....	3
Acknowledgment	i
Table of Contents	ii
<i>Content</i> <i>Page</i>	ii
Abstract.....	v
Chapter One	1
1.Introduction.....	1
1.1. Background	1
1.2. Statement of the Problem	4
1.3. Research Questions	7
1.4. Objectives of the Study	7
1.4.1. General Objective	7
1.4.2. Specific Objectives	7
1.5. Scope of the Study	7
1.6. Significance of the Study.....	7
1.7. Organization of the Study	8
Chapter Two.....	9
2. Review of Related Literature	9
2.1. Theoretical Review.....	9
2.1.1. Development of Agency Problems	9
2.1.2. Development of Incentive Scheme	12
2.2. Controlling of the Agency Problem.....	13
2.3. Empirical Review	14
Chapter Three.....	16
3. Research Design and Methodology	16
3.1. Introduction	16
3.2. The Study Area	16
3.3. Research Population and Sampling	16

3.4.	Sampling Size	17
3.5.	Analysis Methods.....	17
3.6.	Data Source and design of research instruments.....	17
3.6.1.	Source of Data.....	18
3.6.2.	Instruments and Data Collections	18
3.6.3.	Tools for Data Analysis	19
3.7.	The Research Process.....	Error! Bookmark not defined.
Chapter Four		21
4.	Data Presentation, Analysis and Interpretation.....	21
4.1.	General Background Information of the Respondents.....	21
	Table 4.1 Gender of Respondents	22
	Table 4.2 Age of Respondents	22
	Table 4.3 Educational Qualification of Respondents.....	22
	Table 4.4 Position of Respondents in the Company	23
	Table 4.5 Experience of Respondents in the Company	23
4.2.	Results and Discussions of Specific Questions.....	24
	Table 4.6 Causes of Agency Cost Questions?	24
	Table 4.7 Effect of Incentive scheme in reducing agency cost Questions.....	25
Chapter Five.....		27
5.	Conclusions and Recommendations	27
5.1.	Conclusion.....	27
5.2.	Recommendation.....	28
Reference		30

List of Figure

Title	Page
<u>Table 4.7 Effect of Incentive scheme in reducing agency cost Questions.....</u>	25
<u>Table 4.2 Age of Respondents</u>	22
<u>Table 4.3 Educational Qualification of Respondents</u>	22
<u>Table 4.4 Position of Respondents in the Company</u>	23
<u>Table 4.5 Experience of Respondents in the Company</u>	23
<u>Table 4.6 Causes of Agency Cost Questions?</u>	24
<u>Table 4.1 Gender of Respondents</u>	22

Abstract

The primary goal of this study was to evaluate how incentive scheme impact in reducing agency costs within organizations. It sought to understand the root causes of agency costs and the effectiveness of incentive schemes in diminishing the conflict of interest between the principal and agent that creates agency cost. Data was gathered through a questionnaire, with the first section focusing on demographic details and the second section addressing questions related to the causes and effects of agency costs. Analysis was conducted using an ordinal scale, organizing responses numerically. The results underscored the significance of agency problems in generating agency costs and demonstrated the positive influence of incentive schemes in addressing them. The study advocates for the implementation of diverse incentive structures encompassing both intrinsic and extrinsic motivators. Additionally, it suggests enhancing the ownership stake of managerial personnel to effectively tackle agency costs within organizational setups.

Keywords: Agency problems, Agency cost, Incentive Schemes, Intrinsic Incentive, Extrinsic Incentive, Equity and Owner manager.

Chapter One

1. Introduction

1.1. Background

In an organization there are owners, managers and employees, these parties have different kind of relationships in the organization. The relationship between the management (agent) and the owners (principal) of a firm is characterized by an agency relationship. The presence of an agency problem arises when the objectives pursued by management diverge from those of the owners, who seek to maximize shareholder wealth. This issue is explored in the empirical section of the study. As per Lambrechts (1992), enterprises were traditionally managed and owned by the same individuals until 1870. The advent of large public enterprises led to a separation between management and ownership. Owners started hiring professional managers to run their companies, giving rise to the concept of agency theory. This division meant that shareholders became increasingly passive, granting management significant freedom to pursue goals that might not necessarily coincide with the interests of the firm's shareholders.

It has long been acknowledged that the interests of managers in large corporations may deviate from the objective of maximizing shareholder profits. In these enterprises, managers are appointed by shareholders to make decisions that serve the shareholders' interests. As stated by Lasher (2008), this type of relationship introduces a conflict of interest known as the agency problem. This predicament arises when an individual (principal) hires and authorizes another person (agent) to act on their behalf.

An agency relationship, in its narrowest sense, refers to a contractual agreement where one or more individuals (referred to as the principal or principals) enlist the services of another individual (the agent) to carry out actions on their behalf, involving the delegation of decision-making authority to the agent. Early formal analyses by Spence and Zeckhauser (1971) and Ross (1973) examine the challenges associated with structuring the agent's compensation to align their incentives with the interests of the principal.

Jensen and Meckling (1976) argue that conflicts of interest leading to agency problems are inherent in almost all collaborative endeavors among individuals, regardless of whether they conform to the hierarchical structure implied by the principal-agent analogy.

The extensive efforts directed towards formulating a theory of agency have led to the development of two distinct approaches known as the "positive theory of agency" and the "principal-agent" literature. While differing in various aspects, both bodies of literature tackle the issue of contracting among self-interested individuals and operate under the assumption that total agency costs are minimized within any contractual relationship.

The principal-agent literature typically employs mathematical models and is less focused on empirical analysis, whereas the positive-agency literature tends to be nonmathematical and emphasizes empirical investigation. The principal-agent literature primarily delves into analyzing the impacts of preferences and asymmetric information, with less emphasis on the implications of contracting techniques and control mechanisms.

The principal-agent theory in public administration refers to a framework that focuses on the relationship between a principal (such as the government or shareholders) and an agent (such as public servants or managers) in order to ensure accountability and proper exercise of administrative power. It originated as an economic model for market situations and private organizations, but has been increasingly applied to the public sector.

Any person who has the legal capacity (meaning that they are not insane, or in certain circumstances a minor) to perform an act may be a principal and empower an agent to carry out that act. Persons, corporations, partnerships, not-for-profit organizations, and government agencies may all be principals and appoint agents. Any individual capable of comprehending the act to be undertaken is qualified to serve as an agent.

A contract to be made by an agent on behalf of a principal is considered to be the contract of the principal and not that of the agent. It allows the principal to authorize somebody to carry out her duties, either for a specific purpose (i.e., purchasing a house) or generally (i.e., to conduct many transactions). The agency relationship is usually entered into by informal agreement, but also can occur by formal agreement (in certain cases, the agency relationship must be specified in writing). The acts must be legal (i.e., principal cannot hire agent to kill the professor).

Inherent in the Principal-Agent (P-A) relationship is the understanding that the agent will act for and on behalf of the principal. The agent assumes an obligation of loyalty to the principal that

he/she will follow the principals instructions and will neither intentionally nor negligently act improperly in the performance of the act. An agent cannot take personal advantage of the business opportunities the agency position uncovers. A principal, in turn, reposes trust and confidence in the agent. These obligations bring forth a fiduciary relationship of trust and confidence between Principal and Agent.

An agent must obey reasonable instructions given by the Principal. The Agent must not do acts that have not been expressly or impliedly authorized by the Principal. The Agent must use reasonable care and skill in performing the duties. Most importantly, the Agent must be loyal to the principal. The agent must refrain from putting herself in a position that would ordinarily encourage a conflict between the agents own interests and those of the principal (note: one might reflect on the role of certain Enron executives on outside limited partnerships that did business with Enron in the early 2000s). The agent must keep the principal informed as to all facts that materially affect the agency relationship.

Agency costs arise as an internal expenditure within a company, stemming from the actions of an agent representing a principal. These costs result from fundamental inefficiencies, dissatisfactions, and disruptions, specifically in cases of conflicting interests between management and shareholders. The remuneration for agency costs is allocated to the agent involved.

The emergence of agency costs is linked to clashes between shareholders and the executive management of a corporation. Shareholders may aspire to guide management towards operating the company in a manner that enhances shareholder value. Conversely, management may pursue alternative strategies for company growth that could potentially diverge from the shareholders' best interests. In such scenarios, shareholders bear the brunt of the agency costs.

Jensen et al. (1976) identified two categories of agency costs: those stemming from conflicts between external equity holders and owner-managers, and those arising from conflicts between equity holders and debt holders. Ang et al. (2000) and Fleming et al. (2005) demonstrated that increasing the ownership stake of manager-owners can alleviate agency costs resulting from conflicts with external equity holders. However, navigating conflicts between equity holders and debt holders presents a more complex scenario.

Grossman et al. (1982) and Williams (1987) argue that heightened leverage reduces agency costs and enhances firm value by incentivizing managers to align their decisions more closely with the

interests of equity holders. This perspective is commonly referred to as the agency costs hypothesis.

An incentive scheme refers to a plan devised to stimulate individual or group performance, encompassing both monetary rewards like incentive pay and non-monetary incentives. Incentives are flexible rewards granted based on the achievement of specific results. There are two primary categories of rewards:

1. **Intrinsic Rewards:** These encompass activities that impact the intellectual, emotional, and physical well-being of an employee.
2. **Extrinsic Rewards:** These are tangible rewards provided to employees by managers and include elements such as basic pay wages and salary, deferred payments (like pension plans), services and benefits (such as accommodation and medical benefits), and compensation for work not performed (including holidays and leaves).

The research seeks to evaluate how incentive schemes influence the reduction of agency costs within various governmental and non-governmental organizations in Ethiopia, with a specific focus on Addis Ababa.

1.2. Statement of the Problem

Agency problems emerge within the dynamic between a principal and an agent. Agents are typically enlisted by principals for diverse reasons such as disparate skill levels, distinct employment roles, or limitations on time and access. The crux of the agency problem lies in the realm of incentives and the discretion afforded to agents in executing tasks. When presented with an incentive to behave unfavorably for the principal, an agent may be inclined to act in a manner contrary to the principal's interests.

The agents and principals of an organization in Ethiopia whether it is governmental or non-governmental, there is a conflict of interest that can create agency cost and it has an effect on the activities of the organization. Therefore, agency problem is one of the major problem for governmental and non-governmental organization that needs attention, in order to reduce agency costs occurred by the agency problem different incentive schemes are used.

Agency problems, as defined by Business Finance (2021), refer to challenges arising from conflicts. When a principal hires an agent to act on their behalf, aiming to maximize the principal's benefits, potential conflicts may arise. Despite the agent's responsibility to work in the principal's interest, they also harbor their own interests. While fulfilling their duties for the principal, there is

a possibility that the agent may deviate from the primary purpose and act for their personal gain. In the financial realm, agency problems primarily manifest in two forms: conflicts between shareholders and managers, and conflicts between equity holders and debt holders.

The agency problem arises between shareholders and managers within a company. Initially, when a company is established, the founder assumes the roles of both owner and manager, acting in their interest to generate wealth. However, when the owner sells a portion of their ownership to external parties, they relinquish some control over the company, leading to a conflict of interest. In such scenarios, internal managers may prioritize personal gain over maximizing the company's wealth, potentially utilizing company resources for personal advantage. This conflict intensifies when managers hold fewer company stocks, increasing the likelihood of divergent interests.

The resolution to the agency problem between shareholders and managers involves aligning the interests of managers with those of shareholders, compelling them to operate in a manner that maximizes shareholder wealth. This alignment is facilitated through incentive compensation schemes designed to motivate managers, governance structures for monitoring their actions or leveraging mechanisms to constrain their behavior. However, implementing these solutions incurs costs, known as agency costs.

There primary types of agency costs:

1. Costs incurred from implementing methods to monitor managers' actions, such as fees for engaging independent auditors.
2. Costs stemming from establishing the company's structure to prevent managers from deviating from shareholders' interests.
3. Opportunity costs arise when shareholders take the time to reach a consensus before authorizing managerial actions.

The agency problem arises between equity holders and debt holders within a company. Debt holders provide loans to the firm and receive returns in the form of interest payments from the firm's cash flow. The interest rate for each loan is determined based on the firm's risk level at the time the loan is issued. However, once the loan is obtained, equity holders, through their management actions, can alter the risk level of the firm, such as by selling assets or investing in risky projects. This increases the risk borne by debt holders, leading to a decrease in the value of the debt.

While successful risky ventures do not increase returns for debt holders, failed projects expose them to heightened risk. Consequently, debt holders implement safeguards like stricter covenants or elevated interest rates to safeguard their interests. This can impede the company's access to financial markets and escalate debt costs, resulting in agency expenses.

To mitigate these costs, balancing the benefits of equity and debt holders is crucial. Experts advocate for the use of incentive compensation and convertible securities within the company's capital structure as potential remedies.

In the contemporary business landscape, the evolution of the business world has led to the emergence of various new agency problems. One such issue involves conflicts of interest between shareholders who hold control over the company's operations and those who do not, often referred to as minority shareholders. This disparity arises when controlling shareholders, typically owning a significant portion of the firm's ownership, make decisions that prioritize their interests over those of minority shareholders, who lack sufficient voting power to influence decisions.

Another prevalent problem is over-investment, which occurs when managers have surplus free cash flows and invest in projects that do not add value to the company, typically without facing financial constraints. Conversely, under-investment problems arise when a company accumulates excessive debt, leading managers to hesitate in making investments and conducting thorough analyses before deciding. In such cases, managers may overlook potentially lucrative yet risky projects in favor of safer but less profitable investments.

Additionally, there is a type of agency cost associated with the allocation of funds, where money is used to pay dividends instead of being invested in projects with positive Net Present Value (NPV). This practice can lead to missed opportunities for value creation and hinder the long-term growth prospects of the company.

Generally, agency problems stem from the complexity of ownership structures. These issues arise when owners are not solely responsible for managing their businesses and when they rely on debt financing. In essence, when multiple parties are involved in benefit sharing, individuals tend to prioritize their own interests, often leading to conflicts. Shareholders, managers, majority shareholders, minority shareholders, equity holders, and debt holders all invest in businesses, albeit in different capacities, with the expectation of returns. However, due to the involvement of multiple stakeholders, it becomes challenging for any single party to capture all the returns.

1.3. Research Questions

Following the problems discussed above, the study specifically addressed the following basic research questions;

1. How agency problem creates agency cost?
2. How to reduce agency cost of an organization?
3. How incentives affect agency cost of an organization?
4. What kind of incentives help to reduce agency costs?

1.4. Objectives of the Study

1.4.1. General Objective

The general objective of the study is to assess the effect of incentive schemes in reducing agency cost of an organization.

1.4.2. Specific Objectives

The study aims:-

1. To know the agency problems that create agency cost of an organization?
2. To know the type of incentives that helps to reduce agency cost of an organization?
3. To identify the effect of incentive in reducing agency cost of an organization?

1.5. Scope of the Study

The primary focus of the research revolves around evaluating the impact of incentive programs on mitigating agency costs within various governmental (Government and public bodies relationship) and non-governmental (Owner and Managers relationship) organizations in Ethiopia, specifically within Addis Ababa. Subsequently, it aims to examine the conventional economic perspective, which posits that agents are solely motivated by financial incentives. Additionally, the study tries to find alternative approaches for motivating agents, their underlying principles, and how these perspectives influence our strategies for addressing agency problems in practical settings.

1.6. Significance of the Study

This study holds significance for expanding current knowledge by uncovering the potential benefits that incentive schemes can offer to underdeveloped economies in addressing agency costs within organizations. Furthermore, it identifies the primary barriers hindering the adoption of various incentive schemes among organizational employees. This significance is two-fold. Firstly, it prompts employers to enhance their organization's incentive schemes for managers to alleviate

agency problems. Secondly, it encourages employers to consider these inhibitors when designing incentive schemes aimed at reducing agency costs. The study offers numerous advantages for principals and agents by providing valuable insights into factors contributing to agency problems and their impact on agency costs. Additionally, it furnishes both principals and agents with insights into the effectiveness of incentive schemes in mitigating organizational agency costs. Moreover, this study contributes to the limited literature on resolving agency problems and costs within developing economies, serving as a valuable resource for further research in this area.

1.7. Organization of the Study

The study is structured into five chapters. The initial chapter provides an introduction, including a general overview of the study, a statement of the problem, research questions, objectives, scope, and significance of the study. The second chapter focuses on reviewing related literature to identify gaps and establish a framework for addressing these gaps. It involves desk research on the impact of incentive schemes in mitigating agency costs within organizations. The third chapter outlines the research methodology, while the fourth chapter involves the analysis of results. Finally, the last chapter encompasses the study's conclusions and recommendations.

Chapter Two

2. Review of Related Literature

This chapter primarily concentrates on reviewing relevant literature concerning the impact of incentive schemes on reducing agency costs within organizations. It encompasses an examination of empirical studies conducted by various researchers as well as theoretical frameworks. The topics to be discussed include the causes and effects of agency problems, the causes and effects of agency costs, and the effectiveness of incentive schemes in mitigating agency costs within organizations.

2.1 Theoretical Review

2.1.1 Development of Agency Problems

As per Lambrechts (1992), enterprises were traditionally managed and owned by the same individuals until 1870. The advent of large public enterprises led to a separation between management and ownership. Owners started hiring professional managers to run their companies, giving rise to the concept of agency theory. This division meant that shareholders became increasingly passive, granting management significant freedom to pursue goals that might not necessarily coincide with the interests of the firm's shareholders.

The development and growth of listed firms during the past few decades has caused an ever widening gap between ownership and management. The agency theory addresses this relationship between owners (shareholders) and the custodians of their wealth, that is the management of a firm. If management's goals differ from those of the firm, an agency problem arises and the owners have to incur agency cost to overcome this problem (Hall, 1998).

Agency theory assumes that the interests of a principal and an agent are not always in alignment. This is sometimes referred to as the principal-agent problem. By definition, an agent is using the resources of a principal. The principal has entrusted money but has little or no day-to-day input (Carol, 2023).

As corporate structures evolved, the functions of ownership and management became distinct. In larger companies with extensive staff, managers are responsible for managing capital in the shareholders' best interests. However, within such organizations, conflicts may arise between managers and shareholders. Managers, with their in-depth understanding of the company's

operations, might utilize this knowledge for personal advantage, potentially deviating from decisions aimed at maximizing shareholder value. This conflict of interest between managers and shareholders gives rise to what is commonly referred to as the agency problem (Boshkoska, 2014). An agency problem may arise in various business relationships where one party entrusts another to act on their behalf. Nevertheless, there are strategies to minimize the risk of encountering such issues, and understanding how to manage conflicts of interest can be advantageous.

The concept of "agency problems" originates from the division of labor. To ensure effective task delegation, it is essential to ensure that tasks assigned to others are executed satisfactorily. The core of agency problems is grounded in two key assumptions: firstly, actions that benefit the agent may not necessarily align with the best interests of the principal, and secondly, monitoring these actions may pose challenges. Formulating a performance contract, which delineates the nature of each task and the expected standards of performance, often proves to be difficult (Timothy et al., 2014).

Agency problems arise in the relationship between a principal and an agent, often because agents possess different skill levels, hold different positions of employment, or face limitations on time and access. These problems stem from issues related to incentives and the discretionary authority granted to agents in completing tasks. If agents are incentivized to act in a manner that is not beneficial to the principal, agency problems can ensue (James, 2022).

There are numerous factors contributing to agency problems, such as unwarranted enhancements and services that escalate costs for the principal. For instance, if you hire an electrician to install a specific version of a light control system in your home, but they choose to install a newer, more advanced version that requires double the time and money because it complements your home's style better, the agent may prioritize their own interests to profit more from the installation, deviating from your expectations (Indeed Editorial Team, 2021).

Jensen et al. (1976) highlight that agency costs arise when there is an incomplete alignment between the interests of the agent and the owner. The division of ownership and control can lead to the occurrence of agency costs. What Triggers an Agency Problem? Agency problems emerge within the relationship between a principal and an agent. Agents are typically engaged by principals due to differences in skill levels, employment positions, or limitations on time and access (James, 2021).

Agency costs refer to the expenses incurred due to disagreements between shareholders and business managers. Shareholders and managers often disagree on the optimal strategies for a company, leading to what is known as the "agency problem." Costs resulting from these disagreements are categorized as agency costs (Corporate Finance, 2020).

Agency costs are a type of internal cost that a principal may incur as a result of the agency problem. They include the costs of any inefficiencies that may arise from employing an agent to take on a task, along with the costs associated with managing the principal-agent relationship and resolving differing priorities. While it is not possible to eliminate the agency problem, principals can take steps to minimize the risk of agency costs (Maragret, 2001).

The agency theory examines the dynamic between owners (shareholders) and those entrusted with managing their assets, typically the management of a company. When the objectives of management diverge from those of the firm, it leads to an agency problem, compelling owners to bear agency costs to resolve this misalignment (Hall, 1998).

Various indicators signal the presence of an agency problem, leading to excessive or unnecessary costs borne by management due to this conflict situation:

- ✓ High levels of executive compensation;
- ✓ Neglect of managerial responsibilities (shirking);
- ✓ Inappropriate use of corporate resources, such as excessive perks;
- ✓ Failure to invest corporate resources in potentially profitable ventures to the detriment of shareholders;
- ✓ Prioritizing sales growth over profitability or shareholder wealth;
- ✓ Managers engaging in empire-building activities;
- ✓ Focusing on employee welfare objectives;
- ✓ Manipulating dividend policies at the expense of shareholder wealth creation (Cohen et al., 1990).

Agency costs encompass all expenses incurred by shareholders to incentivize managers to prioritize the maximization of shareholder wealth over acting in their own self-interest (Brigham et al., 1993).

Agency theory suggests how a company governs the conflict of interest between the company's owner (principal) and the manager (agent). These agency relationship can be seen in different arrangements like:-

- A. Agency relationship for profit organizations has a purpose of maximizing shareholders wealth, the principals are shareholders and the agents are managers and the directors are governed by non-executive directors.
- B. Agency relationship for government organization has a purpose of implementing government policies, the principals are taxpayers (voters) and the agents are managers elected by representatives and the agents are governed by complex structures which try to achieve the best way to deliver services.
- C. Agency relationship for non-government (charities) organization has a purpose of achieving compassionate activities, the principals are doners, supporters (service users) and the agents are directors and managers and the agents are governed by executive boards accountable to independent trustees (Jensen and Meckling, 1976).

2.1.2 Development of Incentive Scheme

Incentive is an inducement or reward which is given to a worker for his efficiency and hard work and motivate and encourage a worker to produce more and better. Incentives are additional payments to the work hourly rate to the workers contribution towards production.

The incentive theory of motivation is one technique that can help managers maintain a productive team in the workplace. This approach suggests that employees can be motivated by a positive incentive that gives them the desire to perform better and remain productive in hopes that they will receive a reward.

An incentive scheme is a strategy devised to inspire individual or group performance, encompassing both monetary incentives, such as incentive pay, and non-monetary rewards. Incentives are rewards that vary based on the level of accomplishment of specific objectives (Rupali, 2020). Compensation refers to what employees receive in return for their contributions to the organization.

Intrinsic rewards encompass activities that affect an employee's intellectual, emotional, and physical well-being, not explicitly covered by the external compensation system. These rewards are often the most potent and cost-effective for an organization. They can be as simple as acknowledging and appreciating employees for their valuable contributions, fostering a sense of self-worth and pride. Providing a safe and healthy work environment is another form of intrinsic reward, focusing on enhancing the quality of employees' work life. Offering flexibility in work

arrangements, including work-from-home options, is also considered an intrinsic reward. Additionally, intrinsic rewards encompass opportunities for career growth and skill enhancement, thus increasing employees' marketability.

Extrinsic rewards, on the other hand, are tangible rewards bestowed upon employees by managers. These include basic wages, salary supplements, deferred payments like pension plans, and various services and benefits such as medical coverage and transportation allowances. Extrinsic rewards also encompass compensating employees for time not worked, such as holidays and leaves.

Incentivizing an agent to align with the principal's interests helps mitigate the agency's problem. Methods to achieve this include performance-based compensation, direct shareholder influence, the threat of termination, or the possibility of a takeover (James, 2022).

Reward management involves crafting, implementing, and sustaining reward systems that cater to the needs of both the organization and its stakeholders, including managers and employees (Herman, 2017). Rewards can be classified as transactional, comprising tangible rewards like base pay and employee benefits, and relational, encompassing intangible rewards such as learning opportunities, recognition, and personal growth experiences (Herman, 2017).

2.2 Controlling of the Agency Problem

It is not possible to eliminate the agency problem, the principals on and organization can take different types of steps to minimize the cost (risk) occurred by the agency problem, that is known as agency cost and associated with it. Principal-agent relationships can be regulated by contracts or laws in the case of fiduciary settings. Another method is to incentivize an agent to act in better accordance with the principal's best interests. For example, if an agent is paid not on an hourly basis but by the completion of a project, there is less incentive to not act in the principal's best interest (Margaret, 2001).

Stockholders of a company have various methods at their disposal to address agency issues with managers. These methods can be categorized into internal and external measures:

A. Internal measures:

- Internal auditing
- Adjusting managerial salaries and compensation
- ✓ Increasing ownership concentration
- Implementing effective corporate governance practices

B. External measures:

- External auditing
- Capital market mechanisms
- Legal frameworks and regulations (Boshkoska, 2015)

2.3 Empirical Review

This study is primely aimed to access the effect of incentive in order to reduce the agency costs occurred due-to the conflict of intertest between the principal and agent of an organization in Ethiopia particularly in Addis Ababa focusing on governmental, for-profit-governmental, not-for-profit organizations (NGOS) and for-profit organizations. Accordingly an investigation was conducted by collecting data from those representative members and analyze by using methods to observe the cause and effects.

Based on various studies, the impact of incentive schemes on mitigating the agency costs within an organization has been explored. Different authors have drawn distinct conclusions:

Smith, in 1776, expressed apprehension regarding individuals solely engaged in repetitive tasks, fearing it could compromise broader intellectual and social development. Agency issues, often associated with disaffection, a concept attributed to Marx but also anticipated by Smith, worsen due to specialization concerns.

According to Corporate Finance Institute (2022), complete eradication of agency problems is impractical. Incentives, while inherently carrying agency costs, can effectively diminish overall agency expenses when appropriately implemented, as opposed to allowing managerial self-interest to prevail.

The National Productivity Council (2014) describes incentives as a method that encourages human effort, motivating employees to give their best. Matocchio (2006), cited in Tongo (2006), defines incentives as additional forms of compensation beyond basic wages and salaries, which vary depending on employees' achievement of specific standards such as predetermined benchmarks, individual or group objectives, or organizational performance.

According to Tongo (2006), the practice of using performance incentives can be traced back to the era of the scientific management movement spearheaded by Frederick Taylor in the 20th century. Since then, the private sector has consistently employed incentives as a strategy to enhance employee productivity.

Researchers such as Pouliakas (2008), Pinar (2008), and Arnolds and Venter (2007) have investigated the impacts of both monetary and non-monetary incentives on organizations, highlighting how incentives offer a means for firms to motivate their employees to enhance productivity.

Defined by Brigham et al. (1993), agency cost encompasses all expenses incurred by shareholders to incentivize managers to prioritize shareholder wealth over self-interest. When managers' total compensation is tied to the market value of the company's shares, agency costs tend to decrease.

Cohen et al. (1990) outline various costs and behaviors arising from management's agency problem, including excessive management compensation, shirking, empire-building tendencies, and diversion of resources towards employee welfare objectives.

According to MBA Knowledge Base (2021), addressing the agency problem between shareholders and managers involves aligning managers' interests with those of shareholders through diverse incentive schemes aimed at motivating managers.

In an article discussing incentive plans, Rupali G. suggests that managers utilize diverse tactics to inspire employees to enhance their performance, with incentives serving as a pivotal mechanism. These incentives can be classified into two main categories: financial and non-financial.

Financial incentives comprise profit-sharing arrangements, co-partnership programs, bonuses, productivity-linked commissions, and various allowances. Conversely, non-financial incentives encompass elements such as status elevation, opportunities for career advancement, organizational environment, job security, job enrichment, employee participation, empowerment, and recognition.

Chapter Three

3. Research Design and Methodology

3.1 Introduction

This chapter outlines the planned research methodology aimed at refining the defined objectives and crafting conclusions and recommendations regarding the impact of incentive schemes on mitigating agency costs within an organization. It also discusses the qualitative and quantitative analysis methods necessary to achieve these research objectives, building upon the literature review provided in the previous chapter. Subsequently, the chapter introduces and deliberates on the theoretical framework to guide the study. It further details the design of the research instrument, the sampling technique, and the determination of the sample size. Finally, the chapter wraps up with an overview of the statistical techniques employed for data analysis.

3.2 The Study Area

The research area centered on examining the impact of incentive schemes in mitigating agency costs within organizations, with a specific focus on:

1. Governmental entities: The principal-agent problem in the public sector arises from a misalignment of goals and interests between politicians and public servants.
2. Non-Governmental organizations (NGOs): The principal-agent problem emerges when there's a conflict of interest between the owner and manager.
3. Companies established for profit making in Addis Ababa: Various mechanisms are employed to control managerial agency problems.

3.3 Research Population and Sampling

A research population refers to a vast collection of individuals or objects under scrutiny in a scientific investigation, serving as the focal point of study. However, due to the impracticality of testing every individual within such large populations, researchers resort to sampling techniques, as it is both time and cost-effective. In this particular study, random sampling techniques are employed. The population of interest comprises individuals employed in governmental and non-governmental organizations. The selection process utilizes random sampling methods, specifically targeting those individuals directly relevant to the study's objectives.

3.4 Sampling Size

There are various methods to determine sample size, such as employing a census for smaller populations, replicating sample sizes from similar studies, consulting published tables, and utilizing formulas for calculation. In this study, a prospective sampling approach is utilized. Specifically, five members each are selected from Governmental Organizations, For-Profit-Governmental Organizations, Not-for Governmental Organization (NGOs), and Private Organizations. In total, 20 organizations are considered, and within each organization, questionnaires was distributed to at least five individuals representing both principals and agents. Consequently, the total number of respondents are amount to 114.

3.5 Analysis Methods

The analytical method employed for this research utilizes ordinal scales. Ordinal scales involve ranking or rating data using integers in either ascending or descending order. The formula utilized for analysis is: $I = \sum (f*m) / (N)$, Where I represents the mean index, f denotes frequency, m indicates the degree of agreement, and N stands for the total number of respondents.

3.6 Data Source and design of research instruments

Research design serves as a roadmap for attaining answers to the questions under investigation in a study. It outlines the path from the initial questions ("here") to the desired answers about these questions ("there"). This investigation unfolds in two phases: initially, a literature search is conducted, leading to the identification of the impact of incentive schemes. Subsequently, a questionnaire is formulated based on these identified effects. The questionnaire aims to gather opinions from respondents regarding the relative significance of incentive schemes in reducing agency costs. The entire study is meticulously planned and executed to fulfill the research objectives. Following an exhaustive literature review, a questionnaire is developed and distributed to 20 randomly selected governmental and non-governmental organizations, targeting five related parties (principals and agents) from each, totaling 100 respondents. The collected sample is then analyzed and discussed to derive results, conclusions, and recommendations. All research elements, including sample size, location, validity, reliability, etc., are thoroughly explained and deliberated upon in this chapter.

3.6.1 Source of Data

This research employed a descriptive-analytical approach to ascertain the primary impact of incentive schemes on reducing agency costs. To achieve this, both literature review and questionnaire surveys were conducted. The literature review served as a foundation for designing the questionnaire, which was then distributed to professionals occupying managerial roles. Respondents for the questionnaire survey were randomly selected from both the principal and agent sides. The questionnaire responses were evaluated using a five-point ordinal scale (1=Strongly Disagree, 2=Disagree, 3=Undecided, 4=Agree, 5=Strongly Agree) to gauge agreement levels regarding various contributing factors and their potential effects. Participants rated the most recurrent effects based on their professional experience for each contributing factor.

3.6.2 Instruments and Data Collections

To analyze both the qualitative and quantitative aspects of the impact of incentive schemes on reducing agency costs within organizations, data collection relies on the following methods:

Questionnaire: Crafting an effective questionnaire requires expertise and careful consideration. There are no strict rules for its design, but structured questionnaires are developed based on a meticulously crafted set of questions that undergo piloting and refinement until their validity is assured. Hence, pretesting is a crucial step in the questionnaire design process before its finalization. The questionnaire utilized in this study incorporates tick boxes and illustrations. Response options include Very high, High, Medium, Low, and Very low.

Observation: This involves firsthand observation of situations by physically being present at the offices of selected sample organizations in Addis Ababa. Serving as the primary tool for the study, observation proves to be cost-effective and efficient in saving both time and resources.

Books and References: Various books, as well as other reference materials available in libraries and previous course handouts, are consulted to supplement the research findings and provide additional insights.

3.6.3 Tools for Data Analysis

The gathered data were analyzed utilizing ordinal scales, which involve ranking or rating data using integers in ascending or descending order.

The formula employed for analysis is:

$$I = \sum (f \cdot m) / (N),$$

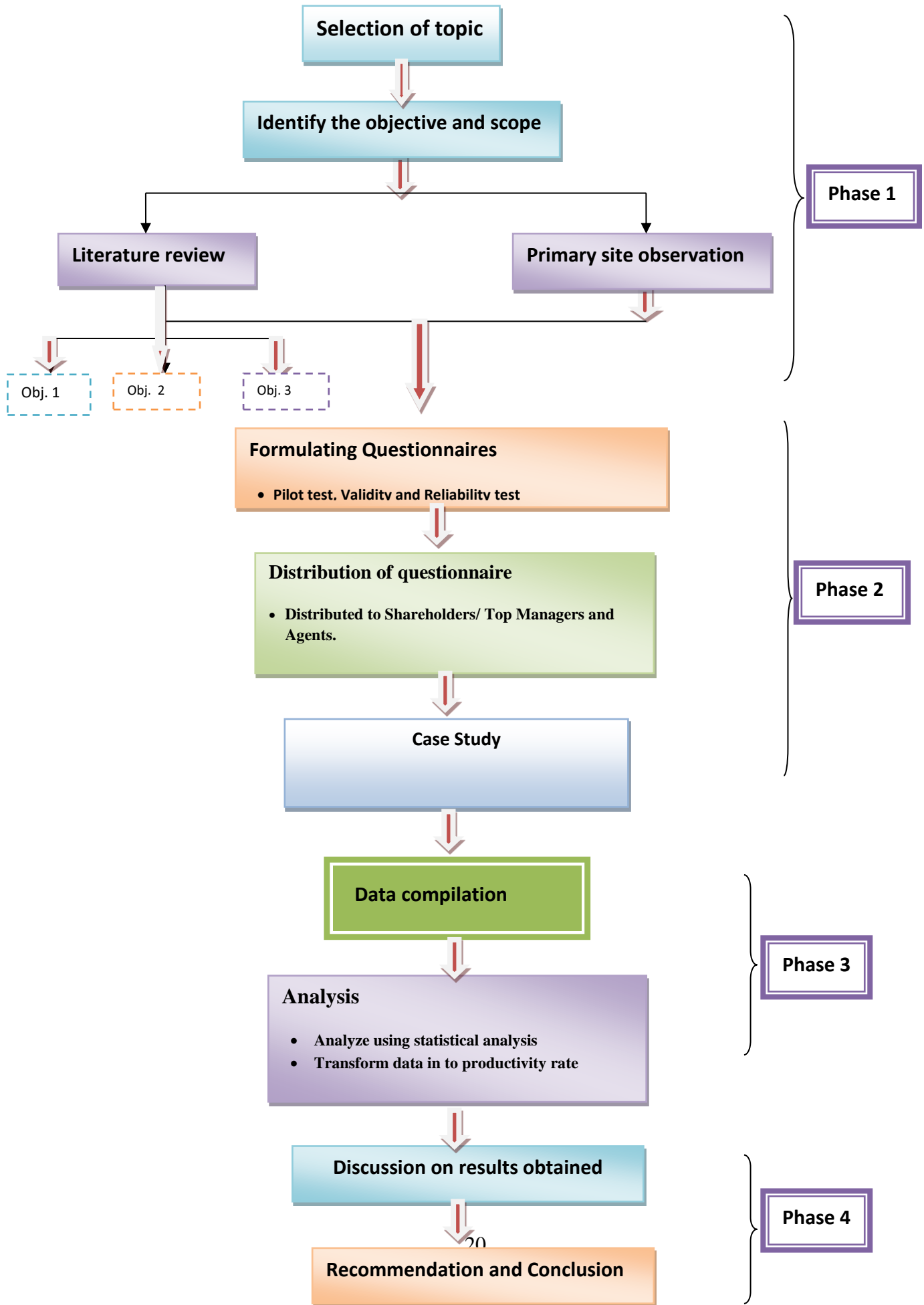
Where: I represent the mean index,

f denotes frequency,

m indicates the degree of agreement and

N stands for the number of respondents.

The research commenced with an extensive literature review to evaluate and identify foundational information pertinent to the study. This review aided in pinpointing the variables of interest. Subsequently, the research instrument was meticulously prepared, followed by the execution of data collection procedures. The gathered data from questionnaires underwent analysis using a straightforward statistical approach, encompassing examination, tabulation, and categorization based on the chosen measurement scale. Upon completing the data analysis, the findings and results were deliberated upon. Finally, drawing insights from the analysis and discussion, the researcher furnished conclusions and recommendations. The entire research process is depicted in Figure 3.1.



Chapter Four

4 Data Presentation, Analysis and Interpretation

This chapter delves into the presentation, analysis, and interpretation of data gathered in the study, shedding light on the effectiveness of incentive schemes in reducing agency costs within organizations. The information presented here stems from primary data sources. To collect primary data, questionnaires were distributed among management staff across various organizational types, encompassing governmental, governmental for-profit, non-governmental not-for-profit, and non-governmental for-profit sectors. The chapter comprises two sections: the first provides background information about the respondents, while the second addresses questions relevant to the research topic.

4.1 General Background Information of the Respondents

Questionnaires were distributed to a total of 20 selected sample population companies, the selection was based on purposive sampling method. Each company had between 5 and 8 management staff members who completed and returned the questionnaires. These resulted in a total of 114 respondents. Here's the breakdown:

1. Five companies were chosen from Governmental Offices, with five respondents from each (totaling 30).
2. Five companies were selected from Governmental Offices for Profit, with six respondents from each (totaling 30).
3. Five companies were selected from Non-governmental Not-for-profit (NGOs), with five respondents from each (totaling 25).
4. Five companies were selected from Non-governmental For-profit (Private Organizations for Profit). From three of these companies, five respondents were considered; from one company, eight respondents were considered, and from another company, six respondents were considered. Therefore, the total number of respondents was 114, comprising all returned questionnaires considered for analysis.

The respondents' general information, including gender, age, educational qualification, position in the company, and experience, is summarized in Table 4.1.4.2, 4.3 and 4.4 respectively.

Table 4.1 Gender of Respondents

Variables	Frequency	Percentage
Male	77	67.54
Female	37	32.46
Total	114	100

As it indicated in the above table 4.1 the total no. of respondents, 67.54% are male and 32.46 % are female, this indicates that there are male dominancy in the companies.

Table 4.2 Age of Respondents

Age	Frequency	Percentage
18-25	0	0
26-35	12	10.52
36-45	29	25.44
46-55	44	38.60
56-65	29	25.44
Total	114	100

As depicted in Table 4.2 above, the highest percentage of respondents falls within the age range of 46-55, comprising 38.60% of the total, with a frequency of 44. Following closely, the age groups ranging from 36-45 and 56-65 account for the second highest percentage at 25.44%, with a moderate frequency of 29. Lastly, the age range of 26-35 ranks third with the lowest percentage of 10.52%, represented by a frequency of 12.

Table 4.3 Educational Qualification of Respondents

Educational Qualification	Frequency	Percentage
8 th – 12 th Grade	0	0
Technical School Graduate	0	0
College Diploma	0	0
BSC or BA Degree	44	38.60
Post Graduate and above	70	61.40
Total	114	100

As indicated in Table 4.3 above, the educational qualifications of respondents from the sampled organizations primarily consist of a BSc or BA Degree and above, given that the participants are management staff. Consequently, among the total number of respondents, 70 of them hold

postgraduate qualifications, representing 61.4% of the sample and ranking first. Conversely, 44 respondents possess BSc or BA degrees, accounting for 38.6% of the sample and ranking second. However, respondents with educational qualifications ranging from College Diploma and Technical School Graduate to 8th to 12th Grade attained 0% percentage and frequency.

Table 4.4 Position of Respondents in the Company

Position in the Company	Frequency	Percentage
General Manager	20	17.54
Manager	32	28.07
Department Head	62	54.39
Staff	0	0
Total	114	100

As depicted in Table 4.4 above, department heads constitute the largest proportion of respondents, ranking first with a percentage of 54.39% and a frequency of 62. Following this, managers rank second with a score percentage of 28.07% and a frequency of 32. General managers are ranked third (last), accounting for 17.54% of the respondents with a frequency of 20. However, lower-level staff members did not participate in providing questionnaire responses, resulting in a score of 0% and a frequency of 0.

Table 4.5 Experience of Respondents in the Company

Experience in the Company	Frequency	Percentage
Under 5 Years	0	0
6 - 10 Years	20	17.54
11 - 15 Years	25	21.93
Above 15 Years	69	60.53
Total	114	100

As illustrated in Table 4.5 above, the largest proportion of respondents, totaling 69 individuals, have over 15 years of experience, accounting for 60.53% of the total and ranking first. Respondents with experience ranging from 11 to 15 years constitute the second largest group, representing 21.93% of the sample with a frequency of 25. Those with 6 to 10 years of experience rank third

(last), comprising 17.54% of the respondents with a frequency of 20. Notably, there are no respondents with less than five years of experience in the company.

4.2 Results and Discussions of Specific Questions

To determine the hierarchy of factors influencing agency costs within an organization, the Relative Importance Index (I) is computed using the formula:

$$I = \sum (f \cdot m) / (N),$$

Where, I represents the mean index, f denotes frequency, m signifies the degree of agreement, and N stands for the total number of respondents.

The degree of agreement is rated on a scale of 1 to 5, ranging from "very low" to "very high."

Table 4.6 Causes of Agency Cost Questions?

No.	Causes of Agency Cost.	Average Index	Rank	Remark
1	The difference between the goals pursued by the management and the owners.	3.89	5	
2	When the principal hires and authorizes an agent to act on his/her behalf.	4.08	2	
3	The conflict of interest between the executive management and shareholders of a corporation.	4.07	3	
4	The conflict between outside equity holders and owner managers.	4.11	1	
5	The conflict between outside equity holders and debts holders.	4.01	4	

Based on the responses obtained from Table 4.6, the causes of agency costs within an organization are ranked from 1 to 5 using the Relative Importance Index (I). According to the analysis:

The conflict between outside equity holders and owner-managers is ranked first, with a mean index value of 4.11.

The cause involving the principal hiring and authorizing an agent to act ranks second, with a mean index value of 4.08.

The conflict of interest between executive management and shareholders of a corporation ranks third, with a mean index value of 4.07.

The conflict between outside equity holders and debt holders ranks fourth, with a mean index value of 4.01.

The difference between the goals pursued by management and owners ranks last (fifth), with a mean index value of 3.89.

Based on the data collected from sample organizations, the analysis suggests that the conflict between outside equity holders and owner-managers is the primary cause of agency costs, while the difference between the goals pursued by management and owners is considered a minor contributing factor.

The Relative Importance Index (I) is calculated using the formula: $I = \sum (f \cdot m) / (N)$, where I represents the mean index, f denotes frequency, m indicates the degree of agreement, and N stands for the number of respondents. The degree of agreement is rated on a scale from 1 to 5, ranging from "Strongly disagree" to "Strongly agree."

Table 4.7 Effect of Incentive scheme in reducing agency cost Questions.

No.	Incentive scheme in reducing agency Cost.	Average Index	Rank	Remark
1	Providing incentive to all employee of the organization.	4.02	6	
2	Increasing owner manager's proportion in equity.	4.07	2	
3	High amount of leverage in the company.	4.04	4	
4	Providing an incentive compensation for managers.	4.04	4	
5	Providing intrinsic type of incentive.	4.05	3	
6	Providing extrinsic type of incentive.	4.17	1	

Based on the responses obtained from Table 4.7, the effects of incentives on reducing agency costs within an organization are ranked from 1 to 6 using the Relative Importance Index (I). Here is the analysis:

Providing extrinsic types of incentives ranks first, with a mean index value of 4.17.

Increasing owner manager's proportion in equity ranks second, with a mean index value of 4.07.

Providing intrinsic types of incentives ranks third, with a mean index value of 4.05.

High leverage in the company and providing incentive compensation for managers rank fourth, with a mean index value of 4.04.

Providing incentives to all employees of the organization ranks last (sixth), with a mean index value of 4.02.

According to the analysis of the data gathered from the sampled organizations, the following conclusions were drawn regarding the impact of incentive schemes on reducing agency costs. It was found that offering extrinsic incentives is deemed the primary incentive scheme for reducing agency costs within an organization, ranking first in effectiveness. Finally, providing incentives to all employees of the organization was identified as a secondary incentive scheme for reducing agency costs, even though with a lesser degree of significance.

Chapter Five

5 Conclusions and Recommendations

5.1 Conclusion

Based on the data collected, analyzed, and shown in Table 4.6 from the respondents of different organizations, the main causes that can create agency costs in an organization ranked from no. 1 to no. 5. However, from the listed causes top of the major causes of agency cost of an organization are-

1. The conflict between outside equity holders and owner-managers.
2. When the principal hires and authorizes an agent to act on his/her behalf.
3. The conflict of interest between the executive management and shareholders of a corporation.

Ranked in descending order, these factors demonstrate substantial mean index values, indicating their substantial impact on agency costs within organizational contexts. Therefore, it is apparent that the conflicts between outside equity holders and owner-managers, the authorization of agents by principals, and the conflicts of interest between executive management and shareholders are major drivers of increased agency costs within organizations.

Following that, depending on the results of the above analysis, the following can concluded as an agency problem created by the conflict between side equity holders and owner managers could ranked as the first with an average index value of 4.11.

The cause that creates an agency problem, when the principal hires and authorizes an agent to act on his/her behalf could ranked as the second, with an average index value of 4.08. Finally, the agency problem created by the conflict of interest between the executive management and shareholders of a corporation also ranked third with an average index value of 4.07.

Therefore, due to these top three high average indexed values causing agency problems high agency costs can created in an organization.

Based on the data collected, analyzed, and shown in Table 4.7 from the respondents of different organizations the main effects of an incentive scheme to be used to reduce agency costs in an organization are ranked from no. 1 to no. 6. However, from listed effects of incentive scheme the top of the most ones that help to reduce agency cost of an organization are:-

1. Providing an extrinsic type of incentive.
2. Increasing owner manager's proportion in equity.
3. Providing the intrinsic type of incentive.

These effects of the incentive scheme that is to be used to reduce agency cost are ranked from 1 to 3 respectively based on the value of the mean index determined by using the respondent's sum of response frequency, degree of measurement, and a total number of respondents.

Following that, one can conclude that agency costs created by agency problems can be reduced by incentive schemes from the different types of incentive schemes based on their effect the extrinsic type of incentive could ranked as the first with an average index value of 4.17.

Increasing the owner manager's proportion in equity could ranked as the second with an average index value of 4.07, and finally providing the intrinsic type of incentive also ranked as the third with an average index value of 4.05. Therefore, due to these top three high average index valued incentive scheme effects, the agency cost created by agency problems can be reduced in an organization.

5.2 Recommendation

To address agency costs resulting from conflicts between managers and owners within an organization, the organization must implement a variety of incentive schemes tailored for both managers and employees.

Throughout this research, an examination was conducted on the causes of agency problems leading to these costs, along with an assessment of the effectiveness of incentive schemes in mitigating them. Based on this analysis, conclusions were drawn, and the following recommendations were put forward:

- ✓ To mitigate agency costs, organizations had to introduce diverse incentive schemes for managers, including:
- ✓ Intrinsic Rewards, encompassing factors such as intellectual, emotional, and physical well-being of employees.
- ✓ Extrinsic Rewards, comprising elements like basic pay wages, salary add-ons, deferred payments (e.g., pension plans), services and benefits (e.g., medical benefits), and pay for work not done (e.g., holidays).

Furthermore, increasing the equity proportion held by owner-managers can help lower agency costs. When owner-managers hold a higher proportion of equity compared to other stakeholders,

their interests become more closely aligned with the organization's success, thereby reducing agency costs. Hence, providing a range of incentive schemes tailored for managers can contribute to lowering agency costs within the organization.

Reference

- Aguinis, H. (2006). What I learned along the way. *University of Colorado at Denver* , 57-61.
- Ajibade, O. E., & SALAKO, O. A. (2021). Incentive Schemes and Employees' Productivity in Private Organizations in Nigeria. *Journal of Public Administration, Finance and Law*, 22, 140-155.
- Ang et al., (2000) and Fleming et al., (2005). Agency Cost and Ownership Structure in Australia. *Pacific-Basin Finance Journal* 13(1):29-52.
- Baker, G. P., Jensen, M. C., & Murphy, K. J. (1988). Compensation and incentives: Practice vs. theory. *The journal of Finance*, 43(3), 593-616.
- Besley, T. J., & Ghatak, M. (2014). Solving agency problems: Intrinsic motivation, incentives, and productivity. Background paper for the.
- Boshkoska, M. (2015). The agency problem: Measures for its overcoming. *International Journal of Business and Management*, 10(1), 204.
- Brahmana, R. K., Loh, H. S., & Kontesa, M. (2020). Market competition, managerial incentives and agency cost. *Global Business Review*, 21(4), 937-955.
- Bratton, W. (2012). Agency theory and incentive compensation. *Research handbook on executive pay*, 101-122.
- Business Finance, (2021). Ways of resolving agency problems and costs. (<https://www.mbaknol.com/business-finance/agency-problem>).
- Fleming, G., Heaney, R., & McCosker, R. (2005). Agency costs and ownership structure in Australia. *Pacific-Basin Finance Journal*, 13(1), 29-52.
- Gaskill, L. R., Van Auken, H. E., & Manning, R. A. (1993). A factor analytic study of the perceived causes of small business failure. *Journal of small business management*, 31(4), 18.

Goerg, S. J., Kube, S., & Radbruch, J. (2019). The effectiveness of incentive schemes in the presence of implicit effort costs. *Management Science*, 65(9), 4063-4078.

Grossman et al., (1982); Williams, (1987). *Journal of Entrepreneurial Finance*, The Agency Advantage of Debt over the Lifecycle of the Firm, Volume 5.

Grossman, S. J., & Hart, O. D. (1982). Corporate financial structure and managerial incentives. In *The economics of information and uncertainty* (pp. 107-140). University of Chicago Press.

Hall, J. H. (1998). The agency problem, agency cost and proposed solutions thereto: a South African perspective.

Hall, J. H. (1998). The agency problem, agency cost and proposed solutions thereto: a South African perspective.

Healy, P. M. (1985). The effect of bonus schemes on accounting decisions. *Journal of accounting and economics*, 7(1-3), 85-107.

Holmstrom, B., & Milgrom, P. (1994). The firm as an incentive system. *The American economic review*, 972-991.

Indeed Editorial Team (2021). What is an agency problem? (with causes and examples). Updated 1 October, 2022.

Institute, C. F. (October 10, 2022). corporate finance. <https://corporatefinanceinstitute.com/about-cfi/> .

James Chen. (June 20, 2022). Agency Problem: Definition, Examples and ways to minimize risk. <https://www.investopedia.com/terms/a/agencyproblem.asp>.

Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. In *Corporate governance* (pp. 305-365). Gower

Lasher, W. R. (2016). *Practical financial management*. Cengage Learning.

Martin, G. P., Wiseman, R. M., & Gomez-Mejia, L. R. (2019). The interactive effect of monitoring and incentive alignment on agency costs. *Journal of Management*, 45(2), 701-727.

Martin, G. P., Wiseman, R. M., & Gomez-Mejia, L. R. (2019). The interactive effect of monitoring and incentive alignment on agency costs. *Journal of Management*, 45(2), 701-727.

Pouliakas.Pinar, & Venter, A. a. (2008). Incentive Schemes and Employees' Productivity in Private Organizations in Nigeria. *Journal of Business Administration, Finance and Law* .

Appendix - A

Addis Ababa University

College of Business and Economics

Department of Masters of Business Administration in Finance

This questionnaire is prepared for the partial fulfillment of MBA in Finance thesis on the effect of incentive scheme in reducing agency cost of an organization in the case of different governmental and non-governmental organizations located in Addis Ababa. In this regard, I kindly request your assistance in responding to the questions listed below. Any information you present will be kept utterly confidential and will be used only for academic purpose. Your cooperation and prompt response will be highly appreciated.

The questionnaire has two parts:

Part -1-General information

Part -2. Questions related to cause and effect of incentive scheme in reducing agency cost.

Thank You for your cooperation!

General Instruction: - put tick mark (√) on the box provided

Part (1): General Background Information

1. Gender. Male Female
2. Age 18-25 26-35 36-45 46-55 56-65
3. Educational qualification?
8th-12th grade Technical school graduate College diploma
B.S.C or BA degree Postgraduate and above
4. What is your position in the company?
General Manager . Manager Department head . Staff

5. How long is your experience in the company?

Under 5 6-10 11-15 above 15

Part - 2: A. Questions related to the causes of agency costs in an organization?

1. Do you agree that the difference between the goals pursued by the management and the owners can create agency problems in an organization?

Strongly-disagree Disagree Undecided Agree Strongly-Agree

2. Do you agree that the agency problem can arise when the principal hires and authorizes an agent to act on his/her behalf?

Strongly-disagree Disagree Undecided Agree Strongly-Agree

3. Do you agree that agency costs can occur when the interests of the executive management of a corporation conflict with its shareholders?

Strongly-disagree Disagree Undecided Agree Strongly-Agree

4. How do you rate the conflicts between outside equity holders and owner-manager in order to generate agency cost?

Strongly-disagree Disagree Undecided Agree Strongly-Agree

5. How do you rate the conflicts between outside equity holders and debt holders in order to generate agency cost?

Strongly-disagree Disagree Undecided Agree Strongly-Agree

Part - 2: B. Questions related to the effect of incentive scheme in reducing agency cost.

1. How incentives affect agency cost of an organization?

Strongly-disagree Disagree Undecided Agree Strongly-Agree

2. Do you agree that agency costs generated from the conflicts between outside equity holders and owner-manager could be reduced by increasing the owner-managers' proportion in equity?

Strongly-disagree Disagree Undecided Agree Strongly-Agree

3. Do you agree that high leverage reduces agency costs and increases firm value by encouraging managers to act more in the interests of equity holders?

Strongly-disagree Disagree Undecided Agree Strongly-Agree

4. Do you agree that incentive compensation is used to solve the agency problem of shareholders-managers and aligning the interests of managers with shareholders?

Strongly-disagree Disagree Undecided Agree Strongly-Agree

5. How the intrinsic type of reward affects the principal agent relationship in reducing agency cost?

Strongly-disagree Disagree Undecided Agree Strongly-Agree

6. How the extrinsic type of reward affects the principal agent relationship in reducing agency cost?

Strongly-disagree Disagree Undecided Agree Strongly-Agree

Thank you!!!!!!!!!!