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# Agency theory and financial crime: the paradox of the opportunistic executive

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## Abstract

**Purpose** – The purpose of this paper is to philosophically address the issue of managerial opportunism and to describe the paradox of the opportunistic executive, particularly when the CEO could be considered as a “criminal-to-be”.

**Design/methodology/approach** – It will be seen to what extent governance mechanisms really contribute to prevent managerial opportunism, particularly through compensation packages (“financial carrots”). Then, Oliver E. Williamson’s viewpoint will be analyzed on opportunism, as his theory has largely influenced the way agency theories actually define managerial opportunism. Williamson was thinking opportunism without referring to philosophical works. The gap in exploring three basic types of opportunism will be filled: the Smithian egoist, the Hobbesian egoist and the Machiavellian egoist.

**Findings** – The Smithian egoist tries to reach an equilibrium between self-interest and compassion, while the Hobbesian egoist is motivated by self-interest, desire of power and the attitude of prudence. The Machiavellian egoist is always searching for power and makes followers’ fear arising. The way governance mechanisms and structures should be designed and implemented could be quite different if the CEO actually behaves as a Smithian, Hobbesian or Machiavellian egoist. CEO’s propensity to commit financial crime could largely vary from one type to another: low risk (Smithian egoist), medium risk (Hobbesian egoist) or high risk (Machiavellian egoist).

**Research limitation/implications** – Smith’s, Hobbes’ and Machiavelli’s philosophy was chosen because the agency theory sometimes refers to it, when defining the notion of opportunism. Other philosophies could also be analyzed to see to what extent they are opening the door to opportunism (for example, Spinoza).

**Originality/value** – The paper analyzes managerial opportunism from a philosophical viewpoint. Whether executives are Smithian, Hobbesian or Machiavellian egoists, their opportunism cannot give birth to similar behaviors.

**Keywords** Financial crime, Adam Smith, Agency theory, Managerial opportunism, Nicolo Machiavelli, Thomas Hobbes

**Paper type** Conceptual paper



## Introduction

Agency theory defines agency costs as transaction costs from the intra-organizational context. Transaction cost theory rather puts the emphasis on the inter-organizational context (relationships with business partners). Both theories actually share the same belief: there is a significant threat that people could behave in an opportunistic way. In both cases, there is an a priori assertion that firms need to have governance structures and control systems to avoid opportunism. Executives could try to get their annual bonus at any cost, including opportunistic decisions: for instance, executives could favor business contracts that have advantageous consequences in the short-term (particularly

on corporate image), without having any positive effect on corporate profitability. [Fehr and Gächter \(2000, p. 177\)](#) recommended conditional bonus payments as an incentive for agents to align their interests with the principals' interests. According to [Jensen and Meckling \(1976\)](#), agency costs include the monitoring expenditures by the owner/principal, the bonding expenditures by the manager/agent and the residual loss. The residual loss would be the following one: (the monitoring expenditures) minus (the costs of direct management by the owner/principal); the costs (for the principal) of the agent's opportunistic decisions exceed the benefits ([Jensen and Meckling, 1976; Gomez, 1996](#)). [Oviatt \(1988, p. 215\)](#) rightly said that the agency theory addresses the problems:

[...] of establishing and maintaining mutually satisfactory behavior on the part of potentially conflicting and self-interested stakeholders, when information about the contractors, particularly the agents, and the tasks is costly, uncertain, incomplete, and asymmetrically distributed among the parties.

The principal and the agent could then adopt an opportunistic behavior. Agency costs are those costs that the principal is ready to invest in, for protecting himself/herself from the opportunistic behavior of the agent.

The aim of this paper is to philosophically address the issue of managerial opportunism. In this paper, we will see to what extent governance mechanisms really contribute to prevent managerial opportunism, particularly through compensation packages ("financial carrots"). Then, we will analyze Oliver E. Williamson's viewpoint on opportunism, as his theory has largely influenced the way agency (and transaction cost) theories actually define managerial opportunism. Williamson mirrored an "aphilosophical" perspective: he was thinking opportunism without referring to philosophical works. We will fill the gap in exploring three basic types of opportunism: the Smithian egoist, the Hobbesian egoist and the Machiavellian egoist. Finally, we will describe the paradox of the opportunistic executive, particularly when he/she could be considered as a "criminal-to-be".

### Governance mechanisms, "Financial carrots" and the opportunistic executive

[Eisenhardt \(1989, p. 58\)](#) explained that the focus of the agency theory is on determining the most efficient contract between the principal and the agent, given that three kinds of assumptions are taken for granted:

- (1) people are always focusing on their self-interest, have a bounded rationality and risk aversion;
- (2) organizational members have conflicting goals; and
- (3) information is something we could sell to others.

So, agency theory is presupposing that human being is always concerned by his/her self-interest and thus that organizational members will necessarily have conflicting interests. Governance mechanisms are set up to limit the agent's self-interested behavior. Indeed, the principal (shareholders) and the agent (executives) are both concerned with their self-interest: they are opportunistic beings ([Popov and Simonova, 2006](#)). Agency theory presupposes that their self-interest cannot be the same. There will inevitably be a conflict between shareholders' self-interest (shareholders' opportunism) and executives' self-interest (managerial opportunism). Governance mechanisms

(including CEO duality and stock option incentives) are used to reduce the intensity of such conflict or to get rid of it. As [Eisenhardt \(1989, p. 61, p. 64\)](#) said, the aim of governance mechanisms is to encourage the coalignment between the agent's preferences and the principal's preferences. Governance mechanisms that play a disciplinary role (such as director monitoring) help to prevent (or reduce) managerial opportunism. Weaker (financial and non-financial) disclosure policies could increase the probability of executives' opportunistic behavior ([Huang and Zhang, 2012, p. 223](#)). Due to information asymmetry between the principal and the agent, organizations must widen the scope of their financial/non-financial disclosure to shareholders and reduce executives' opportunities to promote their self-interest ([Beatty and Harris, 1999, pp. 299-300](#)).

[Rashid \(2013\)](#) analyzed corporate data from 94 non-financial firms which were listed on the Dhaka Stock Exchange (Bangladesh), from 2000 to 2009. According to [Rashid \(2013, pp. 1003-1004\)](#), CEO duality does not influence firm efficiency under two basic efficiency ratios: the expense ratio (= operating expenses divided by annual sales) and the asset utilization ratio or asset turnover ratio (= annual sales or revenues divided by total assets). A high expense ratio implies high agency costs. Insofar as CEO duality is not enhancing firm efficiency, does it mean that any regulatory body in any country of the world should adopt CEO non-duality? If we assume that CEO duality does not give birth to better firm efficiency than CEO non-duality and does not prevent executives' opportunism, then we should get rid of CEO duality as an agency cost. In their Malaysian survey (N = 290), [Ibrahim and Samad \(2011\)](#) explained that the situation could be very different in family-owned and non-family owned firms. In family-owned firms, CEO duality could give birth to a high asset utilization ratio but could reduce the expense ratio. In non-family owned firms, CEO duality could increase the expense ratio but could reduce the asset utilization ratio. CEO duality does not seem to be a requirement to avoid managerial opportunism.

According to [Jelinek and Stuerke \(2009\)](#), above a certain level, managerial equity ownership (the number of shares divided by the number of common shares outstanding; excluding stock options) is not a successful governance mechanism. For instance, in the retail industry, up to 5 per cent, managerial equity ownership actually deters excessive spending, while between 5 and 25 per cent, it does not have any impact on spending. However, when executives hold more than 25 per cent of the common shares ownership, then they have greater propensity to increase expenses. Managerial equity ownership is not a reliable governance mechanism that could get rid of executives' opportunism. [Florackis \(2008\)](#) has identified similar thresholds: up to 10 per cent, managerial equity ownership could help to align executives' and shareholders' interests; between 10 and 29 per cent, managerial equity ownership does not have any alignment effect; when executives hold more than 30 per cent, the impact is negative. [Li et al. \(2008, p. 623\)](#) rather believed that a low level of managerial equity ownership (as it is the case in China) could encourage executives to behave in an immoral and opportunistic way. [Ooi \(2000\)](#) analyzed 83 UK property companies (between 1989 and 1995). The author found that the average stockholding of directors and officers amounts to 24.5 per cent of common equity. However, smaller property companies tend to be closely held by the officers. In larger companies, there was a divorce between ownership and management. The author concluded that in larger companies, officers are more exposed to managerial

opportunism than in small firms. The threshold of managerial equity ownership could thus vary from culture to culture, and perhaps from industry to industry.

### Thinking opportunism without philosophy: revisiting

#### Oliver E. Williamson's viewpoint

According to [Williamson \(1979, p. 234\)](#), opportunism “is a variety of self-interest seeking but extends simple self-interest seeking to include self-interest seeking with guile”. Williamson did not assert that all agents are opportunistic in the same degree: “It suffices that those who are less opportunistic than others are difficult to ascertain *ex ante* and that, even among the less opportunistic, most have their price”. [Williamson \(1979, p. 242\)](#) believed that governance structures are required to attenuate managerial opportunism. Opportunism and bounded rationality should have an equal status. Decision makers are not much more opportunistic than people using their bounded rationality. Most of business people do not undertake opportunistic actions. According to [Williamson \(1993a, pp. 97-98\)](#), most of the time, economic agents are not opportunistic because they are well-socialized. However, there are three kinds of possibilities that could open the door to opportunistic behaviors and decisions:

- (1) opportunities to lie, cheat and steal;
- (2) opportunities to conform to the letter, but violate the spirit of the contract/law; and
- (3) opportunities to induce breach of contract and engage in strategic behavior ([Williamson, 1993a, p. 101](#)).

[Williamson \(1993b, p. 459\)](#) thus asserted that we should “organize transactions so as to economize on bounded rationality while simultaneously safeguarding them against the hazards of opportunism”. Only some economic agents undertake opportunistic decisions ([Williamson, 1981, p. 553](#)). [Williamson \(1993a\)](#) was convinced that opportunism is the best way to describe self-interest seeking. So, what should we conclude? [Williamson \(1993a, pp. 104-105\)](#) interpreted Machiavelli's philosophy as favoring reciprocal (or pre-emptive) opportunism, given the fact that “human agents are not fully trustworthy”. According to [Williamson \(1989, p. 139\)](#), Machiavelli took for granted that “humans have a propensity to behave opportunistically”. [Williamson \(1993, p. 459; Williamson 1993a, p. 105\)](#) considered that Machiavelli's approach is a myopic construction excluding any farsighted understanding of economic conditioning factors. Unfortunately, [Williamson \(1993a\)](#) did not mirror the essentials of Machiavelli's political philosophy. Moreover, the author once quoted Hobbes' *Leviathan* but was unable to give a comprehensive picture of Hobbesian (egoistic) philosophy.

According to [Hodgson \(2004, p. 403\)](#), Williamson's emphasis on opportunism means that the threat of opportunistic behavior is significant. It does not mean that most people are opportunistic most of the time. [Hodgson \(2004, p. 404\)](#) rightly mirrored the basis of Williamson's argument: “all governance structures arise principally to deal with opportunism”. [Hodgson \(2004, p. 405\)](#) argued that Williamson's emphasis on opportunism is misplaced “because there are additional and very important sources of the contracting problems that he identifies”. Opportunism is not the main origin of governance structures, as it is not the principal source of contract non-compliance. According to [Alchian and Woodward \(1988\)](#), Williamson made bounded rationality and

opportunism interconnected. Opportunism reflects the primacy of self-interest but follows from bounded rationality:

[...]people will act in their own interest insofar as it is costly for others to know their behavior (others face costly information)". Williamson acknowledged that opportunism could make people misleading others "in order to expropriate wealth from one another.

Opportunism could open the door to honest/ethical as well as dishonest/unethical behaviors (Alchian and Woodward, 1988, p. 66). Governance mechanisms and structures aim at preventing potential honest and dishonest opportunism and avoiding costly disputes between the principal and the agent.

According to Williamson, there is a potential threat of opportunism. In given situations, someone could decide to undertake opportunistic behaviors. So, what does a potential threat of opportunism actually mean? It means that the interests of shareholders could be threatened or neglected by opportunistic managers. It is striking to observe that the potential threat has nothing to do with unjust behaviors. Shareholders seem not to be concerned with managers' unjust behaviors, except if such behaviors will adversely affect corporate image and/or profitability. If not, executives could take unjust decisions, and it does not matter. Shareholders seem then to be much more opportunistic than managers. Although there is only a potential threat of opportunism, shareholders will strongly support monitoring mechanisms and expenditures to ensure that corporate image and profitability will never be reduced by managers' opportunistic behaviors. Shareholders thus reach a very high level of opportunistic behavior. If managerial opportunism seems to be a potentiality, shareholders' opportunism appears to be a certainty.

### **The unsaid story of the opportunistic executive: the philosophical basis of opportunism**

From a philosophical perspective, opportunism could follow either from philosophical egoism (Adam Smith, Thomas Hobbes), or from Machiavelli's philosophy.

*The Smithian egoist: leading with a self-interested and compassionate state of mind*

The Smithian egoist is the individual who takes the paradox of self-love upon himself/herself. According to Smith (2011, p. 50), the perfection of human nature implies to feel sympathy for others' sadness and suffering, to control our egoistic (inner) trends and to express benevolent attitudes and feelings. Smith unveiled the paradoxical character of self-love: we cannot get rid of our egoistic passions without opening our heart and spirit to compassion and love; we cannot be compassionate and love everybody without taking our self-interest into account.

According to Smith (2011, p. 23), human being is basically selfish. Every human being is much more concerned with his/her self-interest than with others' interests (Smith, 2011, p. 135). Unjust words, behaviors and attitudes are destroying social ties within a given society. That is why, every human being fights them: injustice will eventually negatively affect one's self-interest. Unjust words, behaviors and attitudes do not contribute to strengthen social ties and to favor collective wealth. Individuals then conclude that they must fight injustice: their self-interest could be endangered by a high level of social injustice (Smith, 2011, p. 143). Self-love embraces our body and spirit, faculties, senses and powers. Self-love means that we would like to remain as we are, for ever (Smith, 2011, p. 374). Smith asserted that the fear of death could empoison one's life



and happiness. But the fear of death could also contribute to get rid of unjust behaviors, and thus to safeguard the public interest (Smith, 2011, p. 31, p. 182). The fear of death is basically linked to the eternal wish to safeguard our being as it is, for ever. It is thus an expression of egoistic passions. Self-love cannot be controlled by any attitude of benevolence and generosity. Smith believed that Nature has given us a very weak spark of altruism. Egoistic passions must be controlled, as they unveil an extreme self-love. They could distort the way we perceive the moral/immoral dimension of words, actions or attitudes (Smith, 2011, p. 227). We should control our fear and angry only because it is the only way to ensure that we will be just and benevolent toward others (Smith, 2011, p. 335). Self-love can only be mastered by reason. Exercizing our reason, actualizing our principles of action and seizing the depths of our consciousness (our heart as the representative of the impartial spectator) are the basic means to fight self-love (Smith, 2011, pp. 199-200, p. 298). According to Smith (2011, p. 216), the most virtuous person is the individual who reaches an equilibrium between egoistic feelings and basic sensitiveness toward others' feelings and emotions.

Self-interest is not the final word about human behavior. Human being could deeply wish that others will have happy life, although he/she does not get any personal interest from their happiness. Smith was convinced that even criminals could feel compassion for suffering beings. We do not have precise idea of others' feelings and emotions. We could only imagine what could be our feelings and emotions, when facing given situations and dilemmas. Imagination makes possible for us to put ourselves in other's shoes, as if we would become the same person. That is the only way we could really grasp others' feelings and emotions (Smith, 2011, pp. 23-25, p. 29). We are temporarily integrating others' feelings of sadness and distress and then launching an imaginary change of existential situation, so that it could give birth to a feeling of sympathy. Suffering people could imagine how they could react to the situation if they would be one of the spectators. Smith (2011, pp. 45-46) identified a twofold movement of sympathy: an inner sympathy (spectators' viewpoint) and an external sympathy (the perspective of the suffering individual). According to Smith (2011, p. 27), human being could be sympathetic toward others' passions, whether it is sadness and joy, love and devotion. Love is the mixing of humaneness, generosity, goodness, friendship and respect (Smith, 2011, p. 66). Some passions could give birth to sympathy, and others not at all. We could be much more sympathetic for sadness/distress than for joy/self-accomplishment (Smith, 1999, pp. 83-84). When we hate someone, we will be unable to feel any compassion for his/her pain. We will even feel pleasure, when observing the intensity of his/her suffering (Smith, 1999, p. 113). On the other hand, social passions cannot give birth to hatred and resentment. An excess of love and generosity cannot be the cause of hatred and angry, but rather only of love, understanding, and compassion. Smith defined egoistic passions as being the intermediary state between asocial passions and social passions (Smith, 1999, pp. 75-77).

The intensity of compassion will depend on the extent to which we actually know the real causes of such sadness. We will not be sympathetic to others' suffering if we cannot agree that the cause of such pain actually justifies the intensity of the passion. It is true for sadness, distress and misfortune, as well as for asocial passions such as hatred and angry (Smith, 1999, pp. 70-71, pp. 80-81). It is usually much more important to feel others' sympathy for our misfortune and sadness than to feel others' sympathy for our happiness and joy. Indifference is probably the worst attitude we could have toward

suffering people (Smith, 2011, pp. 28-35). We cannot be sympathetic to others' passions if we do not believe that such passions are suitable to their objects. Being sympathetic to others' passions is approving them, that is, saying that such passions are reasonably connected to their objects and causes. Approving or disapproving others' passions and opinions is observing their continuity or discontinuity with our own passions and opinions. If I am judging that other's reaction to a given situation is disproportionate from its original cause (the other as suffering being), then I am confirming that I could not have a similar reaction, when being confronted with similar circumstances. I am considering the original cause with much less seriousness than the way the suffering individual perceived it (Smith, 2011, pp. 37-40). The way we are morally judging a given passion depends on our capacity to sympathize, that is, our capacity to approve the basic link between the passion and its original cause.

*The Hobbesian egoist: leading with self-interest, power and prudence*

Every voluntary action is focused on one's self-interest because everybody tries to safeguard his/her own being (Hobbes, 1971, pp. 151-152, p. 156, p. 186, p. 198, p. 227, p. 271, p. 332). Human beings have peaceful relationships with each other only because they fear to die (Hobbes, 1971, p. 127). Sometimes, favoring our self-interest implies to prioritize the interests of our friends and relatives (Hobbes, 1971, p. 195). Personal interests could clearly contradict common good (Hobbes, 1971, p. 278). Consciously or not, we could neglect such contradiction, when promoting our self-interest (Hobbes, 1971, pp. 271-280). Our actions are basically linked to the way we have previously assessed their (good/bad) consequences. Any action presupposes a given notion of good/evil, and thus a more or less conscious classification of good/bad consequences. Good consequences are promoting the Good, and bad consequences are reinforcing the Evil (Hobbes, 1971, pp. 561-562).

Desire is the personal measure of good and evil (Hobbes, 1971, p. 159). Desire has three basic objects: power, goodness and happiness (Hobbes, 1971, p. 85). In each case, the desire is insatiable: we always set up required conditions for satisfying our future desires (Hobbes, 1971, p. 95). The desire of power includes the desire of riches and sensual pleasures, the desire of knowledge and the desire of honour/glory (Hobbes, 1971, p. 69, pp. 96-97). Everybody tries to subjugate others and even to destroy them (Hobbes, 1971, p. 122). The love of power makes an integral part of human nature (Hobbes, 1971, p. 593, p. 702). The desire of power is restricted by the need to respect other's freedom, to promote peace and to take just decisions. As long we can do everything we would like to do, we are in a state of warfare. The limitations of one's freedom toward others must thus be the same as the limitations of others toward him/her (Hobbes, 1971, p. 129). Human beings actually have the same existential freedom, except the limitations that have been enacted by laws and regulations (Hobbes, 1971, p. 310). What is just is in accordance with reason, as it implies to comply with existing norms (Hobbes, 1971, p. 145, p. 147). The Golden Rule is one of the most universal norms (Hobbes, 1971, p. 157, p. 173, p. 524). The will as well as the action could be unjust. Our intent to accomplish unjust actions is necessarily unjust (Hobbes, 1971, pp. 364-365). Hobbes (1971, pp. 581-582) was convinced that customs and traditions could not be unjust if they are in accordance with the Sovereign's will (and thus with the intent of the law-maker). Unfortunately, Hobbes (1971, p. 300, p. 370) did not see that the intent of law-makers could be unjust (for instance, in totalitarian states). If laws cannot be unjust, then they cannot be morally



questionable. The apartheid laws in South Africa have clearly proved that laws could be unjust, and thus immoral.

The wise person is able to identify the most predictable consequences following from his/her action, on a personal, social, political, cultural and even environmental level (Hobbes, 1971, p. 325, p. 391). For instance, stealing the poor and the needy is a greater crime than stealing the wealthiest because of the intensity of consequences (Hobbes, 1971, p. 329). What is predictable is what is generally known as being involved in a given causal relationships (Hobbes, 1971, p. 315). According to Hobbes (1971, p. 57), if predictable good consequences go beyond the predictable bad consequences, then the action is apparently good. If predictable bad consequences overstep the predictable good consequences, then the action is apparently wrong. Prudence implies our capacity to remember similar situations (and their good/bad consequences), we have been confronted with (Hobbes, 1971, p. 68).

*The Machiavellian egoist: leading with power and provoking followers' fear*

According to Machiavelli (1980, pp. 114-115), social change is not an easy task, as people who get advantages and privileges from old institutions could lose them, when new institutions will replace the old ones. On the other hand, people who will get advantages and privileges from the new institutions will be led by fear, as old institutions are legally and morally justified. They will not really trust the defenders/representatives of new institutions, as new institutions are much more vulnerable to theoretical and practical criticism than the old ones. Fear and hatred are the bases of socially undesirable behaviors. People should wish to favor the Sovereign's pleasures and fear to harm His interests. The Sovereign should get rid of those who could harm His interests (Machiavelli, 1980, pp. 122-123). The basic desire of people is not to be oppressed, while the basic wish of aristocracy is to oppress people. When aristocrats are favoring the Sovereign's interests, their action could be motivated by pusillanimity, or a basic lack of courage. Then, the Sovereign could take their support for granted. But if their action is motivated by strategic thinking and ambition, then the Sovereign could consider aristocrats as enemies (Machiavelli, 1980, p. 46, pp. 131-132). The Sovereign must learn to undertake right and wrong actions, when circumstances require either goodness (based on honesty) or evil (rooted in corruption) (Machiavelli, 1985, p. 138; 1980, p. 155, pp. 173-174). The Sovereign searches for an equilibrium between love and fear. The Sovereign must be loved by the people. He must also be feared, so that He could take people's obedience for granted. According to Machiavelli (1980), the Sovereign needs to be loved by the people. He will need their support in the face of adversity. But people will be faithful to the State if they actually need his financial support (Machiavelli, 1980, pp. 133-134).

Machiavelli (1985, p. 43, p. 58; 1980, p. 192) did not provide an anthropological view on human nature. He rather observed that in daily life, human beings are usually malicious and unkind. Machiavelli (1991, p. 84) believed that in the long run, education could make the difference. Machiavelli did not make any basic distinction between virtue and vice. Circumstances could transform virtue in a vice, and vice in a virtue. According to Machiavelli (1980), the action having the worst consequences is wrong, while the action having the least bad effects should be considered as the right one (Machiavelli, 1980, pp. 187-188). Machiavelli was not concerned with the moral dimensions of virtue and of vice. He rather believed that the choice of given actions is

always a pragmatic decision. A virtue should always favor the Sovereign's safety, wellbeing and power (Machiavelli, 1980, p. 156). In some situations, observing religious rituals (such as prayer) could strengthen the Sovereign's safety, wellbeing and power. In other situations, such piety could be either useless or counterproductive. The Sovereign should be able to use some virtues or their opposite (for instance, good/evil and just/unjust). The Sovereign should favor goodness, as much as possible. When evil words and deeds become required, the Sovereign should never hesitate to use them to strengthen His safety, wellbeing and power.

Machiavelli believed that in political affairs, the appearance is much more important than the reality, as everybody judges people from what they seem to be rather than from what they really are (Machiavelli, 1985, p. 89). The Sovereign does not need to be faithful, righteous, courageous, merciful and humane. He must only give the appearance that such qualities makes an integral part of His personality (Machiavelli, 1980, pp. 165-167). If a Sovereign cannot be both loved and feared by the people, He should be feared (rather than loved) by the people so that such fear will make His safety guaranteed (Machiavelli, 1980, p. 162). The Sovereign could use laws. But when laws are useless, the Sovereign is justified to use force (the "beast") (Machiavelli, 1991, p. 178; 1980, p. 165). Love is based on reciprocity. But because human beings are malicious and unkind, they are always pursuing their self-interest. Only by necessity could human beings be good, benevolent and generous. Most of the time, people are malicious and unkind. Love could be easily abandoned. Fear means being afraid of punishment, that is, being afraid of annihilation (having much less personal liberty, being tortured and being killed). Because individuals always try to safeguard their own being "as it is", they cannot easily abandon their fear of punishment. The Sovereign must be feared by the people, but never hated by them. Hate is the seed of social and political revolution: when hatred is reaching its higher level, it could give birth to strategical and military plans to get rid of the Sovereign, once for all (Machiavelli, 1980, pp. 162-163, pp. 170-172, p. 183).

### **The paradox of the opportunistic manager and the "Criminal-to-be" executive**

National reports on corporate governance could explain why shareholders easily accept that CEOs get large compensation packages, although executives could behave in an opportunistic way. The Greenbury Report (1995) acknowledges that below such market-related lower limits for the remuneration of directors and senior executives in large companies, it could be really difficult to recruit, retain and motivate people having the right quality and experience (Art. 6.2, 6.50; Birla Report, 2002, Art. 10.3; Combined Code, 2003, B.1). The Hampel Report (1998) put the emphasis on attracting and retaining directors needed to run the company successfully (Art. 2.9, 4.2-4.3). The Greenbury Report said:

Paying over the odds, on the other hand, is incompatible with the fiduciary duty of Directors to act in the company's best interests [...] It can cause resentment among staff and damage the company's reputation (Art. 6.7).

That is why remuneration committees, in their annual reports to shareholders, should justify any policy of paying above the average levels (Greenbury Report, Art. 6.12; Hampel Report, Art. 4.7). The Hampel Report asserted that the market determinism argument ("paying market rates") has limited effects, as remuneration committee can be

deeply influenced by (external) consultants surveys and information the company received from competitors (those information could be uncritical) (Hampel Report, Art. 4.4, 4.15). And such information could give birth to various interpretations (Greenbury Report, Art. 6.3). According to the [Malaysian Code \(2000\)](#), levels of remuneration “should be sufficient to attract and retain the directors needed to run the company successfully”. Compensation packages must link rewards to corporate and individual performance as for executive directors, while for non-executive directors, they should reflect the experience and level of responsibilities undertaken by them (Part 1, B-1). Shareholders implicitly agree that such financial privileges (“financial carrots”) must be given to executives they see as potentially opportunistic beings. This is the real origin of the paradox of the opportunistic executive.

There seems to be a paradoxical belief about managerial opportunism. Such paradox could influence the way owners/principals consider managers/agents and the way they explain managers’ propensity to commit financial crimes. The paradox of the opportunistic executive could be deciphered from those interconnected a priori assertions:

- Executives are very competent people and thus people we should trust.
- Shareholders should not really believe in the executive’s ability to favor their own interests because human beings have a high propensity to behave in an opportunistic way.
- Agency costs (through monitoring mechanisms) are required to ensure that executives are aligning their own interests with shareholders’ interests. To recruit and retain very competent executives, the organization must give them the following privileges: very high wages, stock options, annual bonus, benefits-in-kind (for instance, the private use of a company car and preferential loans), a retirement package and so forth. Compensation packages are provided to those people shareholders have classified as potentially opportunistic beings.

Governance mechanisms are used to monitor executives’ decisions and behaviors to avoid managerial opportunism. However, governance mechanisms could be part of the problem: shareholders agree to give large compensation packages to potentially opportunistic individuals. If managers behave opportunistically, should shareholders say “*mea culpa*”? The paradox of the opportunistic executive implies two unsaid assumptions. On one hand, if executives have never committed any financial crime, then they are providing evidence that:

- agency costs were justified; and
- those executives are reliable persons and very competent top managers.

On the other hand, if executives have committed financial crimes, then they are unveiling that:

- agency costs were justified;
- those executives were not reliable and competent top managers; and
- better monitoring mechanisms should have been set up to prevent such financial crimes.

So, in every situation, agency costs seems to be justified, whether executives are reliable persons. The paradox of the opportunistic executive is reinforcing the conviction that agency costs are always justified.

Are executives “criminal-to-be” individuals? If there is a high risk that executives undertake opportunistic behaviors, would it mean that opportunism could open the way to financial crime? If we consider the disciplinary function of the board of directors and the possibility of cross-directorship, then multinationals could seem to be complex networks of managers (Martimort and Verdier, 2004, p. 1,120). However, cliques could be inter-organizational (through cross-directorship) as well as intra-organizational (for instance, between executives and middle managers). Intra-organizational cliques could give birth to opportunistic behaviors and even to collusive agreements. When collusion appears, then the possibility of occupational and corporate crime is much more a probability than potentiality. Collusion generally favors executives’ and middle-managers’ self-interest to the detriment of shareholders’ self-interest. So, intra- and inter-organizational cliques could be an antecedent of financial crime. Preventing financial crime in the workplace implies to define the overall picture of organizational deviance and to grasp the way various agents are reacting one to the other. A systemic approach of preventing financial crime could be very helpful and relevant (Biagioli and Naardo, 2007). However, such systemic approach does not exclude the necessity to develop a comprehensive set of legal compliance, international control and transparency systems which actually meet the requirements of regulatory bodies and stock exchanges (e.g. New York Stock Exchange (NYSE)) (Nestor, 2004). Insofar as the board of directors set up efficient governance mechanisms, it could contribute to reduce executives’ propensity to commit financial crime, such as fraud, corruption and money laundering (Goldschmidt, 2004). Governance mechanisms and structures do not necessarily prevent financial crime, as the target is managerial opportunism. An opportunistic executive could behave in an honest/dishonest way. He could comply with the laws or commit financial/corporate crime.

The paradox of the opportunistic executive does not take philosophical egoism/Machiavellian thought into account. The paradox takes opportunism for granted and does not bother with philosophical ideas. The egoistic mindset mirrors the conviction that human beings naturally seek their self-interest, as they want to survive and to grow. However, the Smithian egoist tries to reach an equilibrium between self-interest and compassion, while the Hobbesian egoist is motivated by self-interest, desire of power and the attitude of prudence. Unlike Hobbes, Smith did not favor central economic planning to avoid chaotic economic conditions, due to conflicting personal interests. Rather, Smith believed that personal liberty was an organizing principle that could make social harmony and collective wealth possible (Demsetz, 1988, p. 142, pp. 156-157). According to Bowles (1985, pp. 16-19), Hobbes tried to reconcile self-interested behavior (individual rationality) with collective interests (collective rationality). Hobbes believed that the state is “a socially necessary form of coercion”. Hobbes foughted malfeasance. Any neo-Hobbesian approach of the production process implies that a form of command economy is required to reduce malfeasance. Machiavelli did not try to reconcile self-interest and common good. He was not favoring personal liberty. Machiavelli was only focusing on the power games and the best ways to individually survive in a chaotic society. The Machiavellian mindset presupposes that human beings actually behave as if the end always justifies the means. The

Machiavellian egoist is always searching for power and makes followers' fear arising in the organizational setting. Those three philosophical types of egoistic personalities do not open the way to the same words, attitudes and behaviors. Agency theory does not describe various types of opportunism, at least from a philosophical viewpoint.

The Smithian egoist is not prone to commit financial crime, as he/she is searching for an equilibrium between self-interest and compassion (sympathy for others' suffering). The Hobbesian egoist could be more inclined to commit financial crime because he/she is searching for power and tries to safeguard his/her own being. However, the Hobbesian egoist could then have the certainty that he/she is acting unjustly, as laws are always just. Although the Hobbesian egoist uses prudence as virtue, his/her desire of power and self-interest could increase the possibilities that he/she eventually perpetrates financial crime. The Machiavellian egoist could be much more disposed to commit financial crime, as he/she does not make any clear distinction between virtue and vice. The way governance mechanisms and structures should be designed and implemented could be quite different if the CEO actually behaves as a Smithian, Hobbesian or Machiavellian egoist. CEO's propensity to commit financial crime could largely vary from one type to another: low risk (Smithian egoist), medium risk (Hobbesian egoist) or high risk (Machiavellian egoist).

## Conclusion

From a philosophical viewpoint, the way the agency theory uses the notion of opportunism does not mirror the complexities of philosophical egoism (Smith, Hobbes) and Machiavellian thought. When using the notion of opportunism, agency theory is not rooted in the works of Adam Smith, Thomas Hobbes or Nicolo Machiavelli. Opportunism could be psychologically or sociologically described as psychic/social phenomenon. However, when agency theory uses the notion of opportunism, it does not provide any philosophical import. Smith's, Hobbes' and Machiavelli's philosophy was chosen because the agency theory sometimes refers to it, when defining the notion of opportunism. Other philosophies could also be analyzed to see to what extent they are opening the door to opportunism (v.g. Spinoza).

Future research could explore the way organizations could identify executives' Smithian, Hobbesian or Machiavellian behaviors. In doing so, they could implement much more relevant governance mechanisms to avoid managerial opportunism and to prevent financial crime. Moreover, it could be important to analyze shareholders' opportunism from a philosophical viewpoint. Such analyses could help us to better understand why shareholders are fighting managerial opportunism rather than executives' unjust behaviors.

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