

## EXCEPTIONS TO AGENCY THEORY ASSUMPTIONS AND THE RISE OF CONTINGENCY EMPLOYMENT IN MARKETING

*JAMES HENLEY, The University of Tennessee at Chattanooga*

*MICHAEL COTTER, Grand Valley State University*

*CHARLES WHITE, The University of Tennessee at Chattanooga*

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*This study examined the practical problem of staffing using contingency employees and considers how agency theory relates to this increasingly common work situation. The authors propose that contingency employment does not adhere to the standard agency theory assumptions. Deviations from standard agency theory assumptions offered temporary employees an advantage over permanent employees.*

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### INTRODUCTION

For some time, organizations have not been relying solely on permanent employees to staff their operations. They have turned to contingency employees to help fill their staffing needs. Contingent employment consists of people employed in temporary jobs (Bureau of Labor Statistics 2001). The interest in contingent employment has steadily grown. In 1999, the Bureau of Labor Statistics reported that 4.3 percent of the total employment was contingency employment (Bureau of Labor Statistics 2001). There have been many reasons given for this growth such as corporate downsizing with temporary employees used to fill in the gaps after the corporations' employee levels stabilized (Cole 1999). Other organizations have used contingency employment to avoid the higher salaries and benefits of permanent employees (Murphy 1995).

The type of contingency employment has also changed in recent years. Today, administrative-clerical workers still account for 36.5 percent of temporary employees working through temporary staffing firms (Brogan 2000). Operators, fabricators and laborers make up 30.6 percent of temporary employees placed by staffing firms (Brogan 2000). However, the contingency employment traditional

domain of secretaries and laborers has expanded greatly. Today, there are top executives, engineers, scientists, and other professional workers in temporary positions. Executives and managers, professional specialists, and technicians account for 4.8 percent, 4.9 percent, 4.6 percent respectively of the temporary staffing industry's workforce (Brogan 2000).

Marketing is a participant in the move to temporary employees. Marketing and sales represent 3.6 percent of the temporary staffing industry's workforce (Brogan 2000). These jobs include every category from cashiers to sales people (Brogan 2000). Marketing and sales managers are included in the executive and managerial classification created by the American Staffing Association (Brogan 2000).

In addition to downsizing and cost cutting, marketers have other reasons to use temporary employees. In a new product introduction, a temporary sales team devoted to the introduction could ease the risk (Carlson 1994; Carey 1997; Keenan 1999). Current sales staff may not be able to handle the additional products or markets. If the new product fails, the temporary sales staff, rather than a permanent sales staff, is more easily disbanded. Keenan (1999) suggests that any organization without marketing as a core competency should consider employing temporary marketing personnel. Firms with seasonal sales are a natural fit for temporary sales personnel. Once the

prime sales season ebbs, the temporary sales staff is released (Trumfio 1994). Cohen (1996) suggests that for a marketing executive, management experience may be needed most. Consequently, an experienced executive could be brought into the organization, and the successful salesperson left to do what he or she knows best. Murphy (1996) posits that the biggest advantage of hiring temporary marketing personnel is the fresh ideas brought into the organization. The new marketing person is unbiased toward existing methods and less saturated with office politics (Murphy 1996). There are many staffing agencies that specialize in offering temporary marketing personnel to fill temporary staffing needs (Carlson 1994; Cohen 1996; Keehan 1999).

Agency theory deals with the relationships between owners and employees (Pratt and Zeckhauser 1984). The theory offers many assumptions about the nature of the relationship between the parties (Eisenhardt 1989). The purpose of this paper is to use agency theory to offer some reasons for the growth of contingency employment in marketing. The paper first reviews agency theory and its major assumptions. Contingency employment is then analyzed through the use of agency theory.

**AGENCY THEORY**

Agency theory recognizes our complex society and describes most of the situations that face society in terms of principals and agents. In agency theory, the principal is the person, or organization, that makes a contract with another person or organization, the agent, to perform some task (Pratt and Zeckhauser 1984). The theory has been applied to many situations such as finance (Fama 1980; Fama and Jensen 1983), accounting (Baiman 1990), organizations (Hesterly, Liebeskind, and Zenger 1990) marketing (Bergen, Dutta, and Walker 1992), advertising agencies (Ellis and Johnson 1993; Spake, D'Souza, and Crutchfield 1999), sales (Basu, Lai, Srinivasan, and Staelin 1985; Bartol 1999; Krafft 1999) and consumers (Drennan 2000; Singh and Sirdeshmukh 2000). The classic approach to agency theory, which is also known as the positivist branch of agency theory, examines the owners (principals) of an organization and recognizes they cannot perform

all of the tasks (Eisenhardt 1989). Consequently, they hire employees or agents to perform those tasks for the owners.

Agency relationship is used to describe relationships other than owners and employees. For example, an employee may need to hire an assistant. The employee that does the hiring is now a principal in the relationship and the assistant is the agent. This area of employer-employee relationships is the domain of the principal-agent branch of agency theory (Eisenhardt 1989; Bergen, Dutta, and Walker 1992).

To explain the behavior of principals and agents, agency theory makes several assumptions about the parties involved in the relationship and the environment. Agency theory assumes that principals are risk neutral and agents are risk averse, that the environment influences the outcomes of the relationship, that both principals and agents are motivated by self-interests, and that the principal has incomplete information about the agent (Bergen, Dutta, and Walker 1992). The last assumption involves choosing the best type of contract for agents in order to prevent them from shirking their duties (see Table 1).

<b>TABLE 1</b> <b>Agency Theory Assumptions</b>
Risk-Neutral Principals and Risk-Adverse Agents
A Dynamic Environment Influences Outcomes
Principals and Agents are Motivated by Self-Interests
Principal has Incomplete Information about the Agent

Risk preference is the degree to which the agent or principal is willing to accept risk to achieve the organization's goals. In agency theory, the principal is assumed to accept more risk in achieving his or her goals than the agent (Bergen, Dutta, and Walker 1992). The reason is that the principals, who are the stockholders of the firm, are able to diversify their

stock holdings and therefore diversify their risk (Bergen, Dutta, and Walker 1992). The agents do not enjoy this advantage. Most agents are in one employment situation and cannot diversify their risk. For the agents, something that goes wrong with the organization would have a much greater impact on them than on the principals. For this reason, they are much more conservative in their approach to achieving the principal's goals. This goal incompatibility could become a problem (Bergen, Dutta, and Walker 1992).

Businesses and organizations are acutely aware of the environmental uncertainty they face daily. This uncertainty may stem from economics, regulations, or many other factors that could influence operations and cause a deviation from the plan. Agency theory is certainly influenced by this phenomenon (Bergen, Dutta, and Walker 1992). Unfortunately, this uncertainty increases the risk on the part of the principals and agents when entering into a contract. Consequently, agency theory assumes increased risk with an uncertain environment.

In agency theory, the principal and agent are considered motivated by self-interest (Bergen, Dutta, and Walker 1992). In the case of the owner who is a stockholder, the self-interest is higher shareholder wealth. Through the work of the firm's employees or agents, the principal is able to achieve his or her goals. The agent has self-interests such as higher salaries, promotions, and better benefits. In both cases, each participant is able to grant the other's wishes.

For principals to control or manage their agents, they need access to information. Agency theory assumes principals do not have complete information on their agents. From the principal's perspective, he or she would like to have information on the agent's skill and ability to perform the job and achieve the principal's goals. The agent has the information the principal wants. Unfortunately, the agent may not want to share that information with the principal (Bergen, Dutta, and Walker 1992). For example, the agent may not want the principal to know how hard he or she worked on a particular job. The principal

needs some type of mechanism to gain information about the agent's pursuit of the principal's goals. In agency theory, the problem of the agent shirking his or her duty is known as moral hazard (Eisenhardt 1989). Agency theory describes two methods in which to overcome the incomplete information problems of moral hazard: behavior-based contracts or outcome-based contracts (Eisenhardt 1989).

### **Contingency Employment's Role in Agency Theory**

In permanent employment situations, there is a direct link between the principal and agent. The "unity of command" principal is not violated. There is also a direct link when the principal has a contract directly with the contingent employee. However, some contingency employment situations may face a new agent in the form of a temporary employee service. The principal contacts the employment service for employees, and the principal may not actually interact with the temporary employees until they are present on the job. When they are on the job, the temporary employees know that their ultimate employer is the temporary service and not the company to which they have been assigned. Consequently, the temporary service has a dual role of principal and agent.

This paper considers the principal that hires the temporary service to provide employees rather than contracting with temporary employees directly. Consequently, the principal is the company hiring the temporary service. The temporary employees are the agents that will perform the tasks specified by the principal. Since the temporary service inserts an extra layer between the principal and agent, it becomes an intermediate agent.

### **Agency Theory Assumptions and the Use of Contingency Employment**

As stated above, agency theory makes several assumptions about the environment and the behaviors of the principal and agent, some of which are negative. Each assumption is examined in the

context of using temporary employees. Use of temporary employees generates the greatest change in risk assumptions about the agent. This alteration impacts other assumptions, as well. While use of an intermediate agent is a solution to the negative consequences of the dynamic environment, using an intermediary agent is not all positive. Examining the "self-interest" assumption reveals a potential negative impact for the principal. The "incomplete information" assumptions for behavior-based and outcome-based contracts are examined.

### Risk Preferences

Principals are willing to accept greater risk because they can diversify their portfolios. Agents, such as permanent employees, are considered risk averse since they have minimal opportunity for diversification. However, temporary employees are risk neutral because they have diversified their risk. If the means to achieve the firm's goals are not successful and the firm fails, it only means that the intermediary agent will reassign them to another principal. Consequently, little work time is lost for the temporary agent. Further, the intermediary agent diversifies its risk by having many clients.

Since the temporary agents have reduced overall risk through diversification, they are more likely to accept riskier assignments than the permanent employees. The risk neutrality of the temporary agents is an advantage for the principals. Temporary agents are less likely to resist strategies they view as risky since they will not suffer because of the organization's strategic failure. For example, a permanent sales force may resist efforts to take on a new product or market. They may envision the effort as potentially unsuccessful, and that it steals valuable time away from current customers. A temporary sales force could be hired to promote the new product and absorb risk of new product failure. By using temporary employees, the risk preferences and goals of the principals and agents are no longer in conflict.

Even in the situation of a permanent manager of the organization who is a risk-adverse agent, temporary employees allow the manager to attach risk to

temporary agents. This consistency in risk preferences offers the principal the advantage of greater cooperation in implementing risky strategies. The owners/principals can formulate a risky strategy and the manager or risk-averse agent can implement the strategy by passing risk onto the risk-neutral temporary agents who accept the risk.

With conflict in risk preference and goal incompatibility solved by the use of a temporary agent, the use of temporary employees offers a tremendous advantage over permanent employees. Recognition of this advantage by principals could be a major factor that led to the tremendous growth of contingency employment. The following proposition summarizes the discussion.

**Proposition 1: Temporary agents are risk-neutral, and they offer a means to overcome the inconsistent risk orientations and incompatible goals of principals and agents.**

### Dynamic Environment

A dynamic environment brings opportunities, but also carries the risk of changing the existing organizational structure to best meet the new environment. In employment situations, the environment may change so reduction in employees is optimal for the firm's principals. If the principal has a contract with a permanent employee or feels committed to the agent, the principal may feel compelled to absorb the expense of the employee. Also, the organization may hesitate hiring permanent employees to take advantage of a temporary situation. Consequently, a completely permanent workforce could hinder a company competing in a very unstable environment.

The very nature of contingency employment situations is much better suited for environments with substantial uncertainty. If conditions deteriorate, the principal simply notifies the intermediate agent that the temporary agents are no longer needed. The principal has no long-term obligation to the temporary agents. Alternately, the organization may see a sudden opportunity in the

environment that is risky and requires specialized skills. For example, an opportunity may arise in a country not previously served by a company. Rather than have an existing manager take the total responsibility of success or failure in the new market, a local temporary marketing manager could be hired and her knowledge of the market exploited. If the opportunity were not exploited, the temporary marketing manager's service would cease when the opportunity did. Since the temporary agents have diversified their risk, they are willing to accept the flexible role of being called upon when needed and let go when their job is finished.

As advances in communication and logistic technology continue to reduce the size of the world, an event in Europe or Asia could affect an organization as easily as an event in the United States. In defense, contingency employment offers organizational flexibility to adapt to a dynamic environment. This leads to the following proposition.

**Proposition 2: Temporary agents ease the risk of environmental uncertainty in principal-agent relationships.**

### Self-Interest

Motivation through self-interest is much easier with permanent employees than with temporary employees. In a permanent employment situation, the principal can observe the daily efforts of the employees toward the principal's goals. If the goals are not met, the principal can alter the course of action, and then reward employees who are meeting the principal's goals. In a contingency employment situation, the principal may try to motivate the temporary agents by rewarding the behavior that moves the principal's goals. However, with an intermediary agent, the principal may not have as much success as with permanent agents. The temporary agents are also motivated by self-interest. In many cases, however, it is the intermediary agent that has the power to reward the agent with increased salaries or benefits. The temporary agent may view certain requests as outside his job descriptions and

have no motivation to undertake the task. In this situation, the principal must communicate with and persuade the intermediate agent to alter such behaviors of the temporary employee.

The principal is not completely without the means to motivate the temporary employee. In a survey conducted by the Bureau of Labor statistics, temporary workers were asked if they preferred temporary work to permanent work. Approximately 53 percent of the respondents said that they would prefer to have a permanent job (Bureau of Labor Statistics 2001). Consequently, these workers would be very receptive to direction by the principal in hopes that they would be hired permanently. Unfortunately, for management control purposes, the same survey also said that 39 percent of the temporary workers prefer their temporary situation (Bureau of Labor Statistics 2001).

In certain temporary sales agent situations, the principal may have some motivation directly linked to self-interest. If an intermediate agent is compensated through a commission based on the temporary salesforce's sales, the temporary agent is motivated to achieve the principal's goal of increased sales. This situation is explored more in the type of contract appropriate for temporary employees.

For most contingent employment situations, however, trying to use this intermediate agent to motivate the temporary employees toward the principal's goals could be likened to driving a car with a loose steering wheel. The car may eventually turn, but it is going to take a lot more work with a lagged response than if the steering wheel were tight. Ultimately, the principal has only the recourse of replacing the temporary agent, or even worse, replacing the intermediary agent if the temporary agents cannot be motivated. The above discussion leads to the following proposition.

**Proposition 3: The principal has less ability to use self-interest reward mechanisms to motivate temporary agents compared to permanent agents. Self-interest reward mechanisms tend to**

**favor the use of permanent agents over temporary agents.**

**Incomplete Information**

Incomplete information is a problem in determining how best to monitor the agent's progress toward the principal's goals. The principal wants to avoid any moral hazard or shirking of responsibilities. Also, the principal seeks to avoid any deviation from the organization's goals. Agency theory has behavior-based and outcome-based contracts as the solution to the moral hazard problem and goal incompatibility problem.

The behavior-based contract is founded on the premise that the agent's behavior can be monitored. Outcome-based contracts measure the results of the behavior and not the behavior itself. Outcome-based contracts may be more risky for the agent because if the outcome is not achieved, the agent may not reach his or her desired goal. For example, a salesperson on commission will not earn income if sales are not made. Consequently, in outcome-based contracts the agent will not be likely to shirk duties or deviate from goals because the ultimate outcomes are known and must be achieved. For the principal, it would be more cost effective to use outcome-based contracts because they do not require the expensive behavior monitoring systems needed in a behavior-based contract.

**The Appropriate Contract**

Eisenhardt (1989) offers some propositions and conditions in which each type of contract was appropriate. The job characteristics may be the most important factor. For example, some jobs in sales may not be as easily monitored as others. With the job characteristics considered equal, however, management can use the common factors of risk preferences, goal compatibility, uncertain environment, and length of relationship to determine the appropriate contract (Eisenhardt 1989). Each of these situations is examined below in the context of permanent and temporary employees.

As discussed above, agency theory assumes the agent is risk averse. The advocates of agency theory posit that if the agent's risk aversion is high, as in the case of permanent employees, then a behavior-based contract is more appropriate (Eisenhardt 1989). Alternately, when the employees' risk aversion is low an outcome-based contract would be appropriate (Eisenhardt 1989). The reasoning is that the risk-neutral owners and risk-averse agents have incompatible goals. The principal may want to pursue risky strategies and the agent may not want to pursue them. With this conflict of interests, a behavior-based contract is needed to monitor the agent's behavior (Eisenhardt 1989). Bartol (1993) also proposed that in sales situations when the behavior is observable a behavior-based contract is appropriate. In situations where the sales representative's behavior is not observable, an outcome-based contract would be appropriate (Bartol 1993).

This paper proposes that the temporary employee or agent is risk neutral. Given this proposition, agency theory would consider an outcome-based contract more appropriate for temporary employees. Since the temporary agent is risk neutral, the principal can pass the risk to the agent. Also, since the goals are compatible, an outcome-based contract would be appropriate.

An uncertain environment increases the risk of failure for the firm. Since the permanent employee is risk averse, behavior must be monitored because the permanent employee will not want to accept this risk. Consequently, a behavior-based contract is important for permanent employees. The risk-neutral temporary employee will accept more risk. In this situation, the risk of an uncertain environment can be passed to the temporary agent. With the temporary employee accepting the risk, monitoring is not necessary and an outcome-based contract is adequate.

Agency theory directly addresses the length of the relationship (Eisenhardt 1989). For long-term relationships, the principal has time to learn and monitor the behavior of the permanent employee. In

this situation, a behavior-based contract can be used. If the relationship is short, as in contingency employment, it may be difficult for the principal to learn and monitor the behavior of the temporary agent. Consequently, an outcome-based contract may be more appropriate.

The assumptions of risk neutrality, goal compatibility, uncertain environment, and short-term relationship all point to the outcome-based contract as being the best suited for contingency employment. While risk aversion, goal incompatibility, uncertain environment, and long-term relationship indicate that a behavior-based contract would be best for permanent employees. This leads to the following proposition.

**Proposition 4: Given the appropriate job conditions, the use of a less expensive outcome-based contract is best suited for contingency employment situations and a behavior-based contract for permanent employment situations. Based on cost, temporary agents with an outcome-based contract are preferred.**

**Agency Theory Assumptions and Growth of Contingency Employment**

Contingency employment offers the advantages of having risk-neutral agents, stabilizing a dynamic environment, and using a less expensive outcome-based contract. However, temporary employees may be harder to motivate through self-interest than permanent employees. Table 2 summarizes this discussion.

Use of temporary employees offers advantages over permanent employees including: risk neutrality, the ability to help stabilize a dynamic environment by contingency employment, and the option of using an outcome-based contract for contingency employment. Table 3 offers some marketing situations where temporary agents would have an advantage over permanent agents. However, the self-interest assumption leaves permanent agents with an advantage over temporary agents. Nevertheless, the

advantages of contingency employment could outweigh the one disadvantage. These advantages could constitute a major factor in the growth of contingency employment. Based on the agency theory assumptions, the following proposition is made.

<b>TABLE 2</b> <b>Agency Theory Assumptions</b> <b>and Permanent and</b> <b>Contingency Employment</b>		
<b>Agency Theory Assumptions</b>	<b>Permanent Employment</b>	<b>Contingency Employment</b>
<b>Risk</b>	Risk Averse	Risk Neutral
<b>Dynamic Environment</b>	Do Not Stabilize	Do Stabilize
<b>Self-Interest</b>	A Motivator	Not a Motivator
<b>Incomplete Information</b>	Behavior-Based Contract	Outcome-Based Contract

**Proposition 5: The proposed advantages of temporary employees over permanent employees of risk aversion, the ability to help stabilize a dynamic environment, and the option of using a less expensive outcome-based contract for contingent employees have been factors in the growth of contingent employment.**

**CONCLUSIONS**

This manuscript analyzed contingency employment using agency theory as its basis. It was proposed that contingency employment did not adhere to the standard agency theory assumptions. Three of the deviations from standard agency theory assumptions offered temporary employees an advantage over permanent employees. Risk neutrality, ability to stabilize a dynamic environment, and the ability to

<p align="center"><b>TABLE 3</b>  <b>Some Marketing Situations Where                      Temporary Agents Have an Advantage</b></p>		
<b>Situation</b>	<b>Temporary Agent Characteristics</b>	<b>Solution</b>
Risky new product launch.	They are risk neutral.	Hire temporary agents. Because they are risk neutral, they will accept and pursue the principals' goals such as a risky new product venture.
Entering overseas markets.	They help stabilize a dynamic environment.	Hire temporary agents to pursue an opportunity in another country. The permanent workforce is not disrupted from their permanent duties.
Monitoring seasonal sales employees.	They are monitored with a less expensive outcome-based contract.	For some jobs there is not time enough to learn and monitor the behavior of employees. Temporary sales employees can be hired and monitored with a less expensive outcome-based contract.

use a less expensive outcome-based contract were proposed to make contingent employees more attractive to principals than permanent employees. It was also proposed that permanent employees held the advantage of the principal's ability to motivate the permanent employee better through self-interest than the contingent employee. Temporary employees were proposed to be less risk averse than permanent employees. Finally, it was proposed that the three advantages of contingent employment offset the one disadvantage, and these advantages were a factor in the growth of contingent employment.

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