A Focus on 'Control': Reconciling Contemporary Transaction Cost Economics with Behavioural Contingency Accounting Perspectives

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Received: April 6, 2019 Accepted: April 25, 2019 Online Published: April 30, 2019

doi:10.5430/afr.v8n2p189 URL: https://doi.org/10.5430/afr.v8n2p189

> [T]he effectiveness of any accounting procedure depends ultimately upon how it influences the behaviour of people in the enterprise. [Hopwood, 1974; 1]

Abstract

Transaction cost economics and contingency research in managerial accounting currently are approached largely as two formally distinct fields of study. This brief review paper aims to reconcile the literature on both subjects in so far as possible, by examining broadly their underlying assumptions and reported conclusions with the view towards identifying differences and similarities. An important integration is achieved by showing that transaction cost economics and the 'decision influencing' role of management accounting concentrate essentially on different aspects to a shared concern with organisational control. However, it additionally is revealed that transaction cost economics does not account adequately for the existence of management accounting's 'decision facilitating' function, and that in comparison to the former the latter's relatively stronger empirical focus is more suited towards finding potential solutions to the actual control problems which confront real organisations. The paper concludes by observing that both paradigms presently to a large extent do not pay attention to a particular principal-agent situation in which control may need to be exercised.

Keywords: managerial accounting, transaction cost economics, contingency studies, agency theory, organisational control, decision influencing, decision facilitating

1. Introduction

Anthony [1965] identifies management control as a process 'common to all organizations': Otley [1994]. According to Lowe [1971], it is:

> [a] system of organizational information seeking and gathering, accountability and feedback designed to ensure that the enterprise adapts to change in its substantive environment and that the work behaviour of its employees is measured by reference to a set of operational sub-goals (which conform with overall objectives) so that the discrepancy between the two can be reconciled and corrected for.

Demski and Feltham [1976] observe therefore that management control serves both decision facilitating and decision influencing functions. Kren and Liao [1988; 294–295] regard the former as allowing 'the decision maker to improve his [*sic*] action choice with better informed effort', while viewing the latter as providing 'information about the action choice selected by the subordinate that is used as the input into the performance evaluation function of the organization.' Both authors see management accounting as 'a primary source of both decision-facilitating and decision-influencing information in a firm' [Kren and Liao, 1988; 295]. However, the difference between these two roles of accounting [Zimmerman, 1988] has not always been appreciated. Additionally, an important role emerging for management accounting admittedly is the facilitation of organisational learning: Abernethy and Brownell [1997]. It is arguable that perhaps the evidence that accounting 'works' in some contexts and not in others may be attributable sometimes to the alternative roles which accounting plays, rather than to differences in contextual factors [eg Otley, 1978; Hirst, 1981]. As Chapman [1997; 197] observes, studies have moved

> from the carefully made argument of R[eliance on] A[ccounting] P[erformance] M[easures] studies to a looser expectation that accounting as a whole might be appropriate under conditions of certainty and inappropriate

> under conditions of uncertainty. … The studies focused their attention on accounting more widely, but seemed unaware that alternatives to R[eliance on] A[ccounting] P[erformance] M[easures] may exist, hence their confusion at their results.

In this regard, the role of the various managerial accounting functions ultimately should be recognised if Shield's [1997] call for increased 'integrative research' in the area is to be heeded. This is because it is suggested that applying a transaction cost economics paradigm (particularly in relation) to management accounting's potential 'decision influencing' capability reveals arguably perceptive insights obscured admittedly by the present approach which differentiates formally between the two — despite certain apparently substantive similarities [eg Milgrom and Roberts, 1995]. As Baiman [1990; 348] laments, 'transaction cost economics has not yet been applied to specific managerial accounting issues' and this is unfortunate once it is appreciated that the former 'has the potential to enrich our understanding of the role of the managerial accounting process': Baiman [1990; 346]. Accordingly, this paper sets out to address Baiman's [1990] first concern in order for the validity of his second observation to be determined. It aims to integrate the expanded agency theory-based approach to transaction cost economics advocated by Baiman [1990] himself, with the behavioural-oriented contingency perspective followed in the contemporary study of management control. Specifically, it takes up the suggestion of Johnson [1983] by employing the former to explain 'the evolution of managerial accounting procedures' [Baiman, 1990; 346], as well as that of Spicer and Ballew [1983] and Swieringa and Waterhouse [1982], by utilising transaction cost economics 'as a conceptual overview of the managerial accounting process': Baiman [1990; 346]. Extending the work of Baiman [1990]; Chapman [1997] and Kren and Liao [1988], the paper argues ultimately that the current approaches to transaction cost economics and contingency accounting both can be traced to a common, underlying preoccupation with 'control'.

The rest of this paper is structured as follows. Part II sets out the basic ideas underpinning transaction cost economics, and explores an expanded approach to the paradigm as encouraged by Baiman [1990]. Part III then deals generally with the literature on contingency accounting to date, identifying broad observations and conclusions emerging. Part IV consequently attempts to draw together Parts II and III, setting out the similarities and differences between the economic and behavioural approaches, and the implications of these. Part V concludes by observing that the 'control' argument presented calls for an increased integration of the two approaches, in order to promote a more holistic understanding of organisational control.

2. Basic Concepts of Transaction Cost Economics

Williamson [1975, 1986a, and 1986b] may be credited with having consolidated the early literature on the branch of agency theory labelled 'transaction cost economics': Baiman [1990]. Like the principal-agent literature preceding it, the transaction cost approach 'assumes that all individuals act in their own self-interest' [Baiman, 1990; 346]. However, the latter explicitly takes what admittedly is a pejorative view of such conduct, labelling it 'opportunistic behaviour': Klein, Crawford and Alchian [1978].

Reflecting somewhat its label, transaction cost economics largely is concerned with the minimisation of transaction costs (Note 1) — the costs associated with organising private legal agreements in different ways [eg Barron and Umbeck, 1984; Armour and Teece, 1978], brought about by the incidence of the aforementioned conduct [Alchian and Demsetz, 1972]. Traditionally, the paradigm distinguishes itself from the principal-agent literature prior by investigating the management of these (agency) costs [Godfrey *et al*, 1994] (Note 2) primarily in the context of inter rather than intra-firm contractual relationships: Williamson [1979].

However, Baiman [1990; 347 (emphasis in original)] notes that this dichotomy is not as significant as it first appears, because 'although the principal and agent in principal-agent models are usually *interpreted* as having an employer-employee relationship, the model does not require this.'

The opportunistic behaviour with which transaction cost economics is concerned ultimately is managed by what Baiman [1990; 347] describes as 'governance procedures'. Broadly, these are the ways in which firms organise their relationships to minimise the potential for such conduct [Alchian and Demsetz, 1972; Burrows and Black, 1997]. Although in one sense these have been approached traditionally by examining the different ownership of specialised assets (Note 3) in the context of *inter*-firm contracts (ie in relation to 'make-or-buy' and 'lease-or-buy' decisions) [eg Klein, Crawford and Alchian, 1978; Williamson, 1985; Masten, 1984], there is no reason why this necessarily should be the case. (Note 4) Baiman [1990; 347] (admittedly a leading theorist) himself regards 'a firm's cost accounting system as well as budgeting, transfer pricing and cost allocation rules' — all *intra*-firm arrangements — as examples of these procedures. Alchian and Demsetz [1972] employed transaction cost concepts in examining the factors which give rise to different types of firms (eg partnerships, corporations, non-profit organisations), and in explaining the different dynamic of these firms. The recent ground-breaking study by Burrows and Black [1997]

on differences in profit-sharing arrangements adopted *within* Big 6 accounting firms may indicate that the original view of governance as taken by Klein, Crawford and Alchian [1978] and Williamson [1985] is being expanded currently to encompass increasingly relevant situations where the way in which a firm is organised *internally* facilitates the minimisation of its agency costs.

Such a result arguably is overdue. In Baiman's [1990; 348 (emphasis added)] view:

> The main insight provided by the transaction cost economics literature … is that governance *matters*. … It has provided an … explanation for the diverse ways in which firms organize their relationships.

Arguably, Chapman's [1997] observations pertaining to the negative effects on research from an overly narrow view of 'contingency studies' are relevant equally here, with the modification and variation necessary. Studies into agency-based (transaction) costs and how these affect internal organisational choices arguably can be described as relating to governance in a way (albeit *within* the firm), and hence on this view should be regarded also as relevantly valid 'transaction cost' literature [Baiman, 1990]. If it is accepted that the minimisation of transaction costs arising out of contractual arrangements and the implications of this for firm governance lie at the heart of transaction cost economics [Klein, Crawford and Alchian, 1978], then it should matter not whether the said costs or governance issues relate to matters internal or external to the firm — arguably the firm's cost-minimising arrangements *themselves* are emphasised, instead of *where* they are put in place. Although Baiman [1990] observes that this approach appears to conflate the more recent transaction cost literature with its earlier principal-agent predecessors, he does not see this as undesirable. In his words, '[o]ne of the recent developments *whose future growth* will enhance the impact of the principal-agent model is the integration of the transaction cost economics and principal-agent models': Baiman [1990; 366 (emphasis added)]. Accordingly, this is the approach taken by this paper.

In order to appreciate how this current expanded approach to transaction cost economics can inform an understanding of organisational control, the next part of this paper reviews findings from the contemporary literature on managerial accounting, traditionally a crucial part of the overall management control package [Hopwood, 1974].

3. The Role of Managerial Accounting in Organisational Control

Anthony [1965] defines management control as 'the process by which managers ensure that resources are obtained and used efficiently and effectively in the accomplishment of the organization's objectives'. Today, this activity 'encompasses parts of both strategic planning and operational control': Otley [1994; 294]. As Otley notes,

> it is arguably incumbent upon the manager to be continually reformulating strategy to match the environment being faced, and to monitor the implementation of corrective actions at an operational level.

The decision influencing and decision facilitating functions of management control [Demski and Feltham, 1976] admittedly are implicitly appreciated by the above approach. Although management accounting may be 'a primary source of both decision-facilitating and decision-influencing information in a firm' [Kren and Liao, 1988; 295], Hopwood [1974] points out that it ultimately is an administrative control which in the final analysis is part of a broader (decision-influencing) package that comprises also of essential social and self controls. For example, he notes that individuals may 'respond to accounting systems by deliberately manipulating the reported information' if the fairness of these systems has not been internalised into the self controls of the former: Hopwood [1974; 2].

Viewed in light of Hopwood's [1974] observations, the current contingency approach to managerial accounting may be seen broadly as an attempt to explain the conditions under which the use of particular accounting measures will or will not be effective in achieving certain objectives: Chapman [1997]. It represents a move away from universalistic studies prior, which looked essentially for the direct effects of the relevant accounting measures on the variables of interest: Kren and Liao [1988]. Instead, contingency studies recognise that observed effects of the measures on the variables might be *contingent* on other extraneous factors [Hayes, 1977; Otley, 1980; Merchant and Simons, 1986]. Examples of these potential and actual factors identified in the literature past and present relevantly include: uncertainty [Hirst, 1981; Otley, 1978; Govindarajan, 1984; Brownell, 1985; Abernethy and Stoelwinder, 1995; Abernethy and Brownell, 1997]; strategy [Govindarajan and Gupta, 1985; Ittner and Larcker, 1997; Simons, 1987; Abernethy and Lillis, 1995]; incentives [Chow, 1983; Waller and Chow, 1985]; competition [Khandawalla, 1972]; budget participation [Brownell, 1982a, 1982b]; budget difficulty [Chow, 1983; Rockness, 1977]; budget clarity [Treborg, 1976; Treborg and Miller, 1978; Campbell and Gingrich, 1986; Early, Wojnaroski and Prest, 1987]; budget slack [Choudhury, 1985; Waller, 1985; Weitzman, 1976; Cyert and March, 1963; Schiff and Lewin, 1970]; and feedback [Campion and Lord, 1982], amongst others: Kren and Liao [1988]. This list necessarily is incomplete, because it reflects only currently known and hypothesised situational variables: Merchant [1981]. In

this regard, Chapman [1997; 189] observes pessimistically that the managerial accounting literature up to this point has yet to develop 'a credible and comprehensive contingency theory of accounting.' (Note 5) It is arguable that such an overall framework, if it can be constructed, may be built in part by positioning the contingency paradigm within an expanded transaction cost approach.

4. Reconciling the Expanded Approach to Transaction Cost Economics with the Contingency View of Managerial Accounting

Having explored the basic ideas underpinning the current expanded approach to transaction cost economics and the contemporary contingency view of managerial accounting, it can be seen that the two fields focus arguably on different sides to the same 'coin' that is organisational control. Each can inform the study of the other, and may answer questions unexplored under the other approach. However, both approaches presently overlook largely one particular situation in which control may need to be exercised.

4.1 Applying Transaction Cost Economics to Managerial Accounting — The Need for Control and Why It Should Work

One premise of management control is the need to achieve organisational control [Hopwood, 1974]. Managerial accounting plays partly a crucial 'decision influencing' role in this regard [Demski and Feltham, 1976]. It does so by providing information on relative performance, thus enabling this to be measured: Kren and Liao [1988]. For example, by comparing actual results to budgeted results, management may be able to identify under-performing individuals and then potentially take remedial action: Otley [1978]. (Note 6) (This is the classic case of accounting-based performance measure use, as investigated by Hopwood [1972].) To the extent that organisational goals are captured accurately by budget targets, (Note 7) those who relevantly have furthered successfully the organisation's objectives may then be compensated accordingly while those who have not done so may have their actual compensation reduced, relative to their potential compensation: Kren and Liao [1988]. Therefore, by also enabling compensation to be linked to performance, accounting numbers may promote (theoretically, to) control because conduct leading to outcomes desirable to the organisation subsequently can be rewarded and conduct leading to sub-standard outcomes discouraged. (Note 8)

But while management accounting research increasingly may be instructive of the manner in which optimal control might be achieved in this way (eg by varying the emphasis placed on accounting-based performance measures, depending on the circumstances: Hopwood [1972]; Otley [1978]; Hirst [1981]; Govindarajan [1984]; Ittner and Larcker [1997]; Simons [1987]; Abernethy and Lillis [1995]; Abernethy and Stoelwinder [1995]; and Abernethy and Brownell [1997]), it is the agency-based transaction cost literature which concentrates fundamentally on the underlying theoretical *need* for such control in the first place: the divergence of individual and organisational interests [Jensen and Meckling, 1976; Alchian and Demsetz, 1972]. (Note 9) As Baiman [1990; 346 (emphasis added)] argues 'transaction cost economics assumes that *all* individuals act in their own self-interest'. Thus it is unsurprising that an individual's interests may not always coincide with those of the firm: Godfrey *et al* [1994]. For example, economically rational utility maximising individuals would prefer less work to more at the same salary [Kren and Liao, 1988], if they experienced disutility from work and derived utility according to the extent of their remuneration [Baiman, 1990]. Jensen and Meckling [1976] label the costs arising from such opportunistic behaviour 'agency costs', and these properly could be viewed as part of the continuing costs of the transaction that the firm enters into with an individual when the latter becomes party to an employment contract with the former: Godfrey *et al* [1994].

In this context, management accounting may be seen as a mechanism which facilitates the minimisation of these costs [Baiman, 1990]. It does so by enabling compensation ideally to be linked to effort as far as possible, and by enabling effort to be measured through a comparison of actual results to those budgeted: Kren and Liao [1988]. (Note 109) As Baiman [1990; 366] writes, '[m]anagerial accounting is used to acquire and process information for performance evaluation purposes. In turn these performance evaluation measures are then used as inputs to the reward function to determine the agent's compensation.' The latter is accomplished by providing for performance-based remuneration in individuals' employment contracts [Healy, 1985]. This arrangement may be seen as part of the internal governance mechanism of the firm, with which the current expanded approach to transaction cost economics is concerned: Burrows and Black [1997]; Alchian and Demsetz [1972]. This approach to 'governance' works in theory because negative financial consequences for the firm from a lack of employee effort are incorporated ultimately into individual employees' utility functions as a result, accordingly giving them the incentive to put in more effort to meet organisational goals [Kren and Liao, 1988]. (Note 11) This goal-alignment function of management accounting therefore may be traced to the need to influence individuals to make decisions

that are in the best interest of the firm, a need which *prima facie* is explained by the self-interest assumptions of transaction cost economics [Baiman, 1990]. (Note 12)

However, to the extent that management accounting information is incapable of capturing completely individual performance or reflecting accurately organisational objectives, its effectiveness as a transaction cost minimising device (ie governance procedure) is reduced: Tiessen and Waterhouse [1983]. In fact, its overuse may lead even to an *increase* in agency costs as those evaluated under such an approach attempt to manipulate results generated in order to mitigate what they perceive as unfair reporting [Hopwood, 1972, 1974]. Instances where budget numbers might not reflect accurately individual effort, performance or firm goals are not uncommon [eg Hopwood, 1972; Hirst, 1981; Abernethy and Lillis, 1995; Abernethy and Stoelwinder, 1995; Abernethy and Brownell, 1997; Govindarajan, 1984; Brownell, 1985a, 1985b; Govindarajan and Gupta, 1985; Ittner and Larcker, 1997; Simons, 1987], and this outcome may be related to a combination of factors. Identifying these situations and isolating these factors are important roles of current contingency accounting: Chapman [1997]. This is consistent with the observation that most of the research to date has concentrated essentially on the decision-influencing role of management accounting [Kren and Liao, 1988], and this trend may be traced to early and foundational works in the field such as those of Hopwood [1972] and Hopwood [1974]. (Note 13) As has been demonstrated above, this particular focus is consistent with the need for goal-alignment, a need which is explained primarily by the self-interest assumptions underpinning transaction cost economics: Baiman [1990].

4.2 The 'Real World' Approach to Contingency Accounting as a Refinement of Agency Theory in an Actual Organisational Context

Instructive as the assumptions underlying agency theory-based transaction cost economics may be in explaining the need for the decision-influencing role of numbers-driven organisational control, they do not tell the whole story behind the existence of management accounting [Baiman, 1990] (if indeed there is one: Stewart [1992]). The agency theory upon which transaction cost economics is based is precisely that — a theory: Jensen and Meckling [1976]. Kren and Liao [1988] note that most of the research carried out within the transaction cost paradigm has been either theoretical or analytical. With some exceptions (eg Chow [1983]), not enough has been done to test empirically the 'real world' validity of its prescriptions: Demski and Kreps [1982]. In particular, some of the assumptions underlying the theory — for example, the presence of only a single period time horizon and the abilities of economic actors to process information presumed: Fama [1980] — cast some doubt on the actual applicability of the model to practical scenarios: Baiman [1990]. By simplifying essentially the complexity that is human behaviour, arguably the transaction cost economics approach may lose sight of the richness of the real-world phenomena that impact on organisational control concerns [Kren and Liao, 1988; Tiessen and Waterhouse, 1983].

For example, transaction cost economics *assumes* that *all* individuals act in their own self-interest: Godfrey *et al* [1994]. Arguably, this is a narrow and very mechanistic, cynical view of general human conduct that, as Baiman [1990; 345] observes, 'apparently, leaves no room for trust and fairness, which are also claimed to affect behaviour.' Employees' decisions may not further the objectives of the organisation, but this is not *necessarily* because their personal goals diverge from those of the firm under the circumstances: Kren and Liao [1988]. Individuals also may make decisions detrimental to the organisation's goals because they do not understand properly what is required of them, or because they find themselves in positions beyond their ability, training or experience: Merchant [1982] — this is recognised (and mitigated) in part by the legitimate 'decision facilitating' role of managerial accounting [Demski and Feltham, 1976]. Hopwood [1974] also has listed an individual's self-controls as one of the controls upon which an organisation may rely in its search for managerial control. Presumably, this largely will be effective only if the relevant individual's goals do not diverge generally from those of the organisation [Hopwood, 1974] — an idea which does not sit easily with the broad-brush assumptions of human conduct embraced by transaction cost economics [Baiman, 1990]. To the degree that an employee's goals do not conflict *ex ante* with those of the organisation, the distinction drawn between the two by transaction cost economics [Godfrey *et al*, 1994] essentially is a formal one because in so far as this is true there is no need to align substantively as such the former's interests with those of the latter.

The complexities of human behaviour and the richness of real-world conditions admittedly glossed over by transaction cost economics assumptions [Tiessen and Waterhouse, 1983] but recognised arguably as such by the current contingency approach to managerial accounting additionally is borne out by the latter's acknowledgment of the myriad of factors and conditions which might influence the effectiveness of certain organisational controls as governance procedures [Otley, 1978; Hirst, 1981; Brownell, 1982a, 1982b; Govindarajan, 1984; Ittner and Larcker, 1997; Simons, 1987; Abernethy and Lillis, 1995; Abernethy and Stoelwinder, 1995; Abernethy and Brownell, 1997].

Indeed, determining these situational variables and how they interact with the effectiveness of particular (accounting and non-accounting) controls is a significant focus of contingency studies in management accounting: Chapman [1997]; Kren and Liao [1988]. The theoretical assumptions of transaction cost economics suggest that controls are necessary, and that controls which reward behaviour desired generally should be effective forms of goal-alignment [Chow, 1983; Waller and Chow, 1985; Fershtman and Judd, 1984, 1986; Fershtman, Judd and Kalai, 1987; Sklivas, 1987]. However, contingency management accounting studies refine further this idea, by revealing that in the real-world environment in which the firm operates the fundamental linkage proposed between controls and control arguably could be affected additionally by other exogenous factors such as: uncertainty [Hirst, 1981; Otley, 1978; Govindarajan, 1984; Brownell, 1985a, 1985b; Abernethy and Stoelwinder, 1995; Abernethy and Brownell, 1997]; strategy [Govindarajan and Gupta, 1985; Ittner and Larcker, 1997; Simons, 1987; Abernethy and Lillis, 1995]; incentives [Chow, 1983; Waller and Chow, 1985]; and competition [Khandawalla, 1972]. That is, using transaction cost economics alone it is difficult to explain, for example, why contracts differ across different firms and across time within firms [Raviv, 1985], and one must look towards managerial accounting for insights on this issue: Baiman [1990]. (Note 14)

Specifically in a budget setting, the managerial literature has suggested budget participation [Brownell, 1982a, 1982b]; budget difficulty [Chow, 1983; Rockness, 1977]; budget clarity [Treborg, 1976; Treborg and Miller, 1978; Campbell and Gingrich, 1986; Early, Wojnaroski and Prest, 1987]; budget slack [Choudhury, 1985; Waller, 1985; Weitzman, 1976; Cyert and March, 1963; Schiff and Lewin, 1970]; and feedback on performance [Campion and Lord, 1982] (amongst other things), as relevantly influencing the effectiveness of budgets as a control measure: Kren and Liao [1988]. The founding studies in the area of contingency accounting by Hopwood [1972] and Otley [1978] in fact reveal that use of the internal governance procedure that is accounting-based performance measures (as an indication of and hence ultimately a control on performance) is not always effective: Hirst [1981]. That is, over-reliance on such a form of governance for control in fact may have negative implications for performance, in the form of decreased performance or even dysfunctional behaviour [Hopwood, 1972] — precisely what the procedure ironically is intended to discourage and ideally prevent. Otley [1978] has identified one influence leading potentially to such an outcome as being task uncertainty, that is, the uncertainty in the nature of the task facing the individual whose performance is evaluated predominantly under such a measure: Hirst [1981]. An implication from this is that the need for controls as suggested by the transaction cost literature [Alchian and Demsetz, 1972; Burrows and Black, 1997] must be tempered by a detailed examination of the broad factual circumstances under which control is being sought, in order to predict better which controls might or might not be effective: Chapman [1997]; Kren and Liao [1988]. As Baiman [1990; 366 (emphasis added)] cautions, transaction cost economics alone is ‘not at a micro enough level to address the question of *why* we observe particular performance evaluation measures’.

In short, the transaction cost literature suggest the need for controls and suggest theoretically why they might be effective in abstract, but the precise *type* and *mix* of actual controls which potentially will in fact bring about control is a question left for the managerial accounting literature to answer: Baiman [1990]. (Note 15) That is, one really has to look to research from the field of management accounting in order to predict *what* or *which* controls generally will be effective under different real-world conditions [Raviv, 1985]. (Note 16) This represents an on-going project, because current insights inevitably will be incomplete, reflective only of presently known or hypothesised situational variables: Merchant [1981].

4.3 A Shortcoming of Both Approaches?

As informative as the joint approach to transaction cost economics and contingency managerial accounting that has been discussed may be however, both fields either separately or jointly seem currently to be concerned largely with only one potential direction of control: that of the individual by the organisation [Baiman, 1990]. However, arguably it is the case also that the individual may need some form of (legitimate) control over the organisation, for the same reasons that the latter requires control over the former: Alchian and Demsetz [1972]. Coase [1937] has revealed the firm to be a nexus of contracts, and if one accepts the transaction cost economics assumption that the abstract existence of such legal arrangements give rise to incentives for opportunistic behaviour [Klein, Crawford and Alchian, 1978], then the potential exists theoretically that *both* the individual *and* the organisation may have incentives for behaving opportunistically toward *each other* [Riordan, 1987]. However, the literature in each area to date has concentrated primarily on the control of the individual by the organisation; specifically, on ways in which the former’s interests may be aligned with the latter’s: Baiman [1990]. As Riordan [1987] observes, this suggests tacitly that the latter’s aims and objectives are legitimate, or at least relatively more legitimate when they clash with those of the former — it is the former’s goals that need to be aligned with the latter’s, not *vice-versa*.

Yet, as the claims made recently relating to the events surrounding the dispute in *Maritime Union of Australia v Patrick Stevedores No 1 Pty Ltd* (unreported, Federal Court of Australia, North J, 21 April 1998) arguably may show, (Note 17) it is entirely possible that in some circumstances the firm may act opportunistically in relation to the individuals over which it has control: Tham [1998]. (Note 18) In particular, various researchers have noted that accounting is centrally implicated in the control mechanisms of society, and that it is involved in an important way in the conflicts surrounding the exercise of economic and political power [eg Ansari and Bell, 1991; Arrington and Putuxy, 1991; Burchell *et al*, 1980; Cooper and Sherer, 1984; Dillard, 1991; Hopwood, 1987; Lehman and Tinker, 1987; Miller and O'Leary, 1987; Tinker, 1980, 1985, 1988; and Tinker, Lehman and Neimark, 1991]. In light of recent calls for increased 'industrial democracy' in the workplace [Albert and Hahnel, 1991; Gee, Hull and Lankshear, 1996; Hodgson, 1984; Pateman, 1970; and Turner, 1991], perhaps the holistic approach to transaction cost economics and managerial accounting as explored by this paper could be applied also in facilitating a greater degree of legitimate control over the firm by individuals. As Hopwood [1976; 5] observes, '[m]uch of the accounting as we know it today reflects the capitalist ethos, but as social and political pressures change, so we can also expect the forms and philosophies of accounting to change.' Drawing on Alchian and Demsetz [1972; 790] as a starting point, this change broadly could take initially the form of monitoring aspects of employer performance that 'are less easy to meter and are more subject to employer shirking', (Note 19) and expand gradually if it becomes more accepted.

5. Conclusion

Kren and Liao [1988; 303] write that to date '[t]here have been few attempts to integrate behavioural and economic perspectives'. Yet Baiman [1990; 367] observes that one 'way to enhance the impact of principal-agent research on managerial accounting is to better coordinate it with empirical research.' Similarly, Waller [1985] has argued that better insights may be gained if the results of agency and behavioural research are integrated — an point reiterated recently by Shields [1997]. As Kren and Liao [1988; 291] recognise, 'although specialisation in research is at times effective, there are likely to be associated costs, perhaps including lost insights.' The frontiers of management accounting research are being pushed back and redefined continuously, as new directions emerge and novel opportunities present themselves [Foster and Young, 1997; Anthony *et al*, 1997].

Drawing on these insights, the aim of this brief review paper has been ambitious. It has attempted to bridge in so far as possible the formal gap between the fields of transaction cost economics and contingency accounting, by trying to find some common ground between them. Utilising an expanded view of transaction cost economics as advocated by Baiman [1990], it has reconciled the economic approach of the former with the behavioural-oriented perspective of the latter, by tracing both broadly to an underlying concern with the notion of 'control'. Specifically, it has revealed that the need for the managerial control function which is met partly by management accounting's decision influencing role is explained essentially by the self-interest assumptions forming the subject of study in transaction cost economics, but has noted that the question of how actually to attain effective control under particular circumstances ultimately is left best to be answered by the contingency paradigm of managerial accounting. With its situation-specific contextual approach and appreciation of the complexities of human behaviour, admittedly the latter is equipped better to investigate the conditional requirements for true control potentially to be realised in real-world situations. Ultimately, by combining the two approaches, a better understanding of the circumstances under which organisational control is required, and the situations in which particular controls might be effective, may be obtained. Adopting a Lakatosian view [Lakatos, 1970], both paradigms could be characterised as complimentary, with each focusing on a different facet of organisational control. However, the discussion also has revealed that far from being contained squarely within the transaction cost framework, contingency management accounting has something independent to offer. The former arguably ignores the decision facilitating role of managerial accounting, and the latter offers insights into the complexities of human behaviour and richness of real-world conditions which are uncaptured by the former's admittedly simplistic, abstracted assumptions.

However, the nature of the project necessarily has been restricted. A review paper of this kind can hope only to discuss the key conclusions from both areas. It must be left to others to refine further the ideas developed here, by pushing them to their logical boundaries. (Note 20) In particular, this paper has identified the need for both fields whether together or separately to take a broader view of organisational control, one which appreciates fully the incentive and capacity for opportunistic behaviour on the part of all parties to the nexus of contracts that is the firm. Arguably, only then can both transaction cost economics and the contingency approach to managerial accounting contribute more holistically to our understanding of the dynamics of control in relation to contemporary organisations.

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Notes

Note 1. See Williamson [1975, 1986a, 1986b] for a detailed discussion of the literature on this branch of agency theory.

Note 2. Agency costs are the costs which arise from the potentially divergent interests of principals and agents under principal-agent relationships: Jensen and Meckling [1976].

Note 3. A specialised asset is an asset that to a large degree is of value only in relation to its use as contemplated in an individual contractual arrangement relating to it, and which accordingly has poor market substitutes. This lack of a ready availability of the asset may give the party which is supplying it the economic incentive to behave opportunistically towards the party which is benefiting from its use, even after contractual sanctions for such behaviour are taken into account. See Williamson [1985] for examples of such assets, and Klein, Crawford and
Note 4. This conclusion arguably is strengthened by the fact that franchising as an organisational form which blurs the boundaries between the market and the firm constitutes an accepted subject of study for transaction cost economists [eg Rubin, 1978; Klein and Saft, 1985; and Norton, 1988]. See n 14 below for discussion on the application of transaction cost economic concepts to the franchising decision.

Note 5. Chapman [1997] goes on to develop his own theory, which is based on ‘complexity’.

Note 6. However, this assumes that the *effort input* by an individual is reflected accurately in the resulting *output* that is captured by the accounting numbers, which are compared subsequently against the output budgeted or desired [Otley, 1981]. To the extent that this is not the case, such a control measure may not be entirely effective in providing incentives for desired individual conduct: Hirst [1981]. Dysfunctional behaviour may arise as individuals attempt to manipulate the information or results generated in order to eliminate the effect on their evaluation of what they perceive to be elements beyond their control [Hopwood, 1972]. An alternative is to try to build ‘slack’ into the budget to allow for this [Cyert and March, 1963; Schiff and Lewin, 1970; Onsi; 1973]. To the degree that the reporting process does not capture accurately individual performance or effort, discretion is required in interpreting the accounting results in order to compensate for this and accordingly to avoid the behaviour above [Hopwood, 1972]. In so far as such budget evaluation also is dependent on traditional frameworks of responsibility accounting, it additionally may be unsuited to some contemporary organisations which adopt measures such as activity-based costing: Kaplan [1994]. The implications of these observations will be discussed further below.

Note 7. The degree to which this is true may depend on the amount of (un)certainty in the internal and external environment surrounding the firm [Govindarajan, 1984; Brownell, 1985; Otley, 1978; Abernethy and Stoelwinder, 1995; Abernethy and Brownell, 1997], and the organisation’s strategy [Govindarajan and Gupta, 1985; Ittner and Larcker, 1997; Simons, 1987; and Abernethy and Lillis, 1995]. The implications of this will be discussed further below.

Note 8. Bearing in mind the qualifications made in nn 6 and 7, above. Their implications will be discussed further below.

Note 9. Although in fairness Hopwood [1974; 17 (emphasis added)] does allude to this when he writes: 'Have you wondered how today's mammoth enterprises are held together as purposeful organisations? They employ vast numbers of people, *each with their own separate needs, interests and loyalties*.' Otley [1978; 122] makes a comment to similar effect in relation to the manipulation of accounting numbers. Abernethy and Stoelwinder [1995; 6] recognise more specifically 'that those individuals who demonstrate high levels of professional orientation will experience conflict in a bureaucratic organization as they will perceive management-related goals and obligations as contrary to their pursuit of autonomy.' However, the potential divergence of organisation and employee interests is not always acknowledged explicitly in managerial accounting-grounded decision-influencing studies [eg Govindarajan, 1984; Ittner and Larcker, 1997; and Simons, 1987].

Note 10. Bearing in mind the qualifications made in nn 6 and 7, above. In light of these qualifications, it can be argued that this role for managerial accounting represents more of a theoretical ideal than a real-world outcome: Tiessen and Waterhouse [1983]. The implications of this will be discussed further below.

Note 11. Id.

Note 12. The 'decision facilitating' role of management accounting [Demski and Feltham, 1974] and the importance of this function will be discussed further below.

Note 13. Id.

Note 14. In fairness, the transaction cost literature does recognise some of the conditions under which certain contractual forms (such as franchising) may predominate in relation to others (such as ownership), by taking into account for example factors such as potential agent moral hazard and risk-aversion: see, eg, Rubin [1978]; Klein and Saft [1985]; and Norton [1988]. The point is that the number of these studies and the variables which they examine pale in comparison to the number of studies reviewed and cited, and variables relevantly identified and discussed, in the managerial literature such as that by Chapman [1997] and Kren and Liao [1988].

Note 15. Although the transaction cost literature does address itself which governance procedures might be appropriate bearing in mind the use of different asset types in a contractual arrangement (ie lease or buy, depending on the specificity of the asset) [Klein, Crawford and Alchian, 1978], these prescriptions admittedly are limited in scope and do not extend to other potential forms of control, with the exception possibly of that given immediately above in n 14.

Note 16. The distinction between *controls* and *control* (ie that the former do not lead necessarily to the latter, or alternatively that the latter do not follow necessarily from the former) was recognised as early as Hopwood [1974].

Note 17. The union alleged that Patrick Stevedores had conspired illegally with the Minister for Industrial Relations to sack all its workers essentially because they were members of a union, contrary to the freedom of association provisions in the *Workplace Relations Act 1988* (Cth). Further and in the alternative, it was said that the subsidiary labour hire company to which workers performing services for entities in the Patrick group technically were employed brought about its own insolvency by transferring its assets to other (related) companies, therefore triggering itself the very circumstances which could be used to justify retrenchments on economic grounds. All charges ultimately were settled out of court with no admission of guilt by any of the parties accused. For a detailed description of the dispute, see Hannan [1998b] Australian Associated Press [1998]; Davis [1998]; and Davis and Buffini [1998].

Note 18. While acknowledging that the individuals concerned could by the same token relevantly also have acted opportunistically towards the firm: Hannan [1998a]; Davies, Forbes and Birnbauer [1998]; and Davis and Murphy [1998]. What the events alleged arguably go to show is that opportunistic behaviour may *cut both ways* in the principal-agent relationship, that in reality it is not uni-directional by being confined merely to agents.

Note 19. Alchian and Demsetz [1972; 790] give as examples fringe benefits that 'often are in non-pecuniary, contingent form; medical, hospital, and accident insurance, and retirement pensions'.

Note 20. At an empirical level see, for example, Burrows and Black [1997] and Callaghan and Burrows [1998], for the application of transaction cost ideas to managerial accounting practices.