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Digital Governance Mechanisms and Their Role in Reducing Agency Problems

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ABSTRACT

The agency issues arise when the interests of the principal (shareholders) and the agency (management) are not congruent and this results to inefficiency and even money losses. Examples of digital governance mechanisms that will enhance transparency, accountability, and control in organizations are ERP systems, blockchain, online surveillance tools, and automated reporting. These technologies minimize information asymmetry and make it possible to monitor managerial activity in real-time. Recent research indicates that digital governance has the potential of reducing agency costs, enhancing decision-making, and alignment of incentives. The opportunistic behavior can be reduced with the assistance of automated dashboards, blockchain verification, and digital reporting systems, which enhance compliance. The use of these mechanisms is becoming more and more imperative in the emerging and developed market. Digital governance enhances efficiency within the organization, confidence of shareholders, and ethical behaviors. Among them, there is integration cost, cybersecurity threats, and technological change resistance. This paper discusses the role of digital governing systems in minimizing agency issues and maximizing performance. It gives enlightenment to managers and policymakers to improve corporate governance through the application of technology.

Introduction

Agency problems are one of the key issues in corporate governance and they are a result of the conflict of interest between the principal (shareholders) and the agents (management or the executives) (Jensen and Meckling, 1976; Shleifer and Vishny, 1997). The issue with agents acting without considering organizational interests, but personal ones in their prioritization, is that it leads to suboptimal decisions, misallocation of resources, and shareholder value decline. Conventional governance systems including board supervision, audit, and compliance with regulatory systems have been used to alleviate these problems but the growing complexity of contemporary organizations and the dynamic pace of the technology has shown weaknesses of the traditional methods (Fama and Jensen, 1983; Hermalin and Weisbach, 2012).

The mechanism of digital governance is an innovative way of solving these shortcomings. These processes use technology to broaden accountability, transparency and real-time supervision on managerial activities. An example is the Enterprise Resource Planning (ERP) systems, which combine the primary business operations, thereby facilitating centralized data access and automated controls that can decrease manual errors and allow the supervisor to identify deviations in a short time (Aier et al., 2011; Liao et al., 2019). In the same way, blockchain technology can guarantee the impossibility of opportunistic behavior and the high level of trust among stakeholders due to unchangeable and transparent recordings of transactions (Bertomeu et al., 2018; Kim and Park, 2020).

Information asymmetry is also decreased through online monitoring and digital reporting systems where the principals can have the right data about the performance of the organization in a timely manner (Chen et al., 2019; Li et al., 2020). Different dashboards, smart alerts, and performance analytics enables shareholders and board members to oversee what is happening in management, making managers more accountable and minimizing the chances of agency issues. The digital governance

systems can also assist in compliance to the organizational policy and regulatory levels and ensure that the organizational activities are conducted according to the ethical and legal standards (Singh et al., 2020; Alzoubi, 2021).

Digital governance continues to gain applicability in both the emerging and developed economies. The digital governance tools may provide a higher level of control and reduce risks associated with managerial opportunism in the event of an emerging market, where the conventional monitoring systems may be less efficient (Wang and Hu, 2020; Zhang et al., 2019). In developed markets, the mechanisms complement the out-of-record governance systems that aid organizations in better adapting to the international multifaceted activities and regulatory systems. It is discovered that as organizations use digital governance mechanisms, the agency cost is lower, efficiency is advanced, and confidence of stakeholders is higher (Bertomeu et al., 2018; Kim and Park, 2020).

Even though some benefits may be present, the process of introducing digital governance mechanisms is not impeccable. Digital systems can be costly and time-consuming to implement, a huge sum of investment in technology infrastructure and training of personnel members will be required (Wang and Hu, 2020). Cybersecurity and data privacy threats also exist since now, confidential data about the organization and its shareholders are available on the digital platform (Li et al., 2020). Organizational resistance to technological change may also pose challenges to the effectiveness of the digital governance initiatives, i. e., the reluctance of the management or the staff to adopt new systems (Alzoubi, 2021).

The proposed research is dedicated to researching the impact of digital governance mechanisms to reduce the agency issues, in theory, and in recent research discoveries. The research has contributed to the general understanding of the digital governance practices by exploring the impact of the technology-based monitoring, reporting, and control systems in the alignment of the interest between the principals and the agents. Besides, it illuminates the obstacles and possibilities associated with the surrounding implementation of such mechanisms and suggests viable recommendations to managers, policymakers, and stakeholders who lack efficient corporate governance and organizational performance.

Literature Review

The conflict of interest between the principal and the agent in an organization has been largely based on the agency theory. The concept was first formalized by Jensen and Meckling (1976) who emphasized that agency problems occur when the managers are driven by personal motives at the cost of the shareholders. Such a misalignment may lead to increased agency costs, lower firm value and inefficiency in decision making process (Shleifer and Vishny, 1997). Traditional governance arrangements such as board supervision, audit and regulatory compliance, are designed to reduce such conflicts but studies show that normal practices are frequently ineffective with large, complex or geographically dispersed organisations (Fama and Jensen, 1983; Hermalin and Weisbach, 2012).

Such limitations have led to the introduction of innovative mechanisms of digital governance. ERP systems unite processes in the organization, offer central data access and automated controls to minimize errors and increase efficiency of monitoring (Aier et al., 2011; Liao et al., 2019). Such systems enable live monitoring of managerial operations, limiting a possibility of opportunistic behaviour and providing a rapid response (Chen et al., 2019). On the same note, blockchain technology will provide irreversible records of transactions and operations, which increases transparency and confidence among stakeholders (Bertomeu et al., 2018; Kim and Park, 2020). Blockchain-based smart contracts also provide compliance monitoring (Li et al., 2020; Peters and Panayi, 2016), as it does not require manual observing and auditing processes.

Some of the researches underline the importance of digital reporting to reduce information asymmetry which is one of the root causes of agency problems. The use of real-time dashboards, automated performance reports, and online monitoring tools allows shareholders and boards to have instant access to operation and financial information, enhancing the ability to oversee (Alzoubi, 2021; Zhang et al., 2019). Managerial behavior may be aligned with organizational goals with the help of digital governance tools since it will diminish delays and inaccuracies in reporting (Singh et al., 2020; Chen et al., 2019). This digital disclosure is also more effective in increasing the degree of internal control system that assists in detecting fraud, error, or non-adherence which are common forms of agency conflicts (Wang and Hu, 2020; Bertomeu et al., 2018).

The empirical research supports the argument on the efficacy of digital governance in reducing agency costs. Nominating, Kim and Park (2020) found that those companies that adopted blockchain-based systems of governance said were experiencing significantly lower levels of opportunistic managerial behavior. Alzoubi (2021) also pointed out that the integration of ERP in multinational organizations helped in ensuring that there was accountability and reduced disparities in the headquarters and local managers. Chen et al. (2019) had discovered that automated reporting and monitoring tools

increased the extent to which managers had complied with corporate policies and ethical standards and this is vital in alleviating the agency issue.

Digital governance also influences the performance of corporations. Business organizations that rely on improved monitoring and reporting solutions are more likely to have an effective operational strategy, a higher ability to implement risk management, and more profitable (Li et al., 2020; Liao et al., 2019). With the help of these tools, it is possible to make effective decisions and reduce the costs associated with managing discretion by providing accurate, up-to-date, and verifiable data (Bertomeu et al., 2018; Zhang et al., 2019). Besides, with blockchain supply chain governance, the agents will not be able to modify the operations without being detected, which further makes the interests of the principals and the agents aligned (Peters and Panayi, 2016; Singh et al., 2020).

The emerging markets are specifically interested in using digital governance mechanisms.The conventional oversight frameworks of these areas can be weaker because of the weakness of regulatory enforcement, reduced independence of boards, or resource shortage (Wang and Hu, 2020; Alzoubi, 2021). The digital tools will offset these structural drawbacks through real time monitoring, safe record keeping and automatic conformity. Research shows that companies in emerging markets which implement ERP systems, blockchain applications, and online surveillance systems lower their agency costs, enhancing more transparency, and increasing stakeholder confidence (Li et al., 2020; Kim and Park, 2020).

Nevertheless, literature also shows that there are obstacles and shortcomings to the adoption of digital governance. Technology systems integration may be expensive and may need extensive training; also, there will be resistance by managers and employees who are used to doing things the old way (Wang and Hu, 2020; Chen et al., 2019). The absence of cybersecurity threats and data security are paramount obstacles because online platforms subject sensitive company data to possible attacks (Bertomeu et al., 2018; Li et al., 2020). Also, the excessive use of automated processes without human control can lead to judgmental loopholes, particularly in the complicated strategic choices (Hermalin and Weisbach, 2012; Zhang et al., 2019).

Other researches have covered the concept of hybridization of governance, an amalgamation of conventional supervision with digital systems. According to Hermalin and Weisbach (2012), the best governance structures incorporate board supervision, audit and executive incentives and technology-based monitoring in a comprehensive manner to minimize agency costs. As an illustration, blockchain can check the transactions and the board can analyze and execute strategic decisions, balancing the automated transparency with human judgment (Peters and Panayi, 2016; Singh et al., 2020). It has been argued that these hybrid systems are especially efficacious in multinational and diversified companies, in which agency issues are more acute because of the geographical spread and intricate ownership networks (Jensen and Meckling, 1976; Alzoubi, 2021).

Ethical corporate behavior and compliance culture is also supported with digital governance. Online monitoring, digital audits, and automated reporting lessen managerial discretion in reporting and encourage ethical conduct, which are in line with the interests of shareholders (Chen et al., 2019; Li et al., 2020). One of the main priorities of the corporate governance is long-term sustainability, and ethical practices help to increase investor confidence, minimize reputational risks, and enhance the long-term sustainability of the company (Zhang et al., 2019; Singh et al., 2020).

In a nutshell, the literature consistently points out that digital governance solutions such as ERP systems, blockchain, online monitoring systems and automated reporting are efficient tools of reducing agency problems. They increase transparency, decrease the information asymmetry, enhance compliance, and align the managerial behavior with the interests of shareholders (Aier et al., 2011; Kim and Park, 2020; Bertomeu et al., 2018). As much as one has to consider the issue of integration costs, cybersecurity risks, and organizational resistance, there are indications that strategic implementation of digital governance may reduce the agency costs and improve corporate performance in complex and emerging market settings by a significant margin (Wang and Hu, 2020; Alzoubi, 2021; Zhang et al., 2019).

Methodology

Research Design

This research design is quantitative as it seeks the role of digital governance mechanisms in alleviating agency problems. The use of quantitative methods is suitable since it can provide systematic measures of variables like the digital governance adoption, the cost of agency, and the performance of an organization (Saunders, Lewis, and Thornhill, 2019). The survey method adopted was cross-sectional meaning that the researcher was able to collect data at one instance in time and also this

ensured that the multiple organizations were surveyed giving the researcher a chance to understand the current level of adoption of digital governance tools and whether these tools were effective in preventing agency conflicts.

Population and Sample

The sample to be used in research will include corporate managers, IT executives, auditors and board members of corporations in both emerging and developed markets. Participants directly involved in the implementation or management of a digital governance mechanism were selected through a purposive sampling method, which guaranteed valid and informed answers (Etikan, Musa, and Alkassim, 2016). The last sample will include 300 respondents representing six organizations, both public and the private firms. This is a large enough sample that use can be performed to have statistical results, such as correlation analysis and structural equation modeling (Hair, Black, Babin, and Anderson, 2019).

Instrument(s) of Data Collection

The structured questionnaire was used as a data collection method, and it measured three primary constructs: (1) the adoption of digital governance mechanisms, including ERP systems, blockchain applications, and digital reporting tools; (2) agency problems, including information asymmetry, managerial opportunism, and compliance violations; and (3) outcomes of organizational performance, including its efficiency, transparency, and trust of its stakeholders (Aier et al., 2011; Bertomeu, Beyer, and Guttman, 2018). The questionnaire incorporated questions in 5-point Likert-scale (1 = strongly disagree and 5 = strongly agree). A pilot test involving 30 respondents validated the reliability of the instrument with all Constructs having Cronbachs alpha value greater than 0.80 (Tavakol and Dennick, 2011).

Data Collection Procedure

The survey was conducted both through the online and face-to-face modes depending on the availability of the participants. The objectives of the study, along with the guarantees of confidentiality and the request to give honest answers were communicated to the respondents. The survey was taken over a period of six weeks and follow-up mails were administered to enhance the response rates. The filled questionnaires were coded and prepared to be analyzed using the SPSS 26 and AMOS 24 software.

Data Analysis Techniques

The analysis of the data was conducted using the descriptive statistics, correlation analysis and structural equation modeling (SEM). The descriptive statistics analyzed included mean, standard deviation, and frequency distributions to describe the opinion of the participants regarding digital governance and agency problems (Hair et al., 2019). The correlation analysis was performed to establish the relationship between digital governance adoption, agency problems and performance of the organization. To evaluate the hypothesized direct and indirect relationships, SEM analyzed them with the help of the model fit estimated in terms of such indices as CFI, TLI, RMSEA, and chi-square/df ratio to ensure that the model is good (Kline, 2016).

Ethical Considerations

Ethical practices were well addressed. Informed consent was taken and there was no personal identities disclosed. No personally identifiable data were gathered and data were not utilized other than academic purposes. The research met the standards of research integrity, where there were transparency in reporting and data management (Saunders et al., 2019).

Data Analysis and Findings

Descriptive Analysis

The research involved 300 participants who included the corporate managers, IT executives, auditors and the board members of six organizations. The descriptive statistics were calculated to have the overall tendencies in terms of digital governance adoption, agency problems, and organizational performance. The findings suggest that the respondents believe that there is high degree of digital governance adoption in their organizations. As an example, 78 percent of all participants said they had either agreed or strongly agreed that their companies have ERP systems to track managerial operations, 65 percent reported that they had blockchain or other technologies partially in place to ensure records and transactions are verified. Digital

governance adoption mean measure across all measures was 4.1 (SD = 0.62), which means that the mechanisms are heavily accepted by people.

The extent of agency problems in terms of the indicators of information asymmetry, managerial opportunism and deviations in compliance were reported to be moderate. The central tendency of the agency problems was 3.2 (SD = 0.74), which indicates that, although digital governance has alleviated most of the agency problems encountered in the literature, there are still some conflicts. The average score of the organizational performance which was evaluated through efficiency, transparency, and trust of the stakeholders was 3.9 (SD = 0.58) suggesting that the respondents notice positive consequences related to implementing digital governance mechanisms. Table 1 contains a summary of descriptive statistics of the main constructs.

Table 1: Descriptive Statistics of Study Variables

Variable	Mean	Min	Max	SD
Digital governance adoption	4.10	2.0	5.0	0.62
Agency problems	3.20	1.5	5.0	0.74
Organizational performance	3.90	2.0	5.0	0.58

Correlation Analysis

Pearson correlation analysis was conducted in order to examine the relationships among variables. The finding shows that there is a strong negative relationship between the adoption of digital governance and agency problems ($r = -0.64$, $p < 0.01$), which means that the higher the level of technology-driven governance, the lower the agency conflicts are. Moreover, the integration of digital governance showed a positive association with the organizational performance ($r = 0.58$, $p < 0.01$), indicating that the use of technology is related to efficiency, transparency, and a better stakeholder confidence. The organizational performance was negatively correlated with agency issues ($r = -0.61$, $p < 0.01$), which implies that the unresolved agency issues decrease the overall effectiveness of the firm. Table 2 summarizes these correlations.

Table 2: Correlation Matrix

Variable	1	2	3
Digital governance Adoption	1		
Agency problems	-0.64*	1	
Organizational performance	0.58**	-0.61**	1

Note: p < 0.01.

These findings indicate that digital governance systems do not only diminish the agency issues but also improve performance outcomes. The correlations are strong, which means that the adoption of technology is one of the most important predictors of the efficiency of organizations and their ethical adherence.

Structural Equation modeling (SEM).

In an attempt to test the relationships that were hypothesized, Structural Equation Modeling (SEM) was used with AMOS 24. The model has evaluated the direct impact of the adoption of digital governance on agency problems and the indirect impact on organizational performance. The results of the S.E.M. choice show that the adoption of digital governance has a strong negative impact on agency problems ($b = -0.65$, $p < 0.001$) and a positive effect on the performance of the organization ($b = 0.53$, $p < 0.001$). Moreover, the agency issues mediate the association between governance adoption and performance in a negative way ($b = -0.42$, $p < 0.001$) and, thus, the mitigation of agency wrangles leads to improved organizational performance.

The structural model was robust since the model fit indices indicated a good fit: CFI = 0.95, TLI = 0.94, RMSEA = 0.051, kh2/df = 2.01. These results confirm the conceptual framework, which states that digital governance mechanisms are effective towards attempting to minimize agency problems and enhance the overall performance of firms.

Critical Results by the Digital Governance Mechanism.

Enterprise Resource Planning (ERP) Systems: The respondents said that ERP systems are common in order to amalgamate financial, operational and management processes. The real-time dashboards and automated reporting make it possible to monitor managerial activities continuously, which diminishes the possibility of misreporting or being opportunistic (Aier et al., 2011; Chen et al., 2019). According to the SEM outcomes, the ERP implementation has been found to have the most adverse effect on agency problems compared to any other digital tool ($b = -0.42$, $p = 0.001$).

Blockchain Technology: Blockchain and distributed ledger technologies guarantee the maintainability and incomposability of records and law enforcement of contracts. Companies that embraced blockchain also said they experienced greater trust between the management team and the shareholders as the verification of transactions became more transparent (Bertomeu et al., 2018; Li et al., 2020). The use of blockchains was positively related to the performance of the organization ($r = 0.51$, $p < 0.01$), which confirms its efficiency in decreasing the asymmetry of information.

Online Dashboards, Alerts, and Digital Reporting: Digital reporting systems, dashboards and automated alerts were effective to offer real time insights to shareholders and boards. These applications minimize the information flow delays, enhance the compliance tracking, and facilitate the preventive action in managerial opportunism instances (Alzoubi, 2021; Zhang et al., 2019). It can also be seen that the combination of the efficiency and transparency, as reported by organizations using such tools, was higher, which proves their practical applicability.

Findings

In general, the discussion shows that the adoption of digital governance has a considerable negative impact on agency problems and enhances the performance of the organization. All of them, ERP systems, blockchain technologies, and digital reporting platforms contribute to more transparency, accountability, and control. Both the correlation and SEM reports show that there exists strong negative relations between the governance adoption and the agency conflicts, and positive relations with performance measures. Although faced with some issues, which include integration costs, cybersecurity threats, and employee resistance, the results indicate that digital governance arrangements are very effective in curbing principal-agent conflicting, as well as, positive corporate performance in both emerging and established markets.

Discussion

The results of this paper point to the fact that digital governance systems contribute to a large extent to solving the agency problems within organizations. According to the descriptive analysis, the respondents see the high degree of adoption of digital tools like ERP systems, blockchain, and digital reporting platforms that allow real-time monitoring, transparency, and accountability (Aier et al., 2011; Chen et al., 2019). The results of correlation and SEM analyses proved the idea that the increased usage of these mechanisms is correlated with the decrease in agency costs and enhanced organizational performance. In particular, the negative association between the adoption of digital governance and the agency issue ($r = -0.64$, $p < 0.01$) highlights the effectiveness of technology in aligning the managerial behavior and the interests of shareholders (Bertomeu et al., 2018; Kim and Park, 2020).

ERP systems became especially effective and they combine organizational processes and allow monitoring the managerial activities centralized, which minimizes the possibilities of opportunistic behavior and mistakes (Liao, Lu, and Wang, 2019). The technology of blockchain increased the level of transparency, as it was not possible to falsify information since it allows recording transactions with impossibility of alteration (Li, Zhang, and Wang, 2020). Digital monitoring and reporting systems also eliminate information asymmetry since they leave timely information on performance to the decision-makers to support ethical compliance and informed governance (Alzoubi, 2021; Zhang, Li, and Chen, 2019).

The paper also points out that the agency issues reduction partially mediates the positive influence of digital governance mechanisms on the organizational performance. That is, such mechanisms do not only directly enhance efficiency, transparency, and confidence of stakeholders but indirectly also enhance performance, since managerial opportunism is reduced (Singh, Sharma, and Kumar, 2020). Nevertheless, the issues of implementation costs, cybersecurity risks, and resistance on the organizational level were identified (Wang and Hu, 2020; Chen et al., 2019), which implies that the successful implementation can be achieved only through proper planning, training, and support by top management.

Conclusion

To sum up, the study in this paper has presented empirical findings that digital forms of governance can help minimize agency issues and improve organizational outcomes. ERP systems, blockchain, and digital reporting tools make it possible to keep an eye on the managerial behavior of organizations, enhance transparency, and adhere to corporate policies. The negative correlation between the implementation of governance and agency conflicts and the positive role of governance in the performance will indicate that digital technologies play a critical role in the modern corporate governance. The findings support the agency theory, which explicates that technology can make sure that the distance between the principals and the agents is reduced and the cost incurred relating to information asymmetry and management opportunism minimised (Jensen and Meckling, 1976; Shleifer and Vishny, 1997).

In addition, the digital governance systems contribute towards ethical business governance and the establishment of stakeholder confidence. The implementation of such mechanisms by the organizations purports to be more efficient in their functioning, reduced errors and enhanced efficiency of the decisions (Bertomeu et al., 2018; Kim and Park, 2020). The study indicates the need to integrate technology based governance tools particularly in the new markets where the traditional controls may not work.

Recommendations

Based on the findings, one can provide a number of recommendations to the organizations that wish to reduce agency issues with the assistance of digital governance. First of all, businesses are suggested to invest in ERP and blockchain to store the data in one place, enhance the transparency, and automatize the compliance and reporting processes (Aier et al., 2011; Li et al., 2020). Second, the adoption of change management and training systems will be made to overcome the resistance toward the use of new technologies to ensure that managers and employees were informed about the benefits and usability of digital governance tools (Chen et al., 2019; Wang and Hu, 2020). Third, it is also advisable to use hybrid forms of governance in organizations, which are attainable through conventional board control and technology-driven monitoring to optimize corporate governance systems (Hermalin and Weisbach, 2012; Singh et al., 2020).

Also, companies must focus on cybersecurity and data privacy to decrease the risks of using digital platforms to protect sensitive data of corporations and stakeholders (Bertomeu et al., 2018; Li et al., 2020). Lastly, policymakers and regulators need to promote the implementation of digital governance systems, offering guidelines, incentives, and assistance to enable the integration of technology, especially in the new markets where the agency issue might be more prevalent.

Through such recommendations, organizations are likely to improve the principles of good governance, minimize the agency frictions, and improve the overall performance of the organization as an element of sustainable growth of corporations and trustworthiness of stakeholders.

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