The Practical Application of Theory in Accounting Research

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Abstract

As novice researchers or advanced graduate students embark on a research journey, they must not only understand the theory behind their research, but they must illustrate how the theory applies to the practical problems addressed in the research. Once a theory is created, it is tested through research, and subsequently modified, rejected, or accepted to interpret unknown phenomena or make observations about reality. This paper discusses the practical application of theory in research, explores a current view on a theory of interest within the accounting profession, and analyzes prior accounting literature to determine how the theory has been used within the discipline.

Keywords: agency theory, accounting theory, theory application, behavioral theory

1. Introduction

As novice researchers or advanced graduate students embark on a research journey, they must not only understand the theory behind their research, but they must illustrate how the theory applies to the practical problems addressed in the research. Once a theory is created, it is tested through research, and subsequently modified, rejected, or accepted to interpret unknown phenomena or make observations about reality. This paper discusses the practical application of theory in research, explores a current view on a theory of interest within the accounting profession, and analyzes prior accounting literature to determine how the theory has been used within the discipline.

2. Literature Review

When examining the literature concerning the relationship between theory and practice, several studies were identified. In his 1989 article, Van de Ven indicated that research should provide “intimate understanding” of problems within a profession. According to Van de Ven (1989), a central mission of scholars should be to design research which develops theory and advances practical knowledge within a discipline. Research skills should be strengthened so that good theory is developed which is relevant to both the discipline and the profession (Van de Ven, 1989).

In research by Corley and Gioia (2011) the importance of applying theory in scholarly work was emphasized. The authors explored what constitutes a theoretical contribution to practice by examining the requirements for publication in the Academy of Management Review, the discipline’s premier theory journal. Research solicited for inclusion in the journal emphasizes the advancement of knowledge, moves the field’s thinking forward, provides new connections, and explores the practical implications of those connections (Corley & Gioia, 2011).

Connolly (2008) also described the relationship between theory and practice in an article on analytical psychology training and education. According to Connolly (2008), there is a crisis in psychoanalytical education training models which is linked to the disconnect between how theory is taught and how it is applied in clinical practice. He argued that theory has evolved at a fast pace while practice remains static and unchanging. Lessening the gap will only be accomplished when students are taught to take a disciplined and intellectual attitude toward theory and shown how it is tested against observations from practice (Connolly, 2008).

In research by Sampson et al. (2014), the authors reviewed refereed articles in career counseling to determine what extent theory, research, and practice are integrated in the scholarly works. They suggested that the potential contribution of theory to practice is limited because some practitioners are not interested or are reluctant to alter current theory without outside pressure from clients. However, they explained how important maintaining a coherent and relevant professional literature is to achieving the profession’s goals of better understanding vocational behavior and delivering effective career interventions (Sampson et al., 2014).

Wacker's (1998) work on theory offered guidelines to researchers on theory building strategies in the operations management field. The author addressed a common criticism of theory which suggests that theory doesn't have to be applied. He asserted that for theory to be relevant it must address practical problems and build integrated knowledge about a phenomenon (Wacker, 1998). An excellent resource was provided by Schroeder, Clark and Cathey (2014) for examining the development of theory within the accounting discipline and its application to practice. According to their research, development of accounting theory is important because of the role accounting plays in our capitalistic society. As an information system, accounting is a behavioral science whose function is to communicate economic information and assist users in decision making (Schroeder et al., 2014).

The literature review also revealed numerous studies challenging the simplicity of mainstream agency theory in accounting research. A number of scholars advocated combining agency theory with other research perspectives as a way to strengthen its credibility. Research by Kaufman and Englander (2011), Lan and Heracleous (2010), Okhuysen and Bonardi (2011), and Van Puyvelde, Caers, DuBois and Jegers (2012) all suggested combining other theoretical approaches with agency theory to explain various agency relationships in the accounting discipline. Srivastava and Baag (2020) studied the relevance of positive accounting theory as an alternative to agency theory. According to the authors, although the theory is still not fully developed, it is making an important contribution to the accounting field. "Positive Theories attempt to clarify and foresee activities, for example, which accounting transactions firms will pick how firms will respond to recently proposed accounting standards" (Srivastava & Baag, 2020, pg. 102).

In their research, Cohen and Holder-Webb (2006) argued that research tools from the social sciences must be added to the physical science models when studying agency relationships and corporate behaviors. They suggested that agency theory dismisses the organizational and social dynamics of decision making in favor of mathematical measurement and analysis (Cohen & Holder-Webb, 2006). In a study by Wiseman, Cuevas-Rodriguez and Gomez-Mejia (2012), the authors discussed extending traditional agency theory toward a social theory of agency. They challenged critics of agency theory and indicated that its flexibility allows for numerous extensions of the traditional perspective to better understand principal-agent relations in a social context (Wiseman et al., 2012).

Rebitzer and Taylor (2011) also expanded the sociological foundation of agency theory by including a behavioral approach to the classic model. They argued that social preferences are important in analyzing agency problems because they provide an explanation for the reference points and norms agents use to assess their work effort, pay, and ultimately, their happiness (Rebitzer & Taylor, 2011). In an article by Pepper and Gore (2015), the authors proposed a version of agency theory they called behavioral agency theory. The authors argued that the micro-foundations of agency theory are too simplistic and underestimate motivation in the principal-agent relationship. Pepper and Gore (2015) indicated that a set model for behavioral agency theory still does not exist. However, their literature pointed to a number of studies which have utilized some form of a behavioral agency model (Finkelstein, Hambrick & Cannella, 2009; Rebitzer & Taylor, 2011; Sanders & Carpenter, 2003; as cited in Pepper & Gore, 2015).

Five recent accounting research studies were also identified in the literature review which expanded traditional agency theory by utilizing a behavioral framework. A study by Alessandri and Pattit (2014) used a combination of agency theory and behavioral theory to provide an understanding of the drivers influencing firm-level research and development (R & D) investments. Their behavioral agency model was used to provide a more complete understanding of the drivers of innovation activity within a firm. The study examined the relationship between behavioral theory variables, managerial incentives, and R & D investment (Alessandri & Pattit, 2014).

Martin, Washburn, Makri, and Gomez-Mejia (2015) also utilized a form of the behavioral agency model in their study examining CEO's perceptions of organizational efficacy. The authors defined organizational efficacy as the successful execution of required behavior within a firm. They used behavioral agency theory to examine and predict the relationship between CEO's investment strategies, risk behavior, related decision-making outcomes, and their perceptions of firm efficacy. The scholarly article provided both theoretical and practical insights into CEO perceptions of firm efficacy and its impact on risk bearing performance outcomes as well as the way CEO compensation influences executive risk taking and firm performance (Martin, et al., 2015).

Agency theory and behavioral theory were combined in a study by Kim and Bettis (2014) to examine the strategic advantages of holding cash in the asset portfolios of U.S. firms. The general criticism of holding large amounts of cash is that firms are not using it to maximize shareholder wealth. In other words, shareholders' best interests are not served when excess cash is held instead of using it to fund investments or pay dividends. Kim and Bettis (2014) challenged that criticism in their study and offered alternative hypotheses which indicated that excess cash can be used as a valuable strategic asset.

Zona, Minoja and Coda (2013) conducted a study using a behavioral agency model to examine the role financial slack plays in enhancing corporate investments in times of economic hardship. By combining insights from agency and prospect theories, Zona et al. (2013) explored how slack and other organizational characteristics shape an executive's proclivity towards innovative investment. In addition, the study examined the role a company's board of directors can play in shaping executive risk preferences during times of global crisis (Zona et al. 2013).

The literature review also revealed an interesting study utilizing a behavioral agency framework to examine the dynamics of family-operated firms. In their study, Le Breton-Miller, Miller and Bares (2015) explored the governance structure and entrepreneurial tendencies in large, publicly held family firms where issues of agency and opportunistic behavior are most relevant. The authors also compared the conceptual conflicts which exist among the literature regarding family firm conduct and entrepreneurial behavior from perspectives using agency, behavioral agency, and resource-based views (Le Breton-Miller et al., 2015).

3. Discussion/Findings

Several perspectives on the relationship between theory and practice were explored in the literature review. A central theme which emerged among scholars was that the goal of effective theory development should be the advancement of practical knowledge within a given discipline. Following is a discussion of the way theory and practice should be integrated in scholarly work. In addition, based on the literature review, combining aspects of agency and behavioral theories into a behavioral agency framework is proposed as a way to strengthen the application of the theory in accounting research. Five recent studies utilizing such a framework are also identified and evaluated in terms of their practical application to the discipline.

3.1 Relationship between Theory and Practice

Scholarly research should be designed in order to develop theory, provide new connections, and move a field's thinking forward by advancing practical knowledge (Corley & Gioia, 2011; Van de Ven, 1989). Theory is abstract and must be conceptualized in order to rationalize, explain, and master (Popper, 1959; as cited in Connolly, 2008). Practice, on the other hand, aims to realize something concrete from the examination of theory (Connolly, 2008). For example, in career counseling, theory provides the foundation for intervention methods and can be used to simplify complex processes into easily understood and applied concepts (Sampson et al., 2014). When practitioners work with their clients, they integrate formal theories into their intervention methods. Typically, the design of intervention is based on multiple theory-based concepts and can be refined as new theory is developed (Sampson et al., 2014).

Theory must inform research in a way that extends its practical application. Theory informs practice by providing a framework for analysis of a problem, structure when differences of opinion exist, and clear explanations for the pragmatic world. According to Wacker (1998), mature theory provides insight into professional powers and limitations by guiding research toward crucial questions and advancing knowledge in a scientific discipline. As suggested by Stam (2010), good theory provides an intimate understanding of a genuine problem, articulated in a way that provides explanatory leverage, describes innovative features, or provides predictive utility.

Corley and Gioia (2011) argue that for theory to make a value-added contribution, it must be useful. In other words, theory must have the potential to improve the managerial practice of practitioners or improve the research practice of scholars. The central mission of theory is to contribute knowledge to a scientific discipline and apply that knowledge to the practices of the organization (Corley & Gioia, 2011). According to Sampson et al. (2014), in the career counseling profession, theory guides research by formulating research questions, creating construct measurements, and through the interpretation of findings. Theory informs practice by helping professionals understand individual problems and by providing a basis for creating appropriate interventions. Integration of research, theory, and practice is crucial to the profession and will enhance not only the understanding of vocational behavior but the effectiveness of career interventions (Sampson et al., 2014).

Often a disconnect exists between theory and practice. Connolly's (2008) research points to a gap that exists between theory and practice and emphasizes the role education plays in lessening that gap. Students should be taught to reflect on the similarities and differences of theoretical approaches within their discipline and how theories should be used in practice. Connolly (2008) posits that no one theoretical paradigm will ever be appropriate in all instances. It is important that students are encouraged to maintain a healthy and critical attitude toward the practical application of theory. As suggested by Wacker (1998), "practice without theory can quickly become a dull and dangerous occupation" (p. 361).

3.2 Theories of Interest in Accounting

Although agency theory has been used frequently in accounting literature, there are several drawbacks to the mainstream theory which have been addressed in recent years. A number of scholars have recommended combining agency theory with other theories to strengthen its credibility as a viable empirical research theory.

Srivastava and Baag (2020) suggest combining both descriptive and normative theories to make market predictions. To that end, positive accounting theory can be used to focus on a firms choice of accounting techniques and regulatory development. They also suggest the need for developing new theories and blending them with positive accounting theory as a way to advance predictive ability in the dynamic business world. Lan and Heracleous (2010) argue that reformulations of agency theory can inform further theorization by generating insights and developing novel hypotheses that can be empirically tested in new directions. According to Van Puyvelde et al. (2012), combining agency theory with various aspects of stewardship and stakeholder theory provides a more comprehensive principal-agent framework. Okhuysen and Bonardi (2011) also suggest “combining lenses” from multiple theoretical approaches to develop a richer understanding of the explanation of phenomena in an agency relationship. In their view, using insights from various theories based on a multiple-lens perspective provides opportunities to explore more complex phenomena than would be possible with a single theoretical agency approach.

An appropriate theory of interest in accounting which departs from the traditional agency-based framework is one which combines perspectives of both agency and behavioral theory. According to Pepper and Gore (2015), behavioral agency theory provides a better connection between agent and firm performance and shareholder interests. The theory expands on an argument by Wiseman and Gomez-Mejia (as cited in Pepper & Gore, 2015) to incorporate prospect theory into the assumptions of agency theory. In behavioral agency theory the interests of shareholders and agents are assumed to align when executives are motivated to perform given their available opportunities (Pepper & Gore, 2015).

Although no set model for behavioral agency theory exists, numerous studies have pointed to the need of examining behavioral characteristics in the neoclassical economic principal-agent relationship (Cohen & Holder-Webb, 2006; Kaufman & Englander, 2011; Wiseman et al., 2012). Recent advances in behavioral research have suggested that economic agents have a bounded self-interest that has not been addressed in the traditional agent model (Kaufman & Englander, 2011). In its basic form, the traditional model supports an idea that agents are motivated only by extrinsic rewards (Rebitzer & Taylor, 2011). Adding a behavioral perspective allows for an examination of human intentionality, or how behavior is influenced by an individual’s consciousness. Intentionality is often dismissed in the traditional agency framework which considers behavior a function of one’s external environment (Cohen & Holder-Webb, 2006). Behavioral agency theory proposes a more realistic set of behavioral assumptions. The theory puts agent performance at the center of its model and “better explains the mechanisms that connect incentives, agent behavior, and the type of high-performance outcomes that shareholders desire” (Pepper & Gore, 2015, p. 1063).

3.3 Application of Current Theory in Accounting Literature

Alessandri & Pattit (2014) used a behavioral agency model in their study by combining agency and behavioral theory perspectives to examine the drivers influencing firm-level R & D investments. According to the authors, behavioral theory asserts that a firm’s risk-taking actions and decision-making processes are determined by its organizational routines and operating procedures; whereas agency theory suggests that those decisions are motivated by managerial incentives and stakeholder interests. Alessandri and Pattit (2014) obtained data from 573 publicly traded companies in their study to determine if behavioral theory variables and R & D investments were moderated by managerial incentives such as managerial stock ownership and option pay. Behavioral factors considered included organizational slack, threat of bankruptcy, and firm performance relative to aspirations and the resulting attainment discrepancy. Results indicated very strong relationships between behavioral theory constructs, managerial incentives and R & D expenditures. The study by Alessandri and Pattit (2014) highlights the importance of using multiple theoretical perspectives to examine complex financial decisions and provides support for the use of a behavioral agency model as a way to examine the risk-taking actions of corporations such as investing in R & D.

A behavioral agency model was also used by Martin et al. (2015) in their study examining the influence agent (CEO) perceptions of firm efficacy have on risk bearing activities and resulting performance outcomes for a firm. The article advances previous research studies which have suggested that agency costs are increased in companies whose executives fail to pursue high-risk projects because of their inferior investment choices and associated suboptimal performance outcomes. Those studies indicate that executive compensation packages cause risk aversion among executives leading them to adopt more conservative strategic investment choices which negatively influence investment performances (Coffee, 1998; Jensen & Meckling, 1976; as cited in Martin et al., 2015).

In their study, Martin et al. (2015) extended classic agency theory by drawing on a behavioral agency model to examine the contingency effect of perceived firm efficacy. They argued that a CEO's perception of firm efficacy will positively moderate the relationship between the risk bearing activities they choose and resulting performance outcomes. Martin et al. (2015) obtained data from 297 publicly traded technology firms to support their findings. Results suggested that CEOs who perceive high firm efficacy are confident in the capability of a firm (e.g., high firm efficacy) and will take more risk to enhance performance outcomes. Findings from the study also indicated that the effect of equity-based pay on performance outcomes is not only a function of an executive's risk aversion created from his compensation package, but by his perception of firm efficacy. Previous literature focused solely on the relationship between equity-based pay and an agent's risk aversion but did not consider the effect of perceived firm efficacy on risk behavior and investment decision-making. This study makes important contributions to practice by combining the two theoretical perspectives and providing direction to agency scholars and practitioners seeking to understand the effect of executive pay on decision making and firm performance, and how it can be regulated.

In a study utilizing a combination of both agency and behavioral theories, Kim and Bettis (2014) examined the potential advantages of holding more cash than necessary to meet a firm's transactional needs. The scholarly literature on holding excess cash has resulted in conflicting notions. Traditionally, economics-based literature based on agency theory has criticized firms for holding more cash than needed, pointing to an increase in opportunity costs resulting from the cash accumulation policy (Jensen, 1986, 1989; Fama, 1980; Leibenstein, 1966; as cited in Kim & Bettis, 2014). However, more recent behavioral based research has identified strategic benefits of holding large amounts of cash (George, 2005; O'Brien & Folta, 2009; as cited in Kim & Bettis, 2014). Kim and Bettis (2014) combined the two theoretical perspectives in their study to hypothesize and test returns to cash and firm performance using a database of over 63,000 firm-year observations in U.S. publicly held firms. Evidence from their study ran counter to the criticism that cash accumulation stifles shareholder wealth. In fact, study results showed that high levels of cash holdings provided substantial benefits for shareholders. The study provides important practical implications for managers and investors when deciding on or evaluating a firm's cash accumulation policy.

An empirical study conducted by Zona et al. (2013) also combined perspectives of agency theory and prospect theory to examine executive decision-making and corporate investing during a time of major economic downturn. The study used a behavioral agency model to examine the role financial slack and other organizational characteristics play in enhancing corporate investments in times of economic hardship. Financial slack refers to a company's pool of resources which are in excess of the minimum they need to operate at a given production level. The sample for the study was taken from Dun & Bradstreet's list of the 1000 largest Italian manufacturing firms during spring of 2009, which was six months after a major economic downturn. An 11% response rate was achieved, which was in line with previous studies targeting company executives (Pettigrew, 1992; as cited in Zona et al., 2013).

Several hypotheses were formulated in Zona et al.'s (2013) study. The authors predicted that the availability of slack resources enhances corporate investments during times of hardship, and that a company's performance history prior to an economic crisis positively moderates the association between financial slack and innovative investment. The study also examined the board of directors' role and how it affects an executive's investment strategy. Specifically, the study considered two board performance management devices: setting difficult targets and behavioral valuation criteria. Zona et al. (2013) hypothesized that a positive relationship exists between a board's setting of difficult targets and an executive's proclivity toward innovative investment, especially with large amounts of slack resources. The authors also predicted that when a board sets behavioral valuation criteria, it creates a condition of uncertainty for a CEO which leads to an unwillingness to take risks. Results of the study provided support for the aforementioned hypothesized effects. Extant literature exists concerning managerial risk preferences, but is typically conducted under conditions of economic stability. The article by Zona et al. (2013) makes important contributions to practice by extending current research to examine how firms respond to global crisis with innovation investment. By examining the way slack resources and organizational characteristics shape investment practices in times of economic trouble, the study adds to the current body of knowledge within the discipline.

In another study, Le Breton-Miller et al. (2015) used behavioral agency theory to explore the governance conditions under which family firms engage in entrepreneurial activities. The authors suggested that there are three theories used most often in the literature when examining family firm conduct: agency theory, behavioral agency theory, and resource-based theory; and that there are conceptual conflicts regarding the application of each one. Le Breton-Miller et al. (2015) compared and contrasted the differences of each theory, including how each is used to argue for and against entrepreneurship in family firms. From a behavioral agency perspective, the theory on family firm entrepreneurship can be conflicting. Some scholars suggest that entrepreneurial behavior is strained in family firms because their business owners are conservative, risk averse, and try to preserve what they have (Block, 2012, Wiseman & Gomez-Mejia, 1998; as cited in Le Breton-Miller et al., 2015). Others argue that family owners desire to pass on healthy businesses to their children, which provides an incentive for entrepreneurial behavior and risk taking (Miller & Le Breton-Miller, 2005, Miller et al., 2008, 2009; as cited in Le Breton-Miller et al., 2015).

In their research, Le Breton-Miller et al. (2015) suggested that it is the variation in family firm governance that determines which theory of entrepreneurial behavior applies. Accordingly, Le Breton-Miller et al. (2015) used the behavioral agency framework to predict the way governance arrangements in family-based businesses shape their entrepreneurial tendencies. Their proposition considered the structure of leadership roles in family-based businesses. For instance, are executive positions given exclusively to family members or does the company avoid nepotism by recruiting "outsiders" to fill the high-status jobs? Le Breton-Miller et al. (2015) determined that entrepreneurship varies inversely with a governance structure that favors a family pool of executives. The study provides an excellent example of how theory is applied in practice by exploring the contradictory views on entrepreneurship in family firms and offering propositions for reconciling the different perspectives.

4. Conclusion

This paper explored a number of views on the relationship between theory and practice and elaborated on the role effective theory development plays in the advancement of practical knowledge within a discipline. A theory of interest within accounting literature, behavioral agency theory, was identified and discussed. In addition, five research studies utilizing some form of a behavioral agency model were critically evaluated with respect to their development of theory and its application to practice. Each study applied theory in a way that informed practice and added to the current body of knowledge within the accounting discipline.

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