Resolving Principal–Agent Misalignment in Decentralized Corporate Governance: A Mechanism Design Approach to Incentive Contracting Under Asymmetric Information

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Abstract. Principal–agent misalignment remains a persistent structural inefficiency in decentralized corporate governance frameworks, particularly where information asymmetry between shareholders and executive management distorts incentive-compatible contracting. This study develops a mechanism design model integrating adverse selection constraints with moral hazard mitigation protocols to derive optimal incentive contracts in multi-tier organizational hierarchies. Employing a mixed-methods approach—combining axiomatic contract theory with empirical panel data from 214 publicly listed firms across OECD economies (2018–2023)—we identify governance configurations in which residual claimancy structures and performance-contingent compensation schedules converge toward Pareto-efficient equilibria. Our findings demonstrate that tiered vesting mechanisms coupled with board-level monitoring intensity significantly attenuate opportunistic managerial behavior. Policy implications for corporate governance reform and remuneration committee design are discussed.

Keywords: principal–agent theory, incentive-compatible contracting, asymmetric information, corporate governance mechanisms, mechanism design, moral hazard mitigation, adverse selection constraints, executive compensation structure, organizational hierarchy efficiency

Introduction

The structural tension between principals (shareholders and boards of directors) and agents (executive management) constitutes one of the most enduring and operationally consequential challenges in the discipline of business management and organizational economics. Rooted in the foundational agency theory articulated by Jensen and Meckling (1976), this tension has only intensified in the contemporary corporate landscape, where increasingly decentralized governance architectures, globalized capital markets, and complex multi-stakeholder accountability frameworks have amplified both the scope and consequences of information asymmetry. As of 2024–2026, the proliferation of ESG-linked compensation mandates, cross-jurisdictional regulatory divergence under frameworks such as the EU Corporate Sustainability Reporting Directive (CSRD) and the SEC's updated climate disclosure rules, and the growing prevalence of dispersed equity ownership structures have collectively introduced new vectors through which principal–agent misalignment manifests and propagates across organizational hierarchies. The practical stakes of unresolved agency conflicts are substantial. Empirical evidence consistently associates high degrees of managerial discretion under weak monitoring regimes with suboptimal capital allocation, earnings management, and value-destructive acquisition behavior—outcomes that erode long-term shareholder value and distort broader factor market efficiency. Despite decades of scholarly inquiry, existing governance prescriptions frequently fail to account for the endogenous interdependence between incentive contract design, board monitoring intensity, and residual information rents retained by executive agents. Standard remuneration models—particularly those relying on linear pay-for-performance sensitivities—are demonstrably inadequate in environments characterized by multi-dimensional effort and non-verifiable output quality. This paper addresses these gaps by deploying a formal mechanism design framework to derive incentive-compatible contracts that simultaneously bind adverse selection and moral hazard constraints within decentralized governance structures. Unlike prior approaches that treat these constraints independently, our model operationalizes their joint binding conditions, yielding contract schedules that are robust to strategic manipulation by informed agents. The empirical component benchmarks theoretical predictions against panel data drawn from 214 OECD-listed corporations, enabling a rigorous test of the model's predictive validity across heterogeneous governance environments. The remainder of this article is structured as follows. Section 2 reviews the extant literature on agency theory, mechanism design, and incentive contracting, identifying critical theoretical lacunae. Section 3 presents the formal model, including the derivation of optimal contract schedules under joint adverse selection and moral hazard constraints. Section 4 describes the data sources, variable operationalization, and econometric strategy employed in the empirical analysis. Section 5 reports and interprets the empirical findings in relation to theoretical predictions. Section 6 discusses policy implications for remuneration committee design and corporate governance reform. Section 7 concludes with directions for future research.

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