

The Agency Theory

This is where a 'PRINCIPAL' employs an 'AGENT' to perform a task on their behalf (E.g. Shareholder employs a Director to run the company).

This can lead to Agency problems

The number 1 objective of a shareholder should be to 'Maximise Shareholder wealth'.

However, the Directors will also have their own personal objective of improving their own position in terms of pay, BONUSES and STATUS.

Another problem is Information ASYMMETRY, i.e. the Directors have all of the information and the shareholders only receive the information which the Directors provide.

Directors can MANIPULATE information to make the company and themselves better, for example putting a sale through for the reporting financial year when it has not gone through as a sale yet.

The CONFLICTING OBJECTIVES gives rise to the need for an independent third party → The Auditor, to provide reassurance to the Principal that the Agent is properly performing their FIDUCIARY DUTY as stewards of the company.

Fiduciary Duty - A fiduciary duty is a legal duty to act solely in another party's interests. Parties owing this duty are called fiduciaries. The individuals to whom they owe a duty are called principals.

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