**EFFECTIVE FINANCIAL MANAGEMENT**

**Learning Outcome 1: ACTIVITY 2**

**Agency theory and wealth maximisation**

A business can be viewed as an investment agency: its role is to acquire (also known as ‘raise’) finance and to then spend (also known as ‘invest’) that finance to generate a profit. Managers control the business on behalf of shareholders and should make decisions that maximise shareholder wealth.

In a capitalist system, shareholders are considered to be of paramount importance. They provide funds to businesses in return for ownership rights. A key idea underpins modern financial management: the primary objective of a business is to maximise the wealth of its shareholders.

However, businesses do not exist in isolation from the contexts in which they operate. Whilst wealth maximisation remains the primary objective of business, there is a need to take account of a range of other factors. The objectives of financial management include the need to balance wealth maximisation with these factors.

#### Required: In small groups

Identify a business with which you are familiar. This could be a multinational company from which you have purchased goods/services, a business that owns your favourite brand or the business for which you work (or wish to work in the future).

From your research:

1. Explain the concept of a business as an investment agency.
2. Explain the nature of the ‘agency problem’.
3. Discuss the paramount importance of shareholders in a capitalist system.
4. Explain the ‘other factors’ that businesses need to take account of as well as wealth maximization.
5. Prepare a short presentation on your findings.