**EFFECTIVE FINANCIAL MANAGEMENT**

**Learning Outcome 1: ACTIVITY 7**

**The agency problem**

For larger businesses, there is often a separation between the owners or shareholders (the principals) and the managers (the agents). An agency problem can occur when the managers of a business make decisions that are not consistent with the primary objective.

#### 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. Identify the three factors that contribute to the existence of the agency problem in most businesses.
2. Explain the factors that might contribute to the agency problem in your chosen business.
3. Discuss the effects of the agency problem in your chosen business.
4. Discuss the agency problem that is particular importance to financial management.
5. Explain how restrictive covenants might be used to address the problem that you identified in (4).
6. Prepare a short presentation on your findings.