

Agency Problem (Historical development of modern business)

First phase of developing modern corporations

The main driver for the first phase of development was new transportation technologies.

1. Railways – this caused major construction of rolling stock and infrastructure, which required large land acquisitions. By 1904 the top 10 British firms were all railway owners and operators.
2. Shipping (steam) – this was also capital intensive and resulted in the development of large firms.
3. Automobiles (20th Century) – by 1937 GM was the largest manufacturing firm in the world. This initial phase of development stimulated further industrial expansions.

Second Phase

At the start of the 20th Century due to changing demographics and ongoing scientific discoveries populations expanded rapidly. Populations became increasingly urbanised as skills and education increased. Households became increasingly wealthy and there was an increase in demand for consumerism. Increase in demand for:

- Consumer products – housing, food, clothing, cars
- Consumer services – utilities, gas, water, post
- Finance/Banking – banks began to expand rapidly.

Firms grew in size and complexity.

Forms of control

Separation between ownership and control (agency problem)

- Internal developments of legal incorporation and organisation structures.

Problem of Agency

Previously owners carried unlimited personal liability for debts incurred whilst trading. This brought about the establishment of a separate legal entity for the firm, known as limited liability. This also allows public trading of shares in the firm. Many questions were raised regarding the encouragement of misinformation.

- Economic imperative – need to attract greater investment for expansion
- Moral imperative - importance of holding owners and management responsible for their actions.

In business the economic imperative always wins out. Initial skeptics of limited liability were buried beneath a tide of optimism.

Examples of Agency Problem

1. Ernest Hooley – paid journalists to write favourable articles about his enterprise. Enhanced personal reputation through charity work and social connections. Bankrupted four times and is classed as a serial fraudster. This is an example of a company misleading investors and public.

2. Charles Ponzi – originator of Ponzi style pyramid schemes. He promises high returns for existing investors, which were paid for by contributions by new investors. In downturns this scheme becomes ineffective.

Organisational Structure and Principal – Agent Problem

How to motivate professional managers (agents) to pursue best interests of the shareholders (principles) rather than own interests. Also, how to prevent fraud and laziness at the expense of shareholders.

Internal Control Measures

1. Use of information systems to monitor managers
2. Incentive Structures (salaries etc.)
3. Build positive corporate culture
4. Good selection of managers.

External Control Measures

1. Formal reporting requirements (e.g. annual statements)
2. Independent board oversight
3. Critical independent press
4. Takeover market
5. Public regulators (ACCC, ASIC)
6. Industry associations

Example of corporate failure

Alan Bond who started as a sign writer and property transactions in WA made him millions. He was a businessman of the year in 1978 however was bankrupt by 1992 and jailed in 1993 for deception and fraud. This failure has an example of the failure of current accounting and reporting standards in protecting investors. Bond also made close relationships with key banking figures who failed to maintain prudential standards. Most business failures are a result of a lack of morality and ethics.

Corporate Leadership

Characteristics of leadership

Leadership involves followers or subordinates. It involves an unequal distribution of power among leaders and other group members. It suggests that leaders are able to influence and direct their followers.

Leadership and management

Leadership is an important trait of a good manager. It is important for leaders to be responsible, charismatic, situational and transactional.

Charismatic leadership

Charisma is a form of interpersonal attraction that inspires support and acceptance. It allows for vision and the energising of others. This trait is attributed to successful leaders

