How does Principal-Principal Agency Cost affect small family-owned businesses?

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Abstract

This study uses agency theory to examine the relationship between the majority and the minority shareholders in an effort to better understand the principal-principal agency cost as it relates to family businesses. The issues of safeguarding the minority owner's rights and the monitoring of the owner/manager's decisions will play a central role in the discussion of principal-principal agency cost.

The owner/manager is likely to be in a position to exploit information asymmetry to pursue their own agenda, which may include among others, nepotistic altruism, excessive compensation, tunneling and expropriation of funds. Agency theory discussions relating to smaller family businesses tend to assert that as owners and managers are the same there is little likelihood of the principal-agent form of agency cost. While this may be true the topic of PP agency cost has not been adequately explored.

A literature covering large family businesses, like those that pervade Asia, provides theoretical and empirical based agency theory analyses dealing with principal-principal agency cost. An examination of how principal-principal agency cost affects the governance of smaller family businesses builds upon this conceptual base.

This study comprises a literature review that will have an evaluative focus in appraising the quality, breadth and depth of the existing principal-principal agency cost literature relating it to the issues of principal-principal agency cost in small family businesses. By reviewing the literature surrounding the valuation of risk and small family businesses, this study identifies methods which can be used to effectively evaluate the risk associated with investments made into small family owned businesses.

Methods identified can be used to remove the temptation to obscure information and will lead to an increase in sound, ethical business practices. The identification and evaluation of the principal-principal agency costs surrounding small family business will affect the stewardship and governance of the business, especially with regards to the mitigation of the agency cost associated with the firm. The monitoring of the risk arising from the agency relationship between principal and principal will facilitate a more equitable intergenerational transfer of succession and fair representation of the minority investor.