

The Analysis of Agency Theory: A Research for Shuozhou Coal Economy Development

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Abstract: *agency theory was presented by Jensen and Meckling in 1976. Agency theory mainly involves the contractual relationship between the provider of the enterprise resource and the user of the resource. Agency theory is developing from the researching of internal information asymmetry and incentive problems. According to agency theory, the owner of the economic resource is the principal, the manager who is responsible for the use and control of these resources is the agent. And the central task of the agency theory is to study how the client of can design the optimal contract incentive agent under the conflict of interest and information asymmetry. While if the interests of principal and agent are not exactly the same, the principal in the information disadvantage and can not entirely on the agent supervision, the agent has the motive for their own interests, and makes damage to the principal, it will result in the agent problem. This paper combs the related theory of agency theory firstly, and then combines the case to analyze the relative theories, and finally suggest recommendations as to how the issues should be addressed.*

Keywords: *agent theory, principal-agent theory, information asymmetry, conflict of interests, ethic issue, sustainable development*

1. Introduction

Great changes have taken place in China's economy since the reform and opening 30 years ago. In every country in the world, middle and small sized enterprises become a vital economic force in the country it located in. With the development of social economy, the number of middle and small sized enterprises in China also increased. The economy growth rate of China keeps about 8 percent, while the economy growth rate for middle and small sized enterprises is more than 30 percent. However, with the number of managers and shareholders increased, there are more potential conflicts between principal and agent, for the direct reason the separation of ownership and control, the essence of the problem lies in the information asymmetry.

2. An overview of agency theory

The control of modern enterprises is relatively scattered, the owner of the enterprise could not be entirely involved in the business management, which causes the separation of ownership and management. The shareholders are the real owner of the company; they attach the actual occupation, usage and disposition of the enterprise property to the "agent". Agency theory exists in different industries, international business trading, insurance, law, etc. For example, the agent in international business, according to the agent agreement, the exporting party entrust the goods to the agent to sell to the third party, or sign a contract, to achieve or expand the purpose of the export of a foreign trade business.

Due to the different conditions of the agency relationship between two sides, they have different purposes, so the goals will also have different kinds of conflicts. The agency theory also point that the agent acquires more information than the principal. This information asymmetry cause the impacts for principal to monitor whether agents is properly serve for their interest. After signing the agency agreement, both principal and agent want to maximize self interest; however, agent will seek motivations and use all possible opportunities to enrich themselves, and some of these actions will damage to the interest for principal.

Agency theory targets to resolve two main problems that occur in agent relationships. The first agent problem occurred when there are different goals and cause conflict between principal and agent;

or it is difficult and expensive for principal to verify what the agent actually do, which also means that the principal could not verify whether agent has behaved properly. The second agent problem is about risk sharing when principal and agent have different attitudes towards risk. Because the different risk preferences, principals and agent might have different actions. In a word, agency theory is relationships which reflect a principal and an agent cooperative behavior with different goals and different attitudes towards risks (Citeseerx, 1989).

3. Conflicts in Shuozhou coal economy

Shuozhou is a coal-based new industrial city, which is also a typical resource city. The coal industry is the pillar industry of Shuozhou. Relying on the abundant coal resources and superior transportation conditions, some of the local coal industries got rapidly developed in Shuozhou city. However, for the coal industry, state-owned resources management departments and coal enterprises (or private coal owners) represent different parts with different interests; they play a role of the principal and agent respectively, the information asymmetry also existed in. As principal, state-owned resources management departments face the utilization of adverse selection and moral hazard. As agent, coal enterprises are in the information advantage position, but state-owned resources management department is in the disadvantage position. Whether the firm will fulfill its agency obligations depends on its subjective intent and economic strength. Under the separation of ownership and management right, for the individual maximize benefit; coal enterprises always tent to reduce the input of their own elements or taking opportunistic behavior to influence trading. So, it increase the transaction cost for state-owned resources management department, result in moral hazard and waste of state-owned coal resources.

Firstly, the low-level production and predatory operation of coal enterprises caused the seriously resource wasting. The sustainable development gets limitation and affects the long-term development for regional economy. Secondly, driven by the immediate interest, the ecological environment has been damaged, which seriously affects the economic development. Thirdly, because of the overproduction by enterprises, there are more and more safety accidents. The coal economy always troubled in the production accidents. Next, the coal production structure is unreasonable, low utilization rate is the main bottleneck affect the coal economy development, which direct result in the low create profitability and the ability to reduce market risks. The gray consumptions are flocked by rich private, which also influence the development. The last one is the policy expectation. The adjustment for coal policy and increasing credit risk result in the enterprises get into a development weak. Under the market regulation and sustainable development, this agency problem is really tricky.

4. Relative accounting theories to the agency problem

There are several relevant accounting theories refer to the agency problem. From this agency problem, we know that the conflict interest existing between the state-owned resources management department (principal) and coal enterprises (agents).

The main theory is agency theory. For the principal, the goals are improving the capacity of land and resources, protecting major infrastructure construction, supporting key industrial development, promoting regional coordinated development and the construction of new urbanization. In addition, all of these goals are based on the sustainable development. However, the ownership and management rights are separated, state-owned resources management department could not monitor agents completely, and agents want to maximize their interests, so it is direct to against the principal. It results in agency costs, and the agency problem.

In addition, the issue also refers to information asymmetry. For it, the situation where there is imperfect knowledge, in particular it happens if a party has different and better information to another (Economixshelp, 2012). Coal enterprises are agents and could acquire more information that the principal does not have, which in the information advantage position, while state-owned resources management department in the disadvantage position. Accurate information is really important for the market and decision making. Once the market breaks the information balance, it will toward adverse selection, moral hazards and market failure. In this case, state-owned recourses management department has to face the problems. For adverse selection, it is because the asymmetry information resulted in market resources distorted allocation. For this case, the price of coal resource also get contorted, it breaks the balance of supply and demand, which influence the market efficiency.

Asymmetry information is the most common fact in the market, however, if do not build an effective mechanism, the market might be paralyzed. For the moral hazards, it is a situation that one party may get risks because the cost that could incur will not be felt by the party taking the risk. A moral hazard could happen when the actions of one party may change to the detriment of another after a financial transaction (Boundless, 2016).

5. Implications of the relevant theories that adopt IFRS

IFRS are a set of international accounting standards stating how particular types of transactions and other events should be reported in financial statement (Investopedia, 2017). For agency theory, it mainly refers to the IFRS 15. The objective of IFRS 15 is establish the principles that entities could apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer (Iasplus, 2017). After adopt IFRS, there are lots of implications on relevant theories. Because of the identification of principal is not always clear in the contract, so IFRS give a guide for two parties of the contract. IFRS 15 asks for more disclosure, such as the information about the contract with the customer, information on the cost of obtaining or fulfilling the contract, the decomposition information of the income, the adjustment of the contract balance, the information about the performance obligation, the information about the judgment to be used, etc. So, for agency theory, the IFRS will make the obligation clearer for both principal and agent, and it is easier for principal to monitor and oversight what agent do, whether they get improper interest, increase the efficiency of trading. The obvious advantage of IFRS 15 is disclosure. So for information asymmetry, adopting IFRS could not only improve the information environment but also increase the transparency and then decrease the phenomenon of information asymmetry.

6. Recommendations to issues

Establish an effective incentive restriction mechanism in the enterprises. Incentive restriction mechanism could show the expectation of the principal, and improve the efficiency of the coal market. Strengthen the incentive for agents, curbing the potential misconduct of agent. So the possibility of moral hazard could get reduced.

Improve access condition of coal market, use the “exit right” to protect coal resources. Once the ownership find that the agents have compliance issues, they should terminate the cooperate relationship. If there are collusion between government and businessmen, the agent should dismiss from office, and be given criminal sanctions.

Make a coordinate development plan; improve the comprehensive competition of coal. Insisting the scientific development concept to strengthen policy guidance and industry management of the coal industry. Reasonable develop and utilize coal resources, developing circular economy and green coal economy. Using high technology to transform the traditional industry, taking a new road in industrialization.

Promote the listing of coal on the futures exchange. Because the price of coal is controlled by some people, so it is necessary to establish a national coal trading centre, which the coal trading price index is also issued by this trading centre. If the coal can be listed, it will greatly enhance the capacity of pricing and regulation for country. When engage in the international coal trading, it will easy to obtain the international market pricing and international trading initiative. Enhancing the international competitiveness of Chinese coal, slow down even avoid the impact of the international market on China’s coal industry.

Speed up financial innovation, develop coal finance. Firstly, strengthen the planning and management, develop a system of regulation on coal resource, actively explore the feasibility of securitization of coal exploration right and coal resources securitization. So it could enhance the support ability of coal resource and promote the rational development of coal resources. Secondly, establish coal venture capital mechanism, take finance instruments to avoid, transfer, and reduce the financial risks. Finally, support enterprises to issue short-term financing bonds, stocks and long-term bonds, to speed up to be listed, so narrow the imbalance of proportion of direct financing and indirect financing.

7. Conclusion

As the market competition is becoming increasingly fierce, solving agency problem is imperative. Under the agency problem and information asymmetry, the agent is easy to motivate to get self interest, so the adverse selection and moral hazard will exist. So it is necessary to establish an effective incentive and restriction mechanism. Overall, incentive and restriction mechanism is effective to restrict the principal and agent, and could be helpful to solve agency problem.

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