Question #1 of 11

Question ID: 1209421

Which of the following scenarios is *NOT* an example of a principal-agent problem?

A) Top management is awarded large amounts of executive stock options.

B) A senior manager also serves as a director on the board of another company.

C) A board member also serves as a consultant to the company.

Explanation

A senior manager may serve on the board of another company so long as there are no other circumstances that may compromise objectivity. For example, problems arise if the boards of two companies are "interlinked" by way of managers of Company A serving on the board of Company B, and managers of Company B serving on the board of Company A.

(Study Session 8, Module 22.1, LOS 22.a)

Related Material

SchweserNotes - Book 2

Question #2 of 11

Question ID: 1209417

Which of the following would be *least likely* to help control the principal-agent relationship (PAR) problem?

A) Increase the asymmetry of information between the owners of the firm and the employees.

B) Fire employees who misbehave.

C) Alter the behavior of executives through goal setting.

Explanation

Decreasing the asymmetry of information between the owners of the firm (principals) and executives (agents) would help to control the principal-agent relationship (PAR) problem. The PAR problem arises from the agents (executives / employees) having more information about the company than the principals (owners / shareholders) and misusing that information to the advantage of the agents at the expense of the firm or principals. The other two answer choices are methods for reducing the PAR problem by affecting the behavior of agents by setting goals and principles of behavior and removing agents who misbehave and violate ethics.

(Study Session 8, Module 22.1, LOS 22.a)

Related Material

SchweserNotes - Book 2

Question #3 of 11

Question ID: 1209424

The boards in a two-tier board of directors are *most likely* to be structured as a:

A) supervisory board and a management board.

B) external board and an internal board.

C) executive board and a non-executive board.

Explanation

A two-tier board of directors consists of a supervisory board that oversees a management board. A one-tier board consists of a single board of directors, composed of executive and non-executive directors (meaning, respectively, internal and external directors).

(Study Session 8, Module 22.2, LOS 22.b)

Related Material

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Question #4 of 11

Question ID: 1209423

CEO duality exists when the chief executive officer:

A) is simultaneously realistic and optimistic.

B) also serves as chairperson of the board.

C) also has a controlling interest in the firm.

Explanation

CEO duality exists when the chief executive officer also serves as chairperson of the board. CEO duality raises concerns that (relative to independent chairperson and CEO roles) the monitoring and oversight role of the board may be compromised.

(Study Session 8, Module 22.1, LOS 22.a)

Related Material

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Question #5 of 11

Question ID: 1209422

Which of the following *least accurately* describes one of the nontraditional "ESG" business factors that may be critical to a company's long-term sustainability?

A) governance risk exposures

B) environmental risk exposures

C) security risk exposures

Explanation

Environmental, social, and governance ("ESG") risk exposures are the nontraditional business factors that are now recognized as critical to a company's long-term sustainability.

(Study Session 8, Module 22.1, LOS 22.a)

Related Material

SchweserNotes - Book 2

Question #6 of 11

Question ID: 1209425

In the process of identifying and evaluating ESG-related risk exposures and investment opportunities, there is greatest consistency across companies in considerations related to:

A) social.

B) environmental.

C) corporate governance.

Explanation

Corporate governance considerations, for example the structure of the board of directors, have a tendency to to be relatively consistent across companies. In contrast, social considerations and environmental considerations often differ greatly.

(Study Session 8, Module 22.2, LOS 22.c)

Related Material

SchweserNotes - Book 2

Question #7 of 11

Question ID: 1209419

The principal-agent problem can *best* be described as:

A) the agent may act for the well-being of the principal rather than that of the stakeholders.

B) the agent may act for the well-being of management rather than that of the stakeholders.

C) the agent may act for his own well-being rather than that of the principal.

Explanation

In a principal-agent relationship, one party (the agent) acts on behalf of another party (the principal). A principal-agent problem arises when the agent places his own interests ahead of the principal.

(Study Session 8, Module 22.1, LOS 22.a)

Related Material

SchweserNotes - Book 2

Question #8 of 11

Question ID: 1209426

Regarding the process of evaluating ESG risk exposures and investment opportunities related to a company, it is *least likely* that ESG integration will be used in:

A) fixed-income analysis to identify upside opportunities.

B) equity analysis to identify downside risk.

C) fixed-income analysis to identify downside risk.

Explanation

In fixed-income analysis, ESG integration is generally focused on identifying downside risk. In equity analysis, ESG integration is used to both identify downside risks and potential opportunities.

(Study Session 8, Module 22.2, LOS 22.d)

Related Material

SchweserNotes - Book 2

Question #9 of 11

Question ID: 1209418

All of the following are examples of the principal-agent relationship (PAR) problem EXCEPT:

A) two members of a board of directors are having an illicit relationship.

B) a senior executive routinely leaves the office early claiming to work from home yet there is no accountability.

C) an employee calls in sick to use up their sick time since they cannot carry it over to the next year.

Explanation

The PAR problem is generally viewed as being between shareholders (principals) and company executives (agents) but any employee of the firm could be viewed as an agent and therefore contribute to the principal-agent problem if they act in their own best interests to the detriment of the firm. Examples of the PAR problem are:

- CEOs enjoying on-the-job consumption in the form of excessive corner offices or lavish travel that is passed off as a necessary business expense.
- CEOs manipulating the board of directors for excessive compensation packages which are not linked to company performance.
- Executives seeking status by expanding the business (empire building) through acquisitions that do not benefit the existing shareholders. Company size has been strongly linked to executive compensation.

(Study Session 8, Module 22.1, LOS 22.a)

Related Material

SchweserNotes - Book 2

Question #10 of 11

Question ID: 1209416

Which of the following *best* describes the principal–agent problem? An example of the principal–agent problem is when:

A) a board of directors take advantage of their position at the expense of the shareholders.

B) a lawyer recommends protracted legal proceedings to her client.

C) owners of the firm gain at the expense of the employees.

Explanation

Lawyers (the agent) are incentivized to recommend protracted legal proceedings to their clients (the principal) because this will generate income for the lawyer. The principal-agent relationship (PAR) arises when one group delegates decision making or control to another group. The PAR can create problems because the group receiving the power (the agent) generally has an asymmetric information advantage over the group making the delegation (the principal). The PAR problem begins if the agent uses the information advantage for their own best interests to the detriment of the interests of the principal. It is compounded as the asymmetric information makes it difficult for the principal to know enough to detect the problem and evaluate the agent's actions. Modern corporations are built on shareholders (principals) who delegate authority to run the business to executive officers of the company (agents). The board of directors are charged with overseeing the executives of the firm. It is possible for the board of directors to align themselves too closely with the executives of the firm thus contributing to the PAR problem.

(Study Session 8, Module 22.1, LOS 22.a)

Related Material

SchweserNotes - Book 2

Question #11 of 11

Question ID: 1209420

A principal-agent problem may exist between:

A) shareholders and directors. ✓

B) managers and directors. ✗

C) regulators and directors. ✗

Explanation

An agency relationship exists when an individual (the agent) acts on behalf of another individual (the principal). Such a relationship creates the potential for a principal-agent problem where the agent may act for his own well being rather than that of a principal. The key test of whether a principal-agent problem may exist is if one party is responsible for acting in the best interest of the other. Of the answer choices given, directors are responsible for acting in the best interests of shareholders.

(Study Session 8, Module 22.1, LOS 22.a)

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