

Advanced Management Accounting - Week 2

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October 2, 2025

1. Information asymmetry is present in a company where the manager knows more than director about the local business and the processes of the business. The information he has is not information the director can access costlessly. This causes issues as when the manager knows more than the director he may use this as leverage. It may be difficult to motivate him to do tasks and he will use his information asymmetry to further his self-interest. This means the director must employ tactics to motivate the agent. This is therefore a problem.

Adverse selection occurs where there is an ability of a person with more information than another to use the information to their advantage. The person with less information cannot easily identify what the other knows. When the agent and the principal are interacting the information asymmetry may lead to there being unfavourable outcomes for the principal due to the agent being able to use his advantage.

Moral hazard is when the agent does not have an incentive to work under what the principal has delegated as they do not suffer consequences from doing this. This means the relationship is not set up in a way that is favourable for the director. They have barriers to having the work they would like done to be completed and there isn't a recourse for them to follow in the given situation. This can obviously lead to there being situations where the agent acts against the interest of the director. He being free of consequence may make decisions that serve him before the principal.

Non-aligned self interest means that the agent's self-interest is not aligned with the directors goals. This puts a conflict of interest in the way of there being a fully cooperative relationship. It is a state that may exist when the relationship forms or at some point when the agent has some reason to take his self-interest over the directions of the principal.

Differences in risk perspective describes the different risk tolerances of directors and managers, with managers being more risk averse. Managers may lose their position given targets or goals not being met. This puts pressure on the agent and therefore makes him risk-averse. In pursuing his own self-interest this may often be in appearing as a worthy boss so that he is not blamed for shortcomings of the business.

Shirking is an action of the agent avoiding the tasks given to him by the principal.

Opportunism is the idea that managers will act in their own self-interest by taking advantage information asymmetries and lack of oversight.

2. Information asymmetry will exist in the business possibly due to distance, the director may have difficulty in keeping track of the business from afar and there may be possibilities of the agent to pursue his own interests.

Adverse selection may arise from the managers knowledge of the customer base. He may be giving discounts on credit to customers and long paybacks in order to meet his goals for contracts secured in the month. This is lowering shareholder wealth but acting in the interest of the the agent in that he is meeting targets that secure his position in the company.

The agent may commit moral hazard as he is secured from working the full-contracted hours he is due as the UK company cannot monitor his work. He may be able to concentrate his efforts on other ventures as the UK company can only send a agent in every fortnight to see how things are going. Due to his position in the company and a tight workforce he is able to use his time elsewhere.

The agent may want the company to perform more poorly some years for earnings smoothing so he can cast better forecasts in the future years. This will keep him seeming on a steady incline. He may therefore increase expenses and slash profits to fit his own non-aligned self-interest and image of security.

A risk averse manager may push against extending the opening hours as it will disgruntled the staff and put him in a worse position. The director though wants this as he sees the later opening hours as change to make sales due to some trading reason.

A manager may shirk being tasked with setting out forecasts for the next six months but this is ignored due to the current projections plan being more favourable to the agent. He may mask this or avoid it entirely.

The agent may opportunistically decide that given how he is situated there will be a better possibility of his success if he acts on his own will and knowledge rather than than follow orders from the director.

Conflicts of interest can be combatted with many incentives for the agent to put the wealth of shareholders before his own self-interest.

3. Agency theory assumes that actors will bend to self-interest is left unattended. This does not mean that they are necessarily dishonest or disloyal but there is a prevailing ethos of malignant actors in the world. This is clearly evidenced through many global issues and difficulties such as fraud and slavery. Yet it would be better to focus on the profile of management. It is easy to define management as someone of senior authority in a corporate setting. This is also something that you could put as in society as it is a job title in an institution. Managers serve an intermediary role between employees and those in senior authority. They occupy leadership positions and promote ethical behaviour. The levels of misbehaviour they display can be attributed to pressures. Therefore they may be deserving of their elevated status in society.

4. Monitoring may be a short term solution to reign in an unwieldy manager from bad conduct previously performed during their duties. This though may not be an optimal long-term strategy as it requires the deliberate effort of the agent without there being a positive-feedback loop. Remuneration is possibly better suited as a long-term guiding principle to coax the agent into performing with the company and not in their own self-interest.

5. The act of pleasing the senior authority figure who holds a position of responsibility for the manager is something that would be characterised by gaming and falsification of data. Earnings management would be an example of this. Management often use these techniques in order to either present themselves better or hide their true position. This links directly to agency theory and is an important area of study. It though is not wise to view these behaviours outside of common areas of study as they are prone to being misaligned with reality. This would mean it was not a topic best suited to strategic decisions, but could occupy large volumes of work against it.

6. There seems to be a distinct difference in alignment between the various stakeholders. This comes in part from customers and employees pushing for more carbon neutral alternatives, while businesses are not following this through enough. This might lead to government intervention who also seem to be, as the consumers, looking for carbon-neutral performance. The buyers, suppliers and lenders in the market are distinct from the customers, employees and government. This presents a schism in the market, where there are opposing forces for and against carbon-neutrality. With this at play it will mean businesses must come round to finding solutions that appease the current demand for greener business behaviour.