Fall 2008, Hitotsubashi University
Monetary Economics 1
(Corporate Finance)

LECTURE 5

Agency Problem and Capital Structure

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Agency problem in general

- Principal-agent problem
  - Sports player and his/her agent
  - Hideki & Kazuo Matsui and Arn Tellem
  - Daisuke Matsuzaka and Scott Boras

Salary / Fee

Principal → Agent → Job

Benefits

Does the agent have incentives to work for the principal?

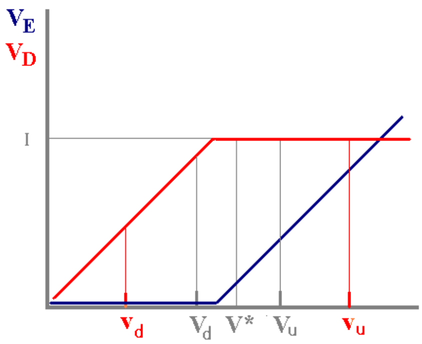
- Why ask agent?
  - Do not have time.
  - Principal's expertise.

- Investors vs the management of the firm
- Variations
  - "Stock holder = management" vs debt holder
  - "Large stock holder = management" vs minor stock holders

Agency problem of debts (1)

- Jensen and Meckling (1976)
  - Stiglitz and Weiss (1980)
- Assume: "Stock holder = management"
- Debt holder
- Risky and safe projects (same mean).
- Because debt exists, the management choose risky project.

Payoffs of stock-holders and debt-holders



$v_d < V_d < V_u < v_u$

- Management(=stockholder) prefers risky project
  - Safe Project: $(0+V_u)/2 = V_u/2$
  - Risky Project: $v_u/2$

- Debt holder prefers Safe project
  - Safe Project: $(v_d+I)/2$
  - Risky Project: $(v_d+I)/2$