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## AGENCY THEORY: ITS RELEVANCE TO TANZANIA'S ECONOMIC RESTRUCTURING

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**Abstract:** Tanzania's current restructuring programme entails not only private ownership but also a dispersion of ownership of companies to a wider public of private entrepreneurs. This paper uses agency theory to examine the contractual relationships between various parties in these privatized companies. An exposition of agency problem and costs is made and ways to reduce them are suggested and analyzed. The relevance of the theory to the restructuring programme is also examined. The paper analyses how privatization is going to define the agency relationships, thereby enabling the application to agency theory in the operations of these companies. This will mutually benefit both investors and mismanagement in these companies by providing investment opportunities and cheaper sources of capital respectively.

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### INTRODUCTION

Reversals of past socialization of the means of production are now taking place worldwide. In developing countries this is due to internal pressure for more democracy, external factors such as International Monetary Fund (IMF) and the World Bank conditions, and the disintegration of the communist block. Tanzania, which had established a centrally controlled economy, is not an exception in this respect.

Like most African countries the country has introduced an economic reform program backed and monitored by World Bank and IMF. Tanzania has embarked on privatization of more than 400 public corporations, which have been owned and controlled by the government since late sixties and early seventies (Jairo, 1994).

### THE PROCESS

The Parastatal Sector Reform Commission, (PSRC) normally negotiates with potential private buyers or co-owners of the public corporations. By April 2000, PSRC had 'sold' 263 public corporations.<sup>1</sup> The Dar es Salaam Stock Exchange (DSE) has also been established

and a few companies have already been listed. Several licensed brokerage companies (agents) have also been admitted as members.

Tanzania Oxygen Limited (TOL) sold its 7.5million shares in 1997/98 and was listed on 15<sup>th</sup> April 1998. Tanzania Breweries Limited (TBL) offered over 23 million shares to the public in May/June 1998. Subsequently the company was listed in the DSE on 4<sup>th</sup> August 1998. Tanzania Tea Packers (TATEPA) offered its shares to the public from 11<sup>th</sup> October 1999 and was subsequently listed as well. The East African Development Bank (EADB) bonds are also listed in the *bourse*. Reports show that a number of other companies are about to issue their prospectuses in order to go public.<sup>2</sup>

The sale of public corporations by the PSRC to individual investors and private companies will lead to private ownership of these corporations. With the intensification of issue of shares through the DSE by the companies in order to be listed, there is going to be a dispersion of ownership of the companies to a wider public of private entrepreneurs. Private ownership of large companies and particularly securities trading through the stock markets is a new phenomenon to most of Tanzanians.

Despite efforts by the Capital Markets and

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<sup>1</sup> Financial Times of April 26<sup>th</sup> 2000.

<sup>2</sup> Financial Times of April 26<sup>th</sup> 2000.

Securities Authority (CMSA) and the DSE to educate the public, there are many Tanzanians who do not know what shares are, and do not know the mechanisms of share trading. Even those who have been exposed to a limited knowledge of share trading would like to know what is going to be the relationship between investors and management of these companies. Some are still skeptical of buying the shares because, *inter alia*, they think the companies will still be controlled by the state, as was the case before privatization.

This paper concentrates on the relationship between shareholders and management, and between bondholders on one hand and shareholders plus management on the other.

The rest of the paper is organized as follows: Section two analyses the agency relationships and problems. Section three examines agency costs, classification of these costs, their manifestations and suggests equilibrium. Section four suggests solutions to agency problems. In section five the suggested solutions to agency problems are analyzed, relating them to Tanzania's situation. Section six discusses the relevance of agency theory to Tanzania. Finally the seventh section provides a summary and conclusion.

## AGENCY THEORY

In privately owned firms, management and the owners of these firms are the same people. Management operates the firm to satisfy its own goals.<sup>3</sup> As a company moves from private to public ownership, the shareholders and management become separate groups. The shareholders elect the board of directors, who then select managers. Management is charged with the day to day running of the company.

The separation of ownership and the dispersion of ownership in a company mean that it is the management that effectively controls the firm. The management is expected

to manage the firm in the shareholders' interest. It is necessary for the control of a large company to be delegated to a small number of directors. It would be impossible, for example, for every shareholder in a large company such as TBL to become involved in its day-to-day management.<sup>4</sup>

Tanzanian investors, currently buying shares in privatized companies or those seeking a quotation on the DSE, need to ask themselves whether the managements in those companies are going to act in shareholders' interest. Brealey and Myers (2000) points out that:

For a long time economists used to assume without questioning that all players acted for the common good but in the past 20 years economists have had a lot more to say about the possible conflict of interest and how companies try to overcome such conflicts. These ideas are collectively known as agency theory.<sup>5</sup>

Investors invest in companies with the aim of getting financial gain, which can come either from dividends or from capital gains. Dividends are the distributions of profits to investors, and the decision to distribute dividends lies with the management of a company. Capital gain is the increment in the value (price) of the shares of the company, which happens when the market's expectations about the company are favourable.

The distribution of dividends and/or the existence of capital gains increase the shareholders' wealth. This is the shareholders' interest we are interested in, and in which management is expected to act.

## The Relationships Between Various Parties in a Company

At this juncture, an analysis of the contractual relationships between shareholders, management and lenders is appropriate. To do this it is important to begin with a couple of questions. When shareholders engage and expect

<sup>4</sup> See Dunn J., (1996: 3)

<sup>5</sup> See Brealey and Myers (2000: 1009)

<sup>3</sup> See Block and Hirt (1989: 6)

management to act in their (shareholders) interest, will it always happen like that?

Do managers have their own interest, which may differ with those of shareholders, or will management necessarily act in the best interest of the shareholders? Can they pursue their own goals at the stockholders' expense? What is the existing relationship between the shareholders and the management and between the company and those parties lending money to the company?

### AGENCY RELATIONSHIP

The relationship between investors and management is called agency relationship. Agency relationship has been defined as:

A contract under which one or more persons (principal(s)) engage another person (an agent) to perform some service on their behalf which involves delegating some decision making authority to the agent (Jensen and Meckling 1976: 308)

Such a relationship exists whenever there is a principal-agent relationship (not only between shareholders and management). There is also such a relationship between the company (shareholder plus management) versus bondholders i.e. those who have provided debt capital to the company.

### Agency Problem

The famous economist, Adam Smith, in the following statement pointed out the existence of agency problem as early as 1776:

The directors of such a (joint-stock) companies, however, being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartner frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always

prevail, more or less in the management of such a company. (Adam Smith, *The Wealth of Nations*, 1776: 702).

In all agency relationships there is a possibility of conflicts of interest between the principal and the agent. Such a potential conflict is called an agency problem. The problem refers to the possibility that the agent may not pursue the interest of the principal. In other words the agent may pursue his own interest, which may be detrimental to the principal. Cosserrat (1994) refers to this problem as "moral hazard".

The way an agent is compensated is one factor, which affects agency problem. For example if you want to sell your property at a price which ranges from Tanzania Shillings (Tshs) 5m-10m and you find an agent who is well placed to find the buyer, the price at which the property will ultimately be sold will depend, *inter alia*, on how you remunerate this agent. If you pay him a fixed amount (say Tshs 200,000), the agent may not strive to get a higher price (close to Tshs 10m) because the agent's incentive is to make a sale not necessary to get you the best price. However, if you tell him that he will get a commission of 10% of the selling price, he will strive to get a price close to Tshs 10m.

### Agency Costs

The existence of agency problem (potential conflicts of interest between shareholders and management) implies that the management is likely to be forced to choose between the stockholder's welfare and their own welfare. Shareholders, being aware of the possibility of conflict of interest, will try to put in place mechanisms to protect their interests so as to prevent or minimize agency problem.

The costs of all these safeguards along with the effects of management abuses, which could not be prevented, are known as agency costs.<sup>6</sup> Agency costs can be direct or indirect.

<sup>6</sup> See Dunn (1996)

Direct agency costs may manifest themselves in various ways such as when directors authorize corporate expenditure, which will benefit management but cost shareholders. Examples of these are expenditures in luxurious consumption and excessive remuneration packages (Ross *et al*, 1993).

Indirect agency costs can be demonstrated by the following example. Suppose a company is appraising a new investment which is expected to create additional wealth and boost the share value but is also a relatively risk underraking. The shareholders (being risk takers) would wish to take the investment (because of the favorable impact on the share value). Directors may be reluctant to take it because if the investment (project) becomes a failure they may lose their jobs. It has been argued (Ross *et al*, 1999) that managers/directors are more risk-averse than shareholders. If directors reject the investment then shareholders may have lost a valuable opportunity. An indirect agency cost therefore is a lost opportunity.

#### AGENCY COSTS OF EQUITY AND AGENCY COSTS OF DEBT

In a company two types of agency relationships exist. This means two potential conflicts of interest exist: the potential conflict between shareholders and management, giving rise to the agency costs of equity, and the potential conflict between lenders (bondholders) on one hand and shareholders plus management on the other, which translates into agency costs of debt. These agency relationships and costs can be analyzed as follows.

##### Agency Costs of Equity: Shareholders (Principal) Vs Management (Agent) Relationship

The (potential) conflicts of interest between these groups bring about the agency costs of equity. These agency costs are composed of a *residual loss*, also referred to as residual agency

risk, bonding (contracting) expenditures by the agent, and monitoring expenditure by the principal.

Acting on their own self-interest, directors do not always make decisions that are optimal for the shareholders. Assuming rational expectations, shareholders anticipate this divergence and reduce the price they are willing to pay for the firm's shares. This reduction in price is the residual loss or the decrease in market value of the firm's equity due to discrepancy between the decision made by the agent and those the principal would have made. Ultimately the management (agent) bears this loss in the form of higher cost of capital (Kelly, (1983), and Cosserat (1994)).

To reduce the residual loss, the agent may contract to ensure (guarantee) that the principal's interest will not be harmed e.g. contracts that restrict management actions, or to provide for retribution if such harm occurs. Examples are restriction on management's actions. These contracts represent the bonding costs that are born by the agent in the form of lost utility that they would have got had their actions not been restricted.

The principal may incur expenditures in attempts to oversee or monitor management's actions. Examples of monitoring costs are, establishing management information (MIS) systems, and paying independent auditors to verify the accounts prepared by management. Major shareholders may insist on having representation on the board of directors or in executive management. These costs are ultimately borne by the agent as they reduce the price received for the firm's equity.

##### Agency Cost of Debt: Lenders (Principal) Vs Management and shareholders (Agents)

Another possible conflict may be the conflict of interest between bondholders and shareholders plus management of companies with debts outstanding; in such instance, decisions favourable to shareholders are not

necessarily in the best interests of bondholders.

This is probably due to another feature of the limited liability company which is lack of any direct responsibility by shareholders or management for the amount owed to both loan and trade creditors. For instance if a company's future is threatened it could be sensible for the management to invest its assets in a high-risk but profitable venture. This could be seen as a gamble which if successful, managers will have maintained their jobs and the shareholders will appropriate the profit from the gamble (Dunn, 1996). On the other hand if the venture fails then the shareholders and directors will not be in a better position, as they would have been if the company had simply collapsed without investing in a risky gamble. If the venture proves failure however, bondholders will be the losers because the assets from which their claims would have been settled have disappeared (Ross *et al*, 1993).

This relationship brings about agency cost of debt. Agency costs of debt can also be analyzed under the same headings as those of equity, however they manifest themselves in different ways. Potential lenders, being aware of the possibility of conflict of interest between them and management, reduce the price they are ready to pay for the firm's securities (debt instruments like bonds, debentures etc). Again this is a reduction in the market value of the firm's debt due to the discrepancy between the potential decisions by the agent and those, which the bondholders would have made had they been running the company. The residual loss on debt is also borne by the agent in the form of higher cost of capital.

The agent (management and shareholders) would try to reduce the residual loss by trying to guarantee the bondholders that they will not pursue interests which are detrimental to them (bondholders). These bonding costs usually take the form of entering into lending agreements (restrictive or protective debt covenants) like setting borrowing limits for the company, or

restricting the company from issuing other (superior) debt instruments without the consent of the existing bondholders. It may also take the form of restricting major (risky)<sup>7</sup> investment by the company unless bondholders approve these investments. These restrictions are a cost to the agent.

Bondholders also may put in place some measures to enable them monitor the policies, decisions and/or activities of the agent. This may take the form of bondholder's representation on the board of directors or even in the executive management team.

#### **Illustration of the effects of agency<sup>8</sup>**

In finance, we value a company (or an investment) on the basis of the present value of cash flows it is likely to generate in the future. Suppose we have a company whose cash flows could be maximized at Tshs 10 million in perpetuity, then at 10%, the company is worth Tshs 100 million and a 20% shareholding would be entitled to Tshs 20 million worth.

Assume that the owner-manager who takes fringe benefits (perquisites), which reduce cash flow profits by Tshs 4 million, is managing the company. This manager bears this reduction alone. He goes on taking these 'perks' if the utility derived from them exceeds profit forgone.

Alternatively if he sells 20% share in the profits the net cost to him of the benefits he consumes is only 80% of Tshs 4 million (i.e. Tshs 3.2 million). This is likely to encourage the manager to over-indulge in these 'perks' since for any shilling spent the cost to him is only eighty cents. Potential (outside) shareholders, anticipate such potential behaviour and when buying that company's securities, do not value them on the basis of profit maximization but on the basis of expected profit allowing for this

<sup>7</sup> Smith and Warner (1979) found that 91% of bond indentures restricted issuance of additional debt, 39% restricted mergers, 36% limited sale of assets and 23% restricted payment of dividends.

<sup>8</sup> This illustration has been adapted from Cosserrat (1994).

moral hazard (Tshs 4 million), and offer only T.shs. 12 million for 20% share.

The difference between the potential value of the 20% share of Tshs 20 million and the value given by investors of Tshs 12 million (Tshs 8 million) is the agency cost known as residual loss. While business risk entails a cost of capital of 10%, agency cost increases this cost to 16.7%. This increased cost of capital is borne by the owner-mnager. Table 1 depicts numerically the foregoing discussion.

Table 1: Demonstration of the Moral Hazard

Expected maximum cash flow profit	Tshs 10,000,000
Residual loss (moral hazard reduction)	4,000,000
Expected actual cash flow profit	6,000,000
20% thereof	1,200,000
Capitalised at 10%	12,000,000
Notional profit for 20% share	2,000,000

NB: the cost of capital, allowing for both business and agency risk, 2m/12m is 16.7%. the 20% shareholding is therefore valued at T shs. 12, million instead of 20 million

### Benefits of Agency Costs

Both parties (investors and management) benefit from the incurrence of bonding and monitoring costs because these costs are likely to reduce the residual loss, in fact this is the *raison d'être* of incurring them. Incurrence of agency costs therefore allows entrepreneurs to access sources of capital, which might otherwise be too expensive. On the other hand investors are provided with investment opportunities that would otherwise not exist.

Using our earlier illustration we can show how agency costs can benefit both the principal and the agent. Our company could generate a cash flow profit of Tshs 10 million and the cost of capital allowing for business risk of 10%. Suppose now that bonding costs incurred by the company's management are Tshs 0.5 million reducing the profit to Tshs 9.5 million, and the monitoring costs incurred by 20% shareholders

is Tshs 100,000. The shareholders are now likely to assign a lower value for residual loss. Suppose they assign Tshs 1,000,000. The expected return on a 20% shareholding will therefore be Tshs 1.6 million; at 10% the capitalized value of this shareholding will be Tshs 16 million, which is higher than Tshs 12 million.

Table 2: How Bonding Costs(MC) and Monitoring Costs (MC) Reduce Residual Loss

	Without BC%MC	With BC%MC
Expected max.cash profit	10,000	10,000
Less: Residual loss	(4,000)	(1,000)
Bonding costs	0	(500)
Expected actual cash profit	6,000	8,500
20% thereof	1,200	1,700
20% share of monitoring	0	100
Expected net profit	1,200	1,600
Capitalised at 10%	12,000	16,000
Notional profit	2,000	2,000
Cost of capital (2/12)1000	16.7%	(2/16)/100=12.5%

### The Concept of Equilibrium in Agency Theory

Agency costs are incurred in order to prevent or reduce agency problem. It was mentioned earlier that agency costs could manifest themselves in form of the effects of the management's abuses when acting against the interest of shareholders or bondholders. In equilibrium therefore the total of the bonding costs, monitoring costs and agent's lost utility due to bonding and restrictive debt covenants should equal the residual loss.

### SUGGESTED SOLUTIONS FOR THE AGENCY PROBLEM

The foregoing discussion suggests that the principal can minimize agent's abuses of his agency position in two ways. One is to remunerate an agent in such a way that his

interest converge those of the principal, and two, is to monitor the agent's decisions and actions and redress any abuse of his position of trust.

### **Remunerating an Agent in Order to Converge the Agency and Principal Interests**

Directors (or managers) of companies get salaries, and other incentive remuneration as managerial compensation. Salaries are usually fixed. Additional incentive remuneration, which may be used as a solution to agency problems, could be cash bonuses, bonus shares, stock options and nonpecuniary rewards i.e. perquisites.

Cash bonuses to directors may be based on performance. Shares may be sold to directors to make them co-owners. Alternatively directors may be given share options, that is, options to purchase shares at a (lower) fixed prices for a given period of time. Share options may be very useful as an incentive for directors to act in the interest of the shareholders because the higher the share value the more attractive the offer.

### **ANALYZING SOLUTIONS TO AGENCY PROBLEMS**

#### **Remuneration**

It has been argued that remunerating directors in such a way that their interests coincide with shareholders is difficult (Dunn, 1996). Reasons given are many. First, performance linked bonuses may be used to penalize directors for events outside their control for example for profit-linked bonuses, and secondly, directors may suffer or take advantage of movements in interest rates and exchange rates, over which they have no influence.

Again the directors' attention may be preoccupied with the performance measures built into the bonus calculation, and could ignore investment in research, advertising and other long-term investments because of the short-term

negative effects of those expenditures on profit. This would mean that in the longer term it is the shareholders who will be losers.

While selling shares and giving share options to directors would induce them to maximize the value of the shares, conflicts of interest may not be eliminated. The reason being that the directors would usually own a smaller proportion of shares, and would only bear (as shareholders) only that smaller proportion of the costs of their abuses like perks they give themselves etc. Hence their interests will not completely coincide with shareholders interests.

We conclude our analysis of solutions to agency problems by proposing that while remuneration incentives help to reduce or prevent agency problems it may be more useful to combine them with close monitoring of directors' actions and decisions. Major shareholders (and bondholders) place their 17 representatives on the board of directors or on the executive management of companies in which they have invested. A good example is the CRDB (1996) Limited, now known as CRDB Bank, where DANIDA being an influential shareholder has representatives in the board of directors and in addition, the deputy-managing director is usually from, or appointed by, DANIDA.

Monitoring may take the form of making use of independent auditors as mentioned earlier or may be through meetings with management to discuss the company's progress.

#### **Other Incentives Converging Directors' Interests to Shareholders**

In addition to remuneration incentives and monitoring of directors, there are other factors which act as incentives for directors to act in the interest of the shareholders and bondholders. These factors include marketability of directors in the labour market; possibilities of removal of directors through proxy, and replacement of management by take over (Ross *et al*, 1993).

Better performance by directors in terms of profit, turnover and share values both in the short and longer terms are likely to result in their promotion. Better performance also makes directors marketable in the labour market, which in turn would mean that better performing directors would command higher pay. Directors knowing these would be inclined to act in the interest of shareholders. Companies in need of debt finance would also have an incentive to act in the interest of their bondholders.

Poor performing managers risk removal through proxy fight. This is the process by which shareholders in their general meeting choose their proxy (members of the board of directors) to represent their interest, the board in turn, appoint executive management. This means for a director/manager to maintain the post he must perform to the satisfaction of his overseer.

Firms that are poorly managed are more attractive as targets for acquisitions. This happens if the predator thinks that she can make better use of the facilities, the market and the location of the prey than the existing management. Poor performing managers risk being replaced when their company is taken over. Directors who do not act in the interest of debt holders also risk being put under receivership by debt holders to recover their money should they detect any breach of trust by directors.

#### RELEVANCE OF AGENCY THEORY TO TANZANIA

Soon after independence and the union between Tanganyika and Zanzibar, the Tanzania government introduced a centrally controlled economy. All major means of production and companies were put under state control. About 400 plus public corporations were formed. (See Nyerere, 1968a, 1977); (Briston, 1978); (Briston and Wallace, 1990); and (Abayo, 1993).

#### Application of Agency Theory Before Privatization

Most of the state enterprises and cooperatives established in late sixties and early seventies had

poor performance and were a burden to the government and taxpayers because despite being given subsidies they could not be self-sustaining. Agency theory can be used to explain this poor performance. The operations of agency theory require a clearly defined relationship between the principal and the agent. One of the major problems during this period was that the shareholder was not clearly defined in these state enterprises.

It was not clear as to who was the owner of these enterprises, was it the taxpayers or the government? Taxpayers did not have an organized body to represent them directly in the running of the company. The government had the president, the ministry and the parliament all having different powers over the enterprises and overseeing them. The strong personal motivation, which exists in private entrepreneurship for constant vigilance in how the affairs of the company are run, did not exist in these enterprises. There were no clear defined agency relationships, hence limited application of agency theory.

This limitation to the application of agency theory, coupled with the fact that during that time public corporation's had other non-financial objectives (e.g. emphasis on provision of services to citizens or to priority areas), and also the fact some of their directors were appointed under political whims rather than proven managerial competence or background (Jairo, 1994, Luoga 1991), led to the failure of most of these enterprises. The weak agency relationships had created opportunities for enrichment despite the fact that the government established its state-auditing firm. Given the non-financial objectives and appointment of directors on the basis of political whims, the Tanzania Audit Corporation (TAC) auditing and reporting, whatever its quality, was mainly for shelves.

#### Application of Agency theory After Privatization

The privatization of state enterprises which started in the early nineties, and which is still



going on will strengthen agency relationship in privatized companies. This is because the principal (shareholders) will be clearly defined and these private entrepreneurs will be keen to exercise constant vigilance in how the affairs of the company are run. Companies will have maximization of share price (profitability) as their goal and agents (directors) will be appointed on grounds of competence.

In short, the application of agency theory in privatized companies is likely to result into better performance.

### **Agency Theory and Financial Reporting**

Financial reporting plays a major role in the application of agency theory to a privatized economy. As Cosserat (1994: 24) puts it:

...The most important role is the determination of contractual compliance such as the maintenance of contributed capital, investment of contributed capital in accordance with the company's objects and that dividends are paid only out of distributive profits. A second... is the provision of information pertinent to the evaluation of the effort expended by management in achieving the goals of investors.

It is therefore evident that the application of agency theory requires the existence of adequate financial reporting system. Wallace and Briston (1993) documents that many approaches aiming at improving accounting in developing countries have emphasized on the supply side of the accounting infrastructure rather than strengthening the factors that could increase the demand side and improve the quality of accounting information.

Jairo (1994) predicts that privatization and establishment of a stock exchange in Tanzania is going to strengthen the demand side of the accounting infrastructure. This demand (by users of financial reports) is in turn going to put pressure on corporate disclosure regulators (like the National Board of Accountants and Auditors, NBAA) to ensure quality control and proper regulatory function.

The recent changes in the demand function have already started to bear some fruits. From its establishment in 1972 to 1994, the NBAA had only issued three accounting standards and six accounting guidelines (Jairo, 1994). After the start of the establishment of the market economy, the period from 1995 to 2000, a number of changes in financial reporting scene took place. In 1995 the NBAA Act, of 1972 was amended to take into account changes in the economic environment, and since then six more accounting guidelines and auditing guidelines, which are more comprehensive, have been issued. All these are laying the ground for the application of agency theory in Tanzania.

### **SUMMARY AND CONCLUSION**

The paper has looked at agency relationships in Tanzanian companies before privatization and how these relationships are likely to be in a market economy. The paper unveiled the intricacies of agency theory, discussing agency costs of debt and equity, illustrating how they arise, how they can be minimized, and the benefits, to both investors and directors, of the incurrence of agency costs.

As a solution to agency problems it has been suggested that convergence of managers' interest towards those of their principal, while useful, could not stand-alone. These efforts should be combined with close and effective monitoring of directors/managers decisions and actions. Other incentives forcing agents to act in the interest of the principal have also been discussed.

It has been concluded that lack of proper agency relationships during 'I government ownership era' blurred the definition of the "principal". This coupled with the "public property is nobody's property" attitude, were among the reasons for poor performance of public corporations.

Privatization is likely to define clearly who is the principal and who is the agent, hence existence of proper agency relationship and a

more feasible application of agency theory. These parties are going to apply the principles discussed in this paper thereby allowing companies to tap sources of capital that might otherwise be too expensive because investors would have penalized the valuation of these companies due to agency problem.

Investors on the other hand are going to have ample investment opportunities. With the existence of bonding agreements and monitoring, directors/managers are going to restrict their shirking and consumption of perquisites. Knowing this, investors are going to invest in companies in which they would not have invested into. This is likely to increase the value of the privatized companies, which is the main goal of financial management.

Currently, as the restructuring process goes on, it is important that both investors and management of Tanzania companies take stock of the relationship, which existed, between directors and the government. That relationship, which contributed to poor performance of public corporations, should be compared with the relationship, which will be there after privatization as discussed in this paper. Prior knowledge of the expected relationship during the restructuring phase is beneficial to both the principal and the agent as it will influence favourably the ownership structures of companies and speed up movement of capital in the capital market.

All this shows that agency theory is more relevant to Tanzania now and will be so in the future than it was before the laying down of the foundations of a market economy. All players in Tanzania's economy (investors, management, and regulators) should therefore get to grips with the theory and adapt its principles for the benefit of Tanzanians.

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