# Monitoring costs of MNC: An agency theory perspective

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## ABSTRACT

*This paper investigates the agency costs of multinational companies (MNC) in relation to agency theory in Malaysian business environment. Using the data of 235 MNCs, this study explores their demand for monitoring costs and these companies' preferences between the monitoring costs components. The data is collected using primary and secondary data. Multiple regression analysis and independent t-tests are conducted to analyze the data.*

*The result indicates that multinational companies demand significantly higher monitoring costs compared to domestic companies. However, the relationship between these companies and their preference between the components of the monitoring mechanisms, that is between directorship and auditing as their monitoring mechanism is not significant. But when the auditing components are further investigated, it reveals that multinational companies would demand more external audit costs compared to internal audit costs. These results are supported by series of independent t-test which indicate that there are significant differences between the demands for monitoring of multinational companies as compared to their domestic counterparts.*

**Keywords:** agency costs, monitoring, MNC, domestic companies.

## 1.0 INTRODUCTION

With globalization of businesses, the number of international organizations is steadily increasing. It is claimed that the importance of multinationalisation is growing exponentially and play an increasingly important role in business (Chang and Taylor, 1999). The dramatic global developments encourage companies to do business across their national boundaries as the world is borderless. In addition to selling their products abroad, more organisations are setting up production facilities across national boundaries to avail business and investment opportunities (Rahman, 2004).

Yudaeva et al. (2003) claim that foreign investment is one of the major sources of sustainable economic growth in transition economies as this investment bring foreign technologies into the countries and facilitate knowledge exchange and adoption of modern production techniques via copying of foreign production methods and technology know-how, as well as add to the country's managerial capital. Foreign investment is also said to increase competition and stimulate the process of innovation, improvements in product design and output composition.

Yudaeva et al. (2003) find that foreign own organisations tend to be more productive than domestic ones. These companies are called 'multinational companies' (MNCs) and are defined as a group of geographically dispersed and goal-disparate organisations that include its head quarters and the different national subsidiaries (Ghoshal & Bartlett, 1990) with different ethnicities and cultural values intertwined and may cause interpersonal conflicts. However, as the parent companies find that by investing in foreign subsidiaries, they increase the risk of return on their investment, they are willing to take the chance. To ensure this goal is achieved, the parent companies will attempt to increase control over their foreign subsidiaries to reduce the uncertainty of these investments. And the heart of control is the monitoring process (Baliga & Jaeger, 1984). A lot of studies have been conducted to examine these MNCs, however, most previous studies focus on how these MNCs affect the productivity (Yudaeva et al., 2003), ownership by MNCs (Chang and Taylor, 1999), performance of MNCs (Boardman et al., 1997); capital structure of MNCs (Mitto and Zhang, 2008; Aggarwal and Kyaw, 2010) and corporate governance of MNCs (Luo, 2005; Kim et al., 2005). Little attention is given to the monitoring costs involved in managing the MNCs. Thus, this study is conducted to examine the monitoring costs incurred by MNCs, and it also investigates the preferences of the monitoring cost components involved.

It is also claimed that the number of MNCs has also increased in developing countries, thus this study will focus on MNCs in Malaysia, which is one of the developing countries in Asia. Statistics show that in Malaysia, foreign investment has been significant in contributing to its economic progress by assisting in technology transfer, joint venture, licensing, franchising, management contract, technical service contract, marketing contract and international subcontracting (Beaumont, 1990; Rahman, 2004). A study on Malaysian companies by Ramasamy (1999) reveals that the number of MNCs in Malaysia has increased where he finds 207 such companies on the main board of Malaysian Exchange. It is reported that foreign direct investment is on an increasing trend in Malaysia with an average annual rate of 8.2 percent, which is from RM3.8 billion in 1983 to RM6.1 billions in 1989, and this value is tripled in 1994 to

RM18.3 billions (Rahman, 2004). Thus, this study recognises these investments by MNCs in Malaysia by investigating their monitoring costs.

This paper proceeds as follows: Section 2 gives a review of the relevant literature which leads to hypotheses development, and Section 3 provides a description of the methodology used for this study. Section 4 presents and discusses the results of the empirical analysis, and finally the last section concludes the study.

## 2.0 LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

### Agency theory and MNCs

Previous studies claim that the monitoring of MNCs can be done through the extended agency relationship between a corporation and its subsidiaries. The extended agency relationship between a corporation and its foreign subsidiaries is described by Ekanayake (2004) as the two levels of principal-agent relationship that exist in the management control system, that is between the organisation's owners (the principal) with the top management (the agent), and between the top management (acting as principal) and the divisional managers, as the agents who manage the decentralised units. This extended relationship is also believed to affect the monitoring costs of the organisation because of its cultural distance, strategic and operational role, and commitment and psychological alignment, which are critical in influencing goal incongruence and information asymmetry within the headquarters- foreign subsidiary relationship (Roth & O'Donnell, 1996; Egolhoff, 1984; Luo, 2005; Nimie, 2005).

The agency theory models the relationship between principals who engage the agents to perform some service on their behalf, and this may involve delegating some decision making authority to the agents (Fama, 1980; Jensen & Meckling, 1976). Human beings are assumed to be risk averse and self interested in nature (Eisenhardt, 1989). Therefore, there is a high potential for agents and principals to differ in their preferences for outcomes (Fama, 1980) where the agents may make decisions that reduce their own risks at the expense of the principal. However, principals will not be able to control the agents' behaviour, they can only bear the risk and uncertainty about what the agents are actually doing, and this is call "agency cost". In a domestic company, this relationship can be clearly seen in the shareholders and CEO / management relationship, where management may decide to invest in projects with negative or sub-optimal present value in order to maximise their own interest (Jensen & Meckling, 1976). However, in complex organisations of multiple business units and layers of management, CEO of a large corporation can be viewed as the principal as he is most directly charged with looking after the interest of the organisation as a whole, and the managers of various subunits held by the corporation as the agents (Chang & Taylor, 1999). Under this extended relationship, managers of the subunits may attempt to maximise their self-interest and the interest of their subunits, even though this may have a negative implication on the corporation as a whole. Chang & Taylor further describe the relationship between the headquarters (the principal) and its foreign subsidiaries (the agent) under this extended agency theory, where the parent company invests funds and resources in the subsidiaries and the subsidiaries in turn are expected to work for the benefit of the parent headquarters. However, the geographic distance and national adaptation requirement between the headquarters and their foreign subsidiaries may increase the corporate headquarters uncertainty about the appropriateness of the subsidiaries decisions (Luo, 2005).

Roth & O'Donnell (1996) claim that cultural distance, strategic and operational role, and commitment and psychological alignment are critical in influencing goal incongruence and information asymmetry within the headquarters- foreign subsidiary relationship. This is also noted by Egolhoff (1984) who claim that the complex environment of MNCs and the physical and cultural distances make control and monitoring for the parent-subsidiary level a much greater problem in multinational than in domestic companies. This is supported by Nimie (2005) who argue that foreign subsidiaries require additional control over management because of the conflict of interest between the management of the subsidiaries and the foreign corporate owner may be magnified by geographical distance and national objectives. The owners would be concerned with sub-optimisation where the actions taken should be beneficial to the subsidiary but also optimal for the organisation as a whole. However, managers of subsidiaries may favour the perceived interest of the national subsidiary rather than the overall interest of the organisation. Consequently, the need for monitoring is higher in foreign subsidiaries of MNCs than in domestically owned subsidiaries. This is supported by Luo (2005) who claim that the complexity of global operation, task programmability and behaviour verifiability when an organisation becomes more globalised are more difficult to monitor and will increase agency costs.

Some MNCs resort to monitor the subsidiaries through staffing control, which is by appointing managers/ directors whose nationality is the same as that of the headquarters. This is consistent with the concept of behaviour control, where the managers/directors are expected to be more likely to act in accordance with headquarters interests than are foreign managers (Egolhoff, 1984; Baliga & Jaegar, 1984; Chang & Taylor, 1999). This has been exercised by Japanese MNCs, where they are said to use their parent nationals extensively in their top and middle management position in all their foreign operations (Tung, 1984). Therefore they can monitor the subsidiaries through the directors that they choose and appoint. Eisenhardt (1989) support this move by citing that another way of monitoring is to invest in monitoring system such as budgetary system, board of directors and additional layers of management. However, MNCs also need to look for other kind of control and monitoring as MNCs may be forced to utilise more national managers and fewer expatriates due to pressures from host country statutes that limit expatriates employment. Another solution to this is for the MNCs to choose auditing as their monitoring mechanism. This is agreed by Baliga & Jaeger (1984) who view control as the monitoring processes used by MNCs to verify that the activities and decisions of the different affiliates yield results consistent with overall goals and strategies. One of the ways to verify the activities of the subsidiaries, which is normally used by organisations, is through auditing (external and internal auditing).

In a Malaysian study by Che Ahmad, Houghton, & Mohamed Yusof (2006), it is argued that foreign companies will incur more agency costs as the distance of the head-quarter induce a higher level of management monitoring and provides incentives for them to hire quality auditors. They also claim that "brand name" auditors are likely to be hired due to perceived needs of international standards and high quality auditing of these organisations. This is supported by an earlier study in US, by Eichenseher (1985), who reveals strong evidence of the tendency of MNCs to employ brand name auditors as compared to domestic companies.

**Hypotheses development**

A MNC is defined as a group of geographically dispersed and goal-disparate organisations that include its head quarters and the different national subsidiaries (Groshal & Bartlett, 1990), with different ethnicities and cultural values intertwined which may cause interpersonal conflicts. To ensure this goal is achieved, the parent companies will attempt to increase control over their foreign subsidiaries to reduce the uncertainty of their investments. It is believed that foreign subsidiaries require additional control over management because of the conflict of interests between the management of the subsidiaries and the foreign corporate owners, as magnified by geographical distance and national objectives (Egolholff, 1984; Nimie, 2005). Egolholff (1984) also claims that the complex environment of MNCs and the physical and cultural distances make control and monitoring for the parent-subsidiary level a much greater problem in multinational than in domestic companies. Therefore, it is argued that companies with foreign subsidiaries or companies with multinational status will demand different level of monitoring mechanisms as compared to domestic companies. In other words, the multinational status of the organisation will affect the organisation's demand for monitoring mechanisms.

The headquarters of MNCs would also be concerned with sub-optimisation where the actions taken should be beneficial to the subsidiary as well as for the organisation as a whole. However, managers of subsidiaries may favour the perceived interest of the national subsidiary rather than the overall interest of the organisation. Consequently, it is argued that the need for monitoring is higher in foreign subsidiaries of MNCs than in domestically owned subsidiaries (Egolholff, 1984; Nimie, 2005). This is supported by the findings of a study by Luo (2005) which claims that the complexity of global operation, task programmability and behaviour verifiability when an organisation becomes more globalised are more difficult to monitor and will increase agency costs. Hence, it is hypothesised that:

$H_1$: A multinational company has a greater total monitoring cost (from directorship and auditing) compared to a domestic company.

Previous literature also argues that MNCs report their results in more detail compared to companies operating in one country only (Jaggi & Low, 2000). Logically, when more details are reported, there will be more things for the auditors to audit, which lead to more audit effort to be put in, and consequently more audit fees will be charged. Niemi (2005) also claims that audit fees should be higher for the subsidiaries of foreign companies than their domestically owned counterparts because of the added complexity in its financial reporting structure and greater need for corporate governance in foreign owned subsidiaries. This is particularly due to the fact that additional sets of financial statements may be prepared in multiple languages and involve foreign currency transformation and transfer pricing, which will require additional audit effort/ procedures and fees.

In addition, Luo (2005) cites that one of the effects of global competition for MNCs on corporate governance is through its monitoring mechanism, the competition is getting tougher, the agency's global organising and decision making should be largely output-based, which requires operational flexibility of the foreign subsidiaries. In this case, the power should be decentralised. Therefore, the need for an assurance system, such as auditing is important to ensure that the power delegated is not misused and the decisions made by the managers /directors of the subsidiaries are in the best interest of the organisation as a whole. It is argued that in this circumstance the independence and opinion of the auditors is highly valued as a monitoring mechanism to be emphasised compared to directorship. Therefore, it is hypothesised that:

$H_2$: A multinational organisation has a relatively lower expenditure on monitoring from directorship compared to auditing (internal and external)

It is also argued that in a foreign-subsidiary relationship, the distance of the head-quarter induces a higher level of management monitoring and this further provides incentives for them to hire quality and brand name auditors (Che Ahmad et al., 2006). Brand name auditors are likely to be hired due to perceived needs of international standards and high quality auditing of these organisations, which operate internationally and involve complex transactions (such as consolidated accounts, more detail reporting and currency transformation). This is supported by an earlier study in US, by Eichenseher (1985), who reveals strong evidence of the tendency of MNCs to employ brand name auditors as compared to domestic companies. Hence, it is argued that in a MNC, the need for an assurance system from a third party that is independent of the organisation, such as external auditing is highly valued than internal auditing, to ensure that the complex transactions are being taken care. This is also because internal auditors are viewed as less independent than external auditors, due to the fact that internal auditors are the staff of the organisation and report to the management of the organisation (Messier and Boh, 2004, p. 10). In Addition, parent companies would normally request a brand name auditor with international reputation (Che Ahmad et al., 2006) be appointed to ensure that the decisions and transactions carried out by the subsidiaries are in the best interest of the organisation as a whole and consistent with international standards. Therefore, it is hypothesised that:

$H_3$: A multinational organisation has a relatively lower expenditure on monitoring from internal auditing compared to external auditing.

## 3.0 DATA AND METHODOLOGY

### 3.1 Data and sample

Data for the study was collected using primary (questionnaires) and secondary sources (annual reports). The population of the study includes all 867 companies listed on the Main and Second Board of Bursa Malaysia. However, the companies classified under finance sector were excluded in this study because of their unique features and business activities, as well as differences in compliance and regulatory requirements (Yatim et al., 2006). The response rate was 27%, with 235 usable samples used in the study. Data was analysed using regression analysis and independent t-test.

### 3.2. Models and Variable definition

There are three models to test the three hypotheses. And there are three dependent variables, one dependent variable for each model.

The first model tests hypothesis 1 ($H_1$):

MONITOR = $\alpha_i$ + $b_1$MNC + γ(Control variables) + $\varepsilon_i$ ................***Model 1***

Where the dependent variable is the monitoring costs of the companies listed in Malaysian Exchange. Directorship and auditing (internal and external) are specified as monitoring mechanisms in the Malaysian Code of Corporate Governance (FCCG, 2001). This total Monitoring (MONITOR) is measured by the sum of organization investment in non-executive directors' remunerations, internal auditors' costs, and external auditors' costs.

The second model test hypothesis 2 ($H_2$):

DIRAUD = $\alpha_i$ + $b_1$MNC + γ(Control variables) + $\varepsilon_i$ ................***Model 2***

Where the dependent variable is the ratio of total directors' remuneration to total auditing. This model test the hypothesis relating to the preference between directorship and auditing.

The third model test hypothesis 3 ($H_3$):

INT EXT = $\alpha_i$ + $b_1$MNC + γ(Control variables) + $\varepsilon_i$ ................***Model 3***

Where the dependent variable is the ratio of the total internal audit costs to total external audit costs. This model test the hypothesis relating to the preference between internal auditing and external auditing.

The independent variable in all models is the multinational status of the company (denoted by MNC) which is a dummy variable, where 1 represent company with multinational status, while 0 for non-multinational company, or domestic company.

Previous studies defined a MNC as any company with production facilities in two or more countries (Martinez & Ricks, 1989), but under one guiding direction (Galbraith, 1978). Some studies emphasise the extent of control over the foreign affiliates. Ramasamy (1999) quotes Dunning (1993), who claims that a MNC should own and control value-adding activities in more than one country. Ramasamy (1999) quotes United Nations (1973) which defines MNCs as organisations that control assets – factories, mines, sales office and the like- in two or more countries. This is supported by Khan (1986), as quoted by Ramasamy (1999), who states that, the ownership of production and service facilities is a necessary pre-requisite of a MNC. Hence a mere investment holding company across the border would probably fail to meet this pre-requisite, as it may not exert effective control over the affiliate company. Thus, this study defines a MNC as a company which operates in at least two countries (as defined by Martinez & Ricks, 1989; Galbraith, 1978), and its parent company holds at least 20 percent equity in its international subsidiaries (as used by Ramasamy, 1999; Rahman, 2004) or control at least 10 percent of its assets (as used by Michel & Shaked, 1986; Collins, 1990).

The controlled variables include in this study are size, complexity, growth and listing status.

# 4. FINDINGS AND DISCUSSIONS

## 4.1. Descriptive statistics

Table 1 presents descriptive statistics of the sample companies. Close to 42% of the sample companies are MNCs. Majority of the companies (92%) have between 5 to 10 directors sitting in their board of directors. About 70% of the sample companies are audited by Big 4 auditors and half of the companies have their own internal audit departments.

**Table 1: Descriptive statistics of the sample companies**

| | Categories | Frequency | % |
|---|---|---|---|
| Category | MNCs | 98 | 41.70 |
| | Domestic companies | 137 | 58.30 |
| | | 235 | 100.00 |
| Board size | Less than 5 directors | 10 | 4.26 |
| | 5 – 6 directors | 64 | 27.23 |
| | 7 - 8 directors | 94 | 40.00 |
| | 9 – 10 directors | 58 | 24.68 |
| | More than 10 directors | 9 | 3.83 |
| | Total | 235 | 100.00 |
| External audit | Audited by Big 4 | 166 | 70.64 |
| | Audited by Non Big 4 | 69 | 29.36 |
| | | 235 | 100.00 |
| Internal audit function | In-house internal audit department | 116 | 49.36 |
| | Outsource / Co-source | 119 | 50.64 |
| | No internal audit function | 235 | 100.00 |

The data was also checked for normality and multicollinearity. The results of standard tests on skewness and kurtosis indicate that there is no problem with normality assumption and the variables can reasonably be considered as normally distributed. Examination of the pairwise correlation coefficient of all variables also indicates that there is no multicollinearity problem, as the correlations are below the threshold value of 0.8 (Gujarati, 2003, p. 359).

### 4.2 Independent t-tests

Independent t-tests are run to examine the differences between the monitoring costs of MNCs and domestic companies. The results are presented in Table 2. The first four rows of the table show the total monitoring costs and its components. Generally, the results indicate that the average total monitoring costs (and all its components) of MNCs are significantly higher than the average monitoring costs of the domestic companies. The total assets and total liabilities of MNCs are also significantly higher than those of domestic companies.

When the performances of MNCs are compared with domestic companies, the findings indicate that the net profit after tax and EPS for MNCs are significantly higher than those of domestic companies. However, the results of their asset utilisation ratio appear to suggest that MNCs do not use their asset efficiently, and the domestic companies seem to have significantly higher asset utilisation ratio than the MNCs. The ROI of MNCs and domestic companies are not significantly different.

In terms of board size, MNCs appear to have significantly greater number of directors in their board, compared to the domestic companies. However, there is no difference between these two groups in their proportion of non-executive directors sitting in their board. This may be due to the fact that all the companies have to follow the same rule as required by the Malaysian Exchange listing requirement. As for the auditors, even though the mean for MNCs are greater than domestic companies(Refer table 3), the result indicates that there is no significant different between these two group in their selection of Big 4 auditors.

**Table 2: Independent t-tests**

| | MNC/Domestic | Mean | T stat (p value) |
|---|---|---|---|
| **Total monitoring costs** | MNC | 1,394,463 | 3.484 |
| | Domestic | 454,752 | (0.000) |
| **Total directors' remuneration (NED)** | MNC | 433,390 | 3.555 |
| | Domestic | 208,439 | (0.001) |
| **Total External auditors' costs** | MNC | 472,810 | 3.229 |
| | Domestic | 113,751 | (0.002) |
| **Total Internal auditors' costs** | MNC | 488,262 | 2.396 |
| | Domestic | 132,561 | (0.018) |
| **Total assets** | MNC | 2,789,987,632 | 2.839 |
| | Domestic | 688,041,555 | (0.005) |
| **Total liabilities** | MNC | 1,538,238,274 | 2.185 |
| | Domestic | 315,378,544 | (0.031) |
| **NPAT** | MNC | 118,413,590 | 2.318 |
| | Domestic | 27,174,033 | (0.022) |
| **EPS** | MNC | 14.42 | 1.765 |
| | Domestic | 7.14 | (0.079) |

| | | | |
|---|---|---|---|
| **Asset utilisation ratio** | MNC<br>Domestic | 1.83<br>4.23 | -3.711<br>(0.000) |
| **ROI** | MNC<br>Domestic | 16.30<br>135.04 | -1.004<br>(0.317) |
| **Board size** | MNC<br>Domestic | 7.82<br>7.26 | 2.265<br>(0.024) |
| **Percentage of Non-executive directors in the board** | MNC<br>Domestic | 0.64<br>0.64 | -0.024<br>(0.981) |
| **Selection of Big 4 auditor** | MNC<br>Domestic | 0.74<br>0.68 | 1.107<br>(0.270) |

### 4.3 Regression Analysis

#### 4.3.1 Total monitoring costs and MNC

Table 3 presents the results of the regression analysis. The result in column 2 of Table 3 indicates that companies which have multinational status have higher monitoring costs compared to domestic companies. The adjusted R squared for Model 1 is 0.738 and the F-value of 111.038 is significant ($p < 0.000$). This adjusted R squared means that close to 74% of the variation in the total monitoring cots can be explained by this model.

The hypothesis variable is significant and at the expected direction. Hence hypothesis $H_1$ is supported. This finding is consistent with the earlier studies by Luo (2005), Che Ahmad (2001) and Nimie (2005).

This result can be explained by the complex relationship between headquarters and subsidiaries. Foreign headquarters and subsidiaries relationship is described as an extended agency relationship between a corporation and its subsidiaries by Ekanayake (2004), where the two levels of principal-agent relationship exist in the management control system, that is between the firm's owners (the principal) with the top management (the agent), and between the top management (acting as principal) and the divisional managers, as the agents who manage the decentralised units. Foreign subsidiaries are said to require additional control over management because of the conflict of interest between the management of the subsidiaries and the foreign corporate owners, which may be magnified by geographical distance and national objectives (Nimie, 2005; Luo, 2005; Egolholff, 1984) and cultural distance, strategic and operational roles and psychological alignment (Roth & O'Donnell, 1996). Nimie further argues that the owners would be concerned with sub-optimisation where the actions taken should be beneficial to the subsidiary but also optimal for the organisation as a whole. However, managers of subsidiaries may favour the interest of the national subsidiary rather than the overall interest of the organisation. Consequently, the need for monitoring is higher in foreign subsidiaries of MNCs than in domestically owned subsidiaries. In a Malaysian study by Che Ahmad et al. (2006), it is argued that foreign companies will incur more agency costs as the distance from the head-quarter induces a higher level of management monitoring and provide incentives for them to hire quality auditors.

**Table 3: Results of OLS estimation**

| Variables | Model 1 | Model 2 | Model 3 |
|---|---|---|---|
| **Dependent variable:** | **MONITOR** | **DIRAUD** | **INTEXT** |
| **Constant** | 1.679*** | 46.29*** | -1.846*** |
| | (2.729) | (5.481) | (-3.986) |
| **MNC** | 0.159** | 1.742 | -0.142** |
| | (2.116) | (1.692) | (-2.514) |
| **SIZE** | 0.533*** | -1.877*** | 0.129*** |
| | (16.00) | (-4.106) | (5.163) |
| **COMPLEX** | 0.237*** | -0.888 | -0.081** |
| | (5.318) | (-1.454) | (-2.403) |
| **RECINV** | 0.476** | 1.516 | 0.359** |
| | (2.439) | (0.566) | (2.443) |
| **LISTAT** | -0.155 | 2.943** | -0.068 |
| | (-1.784) | (2.467) | (-1.041) |
| **TOBINS' Q** | 0.095** | -0.635 | 0.083** |
| | (2.001) | (-0.974) | (2.321) |
| **R Squared** | **0.745** | **0.144** | **0.138** |
| **Adj R squared** | **0.738** | **0.121** | **0.115** |
| **F statistic** | **111.038** | **6.385** | **6.079** |
| **P value** | **0.0000** | **0.0000** | **0.0000** |

MONITOR = Total monitoring costs(ln); DIRAUD = Ratio of director costs to auditing costs; INTEXT = Ratio of internal audit costs to external audit costs (ln); MNC = MNC (Dummy); SIZE = Total assets(ln); COMPLEX =Number of subsidiaries(ln); RECINV = Ratio of inventories and receivables to total assets; LISTSTAT = Board listing (Dummy); TOBINS'Q = Growth

Notes: *** significant at 1% level; ** significant at 5% level ; * significant at 10% level

Another literature argues along the same line by claiming that the effects of global competition for MNCs force their global organising and decision making to be largely output based, which requires operational flexibility of the foreign subsidiaries where the power is decentralised (Luo, 2005). This spurs the need for better assurance and monitoring system compared to domestic companies to ensure that the power delegated is not misused and the decisions made by the managers /directors of the subsidiaries are in the best interest of the organisation as a whole.

Furthermore, it is argued that MNCs report their results in more detail compared to companies operating in one country only (Jaggi & Low, 2000), which will lead to more monitoring costs to be incurred such as audit costs. Logically, when more details are reported, more needs to be audited which leads to more audit effort, and consequently more audit fees will be charged. Niemi (2005) also claims that audit fees should be higher for the subsidiaries of foreign companies than their domestically owned counterparts because of the added complexity in its financial reporting structure and greater need for corporate governance in foreign-owned subsidiaries. This is particularly due to the fact that additional sets of financial statements may be prepared in multiple languages and involve foreign currency transformation and transfer pricing, which will require additional audit effort/ procedures and fees.

An independent t-test which examine the multinational and domestic companies (refer Row 2 in Table 2) also reveals that there is a significant difference between the monitoring costs of MNCs and domestic companies at $p < 0.001$. The descriptive statistic reveals that the average monitoring costs for MNCs is RM1,394,463, which is very much higher than the domestic companies' average monitoring costs of RM454, 753.

### 4.3.2 MNC and preference between directorship and auditing

Column three of Table 3 presents the multiple regression analysis used to test hypothesised $H_2$. The adjusted R squared for Model 2 is 0.121 and the F-value of 6.385 is significant ($p < 0.000$). This adjusted R squared means that more than 12% of the variation in the ratio of director costs to auditing costs can be explained by this model. However, the result indicates that multinational status is not a significant factor in the preference between the directorship and auditing. This result suggest that while monitoring is important (as indicated in the result in Model 1), the preference between directorship and auditing is less clear. Such results deserve further analysis in future research.

### 4.3.3 MNC and preference between internal and external auditing

Column four of Table 3 presents the regression analysis used to test the hypothesised variables for Model 3. The adjusted R squared for Model 3 is 0.115 and the F-value of 6.079 is significant ($p < 0.000$). This adjusted R squared means that more than 11% of the variation in the ratio of internal auditing costs to external auditing costs can be explained by this model.

The results in Table 3 relating to multinational and domestic companies indicate that companies which have multinational status have higher monitoring costs in external auditing compared to internal auditing. This variable is significant and in the expected direction, thus hypothesis $H_3$ is supported. This notion is consistent with earlier studies (Che Ahmad, 2001; Eichenseher, 1985).

This result may be explained by the need for an independent assurance system to check on the management of foreign subsidiaries' operations in multinational setting, as the headquarters need to know whether the overall objectives of the organization are achieved and the shareholders wealth is maximized or not. Internal audit may be considered to be less independent compared to external auditors, especially if this function is done in-house. If the function is outsourced, internal auditors will be reporting to the audit committee, which is the subcommittee of the board of directors of the subsidiaries. On the other hand, external auditors are outsiders and a third party who report to the shareholders of the company, thus they are viewed to be more independent to report on the subsidiaries' operation to the foreign headquarters compared to the internal auditors.

Furthermore, due to the perceived needs of international standards and high quality auditing of these organisations, which operate internationally and involve complex transactions (such as consolidated accounts, more detail reporting and currency transformation), it is claimed that headquarters in foreign control companies are likely to hire brand name auditors with international reputation (Che Ahmad, 2001). This is supported by an earlier study in US, by Eichenseher (1985), who reveals strong evidence of the tendency of MNCs to employ brand name auditors as compared to domestic companies. Even though the independent t-test in Table 2 (refer the last row) indicates that there is no significant difference between MNCs and domestic companies in their selection of Big 4 auditors, but the mean for MNCs in selecting the Big 4 appear to be higher compared to the mean for domestic companies.

Another plausible explanation for the higher external audit costs compared to internal audit cost incurred by MNCs is due to their appointment of brand name auditors with international reputation. This appointment of international auditors may also be due to the fact that the organisations want to portray that their financial reporting is consistent with worldwide standards, with the hope that it can ease their dealing with foreign investors and headquarters or subsidiaries. It is said that auditors with international reputation charge companies at a premium (Chan et al., 1993; Pong & Whittington, 1994; Anderson & Zhegal, 1994; Palmrose, 1986) which lead to higher external audit costs compared to internal audit costs, and results in a negative relationship as indicated in this study.

## 5.0 CONCLUSION

The major purpose of this study is to investigate the demand and preference for monitoring mechanisms by MNCs in Malaysian business environment. The results indicate that MNCs demand significantly greater monitoring costs compared to domestic companies. This may be due to the global and complex environment of MNCs and the physical and cultural distances which make control and monitoring for the parent-subsidiary level a much greater problem in multinational than in domestic companies. However multinational status is not significant when the cost of directorship and auditing are compared. But when internal auditing and external auditing costs are compared, the result indicates that companies with multinational status have significantly more external auditing costs. This result is consistent with prior studies and this result may be explained by the need for an independent assurance system to check on the management of foreign subsidiaries' operations in multinational setting, as the external auditors are viewed as more independent than internal auditors.

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