INSIDE AND OUTSIDE SHAREHOLDERS AND MONITORING: EVIDENCE FROM DEVELOPING COUNTRY

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Abstract

This paper tests the effect of managerial (inside) and block-holders (outside) ownership in relation to agency theory in Malaysian business environment. This study tests the agency relationship in different culture and social contact and provides evidence whether agency theory in non-western organizations have equal impact in Asian organizations. Consistent with agency theory and the convergence of interest hypothesis, managerial ownership (insiders) in Malaysia indicate a negative relationship with the demand for monitoring. This finding may be due to the fact that as the managers are also the owners, there is less conflict, less information asymmetry and less hierarchical organization structure in the companies, which lead to lower monitoring costs. However, another ownership structure, outside block-holders appear to demand more monitoring. This positive relationship may be explained by their effort to compensate their lack of involvement in the daily transactions and internal decisions of the company, especially in the concentrated business environment in the country.

Keywords: agency theory, block-holders, managerial ownership, monitoring costs, ownership structure

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I. Introduction

The divorce between ownership and management functions may lead to the possibility of principal–agent conflicts as the managers may not always act in the shareholders best interests and may misuse the corporate assets (Jensen and Meckling, 1976; Shleifer and Vishny, 1986). This divergence of interest between managers and shareholders may lead to "agency problems", and results in agency costs as described in agency theory (Farrer and Ramsay, 1998). Various factors have been considered to overcome this problem and reduce the costs. Fleming, Heaney and McCosker (2005) claim that ownership structure such as concentrated ownership and managerial structure can mitigate and reduce agency costs of an organization.

When managers own the shares of the firm, they have the incentive to increase the value of the firm rather than shrink as they have entrepreneurial gain in the company (Jensen and Meckling, 1976). It is believed that incentive to consume perquisites declines as manager's share ownership increases because his share of firm's profit increase with ownership while his benefits from perquisite consumptions are constant (Ang, Cole and Wuh Lin, 2000; Fleming et al., 2005), and accordingly, the incentive to pursue personal benefits increases when he own smaller portion of the firm's shares (Mat Nor and Sulong, 2007). Furthermore, as the owners are actively engaged in day to day activities of the company (Nimie, 2005), there will be less information asymmetry, less conflicts and less hierarchical organization structure. This less complex organization structure reduces the need for assurance and monitoring thus require less monitoring and agency costs.

Besides managerial ownership, another ownership structure suggested by the literature to reduce the agency problem is through concentrated ownership. It is claimed that concentrated ownership by outside shareholders (such as block-holders), have greater incentives to align management and shareholders' interests (Li and Simerly, 1998). Block-holders are also said to facilitate behavior-based monitoring from the capital market (Eisenhardt, 1989). Prior studies claim that share ownership by block-holders can help to monitor agency problems (Agrawal and Knoeber, 1996; Fleming et al., 2005; Fosberg, 2004; O'Sullivan, 2000). This is due to the fact that shareholders of an organization have a residual claim on the earnings and assets of the organization and therefore bear proportional to their share ownership, the economic consequences of actions taken by organization managers and directors. If managers engage in opportunistic behavior, shareholders bear a portion of the costs of such actions (Fama and Jensen, 1983a). Large shareholders

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are also claimed to have greater incentive to monitor management and have the necessary power to influence the company's policies since they will bear a significant proportion of managers' value destroying actions (Haniffa and Hudaib, 2006).

However, agency theory is also criticized for its ignorance of the existence of social and authority relationship and assumes social life is a series of contract (Johnson and Droege, 2004). It is unknown whether the agency theory findings in western countries have equal impact in Asian organizations (Ekanayake, 2004; Johnson and Droege, 2004). Previous literature (Conlon and Parks, 1990; HassabElnaby and Mosebach, 2005; Ekanayake, 2004) indicates that there is a possibility that given the cultural differences, the typical nature of agents in agency theory may not be the case with regard to non-western countries. Sharp and Salter (1997) argue that the agency effects are lower in Asia. It is also claimed that there is a limited empirical research that directly tests agency theory in different culture context (Ekanayake, 2004).

Thus, this study empirically examines the agency relationship in Malaysian organizations, one of the Asian countries. Besides being a developing country with an emerging market, Malaysia is chosen in this study because of its unique concentrated business environment. It is claimed that owner managed firms are common among Malaysian companies (Mat Nor and Sulong, 2007), and large shareholders also exist in these companies. This study defines block-holders as those shareholders who hold at least 5% or more of a voting right in an organization and are not linked to the organization management in either business or family relationship. Specifically this study focuses on the effect of managerial (insider) and block-holders (outsider) ownership on the agency costs of Malaysian public listed companies. This study uses the direct measure of agency costs, which are the cost of monitoring the companies as recommended by Malaysian Code of Corporate Governance (FCCG, 2001). This study aims to provide evidence that support or reject prior research findings in western countries relating to the effect of these ownership structures on the agency relationship which is reflected in its agency costs.

The results indicate an inverse relationship between managerial ownership (insider) and monitoring costs as predicted in agency theory. This is supported by the independent t-test which indicates that those companies which have high managerial ownership in their organizations have significantly lower monitoring costs compared to those with low managerial shareholdings. And, another ownership structure, outside block-holders appear to demand more monitoring to compensate for their lack of involvement in internal decisions of the companies. The finding indicates that as the percentage of shareholdings by block-holders increase, the monitoring costs also increase.

The remainder of the paper is organized as follows. The next section discusses the relevant literature on the role played by managerial and block-holders ownership in agency setting and how it affects the agency costs, which lead to the hypotheses development. The methodology employed in this study is outlined in Section III and the results of empirical testing are presented in Section IV. The paper ends with the conclusion of the research.

II. Literature review and hypothesis development

A. Principal-agent relationship in agency theory

Initially, physical assets defined an individual's net worth to denominate wealth (Carlson, Valdes and Anson, 2004). Examples of such assets are lands. Kings and members or royalty defined their power based on the land that they owned. Later, as the economic activities changed from agricultural to industrial economy, this basis changed from ownership of land to ownership of legal entities. In their discussion of the origin of the word "share ownership", Carlson et al. further claim that as a consequence of the industrial revolution, public organizations are established to create goods and services and stocks and bonds are created to support the financing of the new enterprises. These stocks also reflect the ownership of the organizations. If in the past, banks are the custodians of physical assets of their clients (such as coins, jewels, and land deeds), with the full force of industrial revolution, banks begin to "hold shares of ownership" in public organizations, which create the term "shareholders".

With the acceptance of industrial revolutions also, organizations grow bigger, and the owners are no longer the managers of the organizations. It is not practical for the shareholders to make day to day decisions of the organizations and this job is delegated to the managers. This separation between the owner and managers tends to create agency problems as claim in agency theory.

Agency theory postulates that the firm consists of a contract between the owners of economic resources (the principal) and management (the agents) who is charged with using and controlling these resources (Jensen and Meckling, 1976). This theory posits an inherent moral hazard problem in these relationships, which in turn give rise to agency costs for the organization. The agency relationship between the principal and the agent give rise to agency costs because the managers may not act in the owners' best interest, such as consumption of excessive perquisites and sub-optimal investments (Fleming et al., 2005). Agents normally have more information than principals and this information asymmetry adversely affect the principal's ability to monitor whether their interest are being properly served by the agents

(Adams, 1994). The principals want to ensure that their resources are being utilized in the best manner possible, which later will flow back to them in the form of dividend. Whereas the agents are also concern as this would be the measurement of their efficiency in managing the company, and may be the source for the determination of their salary/remuneration in the future.

In the process of discharging the duties, agency theory assumes that the agents and principal will act rationally and they will use the contracting process to maximize their wealth. According to Kren and Kerr (1993), to ensure the efficiency in the contracting process, both principal and agents will incur contracting cost. For instance, to minimize the risk of shirking by agents, the principal will appoint the board of directors (Fama and Jensen, 1983a) and auditors. The board of directors will ensure that the management acts on behalf of shareholders, i.e. increase the wealth of the corporation (Iskandar and Mohd Salleh, 2004). An effective board of directors will provide a measure of reducing the agency problem, which will then lead to transparency of financial reporting and good governance of the organization. And, the external auditors will examine the financial statements prepared by the management to ensure their compliance to the standards, rules and regulations required and reflect the true and fair view of the organization's transactions. Agents on the other hand will incur bonding cost, for example, the cost of internal audit in order to signal to the owner that they are acting responsibly and consistent with their contract of employment (Adams, 1994).

B. Agency costs and managerial ownership

Prior literature suggests various ways to overcome this agency problem. Among others, it is claimed that managerial shareholdings can reduce and mitigate agency costs (Jensen and Meckling, 1976; Agrawal and Knoeber, 1996; Ang et al., 2000; Chow, 1982; Fleming et al., 2005; O'Sullivan, 2000). They argued that the agency costs of equity arise from the direct expropriation of funds by the managers, consumption of excessive perquisites, shirking, sub-optimal investment and entrenching activities. Thus, earlier studies suggest that managers are encouraged to own the organizations' share to motivate management monitoring (Agrawal and Knoeber, 1996; Fleming et al., 2005). This is because the higher the portion of the shares, the more responsible is the manager to increase the value of the companies. According to the original agency theory by Jensen and Meckling (1976), and Fleming et al. (2005), equity agency cost is zero when there is a 100% owned manager organization, and there is a positive relationship between equity agency costs and the separation of ownership and control. As owner manager equity ownership falls below 100%, the equity ownership becomes relatively dispersed. In this circumstance, the manager has a greater incentive for shrinking or the consumption of excessive perquisites. This is due to the fact that although the firm's value falls, the managers only bear a portion of the expense related to their ownership stake (Farrer and Ramsay, 1998). In other words, a lower managerial equity holding is associated with lower incentive and effort exert by the managers in their responsibilities to seek profitable investments. Chow (1982) suggest that when managers own smaller equity stake in their firms they have an increased incentive to falsify financial disclosures, since such disclosures are likely to be utilized by shareholders in setting managers' remuneration.

This notion is also supported by Ang et al. (2000) and Fleming et al. (2005) who find that there is an inverse relationship between the agency cost and managers' ownership share and a direct relationship with the number of non-manager shareholdings. The incentive to consume perquisites declines as his ownership share rises, because his share of the firm's profits rises with ownership while his benefits from perquisite consumption are constant. It is also suggested that managerial shareholdings help align the interests of shareholders and managers in its convergence of interest hypothesis (Jensen, 1993).

The higher the ownership of the firm by the management, the less the conflicts among the stakeholders, the less the agency problem and cost associated with it (Friend and Lang, 1986; Jensen and Meckling, 1976). This is because the insiders have incentives to protect shareholders interests and need less supervision by the board, since board activity is a costly monitoring alternative (Vafeas, 1999). It is also said that increased agent ownership reduces the need for monitoring as the incentive alignment is enhanced. The convergence of interest model suggested by Jensen and Meckling (1976) claim that an increase in the proportion of firm's equity owned by insiders is expected to increase firm value as the interest of inside and external shareholders are realigned, and consequently there is a reduced need for intensive audit. O' Sullivan (2000) finds that significant managerial ownership results in a reduced need for intensive auditing which may be due to the merging functions of ownership and management, and consequently minimize the monitoring motivation for audit. The auditors are also said to be less inclined to undertake additional testing when managers are also significant equity holders, since owner managers are less likely to deliberately mislead themselves (O'Sullivan, 2000). Publicly traded firms in which top management has a larger ownership stake experience corporate crime (proxy for agency cost) less frequently (Alexander and Cohen, 1999). Managers also will have more powerful incentives to make value maximizing decision about capital structure as their stock ownership is high (Berger, Ofek, and Yermack, 1997). Besides increase incentive to

maximize the firm value, holding common stocks also motivate the managers for its underlying voting rights, such as increase their influence on board of directors and hence on the firm's general policy (DeAngelo and DeAngelo, 1985).

However there are also studies which suggest contradict and mix findings, such as Singh and Davidson (2003) who conclude that managerial ownership does not serve as a significant deterrent to excessive discretionary expenses which is used as a proxy for agency cost in their study. Prior studies also claim that managers who owned excessive shareholdings in their companies and not diversified would be more risk averse than other shareholders. This may motivate the managers to adopt overly conservative approach which suppresses shareholders return, as the financial collapse of the company may cause the financial collapse of the directors (Farrer and Ramsay, 1998; Fama and Jensen, 1983b; Loh and Venkatraman, 1993). In other words, if the managerial shareholdings are too high, their interests may not be aligned with the interests of other shareholders.

In terms of this ownership structure's association with another monitoring mechanism, that is auditing, it is found that the lower the managerial share ownership in a company, the greater the probability of the company being audited (Tauringana and Clarke, 2000). Another literature claims that agency theory suggests that in the absence of regulation, the propensity of firms to demand independent audit is a function of the extent of the divorce between ownership and control (Chan, Ezzamel, and Gwilliam, 1993). This is supported by Fan and Wong (2005) who claim that external auditors play a monitoring and bonding role in order to mitigate the agency conflict between the controlling owners and the outside investors.

Thus, it is claimed that management monitoring can be provided by encouraging the managers to own the shares of the organizations (Fleming et al., 2005; Agrawal and Knoeber, 1996). This is supported by Jensen and Meckling (1976) who claim that agency problems can be mitigated by making managers owners of the organizations, because when managers have entrepreneurial gain, they have the incentive to increase the value of the organization rather than shirk.

It is further claimed that the higher the managerial ownership, the lower the demand for monitoring mechanisms as the owners are actively engaged in day to day activity (Niemi, 2005), and therefore will lead to less conflicts and less information asymmetries. Ang et al. (2000) and Fleming et al. (2005) claim that the incentive to consume perquisites declines as managers ownership share arises, because their share of the organization's profit rises with ownership while their benefits from perquisite consumption are constant. This is supported by Jensen and Meckling (1976) and Mat Nor and Sulong (2007) who argue that when managers own a smaller portion of the organization's share, they have greater incentive to pursue personal benefits and less incentive to maximize organization value. Thus, one of the ways to reduce the associated increase in agency costs is to increase the shares held by managers. It is also assumed that owner-managers are more efficient in controlling corporate assets than hired managers, which result in less hierarchical organizational structure. This less complex organization structure also reduces the need for assurance and monitoring (Abdel-Khalik, 1993). Jensen (1986) further argues that management risk averse behavior will give an impact on audit effort through the audit risk assessment, which would result in lower audit effort and fees (Niemi, 2005). In summary, manager owned organizations are predicted to have lower perquisite consumption, less conflict, lower information asymmetry, less hierarchical and lower organizational complexity and lower risk, which would result in lower monitoring needed. Furthermore, the greater the shares held by the managers, the greater is their incentive to maximize the organization value and reduce the monitoring costs. Therefore, it is hypothesized that:

H_1: The greater the ownership control by the managers (insider), the lower is the total monitoring costs of the organization.

C. Agency costs and block-holders ownership

Another ownership structure, that is block-holder equity stake, also indicates greater incentives and capability to monitor management (Singh and Davidson, 2003; Fleming et al., 2005; Fosberg, 2004). Prior studies claim that share ownership by block-holders can help to monitor agency problems (Agrawal and Knoeber, 1996; Fleming et al., 2005; Fosberg, 2004; O'Sullivan, 2000). This is due to the fact that shareholders of an organization have a residual claim on the earnings and assets of the organization and therefore bear proportional to their share ownership, the economic consequences of actions taken by organization managers and directors (Haniffa and Hudaib, 2006). If managers engage in opportunistic behavior, shareholders bear a portion of the costs of such actions (Fama and Jensen, 1983a).

It is also said that block-holders existence in an organization can resolved the conflict of interests over financing policy arise between managers and shareholders because of the fact that managers preference for lower organization risk due to their under-diversification (Fama, 1980), and managers' dislike to being subject to performance pressure that large fixed interest payment entails (Jensen, 1986). Managerial insiders are reluctant to use the optimal amount of debt financing for the organization because of the additional bankruptcy risk associated with higher level of debt engender (Fosberg, 2004).

Therefore managers will not issue the optimal amount of debt without pressure from a disciplining force (Jensen, 1986). However, the shareholders want the leverage to be used at its optimal level in order to maximize the organization value. Berger et al., (1997) and Borokhovich, Brunarski, Harman, and Kehr (2005) claim that this conflict can be resolved by having block-holders in the organization as they find that leverage rises in the presence of significant block-holders. Again, this suggests that block-holders have a strong incentive to monitor the opportunistic behavior of organization managers.

A local study by Mat Nor and Sulong (2007) postulates that large share ownership provides the incentive of controlling shareholders to use their influence to maximize value, exert control and to protect their interest in the company. They further claim that majority control gives the largest shareholders considerable power and discretion over organization's important decisions.

This is supported by Haniffa and Hudaib (2006) who claimed that large shareholders have greater incentive to monitor management and have the necessary power to influence the company's policies since they will bear a significant proportion of managers' value destroying actions. On the other hand, a well-diversified investor is not particularly worried as the bankruptcy risk of any one organization in the portfolio of investments will not have a large impact on their wealth. Consequently, a shareholder's incentive to monitor insiders and ensure that the organization is properly managed is directly related to the proportion of the organization's shares that the shareholder owns. And it is further expected that block-holders would favor more extensive audit and consequently pay higher audit fees as they have the financial incentives to ensure maximum monitoring is undertaken (O'Sullivan, 2000). Furthermore, this scenario may be expected in Asian countries such as Malaysia as the businesses are claimed to be very concentrated (Ow-Yong and Guan, 2000; Mat Nor and Sulong, 2007), especially with family businesses (Haniffa and Hudaib, 2006). Thus the outside shareholders have no idea about how the businesses are conducted unless through an external verification such as an audit.

This is supported by another literature, Hay et al., (2008), who suggest two possible outcome of having block-holders in the governance structure of an organization. The first outcome is consistent with agency theory. A block-holder that is actively involved in operations and decision making (such as managerial shareholdings) may have such a broad span of control over activities and internal control that the need for other mechanisms such as external auditing may be reduced. On the other hand, a major outside shareholder (such as outside block-holders) may also use this influence to increase external auditing to compensate for a lack of control over other internal decisions.

Hence, it is argued that block-holders will assist in the monitoring of the organization as they have the incentive to do so and this monitoring is directly related to the proportion of the organization's shares that the shareholders own. And, as the data is collected using Malaysian sample companies which are claimed to be concentrated, especially with family businesses, and the study defined block-holders as outside large shareholders who are not involved in the daily activities of the companies, these large shareholders are expected to demand more monitoring to compensate for their lack of control over the internal decisions and daily transactions happen in the companies. This is also consistent with the earlier studies (Adams, 1994; Kren and Kerr, 1993) which claim that the principals and agents in the agency relationship will incur contracting costs to minimize the risk of shirking by the agents, ensure optimal investment of the organizations and motivates more transparent reporting. Thus, it is hypothesized that:

H_2: The greater the ownership control by the block-holders (outsider), the greater is the total monitoring costs of the organization.

III. Data and Methodology

A. Data and sample

Data for the study was collected using primary and secondary sources. Primary data was collected using cross-sectional surveys which were sent to Malaysian public listed companies. Data collection cannot be done solely by using secondary data, as some of the information needed (such as internal audit costs) for the study is not available from secondary sources (such as annual reports).

The population of the study includes all 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, Kent and Clarkson, 2006; Mat Nor and Sulong, 2007). Questionnaires were sent to all 867 companies in the population.

Once the questionnaires were returned, the annual reports of those companies with completed questionnaires were scrutinized for further information to be used in the study. The secondary data was hand-collected from the companies' annual reports which were available at Bursa Malaysia's website (http://www.bursamalaysia.com.my).

In the annual report, the Directors' Report, Statement on Internal Control, Corporate Governance Statement, directors' profile, Shareholdings Statistics, Corporate Information, Statement of Directors' Shareholdings, the financial statements and notes to the accounts are scrutinized. Information on directors' shareholding and directors' background can be

gathered from the directors' profile, Corporate Governance Statements, Shareholdings Statistics and notes to the accounts. The external audit fees, book value of the assets, total receivables, total inventories, total long term debts and number of subsidiaries can be gathered from the financial statements and notes to the accounts. The information about the existence of the internal audit department is normally included in the Statement of Internal Control; however, it is not mandatory to disclose the internal audit cost. Only 3 companies voluntarily disclose their internal audit costs. Information needed to calculate Tobin's Q and return to total assets (ROA) can be gathered from the financial statements. Data from the annual reports were then transferred to the worksheets.

The information gathered from the questionnaires was also tabulated in the worksheet and further matched and validated with the information obtained from the annual report. This will then address the reliability concern of our survey data as conducted by Anderson, Francis and Stokes (1993) in their study of Australian companies. Non response bias was also conducted for the data collected from the questionnaires.

After considering the incomplete and inconsistence questionnaires, there were 235 usable samples for the study. The data was also inspected for outliers by means of standard regression diagnostics at three standard deviations (as suggested by Hair, Anderson, Tatham and Black, 1998, p. 65). Normality check of the data was also carried out and some of the measures were transformed into logarithm to control for skewed nature of data. As multivariate regression is used to analyze the data in this study, assumptions of multicollinearity, homoscedasticity and linearity are also tested.

B. Variable definition

Dependent variable in this study is the monitoring costs of the companies listed in Bursa Malaysia. Earlier studies use indirect measurement such as asset utilization ratio (Singh and Davidson, 2003), ratio of selling and administration expenses to sales (Singh and Davidson, 2003) and ratio of operating expenses to sales (Ang et al., 2000) as proxies for agency costs incurred by the firms in monitoring their firms. But this study uses measurements that are directly related to these firms in monitoring the shareholders wealth of their companies. Directorship and auditing (internal and external) are specified as monitoring mechanisms in the Malaysian Code of Corporate Governance (FCCG, 2001). Thus, the dependent variables in this study involve the costs of these monitoring mechanisms demanded by the organization in Ringgit Malaysia (RM). However, as the executive directors are in-charged of managing the companies, and the non-executive directors are said to monitor and controlling the opportunistic behavior of the management (Jensen and Meckling, 1976; Haniffa and Hudaib, 2006), this study does not include executive directors' remuneration as monitoring costs. Hence, total Monitoring (MONITOR) is measured by the sum of organization investment in non-executive directors' remunerations (DIRREMNED), internal auditors' costs (INTCOST) and external auditors' costs (EXTCOST).

Table 1. Operationalization of the research variables

Variable	Explanation	Measurement
Dependent variable: MONITOR	Total of external audit costs, internal audit costs and non-executive directors remuneration	Total Monitoring = External audit costs (EXTCOST) + Internal audit costs (INTCOST) + Non- executive Directors remunerations (DIRREMNED)
Independent variable:		
MGROWN	Managerial ownership(Insiders)	Percentage of executive directors' shareholdings (%)
BLKOWN	Block-holders shareholdings (Outsiders)	Percentage of block-holders' shareholdings (%)
Control Variables:		
SIZE	Size of the organization	Natural log of total assets
COMPLEX	Complexity of an organization's operation	Natural log of number of subsidiaries (including its head-office)
RECINV	Complexity of an organization's assets	(Inventories and Receivables)/ Total assets
DEBT	Debt of the organization	Long term debt / Market value of the firm
RISK	Risk of an organization	1 if company has a loss in current year and 0 otherwise.
ROA	Performance of an organization	Profit before interest and tax /Total Assets (ROA)
GROWTH	Growth of an organization	Market value of the firm / total assets (Tobin's Q)
LISTSTAT	Listing status of an organization	1 if company is listed in the main board, and 0 otherwise
INDUSTRY	Industry	CONTRASE – for companies in consumer, trading and services sectors; INDPROP - for companies in industrial, construction and property sectors

The independent variables in this study are managerial ownership (MGROWN) who are the insiders and block-holders ownership (BLKOWN), who are the outsiders. The study defines managerial ownership as the total percentage of executive directors' shareholding, while the block-holders is the

total percentage of shareholding of block-holders who hold at least 5% or more of a voting right in an organization and are not linked to the organization management in either business or family relationship. The controlled variables include in the study are size, complexity, performance, risk, growth, listing status and industry.

The following model is used to analyze the relationship between the monitoring costs and ownership structure:

$$MONITOR = \alpha_i - b_1 MGROWN_i + b_2 BLKOWN + b_3 RECINV + b_4 DEBT b_5 COMPLEX_i + b_6 SIZE_i - b_7 RISK_i - b_8 ROA_i + b_9 GROWTH_i + b_{10} LISTSTAT_i + b_{11} CONSTRASE_i + b_{12} INDPROP_i + \varepsilon_i$$

Variable definitions, labels and measurement used are reported in Table 1.

IV Results and discussions

A. Descriptive statistics

Panel A and Panel B of Table 2 presents the descriptive statistics for the variables used in the study. Panel A reports those for continuous variables and Panel B presents those for dichotomous variables. Panel A shows that non-executive directors' remunerations constitute the largest component of monitoring costs, followed by internal audit costs and external audit costs ranking second and third respectively. The mean percentage of shareholdings by the managers is about 27%, which is approximate the 34% average of Haniffa and Hudaib (2006) findings. The mean percentages of block-holders shareholdings, which do not include those parties involved in the management or have any family relationship with the managers, is about 15%. Further analysis indicates that about 21.3% of the cases have the cumulative largest shareholders owning more than 25% of the issued shares in the companies, and about 42.5% with accumulative largest shareholders owning between 5% to 25%. This suggests that Malaysian companies are concentrated and less diffused.

The ratio of long term debt to the market value ranges from 0% to 93% with the average close to 15%. The descriptive statistics also show that the sample companies cover a wide range of companies, some moderately small and some relatively large, range from those with RM18 millions to RM65,092 millions of total assets. The complexity of the companies in terms of their operations range from simple, where there are companies with only their head office with no subsidiary, to more complex. The complexity of their assets' compositions also reflect the same pattern, the ratio of inventories and receivables to total assets range from 0.19% to 80% and the average is about 31%. On average, the respondent companies have the total assets of RM1,564 millions and 20 subsidiaries, while the average Tobin's' Q is 1.05. Panel B reports that about 75% of the companies are listed in the main board of the Bursa Malaysia, and the balance in the second board. Only 20% of the companies suffer a loss in the current year.

Table 2 . Descriptive statistics of variables

Panel A:Continuous variables				
Variables	Mean	Std dev	Minimum	Maximum
INTCOST (RM)	280,896	971,753	0	10,000,000
EXTCOST (RM)	263,487	732,805	15,000	9,700,000
NEDREMM (RM)	302,249	435,358	0	4,045,000
MONITOR (RM)	846,632	1,799,424	56,900	21,010,000
MGROWN	0.272734	0.2323824	0.0000	0.8637
BLKOWN	0.151725	0.1910793	0	0.7657
DEBTSTRC	0.1468	0.1584435	0.0000	0.9328
RECINV	0.308798	0.1945093	0.0019	0.8046
COMPLEX	19.74	34.801000	1.0000	445.00
SIZE (RM)	1,564,597,791	5,679,828,495	18,261,685	65,092,100,000
ROA	0.010054	0.2258620	-3.0172	0.2037
GROWTH	1.051495	0.7091715	0.3081	7.9680
Panel B : Dichotomous variables				
	Yes	%	No	%
LISTSTAT	175	75	60	25
RISK	46	20	189	80
CONTRASE	78	33	157	67
INDPROP	126	54	109	46

Variable definition:

INTCOST = Total internal audit cost in RM; EXTCOST = Total external audit costs in RM; NEDREMM = Total NED remunerations in RM; MONITOR = Total monitoring costs in RM; MGROWN = Executive directors' shareholdings (%);DEBTSTRC = Long term debt to market value of the firm; RECINV = Ratio of inventories and receivables to total assets; COMPLEX = number of

subsidiaries(including the head office); SIZE = Total assets in RM; ROA = ROA; GROWTH = Tobin's Q; RISK = Current year loss(Dummy); LISTSTAT = Board listing (Dummy); CONSTRASE = Companies in consumer, trading and service sectors (Dummy); INDPROP = Companies in industrial, constructions and property sectors (Dummy).

The results of standard tests on skewness and kurtosis in Table 3 indicate that there is no problem with normality assumption [11]. A visual check for normality using histogram and normal probability plots is also carried out. All the histograms appear to be reasonably normally distributed and the normal distribution of the probability plot forms a straight line and the values appeared to fall approximately on this normality line. Thus, these variables can reasonably be considered as normally distributed. In summary, the model does not violate the basic OLS assumptions and could be used to test the expected hypotheses.

Table 4 presents the correlation matrix for the dependent and independent variables. The result indicates that there is no multicollinearity problem, as the correlations are below the threshold value of 0.8 (Gujarati, 2003, p. 359).

Variable definition:

MONIITOR = Total monitoring costs(ln); MGROWN = Executive directors' shareholdings (%); DEBTSTRC = Long term debt to market value of the firm; SIZE = Total assets(ln); COMPLEX = number of subsidiaries(ln); RECINV = Ratio of inventories and receivables to total assets; ROA = ROA; RISK = Current year loss(Dummy); GROWTH = Tobin's Q; LISTSTAT = Board listing (Dummy); CONSTRASE = Companies in consumer, trading and service sectors; INDPROP = Companies in industrial, constructions and property sectors.

[11] The data is said to be normal if the standard skewness is within ±1.96 and standard kurtosis is between ±3.0 (Mat Nor and Sulong, 2007; Abdul Rahman and Mohamed Ali, 2006; Haniffa and Hudaib, 2006).

Table 3. Normality test statistics of sample companies

Variable	Mean	Minimum	Maximum	Std Dev	Skew ness	Kur tosis
MONITOR	12.9841	10.9491	16.8605	1.0005	0.864	0.922
MGROWN	0.2727	0.0000	0.8637	0.2324	0.210	-1.230
BLKOWN	0.1517	0.0000	0.7657	0.1911	1.500	1.470
REVINV	0.3088	0.0019	0.8046	0.1945	0.329	-0.888
COMPLEX	2.4998	0.0000	6.0981	0.9091	0.232	1.430
RISK	0.2000	0	1	0.3980	1.544	0.386
SIZE	19.744	16.720	24.8991	1.4171	0.911	0.887
LISTSTAT	0.7400	0	1	0.4370	-1.130	-0.731
CONSTRASE	0.3300	0	1	0.4720	0.718	-1.497
INDPROP	0.5400	0	1	0.5000	-0.146	-1.996
ROA	0.0101	-3.0172	0.2037	0.2259	-10.814	140.20
GROWTH	1.0515	0.3081	7.9680	0.7092	5.424	42.856

Note: Figure in the parenthesis is the P value

Table 4. Correlation matrix

Variable	MONITOR	MGROWN	BLKOWN	DEBTSTR	RECINV	RISK	SIZE	COMPLEX	ROA	GROWTH	LISTSTAT	CONSTRASE	INDPROP
MONITOR	1.00												
MGROWN	-0.26***	1.00											
BLKOWN	0.31***	0.45***	1.00										
DEBTSTRC	0.24***	-0.01	0.08	1.00									
RECINV	-0.21***	0.19***	0.16***	-0.37***	1.00								
RISK	-0.25***	-0.03	-0.09*	0.07	0.00	1.00							
SIZE	0.82***	-0.21***	0.28***	0.42***	-0.40***	-0.23***	1.00						
COMPLEX	0.61***	-0.10*	0.05	0.22***	-0.14**	-0.04	0.52***	1.00					
ROA	0.15**	0.07	-0.02	0.02	0.05	-0.43***	0.20***	-0.05	1.00				
GROWTH	0.09*	-0.13**	0.18***	-0.16**	0.00	0.01	0.05	-0.04	-0.50***	1.00			
LISTSTAT	0.32***	-0.13**	0.15***	0.06	-0.23***	-0.28***	0.47***	0.21***	0.18***	0.06	1.00		
CONSTRASE	0.11*	-0.11*	0.14**	-0.02	0.09*	-0.10*	0.02	0.09*	0.07	0.04	0.00	1.00	
INDPROP	-0.15**	0.10*	0.13**	0.01	0.09*	0.09*	-0.09*	-0.07	-0.08	-0.08	-0.09***	-0.76***	1.00

Notes: *** significant at 1% level
** significant at 5% level
* significant at 10% level
(See variable definition in Table 3)

B. Results of main model

Column two of Table 5 presents the multiple regression analysis used to test the main model. The adjusted R squared for the model is 0.757 and the F-value of 61.837 is significant (p <0.000). The value of the adjusted R squared is very high, as well as statistically significant, which suggests that it is a good predictive model of monitoring costs for Malaysian data. It means more than 75% of the variation in the monitoring costs can be explained by the model. This adjusted R squared is also very much higher compared to a similar study by Anderson et al. (1993) on monitoring cost, which use Australian data, but with only one independent variable (assets in place), where its adjusted R-squared is 0.423.

Managerial ownership (insider)

The independent variable, managerial ownership appears to have significantly negative relationship with monitoring costs as predicted by agency theory. This result implies that the greater the managerial ownership in an organization the lower is its total monitoring costs. This finding is consistent with earlier studies in western countries by Jensen and Meckling (1976), Fleming et al. (2005), Ang et al. (2000), Jensen (1993), Nimie (2005) and Friend and Lang (1986).

This result is also consistent with the convergence of interest model which claim that an increase in the proportion of firm's equity owned by insiders is expected to increase firm value as the interest of inside and external shareholders are realigned, thus result in less conflict among the shareholders. Furthermore there will be less information asymmetry and less hierarchical organizational structure as the managers are now the owners, and are actively engaged in day to day activities of the organizations (Nimie. 2005). This is agreed by Ang et al. (2000) and Fleming et al. (2005) who claim that the managers' incentive to consume perquisites declines as their ownership share rises because his share of the firm's profits rises with ownership while his benefits from perquisite consumption are constant. A local study by Mat Nor and Sulong (2007) also argues along the same line by claiming that when managers own a smaller portion of the organization's share, they have greater incentive to pursue personal benefits and less incentive to maximize firm values. In addition, holding common stocks also motivate the managers for its underlying voting rights, such as increase their influence on board of directors and hence on the firm's general policy (DeAngelo and DeAngelo, 1985).

Furthermore, this result may also be more pronounced in Malaysian concentrated business environment, where owner-managed companies are common among listed companies in Malaysia (Mat Nor and Sulong, 2007), especially with family businesses (as claimed by Haniffa and Hudaib, 2006). This concentrated agency setting is expected to have low conflict among the contracting parties (Fleming et al., 2005; Fama and Jensen, 1983a), thus lead to low risk (Francis and Wilson, 1988) and low monitoring costs. They tend to run the businesses themselves or appoint family members, and they are concern with the survival of the organizations, not only over their lifetime, but also with the wellbeing of the next generations (Bhattacharya and Ravikumar, 2001). Thus, they will really consider the monitoring costs incurred by the companies and the allocation of the resources in order to ensure the future survival of the organizations.

The finding of this study is also consistent with a study by Nikkinen and Sahlstrom (2004) who conduct an analysis of audit pricing (one of the monitoring costs in this study) and its relationship with agency theory by using data from seven countries including Malaysia. Consistent with the theory, they find a significant negative relationship of managerial ownership with audit fees at 5% level of confidence for Malaysian data.

Further tests are carried out, where the sample companies are segmented into companies with high and low managerial shareholdings by using the average managerial shareholdings in Table 2 as a cut-off point. The main model is re-estimated using this alternative. The re-estimated result for the alternative is presented in column three of Table 5, which indicates that managerial ownership is negatively significant at $p < 0.07$, while other variables remain the same. Independent t-test is also carried out using the same data. The result of the test reveals that the monitoring costs of companies which have high managerial shareholdings are significantly different from those with low shareholdings (at p-value < 0.00). The average monitoring costs for those with high and low shareholdings are RM533, 436 and RM1,196,508 respectively.

Table 5. Cross sectional OLS regression of monitoring costs on managerial ownership and block-holders

Variables	Main Model	Segmented the companies to those with high and low managerial shareholdings	Segmented the companies to those with high and low block-holders shareholdings
INTERCEPT	1.998**	1.967**	1.930**
	(3.038)	(2.994)	(2.961)
MGROWN	-0.266**	-0.108*	-0.284**
	(-1.663)	(-1.497)	(-1.850)
BLKOWN	0.421**	0.452**	0.183**
	(2.116)	(2.319)	(2.455)
DEBTSTRC	-0.511**	-0.534**	-0.510**
	(-2.081)	(-2.181)	(-2.081)
RECINV	0.517**	0.500**	0.499**
	(2.592)	(2.514)	(2.510)
RISK	-0.169**	-0.163*	-0.181*
	(-1.761)	(-1.702)	(-1.895)
SIZE	0.530***	0.531***	0.533***
	(14.434)	(14.452)	(14.700)
COMPLEX	0.280***	0.282***	0.283***
	(6.326)	(6.351)	(6.396)
ROA	0.096	0.105	0.129
	(0.472)	(0.514)	(0.634)
GROWTH	0.066	0.064	0.073
	(1.127)	(1.080)	(1.249)
LISTSTAT	-0.248**	-0.250**	-0.249**
	(-2.856)	(-2.869)	(-2.879)
CONSTRASE	-0.062	-0.060	-0.048
	(-0.564)	(-0.540)	(-0.440)
INDPROP	-0.150	-0.152	-0.140
	(-1.450)	(-1.467)	(-1.352)
R-squared	0.770	0.769	0.771
Adj R-squared	0.757	0.757	0.759
F-Statistics	61.837	61.649	62.387
P-value	0.000000	0.000000	0.000000

(See variable definition in Table 3)

Block-holders ownership (outsider)

Another ownership structure, concentrated ownership by outside block-holders in the main model is also significant. The result suggests that as the percentage of ownership by block-holders increase, more monitoring costs are incurred. This finding is consistent with the earlier literature by Adams (1994) and Kren and Kerr (1993) which claim that the principals and agents in the agency relationship will incur contracting costs to minimize the risk of shirking by the agents, to ensure optimal investment of the organizations and to motivate more transparent reporting. In addition, this finding is also supported by a study by Hay et al. (2008) who suggest that a major outside shareholder may also use their influence to increase monitoring costs to compensate for a lack of control over other internal decisions. This is particularly more pronounced in Malaysian business environment which is claimed to be more concentrated with family businesses who normally would appoint their family members to run the businesses and the outsiders do not know what is happening in the companies. Thus, the only way to find out is through an independent check by high quality auditors or having a really independent directors or audit committee. Obviously, in this situation, these outside block-holders have the financial incentives to ensure that maximum monitoring is undertaken (O'Sullivan, 2000).

Another plausible explanation for this positive and significant result in this study may be associated with the pressure for more monitoring costs by minority shareholders as a balance against the power of the major shareholders. This scenario of large shareholders (such as block-holders) is especially pronounced in the Malaysian business environment which is dominated by concentrated ownership (Ow-Yong and Guan, 2000; Mat Nor and Sulong, 2007; Haniffa and Hudaib, 2006). The minority shareholders in this scenario is said to be in the highest risk of being expropriated (Ow-Yong and Guan, 2000) and protection of minority shareholders may be problematic (Haniffa and Hudaib, 2006), which explain the motivation for the formation of Minority Shareholders Watchdog Group (MSWG) in the year 2000, in Malaysia. Through this body, the minority shareholders can voice their dissatisfaction

and urge for more monitoring in the listed companies to protect their interest. They have urged for more monitoring of management activities (BPPSM komen, 2005) and demand that block-holders play a more dominant monitoring role (Watchdog group, 2002; Isu KFCH, QSR, 2005). This positive relationship may be due to the pressure from this group to ensure that their interests are protected.

This greater demand for monitoring mechanisms by outside block-holders in this study may also be due to their reactions to the requirement by the Code after 1997/98 financial crisis and to protect their interest in response to the recent increase in governance problem among listed companies in Malaysia (such as those highlighted in the newspaper: Negligence suit, 2002; Wan Hussin and Ibrahim, 2003; Sidhu, 2006; KFC saman, 2006) and the fear of Enron case incident in Malaysia (as reported in Pengaudit, 2002). Many companies were closed down/ bankrupt after the crisis, which spur a lot of countries to improve their governance and regulations, and professional bodies to re-look at the existing code of conducts and consider its appropriateness. The same scenario happens in Malaysia, the listing requirements are reviewed, the Code is released, MSWG is formed and MIA's Bye-laws and code of conducts are revised. There are also calls for block-holders to play their monitoring roles to protect the shareholder wealth (Watchdog group, 2002; Isu KFCH, QSR, 2005). Thus, the researcher argues that the positively significant result in this study is due to the fact that, learning from the companies downfall after the crisis which also involve the interest of the large shareholders, and the tighten regulations (such as those revised requirements introduced by the exchange and the Code) after the crisis, coupled with the fact that increase monitoring can compensate for their lack of control over other internal decisions by the management, motivate the block-holders to answer the calls for a better monitoring role compared to before and during the crisis.

Additionally, the outside block-holders are also segmented into block-holders with low and high shareholdings by using the average block-holders shareholding in Table 2 as a cut-off point. The main model is re-estimated, and the result is shown in Table 5 (column four). All the significant variables are the same as the earlier result in the main model. Those companies with high outside block-holders' shareholdings appear to have higher monitoring costs compared to those with low block-holders' shareholdings. An independent t-test runs using the same data reveals that the monitoring costs of companies having high outside block-holders' shareholdings are significantly different from those with low shareholdings at 5% and 10% level of confidence. The average monitoring costs for those with high and low outside shareholdings are RM1,400,075 and RM576,916 respectively.

V. Conclusions

Overall, the findings from this study indicate that ownership structure, particularly, the concentrated ownership by managers and block-holders affect the demand for monitoring costs by Malaysian companies. This study tests the agency relationship in different culture and social contact and provides evidence whether agency theory in non-western organizations have equal impact in Asian organizations. The result suggests that managerial ownership in Malaysian companies has a significant negative relationship with total monitoring costs as predicted by agency theory. This finding is also consistent with the findings of the earlier studies in western countries (O'Sullivan, 2000; Ang et al., 2000; Fleming et al., 2005).

Another ownership structure examines in this study, outside block-holders appear to demand more monitoring mechanisms which lead to more monitoring costs. This result may be explained by the concentrated business environment (such as family shareholdings) and owner managed companies in Malaysia, which motivate the block-holders, who are the outsiders to request for more monitoring of the management of the companies. This finding support the earlier findings by Hay et al. (2008) who suggest that a major outside shareholder may also use their influence to increase monitoring to compensate for a lack of control over other internal decision.

The conclusions drawn from this study should be interpreted in a limited way, which would potentially represent opportunities for further investigation in future research. First, this study is a cross sectional study, where it uses one year data in 2006 only. Future research could extend the study to include more years of data, thus longitudinal studies can be conducted and further investigation on the impact of the organizational attributes on the demand for monitoring mechanisms in the short and long-terms can be analyzed. Secondly this study only examines two types of ownership structure which are managerial and block-holders ownership. Future research can also examine other forms of ownership structure which is unique to Malaysian companies, such as family ownership and government-link companies, in relation to their relationship with the demand for monitoring mechanisms.

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