

Wk 1 Lecture 1.2 Activity 2 – Agency Problem

1. Explain the agency problem of MNCs.

ANSWER: The agency problem reflects a conflict of interests between decision-making managers and the owners of the MNC. Agency costs occur in an effort to assure that managers act in the best interest of the owners.

2. Why might agency costs be larger for an MNC than for a purely domestic firm?

ANSWER: The agency costs are normally larger for MNCs than purely domestic firms for the following reasons. First, MNCs incur larger agency costs in monitoring managers of distant foreign subsidiaries. Second, foreign subsidiary managers raised in different cultures may not follow uniform goals. Third, the sheer size of the larger MNCs would also create large agency problems.

3. What approach could the case study MNC take to solve the agency problem you have identified? State the pros and cons of each method.

ANSWER:

Method	Pros	Cons
Independent board of directors	Protection of minority shareholders' interests increased risk sharing	Often not sufficient independent of management and therefore ineffective.
Partial concentration of ownership and control in the hands of a large shareholder	A large shareholder has the self-interest to monitor management's activities to prevent abuses.	Possible collusion between management and large shareholder against smaller shareholders. Reduced liquidity in the stock.
Executive compensation with options or bonuses related to performance	Provides a direct incentive to maximise stock price	Rewards management for good luck. Subject to manipulation and possible short-term focus to allow management to get rich.
Clearly defined fiduciary duties for CEOs with class action law suits	Provides a complementary discipline device	Increases legal costs and enriches lawyers at the expense of shareholders
Hostile takeovers and proxy contests	Directly disciplines bad management	Provides an incentives for raiders to expropriate wealth from creditors and employees.