Full title: BOARD OF DIRECTORS PAY AND PERFORMANCE: FROM THE PERSPECTIVE OF MALAYSIAN GLCS

Authors: 
HOOY CHEE WOOI
School of Management,
University Sains Malaysia.
Email: cwhooy@usm.my

TEE CHWEE MING
School of Business Administration
Wawasan Open University
Email: cmtee@wou.edu.my

Abstract: This paper aims to fill up the research gap on pay-performance of Malaysian Government Linked Companies (GLCs) by conducting a panel regression analysis based on 2001-2006 data. The GLCs pay determinant is modeled upon 4 core groups, namely, accounting ratios, company size, market measurement and board structure. All accounting ratios are found to be significantly positive linked to pay, except for ROE which is negatively linked to pay. However, company size remains the dominant pay determinant. This suggests that the board is adopting a managerial theorist approach in management. In addition, the insignificant abnormal returns imply that GLCs board adopts a prudent and conservative risk management policy. The Achilles heel of GLCs is the failure of independent directors to be effective internal monitors of the company. The insignificant relationship is indeed puzzling as GLCs fulfill the minimum 33% threshold required by the Malaysian code of corporate governance as reported in Securities Commission (2007). Interestingly, our empirical findings seem to suggest that to some extent, Malaysian GLCs directors are underpaid. Thus, the negative perception on Malaysian GLCs directors’ pay-performance is unsubstantiated.

Keywords: Corporate governance, Government-linked Companies, Director Pay, Performance, Board structure

JEL Classification Codes: G35

Conference Track: Track D - Finance

*Corresponding to:

HOOY CHEE WOOI
Finance Section,
School of Management
Universiti Sains Malaysia,
11800 USM
Penang, Malaysia
Email: cwhooy@usm.my
Telephone: 604-653-2897
Fax No: 604-657-7448
BOARD OF DIRECTORS PAY AND PERFORMANCE:
FROM THE PERSPECTIVE OF MALAYSIAN GLCS

Hooy Chee Woot and Tee Chwee Ming

Universiti Sains Malaysia, Malaysia
Wawasan Open University, Malaysia

Abstract

This paper aims to fill up the research gap on pay-performance of Malaysian Government Linked Companies (GLCs) by conducting a panel regression analysis based on 2001-2006 data. The GLCs pay determinant is modeled upon 4 core groups, namely, accounting ratios, company size, market measurement and board structure. All accounting ratios are found to be significantly positive linked to pay, except for ROE which is negatively linked to pay. However, company size remains the dominant pay determinant. This suggests that the board is adopting a managerial theorist approach in management. In addition, the insignificant abnormal returns imply that GLCs board adopts a prudent and conservative risk management policy. The Achilles heel of GLCs is the failure of independent directors to be effective internal monitors of the company. The insignificant relationship is indeed puzzling as GLCs fulfill the minimum 33% threshold required by the Malaysian code of corporate governance as reported in Securities Commission (2007). Interestingly, our empirical findings seem to suggest that to some extent, Malaysian GLCs directors are underpaid. Thus, the negative perception on Malaysian GLCs directors’ pay-performance is unsubstantiated.

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1. Introduction

According to Putrajaya Committee on GLC High Performance (2006), Government Linked Companies (GLCs) are defined as companies in which the Malaysian government has a direct controlling stake. Its modus operandi is commercial in nature. The controlling stake refers to the power of the government to appoint member of the board of director and be involved in major decision making like for example contract awards, restructuring, financing, acquisition and divestment. In 2001, KPMG Malaysia initiated a survey on directors’ remuneration in Malaysian public listed companies. Since then, the figure of directors’ compensation attracts widespread attention from the Malaysian public and investors.

For a long time, Malaysian GLCs had under performed in comparison to the private sector. This is due to government interference, inadequate rewards, inept management and lack of transparency. In 2004, the Malaysian government spearheaded the initiative to revamp the GLCs. This mission is important as GLCs are key drivers of Malaysian economy and substantial investor in the financial markets. In July 2005, the Putrajaya Committee on High Performance GLC launched a set of Policy Thrusts, Guidelines and 10 Initiatives as part of the GLC Transformation Programme. This was followed by the publication of Green Book, Orange Book, Blue Book and Yellow Book which focus on the area of GLCs board effectiveness, leadership development, adopting best management practices at operational efficiency in GLCs. Subsequently in 2006, GLCs CEOs unveiled a series of company’s Key Performance Indicators (KPIs) to

* Corresponding Author: Hooy Chee Woot, Finance Section, School of Management, Universiti Sains Malaysia, 11800 USM, Penang, Malaysia; Tel: 604-653-2897, Fax: 604-657-7448; E-mail: cwhooy@usm.my
the financial markets (http://www.pcg.gov.my/trans_manual.asp). The main objective is to implement performance oriented culture and compensation which has long eluded GLCs. By announcing these series of KPIs, GLCs management are opening themselves up for scrutiny by the public and investing community. Thus, more disclosure, transparency and good corporate governance standards are expected from all levels of management. As of 31 March 2008, significant improvement in the performance of 20 GLCs was reported (Putrajaya Committee on GLC High Performance, 2008, pp.1-10).

Given the development scenario of Malaysian GLCs over the last decade, there is a need to understand how the GLCs actually work under pay-performance framework. As there is a dearth of existing GLCs pay-performance literature, the main aim of this paper is to fill up this research gap by conducting pay-performance analysis based on a sample of Malaysian GLCs for the year 2001-2006 through a panel regression approach. In accordance to existing literature, the performance of GLCs are segregated into three core groups, namely accounting ratios, company size and market measurement. Based on the studies by Main (1991), Jensen (1993) and Conyon and Peck (1998), we add another perspective which is board independence. In short, with the exception of market performance and board structure, all our proposed variables have played a significant role in determining GLCs’ directors’ remuneration.

Our study is significant due to 3 factors. Firstly, past pay-performance and board independence empirical studies in US and UK have ignored the area of GLCs. This could be due to the market structure and system. For example, GLC is unheard off in US as the government adopts a hand off approach in the laissez faire system. Hence, our study sought to fill up this gap by pioneering the study on GLCs pay-performance and board independence. Secondly, Malaysian GLCs are viewed by taxpayers and investors as a privatised entity of government civil service. Thus, GLC’s profit maximisation and efficiency objectives are hindered by pervasive government intervention1. As such, one would expect GLCs directors to under perform and overpaid. However, we would like to provide empirical evidences to support or disapprove this statement. Finally, the findings from our study can be used to construct a GLC remuneration policy that is performance oriented.

This rest of the paper is organized as follows. Section 2 provides a brief literature review. Section 3 discusses our model for GLC director pay-performance, the panel framework of our analysis and the sample data. Section 4 presents the results and discussion on the major findings. Concluding remarks are in the final section of the paper.

2. Literature Review

Proliferation of pay-performance empirical study since 1970 is due to the availability of data on director’s remuneration. As observed by Cosh (1976) in United Kingdom, regulators and government have made statutory requirement for more disclosure on director’s remuneration in public listed companies. Nevertheless, findings are mixed. Evidences from Main (1991), Main et al. (1996) and Conyon and Peck (1998) show a positive significant relationship between corporate performance and director’s remuneration. When these results are segregated into profitability and company size, Lewellen and Huntsman (1970) persistently indicate that the former is more significant determinant than the latter. This finding contradicts Cosh (1976) study that provides evidence that company size is more dominant. In Malaysia, Hassan et al. (2003) and Abdullah (2006) study failed to find significant linkage between pay and performance. In regards to the empirical studies on GLCs, Groves et. al. (1994 and 1995) and Mengistae and Xu (2004) reported a positive relationship between pay and ROEs accounting performance at various level of management during the 1980s. However, the pay-performance sensitivities in China’s State Owned Companies (SOEs) are low as concluded by Firth et al. (2006). Nevertheless, China SOEs place great importance on profit rather than stock returns from 1998-2000. This contradicts the findings of Huang and Zhang (1998) which suggest that performance is not a criterion to reward top managers. In fact, satisfying the non profit interests of the State sometimes is a major criterion to reward top managers as shown by Qian (1995).

1 Government intervention refers to politicians being appointed as CEO or director, lop sided business agreement being imposed on GLCs to favour selected business cronies of the government and bailout of failed companies.
According to Main (1991), board structure can also influence the compensation package received by directors. Jensen (1993) suggests that the board of director should play the role as the highest internal monitoring mechanism when it comes to remuneration package for directors. Emphasis is placed on the independence of directors as they are more willing to use their power vested in them to protect shareholder’s interest as indicated by Weisbach (1988). However, Pearce and Zahra (1991) argue only proactive boards are able to perform the above duties because they are dominated by independent directors, possess higher level of expertise and have frequent meetings to ensure timely dissemination of information and effective decision making. Using pay performance sensitivity, Mishra and Nielsen (1999) found out that independent directors play an effective internal monitoring role within the company. Study by Abdullah (2006) on Malaysian companies suggests an increase in awareness on corporate governance issue after then 1997-1998 Asian currency crises. This explains the negative significant relationship between board independence and director’s pay which is considered by Cadbury (1992) as best practices in corporate governance. Taking cue from this, Securities Commission (2007) made it compulsory that at least 33% of the board of director must be non executive and independent.

3. Data and Research Methodology

We adopt the contemporaneous relationship CEO pay-performance sensitivity framework by Jensen and Murphy (1990). The direction of causality is from performance to pay. This means higher performance leads to higher remuneration payout. However, we perform slight modifications on Jensen-Murphy model to suit our research objective. Firstly, we replaced CEO dependent variable with the aggregate board of director remuneration. Secondly, the sensitivity perspective is replaced with the relationship between pay and performance. Thirdly, shareholder’s wealth consists of accounting ratios, company size and market measurement. Fourthly, we add board structure as the fourth core component to provide a comprehensive review on pay-performance and board independence relationship. Finally, the independent variables are lagged by one financial reporting year, Kerr and Bettis (1987) argue this approach will produce relatively accurate results than studies which do not lag their independent variables. By lagging the independent variables by one financial reporting year, current directors’ remuneration in year t will be based on the company’s performance in the previous financial reporting year. Empirical studies that do not lag their independent variables assume that directors’ remuneration package is based on the expectation of corporate performance for year t. Thus, it is unlikely to capture accurate relationship between pay and performance. However, it is not necessary to lag board independence variable because the tenure of a director is at least one year in Malaysian public listed companies.

Our regression model for director remuneration is given by the following equation:

\[
\ln(DIR_{it}) = \beta_0 + \beta_1 ROE_{it-1} + \beta_2 EPS_{it-1} + \beta_3 DPR_{it-1} + \beta_4 \ln(TA_{it-1}) + \beta_5 BIND_{it} + \\
+ \beta_6 ANR_{it-1} + \eta_i + \nu_t + \epsilon_{it}
\]

(1)

where \(DIR_{it}\) is Director’s remuneration, \(ROE_{it-1}\) is Return on equity, \(EPS_{it-1}\) is Earning per share, \(DPR_{it-1}\) is Dividend payout ratio, \(TA_{it-1}\) is Total assets, \(BIND_{it}\) is Percentage of independence director, \(ANR_{it-1}\) is Abnormal stock returns, \(\ln\) represent natural logarithm, and \(\epsilon\) is the error term for company \(i\) over time \(t\). The board of director consists of executive non independent and non executive independent directors.

Director’s remuneration (DIR) figures are obtained from company annual report from accounting year 2001 till 2006. Following the methodology underline by O’Reilly et al. (1988), Main (1991), Main et al. (1996), Hassan et al. (2003), Firth et. al. (2006) and Abdullah (2006), our study includes only cash remuneration (basic salary, bonus, allowances, fees and pension benefits) as components of total board’s remuneration. Stock options are excluded due to unavailability of data in Malaysian public listed companies. Besides that study by Conyon (1997) that employs both cash and stock options component produce the same result.

The most essential variables that provide explanation to director’s remuneration are accounting ratios. Here we include 3 accounting ratios. ROE (%) is the ratio of net profit after tax and interest over shareholder’s
equity. Putrajaya Committee on High Performance GLC (2008) lists ROE as a KPI. Empirical studies by Cheng and Firth (2005) and O’Reilly et al. (1988) reported a significant positive relationship between pay and ROE. This result is not shared by Doucouliagos et al. (2007) because ROE is only robust if lagged by 2 years. EPS (RM) is net profit accrued to each shareholder after deducting interest, tax and minority interests. In their landmark study on British firms, Lewellen and Huntsman (1970) reported that profitability factor dominates company size in determining director’s remuneration. Meeks and Whittington (1975) conclude that profitability factor should not be underestimated in determining pay. Thus, Sloan (1993), Conyon and Leech (1994) and Conyon et al. (2000) suggest earnings as a proxy for managerial effort. Thus, EPS is listed by Putrajaya Committee on High Performance GLC (2008) as a KPI for GLCs. However, study by Conyon et al. (2000) failed to find a significant relationship between pay and EPS. The relationship is only positively significant if EPS is lagged by two years as reported by Doucouliagos et al. (2007). DPR (%) is obtained by dividing gross dividend per share (DPS) with earnings per share (EPS). An increasing DPR trend indicates that the agent is creating shareholder value. Healy (1982) reported results that significantly link pay to dividend payout. Utilising the principal agent theory, Battacharya et al. (2008) develop a dividend payout model which proves that pay moves up (down) if there is an increase (decrease) in dividend payout. Thus, DPR is listed as a KPS by Putrajaya Committee on High Performance GLC (2008).

We also include company size as proxy by total assets (TA). Empirical findings by Ueng et al. (2000) and Cosh (1976) conclude that company size measured by total assets is a dominant pay determinant compare to other financial variables. This is consistent with managerial theory of firm which states that the expansion of a company will lead to an increase in corporate power, control and monetary benefits.

Stock return represents the annual average compounded return for each accounting year. Coughlan and Schmidt (1985), Kerr and Bettis (1987) and Main (1991) interpret shareholder value as stock return. All their studies concur that a director’s pay should be benchmarked against abnormal return. Main (1991) argues that it is reasonable to tie director’s compensation to abnormal return as they are only rewarded for beating market average. However, all the three studies conclude that the influence of abnormal return on compensation package is weak. Here, we defined abnormal returns (ANR) based on an equilibrium model of an individual firm that assumes stock returns have a multivariate normal distribution consistent with the well-known Capital Asset Pricing Model (CAPM).

Lastly, the independent director’s effectiveness in enhancing shareholder value is measured by the percentage of independent non executive directors on total directors (BIND). Cheng and Firth (2005), Conyon and Peck (1998) and Main (1991) reported that independent directors do not reduce directors’ remuneration package. On the contrary, higher number of independent directors leads to higher directors’ pay package.

Panel data estimation techniques are employed, as it offers great flexibility in modeling heterogeneity bounded in firm-specific performance, as well as for temporal changes in the firms’ operating environment. As is customary in panel data analysis, we estimate both a fixed effect and a random effect model. The general model which we refer to can be written as follows:

\[ y_{it} = \mu + \beta X_{it} + \eta_i + \nu_i + \epsilon_{it} \]

where \( y_{it} \) denote our dependent variable (DIR\(_a\)) for firm \( i \) at period \( t \), \( \beta \) is \( K \times 1 \) and \( X_{it} \) is the \( it \)-th observation on the \( K \) number of determinantal variables \( (k=8 \) in our case). The term \( \eta_i \) is the unobservable cross-sectional unit specific residual that accounts for individual effects, the term \( \nu_i \) is the unobservable time specific residual that accounts for period effects and the term \( \epsilon_{it} \) is the usual error term after taking out the individual and period effects. Basically these residual are component of the error term from model.
as given by
\[ \epsilon_p = \eta_p + \nu_p + \varepsilon_p. \]
We use a simple Chow test to identify the existence of individual effects. If we reject the null hypothesis of homogeneous effects across firms and over time, then a model capturing individual heterogeneity is more appropriate. If the model passed the first stage (significant fixed effects), we then apply a specification test devised by Hausman (1978) to test for the orthogonality of the random effects and the loaded determinant variables. The Hausman test will inform us regarding which model to stress; if the test is significant we focus on the fixed effect model, whereas we report the random effect model if the Hausman test is insignificant.

All our financial data is obtained from Thomson Datastream for the financial reporting year 2001-2006. The criteria to select a company into our sample of study are listed as below:

(i) The company must not be taken private and de-listed from Bursa Malaysia.
(ii) The company must not currently undergo any form of corporate restructuring that will have impact on its core business.
(iii) The company must not be involved in merger and acquisition exercise. Re-branding is allowed as long as the core business remains intact.

Based on the above selection criteria, our sample of study includes 21 GLCs. This represents 54% of the total 39 GLCs listed in Bursa Malaysia in 2004.

4. Results and Findings

The summary of the descriptive statistics for the panel data are reported in Table 1. Besides the variables used in model (1), we also report descriptive statistics for the raw value of director remuneration and total asset. Not all the panel series are normally distributed as can be seen in the rejection of the Jarque-Bera normality test. As the government maintains investment in all sectors of the economy, the values of coefficient of variation (CV) indicate that ROE, EPS and abnormal returns (ANR) are widely spread out. Plantation and oil and gas companies should be under the maximum group. Meanwhile companies in airlines and car manufacturing sector should fall under the minimum category due to rising fuel price, inability to face competition and inefficiency in productivity. The other variables with wide range are the values of TA and DIR before taking logarithm.

The average remunerations received by the board of directors in Malaysian GLCs is RM 1.84 millions but the standard deviation is RM 1.89 millions, indicating a huge deviation in directors remuneration across the GLCs, where the highest is RM 12.5 million (MAYBANK in 2006) and lowest is only RM 0.21 millions (MBSB in 2001). The fact that Maybank’s directors are the highest paid could also be due to the fact that they are managing the biggest company in terms of total asset worth RM 223 billion in 2006. The wide total asset band RM 760 million – RM 223 billion with a standard deviation of RM 38 million can be attributed to the wide range of industry that GLCs are operating in. A variable worth commenting is the high DPR by Malaysian GLCs. Their average payout of 37.39% out performs Kuala Lumpur Stock Exchange DPR average of 20% between 2002-2006 (The Edge Daily, 16 May 2008, p.1). Some GLCs are paying as high as 163% to its shareholders. We are of the opinion that the government has a strong incentive to ensure good returns on its investment as dividend is a source of revenue to annual government

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2 The fixed effect specification assumes that company-specific effects are fixed parameters to be estimated, whereas the random effect model assumes that companies constitute a random sample. The fixed effects model allows the unobserved firm effects to be correlated with the explanatory variables.

3 Crude palm oil price has increased from RM 1,200/ton to RM 4,200 from 2004 till 2008 while oil price has increased from $38 in 2004 to $142 by June 2008.

4 Malaysian Airlines System losses peaked at a loss of $1.21 in 2005 due to rising oil price, falling services standards and inefficiency. MAS 22,000 employees need downsizing (The Edge Daily, March 28, 2008 pp.3-5). Proton’s market share of car sales has fallen from a peak of 75% in the 1990s to only 38% by 2006 (The Edge Daily, March 28, 2008, pp.1-3). Correspondingly, EPS has fallen from $2.06 in 2002 to only 8 cent in 2006.

5 Trading and services company (i.e. pharmaceutical) has lower assets than banking groups or capital intensive companies like airlines and automobile industry.
budget. Thus, agency theory is enforced by consistent dividend payout as suggested by Gugler (2003). In addition, Litter (1956) is of the opinion that market will grant a hefty premium for consistent dividend payout. Hence, investment on Malaysian GLCs should only be on the long term basis. In regards to board structure, the mean GLC’s board independent ratio is 39.5%. This is above the minimum 33% ratio required under the Malaysian code of corporate governance as reported in Securities Commission (2007) and Greenbury (1995). Some GLCs reached a maximum of 77%, indicating a high awareness among these companies on the need to institute the best practices of corporate governance.

Table 1: Summary of Descriptive Statistics

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>Maximum</th>
<th>Minimum</th>
<th>Std. Dev.</th>
<th>CV</th>
<th>Normality</th>
</tr>
</thead>
<tbody>
<tr>
<td>DIR</td>
<td>1,840,292.00</td>
<td>12,507,000.00</td>
<td>210,000.00</td>
<td>1,896,460.00</td>
<td>1.0305</td>
<td>1,836,0500***</td>
</tr>
<tr>
<td>Ln(DIR)</td>
<td>14.0903</td>
<td>16.3418</td>
<td>12.2549</td>
<td>0.8252</td>
<td>0.0586</td>
<td>0.8745</td>
</tr>
<tr>
<td>ROE</td>
<td>6.3387</td>
<td>313.0000</td>
<td>-111.0000</td>
<td>36.7302</td>
<td>5.7946</td>
<td>8.159,2810***</td>
</tr>
<tr>
<td>EPS</td>
<td>0.2621</td>
<td>2.0760</td>
<td>-1.5600</td>
<td>0.5097</td>
<td>1.9444</td>
<td>131.8955***</td>
</tr>
<tr>
<td>DPR</td>
<td>37.4775</td>
<td>163.6364</td>
<td>0.0000</td>
<td>32.1682</td>
<td>0.8583</td>
<td>29.8080***</td>
</tr>
<tr>
<td>TA</td>
<td>19,268,601.00</td>
<td>223,000,000.00</td>
<td>760,777.00</td>
<td>38,176,927.00</td>
<td>1.9813</td>
<td>1,118,2830***</td>
</tr>
<tr>
<td>Ln(TA)</td>
<td>15.6888</td>
<td>19.2228</td>
<td>13.5421</td>
<td>1.4124</td>
<td>0.0900</td>
<td>6.3262**</td>
</tr>
<tr>
<td>BIND</td>
<td>39.5397</td>
<td>77.0000</td>
<td>30.0000</td>
<td>8.0703</td>
<td>0.2041</td>
<td>263.2576***</td>
</tr>
<tr>
<td>ANR</td>
<td>-0.3046</td>
<td>4.7500</td>
<td>-4.3400</td>
<td>1.4931</td>
<td>-4.9017</td>
<td>16.9981***</td>
</tr>
</tbody>
</table>

Note: Std. Dev. refers to standard deviation; CV refers to Coefficient of variation (standard deviation divided mean); Normality refers to Jarque-Bera normality test where the figure in the parenthesis is the probability values and, ** and *** implies significance at 95% and 99% confidence level, respectively.

The estimates for the one-way cross-section random period fixed effect model are reported in Table 2. All the variables are significant in explaining GLC’s directors’ remuneration, with the exception of abnormal returns ANR. Except for ROE, the estimated coefficients signs conform with the predicted sign in our proposed hypotheses in section 3. The R² and adjusted R² of the panel model basically explain about half of the variation in the direction’s remuneration.

The coefficient for ROE is -0.0034 and it is statistically significant, implying an increase of 1% in ROE leads to a decline of director’s pay of 0.0034%. Taking the average director pay of RM 1,840,292 as reported in Table 1, the decline value is about RM 62, which is not a significant impact. However, this result seems to suggest that GLC’s directors’ are not rewarded at all for good performance. In fact, they were penalized! The GLCs directors’ remuneration is also significantly attributed to improvement in EPS. The estimated coefficient indicates that a ringgit increase in EPS leads to 0.43% increase in directors’ pay. Based on an average EPS of 26 cent in Table 1, a 1% increase in EPS or 0.26 cent probably leads to about RM 207 increase in directors’ remuneration. In terms of dividend, GLCs directors seem to deliver value for money services to their shareholders. Shareholders should be pleased to know that for every 1% increase in DPR, GLCs directors’ pay only rise by a negligible figure of 0.0029%, which about RM53 in value. This result certainly conforms to the corporate governance best practices underlined by Cadbury (1992), Greenbury (1995) and Securities Commission (2007).

The impacts of ROE, EPS and DPR are negligible when compared to the impact of company size. This is because based on the estimated coefficient of 0.1432 for Ln(TA), GLCs directors shall receive a pay raise of RM 2635 for every 1% increase in total asset. The dominance of firm size over EPS is not surprising as previous empirical studies indicate that company size is the most important factor in determining directors’ remuneration. It is reasonable for a director in a large firm to be paid more than in a small firm due to larger

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6 The management will have less free cash flow to squander on unprofitable investment projects. As such, the firm’s management will be forced into capital market to raise fund. According to Easterbrook (1984), the firm’s management will have the incentive to effectively monitor the project’s return.

7 The results from the F and Hausman model selection tests implies that one-way cross-section random period fixed effects specification is preferred for our model. The results are not reported here to conserve space, they are available upon request.
hierarchy\(^8\), the complexity of the job function, duties and decision making\(^9\), bigger firms tend to hire directors from bigger firms, external hiring of top directors tend to be done by bigger firm which carries higher premium\(^10\) and prestige and status attached to larger firm.

Table 3: Panel Regression Estimates on Model (1)

<table>
<thead>
<tr>
<th>Coefficient</th>
<th>White Standard Error</th>
<th>Probability Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>(\beta_0) [constant]</td>
<td>11.5824***</td>
<td>0.9607</td>
</tr>
<tr>
<td>(\beta_1) [ROE ]</td>
<td>-0.0034***</td>
<td>0.0008</td>
</tr>
<tr>
<td>(\beta_2) [EPS]</td>
<td>0.3347***</td>
<td>0.0955</td>
</tr>
<tr>
<td>(\beta_3) [DPR]</td>
<td>0.0029***</td>
<td>0.0010</td>
</tr>
<tr>
<td>(\beta_4) [In(TA)]</td>
<td>0.1432**</td>
<td>0.0586</td>
</tr>
<tr>
<td>(\beta_5) [BIND]</td>
<td>0.0034</td>
<td>0.0038</td>
</tr>
<tr>
<td>(\beta_6) [ANR]</td>
<td>-0.0268</td>
<td>0.0240</td>
</tr>
</tbody>
</table>

R2 | 31.00% |
P-statistic | 3.6931*** |
Jarque-Bera | 6.5866** |

Note: White standard error is robust to observation specific heteroskedasticity in the disturbances by allowing the unconditional variance matrix to be an unrestricted diagonal matrix. * and ** and *** imply significance at 90%, 95% and 99% confidence levels, respectively. Note that with lag one explanatory variables; there are only 5 years data left for all the 21 GLCs with a total of 105 pooled observations. Estimation of the random effects is based on feasible GLS techniques.

Another main focus of this paper is the internal monitoring role of independent director in Malaysian GLCs. The insignificant positive relationship implies that the independent directors have been ineffective in their fiduciary role to shareholders.\(^11\) This should not have happen as GLCs board structure meets the minimum 33% ratio of independent directors as required under Malaysian code of corporate governance as reported in Securities Commission (2007). Our finding seems to imply that numbers do not necessarily translate into action. Firstly, we cannot discount the possibility of the existence of fat cat culture as espoused by Bebchuk \emph{et al.} (2002) in Malaysian GLCs. The theory can be slightly modified to state that entrenched CEOs and executive directors use captive independent directors to award themselves a big pay raise. Secondly, there is a strong likelihood that GLCs' CEOs use their power to influence the selection and career advancement of independent directors (see Zajac and Westphal, 1994). Finally, independent directors attach great importance to title and prestige to their position. Hence, according to Mace (1986), they are willing to rubber stamp any decisions made by CEOs and executive directors.

In regards to market measurement, our result implies that director's pay in Malaysian GLCs is not tied to their stock performance. This could be due to criticism on the appropriateness of using stock returns to reward director. The main concern is market measurement will encourage short term orientation, whereby the directors will emphasize quarterly performance at the expense of sustainable long term investment projects (Rapaport, 1978 and Thurow, 1981).\(^12\) In addition, emphasis on abnormal return will only

\(^8\) See Mahoney (1979).
\(^9\) This is based on human capital theory espoused by Becker (1964) and Agarwal (1981).
\(^10\) Murphy and Zabojnik (2004) reported externally hired CEOs are paid 15.3% more than internal promoted CEO. The premium of external hires has increased from 6.5% in the 1970s to 21.6% in the 1990s.
\(^11\) According to Cadbury (1992), a significant inverse relationship between directors' remuneration and board independence indicates the effectiveness of independent directors as internal monitor. However, this is inconsistent with the positive significant relationship findings reported by Main (1991) and Conyon and Peck (1998).
\(^12\) Corporate greed by the CEO and board of directors of Enron led to systematic manipulation of financial statement for many years before a whistle blower blew their cover in 2001.
increase the risk premium of GLCs as the board will have to invest in risky projects and increase leverage. In fact, market measurement has never been listed as one of the KPIs by Putrajaya Committee on High Performance GLC (2008). Thus, we suggest that the decision to purchase GLCs stocks should be viewed as a long term value investment strategy.\textsuperscript{13}

5. Concluding Remark

There is a dearth of pay-performance study on GLCs. Thus, this research paper sought to fill up this gap by analysing the directors’ pay determinants in Malaysian GLCs. To present a comprehensive perspective on pay determinants, we divide it into 4 core groups, namely, accounting ratio, market measurement, company size and board structure.

Malaysian GLCs are viewed as an extension of civil service, inefficient, a tool of political patronage and a cash cow mechanism for corporate bailouts, hence, the perception of overpaid and underperformed Malaysian GLCs directors.\textsuperscript{14} Interestingly, a substantial portion of our empirical findings are contrary to the widely held negative perception on GLCs. Although our results are not unanimous, we would like to suggest that on many counts, Malaysian GLCs directors are actually underpaid. Firstly, all accounting ratios are significant determinants of directors’ remuneration. In fact, the percentage increase in DPR exceeded the increase in directors’ remuneration. We also reported a significant negative relationship between directors’ remuneration and ROE, suggesting that GLCs directors are penalized for good performance. Secondly, abnormal stock returns do not determine directors’ remuneration package. This should not be interpreted as underperformance as stock returns has never been listed as a KPI by Putrajaya Committee on High Performance GLC (2008). On the contrary, the insignificant relationship should also be viewed positively because the board does not think it is appropriate to encourage directors to take excessive risk to increase their pay. Hence, investment by GLCs should be viewed from a long term perspective of sustainable value creation to shareholder. Thirdly, company size is a chief determinant of directors’ remuneration. Finally, in regards to board structure, we conclude that independent directors have failed in their internal monitoring role. The failure of their fiduciary duty to shareholder is mind boggling as GLCs ratio of independent directors to total directors exceeded the threshold 33% required under the Malaysian code of corporate governance as reported in Securities Commission (2007). In our opinion, GLCs independent directors fall under the statutory group as defined by Pearce \textit{et al.} (1991).\textsuperscript{15}

Based on our findings, we would recommend GLC’s directors’ remuneration to be substantially linked to ROE, EPS and DPR. This is because these ratios are strong indication on the future sustainability of the company’s profitability and cash flow. ROE, EPS and DPR must take precedent over total asset when it comes to determining pay for directors. This is to prevent the implementation of managerial theories approach in the management, whereby directors can increase their remuneration package by increasing total assets. An excessive company expansion will result in higher leverage, risk premium and failure to develop core competence. In addition, measure must be taken to improve the effectiveness of independent directors. It is encouraging to know that the Putrajaya Committee on High Performance GLC (2005a, 2005b) has taken the initiative by introducing guidelines under the Green Book to improve board effectiveness. A direct approach that can be taken by the government is to ensure that independent directors are selected based on meritocracy, experience and competence.

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\textsuperscript{13} The other side of the coin is GLCs stocks are not for speculators and margin borrowers.
\textsuperscript{14} This is evident during the height of the Asian Currencry Crisis 1997-1998, whereby, failed companies owned by businessmen with strong links to the government were bailed out by GLCs. In addition, GLCs were forced into an unfavourable concessionsaire agreement with these politically linked individuals The Edge, (2004), “Reforming the GLCs and Khazanah”, 12\textsuperscript{th} July-18\textsuperscript{th} July, pp. 58-59.
\textsuperscript{15} A possible explanation is political appointment and retired senior civil servants.
References


The Edge Daily (2008) Maybank to maintain 60% dividend payout policy. 16 May, p.1.


