

EXECUTIVE DIRECTOR COMPENSATION IN MALAYSIA: A STUDY OF FIRMS WITH SUBSTANTIAL SHAREHOLDING

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Abstract: In corporate governance studies, two types of conflicts are identified. Type I conflicts exist in companies where ownership and management are separated. But when substantial shareholders manage the company, the probability of expropriation of minority shareholders gives rise to Type II conflicts. Hence in countries where share ownership is highly concentrated, Type II conflicts are said to be more prevalent. Since research by many scholars has shown that equity ownership in Malaysia is highly concentrated, a study has been conducted on one category of Malaysian public listed companies – those in which the single largest shareholder owned at least 10% of the shareholding – to investigate a possible form of expropriation: compensations paid to executive directors. This paper reports on the board compensation characteristics of these substantially owned Malaysian companies.

This study confirmed the findings of previous studies on the Malaysian corporate sector, which was found to be highly concentrated in terms of ownership. Slightly over one half (51%) of the main board listed companies in the selected sectors were found to have single largest shareholders owning no less than 10% of the total shares. Among the PLCs where the single largest shareholder held no less than 10% share ownership, a quarter of the sample was found with

share ownership of more than 50%. It also confirmed the family ownership pattern as reported in other studies, since 91% of the sample firms in this study were found to be owned by individuals, families or private firms (which were owned by the individuals or families). Study of the compensation received by executive directors found that the bulk of their compensation was fixed in nature. Indeed salaries made up 75% of the executive directors' total emoluments. Dividends received by executive directors through their share ownership represented another major source of their income. Among these substantially owned and controlled firms, total dividend income in fact exceeded the total emoluments received by the executive directors. This paper concludes that the phenomenon calls for further study to establish the likelihood of Type II conflicts among these Malaysian firms.

Keywords: corporate governance, director compensation, expropriation, Type II conflicts

INTRODUCTION

In corporate governance studies, two types of agency conflicts are commonly identified. As a result of the separation between ownership and management, principal-agent problems arise, which are known as Type I conflicts. Shareholders

therefore have to devise ways and means to align the objectives of the professional managers to those of the shareholders. When substantial shareholders are directly involved in the management of the company, such misalignments are obviously minimised. However, a different type of conflicts come into the picture since there is probability of expropriation of minority shareholders by the majority shareholders who may be closely involved in the day-to-day management and operations of the firm. These are highlighted as 'principal-principal' problems and referred to as Type II conflicts (Young et al. 2008). Expropriation of minority shareholders can take the form of expropriation of cash flows, or assets, or equity, or a combination of two or more of these firm attributes (Atanasov, et al. 2008). Cash flow expropriation includes sale of a firm's output at below-market prices to another firm in which the family has significant or complete cash flow rights, or over-payment for inputs purchased from such firms. It may also be in the form of excessive salaries or perquisites for family members or insiders (Bhaumik and Gregoriou 2010). In countries where share ownership is highly concentrated, Type II conflicts are therefore likely to be more prevalent.

While generalising about corporate governance of Asian countries (or any other region for that matter) is perilous given the variations across countries and companies, there has been considerable research evidence that shows share ownership among Asian companies is highly concentrated. Claessens, Djankov and Lang (2000) reported that more than two-thirds of the approximately 3,000 companies in their sample were controlled by a single shareholder. Moreover, it has been found that family ownership constituted the main form of majority ownership. While Liu, Yang & Zhang (2011) highlighted that family ownership was a prevalent feature of corporate governance in Asia, Claessens et al (2000) provided data that asserted that the largest ten families in Indonesia, the Philippines and Thailand controlled one half of the corporate assets. At the same time, the largest ten families in Hong Kong and Korea controlled about one-third of the corporate assets in these two countries. In Malaysia, 76% of gross domestic product (GDP) was reported to be accounted by the outputs of the top 15 family-controlled pyramid of companies (Morck, Wolfenzon & Yeung 2005). In addition, it has also been shown that controlling family shareholders did sometimes exhibit behaviour of expropriating minority shareholders. In their study, Filatotchev et al. (2011) assessed the phenomenon of controlling family shareholders utilising information about the company to extract wealth from minority shareholders. Family shareholders were found to have incentives to extract private benefits of control at the expense of minority

shareholders by using private information for their own financial gain within a less transparent corporate structure. There have also been other reports on the problems of concentrated ownership and family control in Malaysia. A survey by PricewaterhouseCoopers (2001) found that family-controlled companies had high number of executive directors who were related to the controlling shareholders. Family ownership was found to constitute over 43% of the listed companies on the main board of Malaysia's stock exchange from 1999 through 2005 (Ibrahim et al. 2008).

The issues of high concentration and family control become more critical since some studies discovered that director remuneration in Malaysia was not directly related to firm performance. For example, out of the top 20 firms which paid the highest remuneration to their executive directors in 2001, five were net loss-making companies (KPMG 2002). The situation was not any better in 2003, where six out of the top 20 highest paying firms were net loss-making (*Malaysian Business* 2004). These reports and cases clearly raise the high likelihood of expropriation of minority shareholders.

In view of this possibility of expropriation of minority shareholders, especially by individuals or families that constitute the majority shareholders, it is important that studies be conducted to investigate such companies. This paper reports on some preliminary data of an in-depth study that attempts to identify the managerial ownership levels at which alignment and entrenchment effects could take place among Malaysian public listed companies in which the single largest non-institutional shareholder held at least 10% of the shareholding.

METHODOLOGY

In order to focus on companies with substantial shareholding, a rather stringent requirement was imposed – that the single largest shareholder owned 10% or more of the total shareholding. As will be shown later, while this criterion appears stringent, it has nonetheless resulted in the inclusion of over one half of the total companies in the population, which is itself a reflection of the fact that Malaysia has very high percentage of concentrated ownership. However, a substantial shareholder could well be the government (or government-linked companies), local or foreign institutional investors. Since our focus is on individual or family ownership, we have thus excluded from our sample substantial shareholders belonging to these three categories of investors. We have used the term 'single largest non-institutional shareholder' to refer to the firms selected for our sample.

Table 1: Sectorial composition of Population and Sample Firms

Sector	Total Number of Firms Listed	Number of Firms Selected	
		number	percentage
Consumer Products	68	37	54.4%
Industrial Products	108	59	54.6%
Construction	31	18	58.1%
Trading and Services	104	39	37.5%
Properties	63	38	60.3%
Total	374	191	51.0%

Table 2: Types of share ownership of single largest shareholder

Types of share ownership	Frequency	Percent
Individual or family	66	34
Private firm or Sdn Bhd	108	57
Public listed company	17	9
Total	191	100

Table 3: Distribution of shares owned by the single largest shareholder

Share ownership (%)	Frequency	Percent
10% – 33%	88	46
> 33% – 50%	56	29
More than 50%	47	25
Total	191	100

Table 4: Components of Director Remuneration

Remuneration Component		ED	Non-ED
Fixed Fee based on Position	Annual Salary/Fixed Fees	Yes	Yes
	Allowances e.g. traveling, car, housing & telephone	Yes	Yes
	Supplementary Directors' Fees (related to directorship functions e.g. meeting allowances and position allowances)	Yes	Yes
Variable (EDs only)	Salary/ Fee Increment	Yes	No
	Cash Bonus	Yes	No
	ESOS	Yes	No
Benefits-in-Kind (mainly Eds)	Telephone expenses, staff discounts, retirement schemes, loans, company cars.	Yes	Limited

Source: Directors' Remuneration Survey 2006 (KPMG), p.9.

Table 5: Percentile distribution of Director Remuneration of Sample Firms (2002 – 2007)

	Percentiles						
	1%	5%	25%	50%	75%	95%	99%
Salary (RM million)	0	0.23	0.60	1.05	1.77	3.86	28.7
Bonus (RM million)	0	0	0	0.046	0.24	1	3.41
Total Remuneration (RM million)	0.072	0.29	0.76	1.41	2.43	5.9	35.7
Dividend (RM million)	0	0	0.001	1.43	4.42	23.5	117

All data have been obtained from published sources, covering the time period of 2002 to 2007. The year 2002 was chosen because Malaysian listed companies were required to disclose separately remuneration paid to executive and non-executive directors beginning from the financial year 2001. During field work, the bulk of the time and efforts was spent on searching, categorizing and standardizing director remuneration data, which had to be manually compiled from each year's annual reports of the respective companies. Financial data on each of the companies were extracted from Data Stream.

For this study, attention was concentrated on the five largest sectors (in terms of number of companies listed) on the Malaysian stock exchange. They include the following sectors: consumer products, industrial products, construction, trading & services, and properties. Following the methodology adopted by Dogan & Smyth (2002), firms in finance, plantation and mining sectors have been excluded to improve data uniformity and reduce potential biases due to differences in accounting procedures in these sectors and other forms of incompatibility. These five sectors accounted for 80.7% of the total number of listed firms on the Main Board of Bursa Malaysia (Malaysian stock exchange). Of the total of 374 listed firms in the five sectors, Table 1 shows that 191 firms satisfied our criteria of each having one single largest shareholder owning at least 10% of the total shareholding, and that these largest shareholders were not government, local institutional or foreign investors.

From Table 1, it can be seen that the percentage of firms with one single largest shareholder ranged from 60.3% in the properties sector to 37.5% in the trading and services sector. In all other sectors it hovered around 55%. Overall, such firms accounted for 51% of all the firms in our sample. This in itself is an evidence of the high concentration of single largest, non-institutional share ownership in Malaysia, as has been reported in other studies.

Nature of Single Largest Shareholder

Data on the single largest shareholders of these firms provided opportunities for us to uncover a number of their salient features. Table 2 shows the types of ownership of these shareholders. We can see from Table 2 that the predominant type of share ownership is through private firms which are limited in liability. In Malaysia they are known as 'sendirian berhad' or in its acronym: 'Sdn Bhd.' Well over one half (57%) of the 191 sample firms each had a single largest shareholder, in the form of private companies, owning 10% or more of its total shares. This is thus the most predominant type of ownership. At the same time, Table 2 shows that another one-third (66 firms) were owned by individuals or families. Together,

these two types of ownership accounted for 91% of the 191 firms in our sample. It should be pointed out that the private firms could in turn be owned by individuals or families. To take up this investigation, however, would entail manual checking and verification of each of the registered owners of these firms at the Malaysian Companies Commission – a task that called for worthwhile but tedious, time-consuming and challenging efforts. The final type of share ownership shown in Table 2 is 'public listed company', which means the sample listed firm is in turn owned by another listed company. In many cases, such ownership could be pyramidal or cross-holding, both of which were reported to be prevalent in Malaysia and other Asian countries (Morch, Wolfenzon & Yeung 2005). The analysis of the types of share ownership of our sample firms has therefore confirmed findings of previous studies which found high concentration of family ownership among public listed companies in Malaysia.

Next we are interested to look at the percentage of share ownership held by the single largest shareholder. As expected, ownership is more concentrated at lower thresholds. We see in Table 3, in nearly one half (46% or 88 firms) of the sample, the single largest shareholder owned between 10-33% of the total shares. This could be due to 33% ownership being the trigger, beyond which mandatory general offer (MGO) has to be made. We found lesser firms with higher levels of ownership concentration. 56 firms (29%) were found to have their single largest shareholders holding between 33% and 50%, while in 47 firms (25%) the largest shareholders owned more than 50%. Ownership pattern in Table 3 also shows that the single largest shareholder held more than one-third of the total shares in more than one half (54%) of the firms. As there could also be other large shareholders, the number of shares available in the open market for trading (public float) was necessarily limited. The low liquidity has serious implications on the volatility of the share price.

Further computation shows that the mean value of share ownership (of the single largest shareholder) for the 191 firms is 37% (s.d. = 16%). Our study therefore found that on average, the single largest shareholder owned one-third of total equities. This is consistent with Abdullah (2001)'s study where the percentage was found to be 36%. Similarly, it was reported in *The Edge Malaysia* (2006) that the controlling shareholders of most Malaysian companies had 30-40% of total outstanding shares. Furthermore, the standard deviation of 16% means that in nearly two-thirds (64%) of our sample firms, the single largest shareholders owned between 21% and 53% of the total share capital. This can be taken

as a further indication of the high ownership concentration in Malaysia.

Compensation of Executive Directors

According to the Directors' remuneration survey 2006 (KPMG), remuneration paid by Malaysian public listed firms to their directors (executive director – ED and non-executive director – Non-ED) are made up of three components namely (i) fixed fee based on position, (ii) variable remuneration, and (iii) benefits-in-kind.

Table 4, taken from KPMG survey (2006), shows the three components of director remuneration in Malaysia. The fixed remuneration component includes annual salary and or other fixed fees, allowances, and supplementary directors' fees. These fees are received by EDs and Non-EDs. On the other hand, the variable remuneration component is comprised of increments in salary or fee, cash bonus, and ESOS (Employees' Shares Options Schemes). This variable remuneration, however, is only applicable to EDs but not for non-EDs. Similarly benefits-in-kind are mainly provided for EDs. Common benefits-in-kind include telephone expenses, staff discounts, retirement schemes, loans, insurance cover, leave passage, housing provision, company cars, club membership and annual leave. As a percentage to basic salary payment, the amount of benefits-in-kind can range from 10% to 20% of the basic salary paid to EDs (Ibid.).

Types of Compensation In Sample Firms

Director remuneration data in our study is based on secondary data manually collected from each company's annual reports. Considering that Malaysian companies in general were not enthusiastic in voluntarily disclosing information, our data collection did not yield as rich information as that reported in the dedicated surveys conducted by professional bodies such as PricewaterhouseCoopers and KPMG, which were further endorsed by the government authorities.

As can be seen in Table 5, we have been able to compile and classify three types of director compensation to EDs, namely: (a) Salary, (b) Bonus, (c) Total cash emoluments (salary, bonus, fees, allowances & other pecuniary benefits).

Data in Table 5 are presented in percentile distribution format so that to show the range and distribution of the remuneration components. This yields more information compared to the mean statistic, which is a singular number and could be influenced by outliers. From the percentile distribution shown in Table 5, we notice that director remuneration is highly skewed. In terms of salary paid to EDs, for example, the quantum increased

dramatically after the 50th percentile. While the bottom half received RM1.05 million in terms of salary, the top half was paid a total of RM27.65 million. Bonus payment is similarly skewed. A comparison of the 50th and 99th percentiles indicates that a huge gap existed in bonus payment (RM46,000 and RM3.41 million respectively). As a result, total remuneration which is the sum of the salary and bonus, displays a similar disparity.

As the various types of remuneration payments were highly skewed towards the higher end, it therefore makes more sense to show the percentile distribution for overall trends in the sample and use the median statistic in our analysis. The median firm in the sample paid RM1.41 million of total cash remuneration to their executive directors who sat on the board of directors. This amount of cash remuneration is about the same as the RM1.48 million (mean) paid by healthy firms to their directors in 2001 as reported by Abdullah (2006). In addition, the table shows that approximately 74.5% of the total remuneration paid by the sample firm was in the form of salary (RM1.05 million). We therefore observe that total remuneration was largely made up of fixed component. Fixed salary constituted the overwhelming component of director remuneration among our sample firms.

The first observation about bonus as a form of remuneration payment is that at least 25% of the sample firms did not provide any bonus at all to their directors. Indeed, one half of the 191 firms reported a combined bonus payment of RM46,000 only. As a percentage of total remuneration, this made up a meager 3% of total remuneration. Fixed fees in the form of salary was therefore found to be the most commonly used way of director remuneration among the sample firms.

Table 5 also shows that dividend received by executive directors through their share ownership in the firm provides another important source of cash income. The RM1.43 million dividends received by executive directors in the median firm were even slightly larger than their cash remuneration. For the sample as a whole, however, directors in a quarter of the firms received a combined total of RM1,000 only. They literally received next to nothing in terms of dividends. Since dividends and bonus are two major variable payments receivable by EDs, we can conclude that variable payments do not feature prominently as remuneration components in our sample, although among the higher paying sample firms dividend payments could constitute a main source of income.

SUMMARY AND CONCLUSION

Although this paper reports on some of the preliminary findings based on the profiles of 191 sample firms examined in a broader study, a number of significant observations have been noted, and it appears that they are consistent with those reported in existing literature. This study confirmed the findings of previous studies on the Malaysian corporate sector, which was found to be highly concentrated in terms of ownership. Slightly over one half (51%) of the main board listed companies in the selected sectors were found to have non-institutional single largest shareholders owning no less than 10% of the total shares. Among the PLCs where the single largest shareholder held no less than 10% share ownership, a quarter of the sample was found with share ownership of more than 50%. It also confirmed the family ownership pattern as reported in other studies, since 91% of the sample firms in this study were found to be owned by individuals, families or private firms (which were owned by the individuals or families). Study of the compensation received by executive directors found that the bulk of their compensation was fixed in nature. Indeed salaries made up 75% of the executive directors' total emoluments. Dividends received by executive directors through their share ownership represented another major source of their income. Among these substantially owned and controlled firms, total dividend income in fact exceeded the total emoluments received by the executive directors. This paper concludes therefore that the phenomenon calls for further study to investigate the likelihood of Type II conflicts among these Malaysian firms.

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