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Differences in Directors' Remuneration and Firm Value of Malaysian Listed Firms

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ABSTRACT

Directors' remuneration has attracted considerable interest among scholars and financial analysts as it is seen to be one of the main reason of good firm performance. This paper aimed to examine relationship cash and non-cash director's remuneration towards firm value in Malaysia. Data and materials were collected from Bursa Malaysia website and Eikon Thomson Reuters. Data on director's remuneration, CEO duality and board size were obtained from the annual report whereas other variables such as the firm value, firm size and leverage were collected from Eikon Thomson Reuters database. 602 firms from different industries ranging from 2014 to 2016 period was used as the sample of this study. Regression analysis shows that non-cash directors remuneration has a stronger significant positive relationship with firm value rather than cash remuneration. It proves that the remunerations received by directors can motivate them to perform better for the firm. The analysis also shows that board size and firm age to have a positive and significantly related with the firm value. Nonetheless, the potential limitation of using firm value as the only dependent variable may not provide more meaningful insight of the impact of other components of the performance measure such as excess in value, growth and other performance measure. Hence, future studies may use these variables for further research.

Keywords: Cash remuneration, Non cash remuneration, Director, Firm Value

Introduction

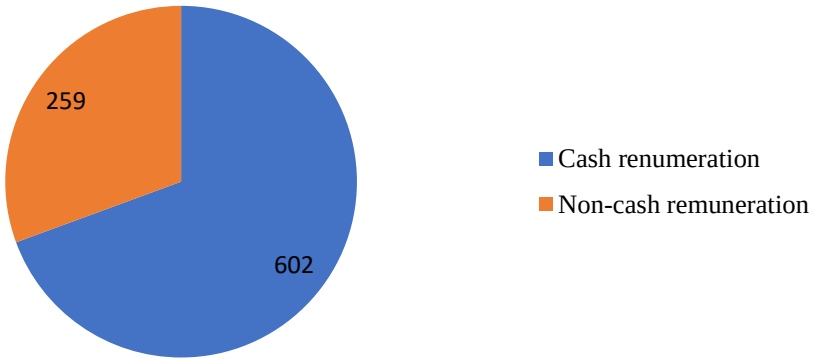
Debate on director's remuneration among people nowadays has been discussed widely. It has taken a major stage in discussion on the issue of corporate governance. The argument for a higher remuneration level received by directors is that it will attract highly caliber candidates which, in turn, will result in increased business performance (Patel & Simon, 2014). Based on a previous study by Raithatha and Komera, (2016), it was found that there is a positive relationship between director remuneration and the firm performance. But, this understanding on director's remuneration cannot be used for a long period and taken as a solid conclusion.

As stated in Malaysian Code on Corporate Governance (MCCG), Malaysian companies need to make a specific disclosure on the level of remuneration paid to directors. However, in Malaysia, most companies hide the detail of the director's remuneration even though it is one of the best practice that are recommended by the MCCG (Yeong, 2011). Since there are a lot of companies not prepared to disclose the detail of the director's remuneration, it will give disadvantages to the shareholders of the company to make an informed decision when voting on the approval of directors' remuneration. It also can limit the understanding of the shareholders towards the relationship between the level of directors pay and firm performance.

Previous researches were active in explaining director remuneration by using an agency theory, managerial power approach and efficiency wages theory. Since directors provide decision making, they are typically better informed about firm as compared to shareholders. Hence, a potential issue of interest arises due to the partition of ownership and managerial control. The relationship between the director's remuneration and firm value might have a positive relationship. This proclamation was supported based on the prior study by (Diks, 2016), whom found that there is a positive relationship between directors' remuneration and firm value.

Interestingly, from our sample, only around 43% of 602 listed firms use non–cash remuneration to compensate director's performance. Many studies (e.g. Talha et al., 2009, Haron and Akhtaruddin, 2013) in Malaysia ignored the important separation of non-cash directors' remuneration which could have different effects to firm performance. It is believed that non-cash director remuneration is more effective in motivating directors to enhance market performance rather than cash remuneration. Therefore, this study aimed to examine the relationship between cash and non-cash director's remuneration towards the firm value in Malaysia.

Chart 1: Number of firms Disclosed Directors' Remuneration Types



Literature Review

Agency Theory

Agency theory is a management theory that explained the relationships and self-interest in business organizations. The main idea of the agency theory is that one party delegates work to a second party which known as agent. It explains how best to organize relationships in which one party (principal) determines the work and which another party (agent) performs or makes decisions on behalf of the principal (Jensen & Meckling, 1976)

Since the shareholders of the firm (principal) not involve with the firm, it can cause the misalignment between the principle and agents (directors). If the conflict arises between the agent and principle it can cause poor result in firm value. The most reason the problem arise between principle and agent is when they have different interest towards company (Hill & Jones, 1992). Agency theory also helps the firm in develop the director remuneration package. The firms need to provide a remuneration package that can attract and motivate the directors, so they can have focused more on the firm performance. But, firms need to avoid pay more than is necessary or in other words overpay.

Agency cost happen when the failure of the agents which hired by the principals of a business to fully comply with the terms and responsibilities stipulated in their contract. It suggests that the directors should be rewarded based on their performance to avoid agency cost. Agency cost may arise because of the firm executive may act in their own interest. For example, they may raise their own salaries to an unrealistic level.

Studies on Relationship between Directors Remuneration and Firm Value

Directors remuneration is closely related with firm value as one of the financial performance. There are two ways how director's remuneration effects firm performance. First, remuneration based on performance contract will make the directors ensure the firm has market or financial performance sustainability. Second, high remuneration package to directors will motivate them to increase firm value (Patel & Simon, 2014). The amount of the remuneration package paid to directors should be capable enough to attract and retain good directors (Razali, et al., 2018). The relationship between the directors' remuneration and the firm values is positively related based on the previous study. According to Miyienda, Oirere, and Miyogo (2013), there is a positive relationship between director's remuneration and firm's performance. They also found that there is strong relationship between director's remuneration and the earnings after tax. However, in relationship between the return on asset and firm value, they found that there is a weak relationship with directors' remuneration.

Meanwhile, in Malaysia, prior studies prove that there is a positive relationship between directors' remuneration and firm performance. Directors' remuneration was calculated by added cash and non-cash directors' remuneration. Based on a study by Haron and Akhtaruddin (2013) on 120 companies in Bursa Malaysia, there is a positive relationship between firm performance such as firm value and directors' remuneration. This study can be a strong evidence to support the positive relationship between director's remuneration and firm performance. However, even though the sample used by them were high which is involving 120 companies in Bursa Malaysia, the data collected is only for one-year period which is on 2005 and the result reported may not be strong enough to make a solid conclusion. In other prior studies by (Talha et al., 2009), they also found a positive relationship between total director remuneration paid and firm performance.

On the other hand, Usman (2010) found statically insignificant negative relationship between chief executive officer (CEO) compensation and firms performance. The study was conducted using data from 2004 to 2008 cannot prove the evidence that CEO compensation is positively related with the firm's value. Even though the study cannot prove the positive relationship, the study found that the larger the firms, the higher the remuneration package paid to the CEO. The researcher concluded that the firms' size is positively related to the firms' performance and larger boards do not necessarily mean greater remuneration package to the directors. Raithatha and Komera (2016) examined the relationship between executive

compensation and firm's performance. The study was conducted using a sample of 3,100 firms in India over the period of 2002 to 2012. They concluded that, the remuneration paid to the directors had a positive relationship with the firms' performance.

Non-cash director's remuneration such as equity based compensation will influence directors to be more cautious if they have considerable amount of wealth tied to the firm. The bound wealth dismays them to misuse firm resources and encourages them to engage in behaviours that will enhance the firm value (Abedin, 2015). Dah et al., (2012) studied the effect of Chief Executive Officer (CEO) equity-based compensation on firm value. They found that there is a positive relationship between equity based compensation and firm value. Although there are very limited studies on equity based compensation and firm value, many researchers suggested that the increase in the level of directors' equity will increase firm value (Fahlenbrach & Stulz, 2009, Basuroy et al., 2014, Wahba et al, 2014).

METHODOLOGY

Research Design, Sample Description and Data Collection

Based on this study, there is only one dependent variable which is the firm value and two independent variables which is cash and non-cash directors' remuneration followed by five control variables which are the CEO duality, board size, firm age, firm size and leverage. This type of research is in the form of quantitative study and the model that has been used to test the relationship between directors' remuneration and firm value is Regression Model analysis. This study is utilizing secondary data and information. All data and materials were collected from Bursa Malaysia website and Eikon DataStream. Data such as directors' remuneration, CEO duality and board size were obtained from the annual report whereas other variables such as the firm value, firm size, leverage were collected from the Eikon Thomson Reuters database. The sample for this study involved 602 different listed firms on Bursa Malaysia's Main Board over 3 years period which is from 2014 to 2016. It represents 63.98% from total population (919 firms).

Regression Model

The model used to test the hypotheses is as follow:

Functional form:

FIRM_VALUE = f (Cash and non-cash directors remuneration, board size, CEO duality, firm size, firm age, leverage)

Hence our function can be estimated under the following model:

$$FIRM\_VALUE_{it} = \alpha + \beta_1 CASH\_REM_{it} + \beta_2 CASH\_REM_{it} + \beta_3 BOARD\_SIZE_{it} + \beta_4 CEO\_DUA_{it} + \beta_5 FIRM\_SIZE_{it} + \beta_6 FIRM\_AGE_{it} + \beta_7 LEV_{it} + \epsilon_{it}$$

Variables Definition

Dependent variable

FIRM_VALUE = Firm Value

Independent variable

$CASH\_REM_{it}$ = Directors remuneration in term of cash

$NONCASH\_REM_{it}$ = Directors remuneration not in term of cash

Control variable

$BOARD\_SIZE_{it}$	=	the firm's board size
CEO_DUA_{it}	=	the firm's CEO duality
$FIRM\_SIZE_{it}$	=	the firm's size
$FIRM\_AGE_{it}$	=	the firm's age
LEV_{it}	=	the firm leverage
i	=	company
t	=	time

Result and Discussion

Descriptive Statistics

Table 1: Descriptive Analysis

Variable	Mean	Min	Max	Std. Dev.
FIRM_VALUE	1.352313	0.001935	140.5347	6.049396
CASH_REM	6.302943	3.903090	9.052682	0.438145
NONCASH_REM	4.802277	3.100371	7.335961	0.577454
BOARD_SIZE	7.416714	3.000000	22.00000	2.044210
FIRM_AGE	30.45378	0.000000	188.0000	19.46741
FIRM_SIZE	8.473817	5.094310	10.82412	0.711310
CEO_DUAL	0.227170	0.000000	1.000000	0.419122
LEV (%)	0.476182	0.002444	78.03287	2.437412

An analysis of Table 1 shows that the mean of the firm value for the sample companies is 1.352313 and varies from 0.001935 (minimum) to 140.5347 (maximum). The standard deviation is 6.049396. Firm value of this study is calculated by divided market capitalization to total assets. For the independent variable which is director cash (CASH_REM) and non-cash remuneration (NONCASH_REM) were transformed into the natural logarithm. The mean for cash remuneration is 6.302943 and varies from 3.903090 (minimum) to 9.052682 (maximum). The standard deviation is 0.438145. For non-cash remuneration, the mean is 4.802277 with range between 3.100371 (minimum) to 7.335961 (maximum). The standard deviation for non-cash remunerations is 0.577454.

For control variables, the board size (BOARD_SIZE) was calculated by the number of the directors in the company. The mean for the board size is 7.416714 or around 7 to 8 people and varies from 3.00 people (minimum) to 22.0 (maximum) people. The standard deviation is 2.044210. The next control variable is firm age (FIRM_AGE) which calculated by current years minus the incorporations date. The mean for firm age is 30.45378 years and the range is from 0.00 year (minimum) to 188.00 years (maximum). The standard deviation is 19.46741. For firm size (FIRM_SIZE) which calculated by transform the value of the total asset to the natural logarithm, the mean is 8.473817 and has the range between 5.094310 (minimum) to 10.82412 (maximum).

The standard deviation for firm size is 0.711310. For CEO duality which is the dummy variable, the mean is 0.2271. It means that CEO duality from the sample is around 22.71% that CEO also holds the position of the chairman of the board. Range of CEO duality in this

study is from minimum value 0 to maximum value 1. The standard deviation is 0.419122. The last variable is the leverage. It was calculated by the total liabilities divided by the total asset of the firm. The mean for leverage is 47.62% and the range is between 0.002444% (minimum) to 78.03287% (maximum).

Pearson Correlation

Table 2 shows the summarization of the correlation between the variables. The director cash remuneration (CASH_REM), non-cash remuneration (NONCASH_REM), board size (BOARD_SIZE), firm age (FIRM_AGE) and firm size (FIRM_SIZE) has a significant positive correlation with the firm value. There are also variables that has a negative relationship with the firm value which is CEO duality (CEO_DUAL) and leverage (LEV).

The first independent variable which is CASH_REM has a significant positive relationship with director remuneration (NONCASH_REM) at 1% significance level. Control variables such as BOARD_SIZE, FIRM_AGE, FIRM_SIZE and LEV have a significant positive relationship with second independent variable which is CASH_REM. Most of the relationships are significant at 1% significance level. NONCASH_REM has positive relationship with BOARD_SIZE, FIRM_AGE, FIRM_SIZE at 1% significance level.

In relation to relationship among control variables, BOARD_SIZE shows a significant positive relationship with FIRM_AGE and FIRM_SIZE at 1% significance level. The second control variable, FIRM_AGE shows a significant positive relationship with FIRM_SIZE and CEO_DUAL at 1% significance level. There is no relationship appeared between FIRM_SIZE and CEO_DUAL or FIRM_SIZE and CEO_DUAL. Lastly, CEO_DUAL has a positive relationship with LEV at 1% significance level.

Multiple Regression Analysis

Based on Table 3, the coefficient value of the directors' cash remuneration (CASH_REM) is 2.1718 with the t-statistic value of 2.2830. The non-cash director remuneration (NONCASH_REM) has coefficient 1.8563 and the t-statistic value is 3.0049. The p value for director cash remuneration is 0.0227 and the non-cash remuneration is 0.0027. It means that the directors' cash remuneration is significant at 5% level and the non-cash remuneration is significant at 1% level. The non-cash directors' remuneration has a stronger significant positive relationship with firm value rather than cash remuneration. These results prove that the total remuneration package paid to the directors plays a significant role in increasing firm value because the total remuneration received by the directors can motivate them to perform better for the firms (Razali, et al., 2018). It also helps the firm to secure and retain highly credible director for a firm to have a good performance aligned with the firm value. Past researches also explained that the higher the remuneration paid to directors, on average, leads to higher firm performance (Diks, 2016). A study by Raithatha and Komera (2016) also suggest that the total remuneration packages received by the director can increase the firm performance.

Negative relationship appears between board size (BOARD_SIZE) and the firm value. The coefficient of the board size is -0.3840 and the t-statistic is -2.3910. The p value of the board size is 0.0171. It means that the board size is significant at 5% level. Previous study also found negative relationship between board size and firm performance. Sheikh and Khan (2016) proved that, the smaller boards are more effective than bigger boards because bigger boards may become the cause of delays in decisions making which in turn negatively influence

the firm performance. Deschênes et al., (2014) and Nguyen et al., (2015) also found that there is a negative relationship between board size and firm value.

This study shown that the firm age (FIRM_AGE) has positive relationship with the firm value. The firm age coefficient is 0.0793 and the t-statistic is 5.2087. The p value of the firm age is 0.0000. It means that the firm age is positively related with the firm value at 1% level of significant. This result is aligned with past studies where the researchers claim that older firm can be more profitable compared to younger firm due to the experience and efficiency (Hopenhayn, 1992). Besides that, Leite and Carvalhal (2016) conclude that older firms have better governance practices due to the inherence of natural maturity that reduce the agency problems. However, based on past researches, there are also studies that argue and claimed that young firms perform better than older firms. This is because older firms have a problem of rigidity over time which causes slow growth and lead to decrease in research and development (R&D) activities.

There is a positive relationship between the firm size (FIRM_SIZE) and the firm value. The coefficient of the firm size is 0.0375 and the t-statistic is 0.0731. The p value of the firm size is 0.9417. The result is not significant relationship with the firm value and not consistent with Sheikh & Khan (2016). They found that firm's size is negatively significant with firm value. The larger firms may not be able to enjoy economic of scale. It has been argued that larger firms will have a more complicated operation structure and environment compared to small firms (Firth et al., 1996).

The CEO duality (CEO_DUAL) has a negative effect with the firm's value. The coefficient is -1.0913 and the t-statistic is -1.4652. The p value for CEO duality is 0.1433 which means that it was insignificant. CEO duality enables the CEO of the firms to gain full control in dominating the decision making of the firms. By holding two main positions in the company, CEO may have a strong access over the board of directors in shaping his own compensation. It is not consistent with prior study that found positive relationship between CEO duality and firm value. Elloumi & Gueyie (2001) has claimed that, the greater the power of the CEO in the firms may lead them to have higher remuneration package. Moreover, the remuneration package itself will motivate the CEO to perform better in the firms.

Lastly, leverage (LEV) has negative effect with the firm value. The coefficient for the leverage is -0.0551 and the t-statistic is -0.6649. The p value of the leverage is 0.5063 which means it is not significant. This result is not consistent with the prior study (Sheikh & Khan, 2016) where they found that there is a positive relationship between leverage and the firm's value. Jensen (1986) claimed that debt can be an effective tool to mitigate the agency problems between managers and shareholders. When the agency problem within the firm is less, it will increase the productivity of the firms and automatically increasing the firm value.

Conclusion and Implication of the Study

Based on the results and discussion, the directors' remuneration which are cash and non-cash remuneration are positively related with the firm value. The non-cash directors' remuneration has a stronger relationship with firm value rather than cash remuneration. It can be concluded that firm should use non cash remuneration compared to cash remuneration to motivate the directors to increase firm value. This is because non-cash director's remuneration such as equity based compensation, equity options, and benefits in kind will influence directors to be more cautious if they have considerable amount of wealth tied to the firm. The bound wealth dismays them to misuse firm resources and encourages them to engage in behaviours that will enhance the firm value. Higher remuneration package

received by the directors can motivate the directors in increasing the firm value. Thus, remuneration higher package given by firm should be aligned with firm performance and could reduce agency cost. It also helps the firm to secure and retain credible director for a firm to have a good performance aligned with the firm value. The higher the remuneration paid to directors, on average, leads to a better firms' performance.

The board size has negative relationship with the firm value. It shows that the bigger the size of the board, the less effective performance will be. This is because of the communication barriers in the board of directors since it involves higher number of directors. Next variable is the firm age and it has a positive relationship with the firm value. This result has proven that older firm will increase the firm performance since they have more experience and resources compared to younger firms. This is due to the fact that they already stayed in the industry for a long time.

As far as this study is concern, the directors' remuneration is positively related to firm value. Based on this findings, it may help the shareholders of a firm to understand the reason behind the total remuneration packages received by directors. It is important for shareholders because some of them tried to discover whether the directors are under or overpaid on the company they invest. Next, this paper also may help the investor in making the decision in term of investment. Since this paper finds that the directors remuneration packages are positively and significantly related with firm value, it may help the investor in choosing the company to invest. Investor can make decision by comparing the total remunerations received by directors in the firm. The result itself showed that higher total remuneration package may increase the firm value. This study may assist investors since it provides the latest information on director's remuneration.

Furthermore, this study may also provide guidelines to the regulator as well. There are some variables that are positively and significantly related with the firm value. Hence, regulators such as Bursa Malaysia need to enforce the rules in terms of the disclosure of important information and ensure that the firms provide the total remuneration package received by the directors so that stakeholder can utilize the information towards a better decision making.

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Table 2: Pearson Correlation Coefficient

		FIRM_VALUE	CASH_REM	NON_CASH	BOARD_SIZE	FIRM_AGE	FIRM_SIZE	CEO_DUAL	LEV
FIRM_VALUE	Pearson	1							
	Sig.								
CASH_REM	Pearson	.063*	1						
	Sig.	.012							
NONCASH_REM	Pearson	.177**	.304**	1			.		
	Sig.	.000	.000						
BOARD_SIZE	Pearson	.008	.267**	.247**	1				
	Sig.	.743	.000	.000					
FIRM_AGE	Pearson	.126**	.051*	.175**	.099**	1			
	Sig.	.000	.030	.000	.000				
FIRM_SIZE	Pearson	.057*	.322**	.290**	.309**	.170**	1		
	Sig.	.021	.000	.000	.000	.000			
CEO_DUAL	Pearson	-.010	.027	-.006	.022	.084**	-.018	1	
	Sig.	.700	.258	.869	.350	.000	.451		
LEV	Pearson	-.006	.072**	.042	.006	.019	-.019	.071**	1
	Sig.	.820	.002	.238	.801	.422	.423	.003	

*. Correlation is significant at the 0.05 level (2-tailed) and **. Correlation is significant at the 0.01 level (2-tailed).

Table 3: The Coefficient of Multiple Regression Analysis

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-20.94179*	5.399904	-3.878178	0.0001
CASH_REM	2.171764*	0.951298	2.282949	0.0227
NONCASH_REM	1.856297**	0.617764	3.004864	0.0027
BOARD_SIZE	-0.382960*	0.160170	-2.390967	0.0171
FIRM_AGE	0.079295**	0.015223	5.208731	0.0000
FIRM_SIZE	0.037497	0.512785	0.073125	0.9417
CEO_DUAL	-1.091301	0.744810	-1.465207	0.1433
LEV	-0.055105	0.082881	-0.664871	0.5063

R-squared	0.076942	Mean dependent var	1.714795
Adjusted R-squared	0.067905	S.D. dependent var	8.529665
S.E. of regression	8.234972	Akaike info criterion	7.065660
Sum squared resid	48487.56	Schwarz criterion	7.116376
Log likelihood	-2546.236	Hannan-Quinn criter.	7.085236
F-statistic	8.514115	Durbin-Watson stat	0.138839
Anova Prob (F-statistic)	0.000000		

*. Correlation is significant at the 0.05 level (2-tailed) and
**. Correlation is significant at the 0.01 level (2-tailed).

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