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# Remuneration Committee and Director Remuneration in Family-Owned Companies: Evidence from Malaysia

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*This study examines the relationship between remuneration committee and director remuneration in family firms. The proxies of remuneration committee are the numbers of committee members and non-family member on the committee. The family firm proxy is a dummy variable that is one (1) if the firm is a family firm and zero (0) if it is a non-family firm. The dependent variable (director remuneration) is measured by fees, salary, bonuses and benefit of kin. The sample size of this study is 537 firms listed in Bursa, Malaysia with 1611 panel data from 2007 to 2009. Findings from this study reveal that there is significant positive relationship between remuneration committee and director remuneration, which suggests the effectiveness of the remuneration committee role. However, evidence shows that the remuneration committee is significantly negative in family firms. Our study suggests that family firm combine power and control to mitigate effectiveness monitoring by remuneration committee, which provided an opportunity for them to expropriation.*

**JEL Code:** G30, G32 and G34

## 1. Introduction

Malaysia's government emphasizes the importance of corporate governance being implemented on firms listed in Bursa, Malaysia. Through this practice, shareholder's right will be protected. Furthermore, the practices of governance mechanisms are contained in the Malaysian Code on Corporate Governance (2000) related to issues of composition board, board of directors, director remuneration, board committee and their mandates and activities. Under the best practices in corporate governance, the MCCG describe board remuneration as one of the effective aspects of corporate governance, which should reflect on the responsibility and commitment of executives as well as non-executive directors in the board of directors.

Boards of directors are responsible for the direction of firms, including generating profit, expanding the business, increasing market price, and attracting new investors. When boards of directors have similar interests with shareholders, firm objectives can be achieved, possibly increasing shareholder wealth. As agency theory suggests, to align the interests of both parties the firm can provide

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incentives, which will tend to mitigate the agency problem (Jensen & Meckling 1976). Notion of this, the better remuneration should be linked to performance and board member abilities (i.e., knowledge, skills, and experience). Furthermore, remuneration committees are responsible for designing packages that follow the best-practice suggestions for corporate governance and are likely to be contractually accepted by board members. However, involving family member in remuneration committee in family firm possibly made director remuneration become less transparent seems they are design for their own remuneration. It can also be argued that the uniqueness of family firms may influence the role played by non-family members on committees.

Family firms tend to keep the top position although they are not talented or qualified to run a business due to increased personal interest. Moores and Craig (2008) notes that family firms prefer to keep top management for family members rather than hiring qualified outsiders. Non-executives have less power to argue or oppose actions taken by family members because family appoints them. Family groups in committees actively can influence the committee decision making to benefit them. This fact influences the direction of family group divergences from maximizing profit towards increasing personal wealth; this trend does not follow the MCCG's revised 2007 suggestion, thus, the agency problem becomes serious between majority shareholders and minority shareholders (Jiang & Peng 2010; Young et al. 2008). Consequently, expropriation via remuneration may be very hard to eliminate in family firms.

As previously stated, director remuneration can be used to align the interests of boards of directors and shareholders (Andreas et al. 2010) or of majority and minority shareholders (Jiang & Peng 2010; Young et al. 2008). However, there are a limited number of studies that have examined who is best equipped to design the best remuneration packages (Anderson & Bizjak 2003; Main & Johnston 1992) in family firms. Furthermore, remuneration committees play an important role in the determination of executive pay, but only a few studies have examined the relationship (Main & Johnston 1992; O'Reilly et al. 1988; Singh & Harianto 1989).

The objective of this paper is to examine the relationship between remuneration committee and director remuneration in a family firm. The sample size of this study is 537 firms listed in Bursa, Malaysia with 1611 panel data from 2007 and 2009. We find that there is significant positive relationship between remuneration committee and director remuneration. Further analysis find evidence family firm uses power and control to mitigate effective monitoring of remuneration committee towards director remuneration which is open for family member to expropriation.

The remaining chapters are organized as follows: Chapter 2 outlines the relevant literature, while developing fully the ideas in past research that are most important to the present study. Research design issues and methodology are explored in Chapter 3. Details of the final sample and the measurement of variables are also discussed in this chapter. The results and discussion are presented in Chapter 4. Chapter 5 sets out the study's conclusions, limitations, and some suggestions for further research.

## 2. Literature Review

The motivation of majority shareholders in family firms could increase when their intention is linked with firm objectives. Moreover, the long-term survivor who puts firm performance first is very important; this is purposefully the firm's incorporation initially. Therefore, family groups focus on firm performance in order to hand over the firm for the next generation (Anderson & Reeb 2003). Prior research (e.g. Anderson & Reeb 2003; Miller & Le Breton-Miller 2006; Villalonga & Amit 2006) show that a family firm's performance is better than non-family firms, attracting more investment from minority shareholders with better payout dividends. However, it is very challenging because the firm belongs to them. Keeping the firm successful in the long term and preventing expropriation from minority shareholders is in the hands of family members.

Agency theory suggests that board of director intends to increase personal wealth via remuneration. This ability is contrary to minority shareholder goals, leading to the higher agency problem. Therefore, effective remuneration is very important to influencing the board of director to switch personal interest towards fulfilling firm objectives. This may lead the business to better performance, where no expropriation exists inside the firm. Accordingly to Finkelstein and Hambrick (1989) as well as Fama and Jensen (1983), the board of director accepts effective remuneration as a contract and mitigates the agency problem.

The implication of accepting remuneration as a contract is that boards of directors are required to utilize knowledge, skills, and expertise purposefully to maximize shareholder wealth. Thus, better remuneration components motivate boards of directors to be creative with great ideas. According to Carter and Zamora (2009), providing suitable salaries as remuneration has significant impacts on motivation of executive to increase firm performance. Accordingly, the remuneration committee is responsible for designing great remuneration to offer as a contract, which aligns closely to majority shareholder desires while increasing shareholder wealth. Bebchuk and Fried (2003, p. 1) explain optimal contracts boards are assumed to design compensation schemes to provide managers with efficient incentive to maximize shareholder.

For example, Paarsch and Shearer (2000) study in the British Columbia tree-planting industry indicate that incentives increased productivity by almost 173 trees per day, which is equivalent to about 22.6%. They also find that the workers were willing to undertake extra work due to incentives being based on the productivity. In contrast, under the fixed salary system, worker contribution is at a minimum (Paarsch & Shearer 2000).

The board of director is required to utilize knowledge and expertise if they accept proposals able to increase performance. When they use their expertise for great planning and strategies, the firm objectives possibly can be achieved. Therefore, the majority shareholder pay should be increased. Bender (2007) explains that strong corporate strategies tend to increase remuneration packages. In addition, combination of the right mix of remuneration components linked to abilities able to motivate the board of director to be creative and come in with a great idea. An optimal contract refers to the right combination with a mixed of level of remuneration and matching board of director desires, skills, knowledge and

expertise. Carter and Zamora (2009) explain that providing a suitable salary as remuneration significantly impacts the motivation of shareholders to increase firm performance.

Remuneration committee play important role to design better remuneration which is tends to motivate board of director to work harder. According to Anderson and Bizjak (2003) and Ezzamel and Watson (2002), remuneration committees play important roles in the executive pay-setting process. Shareholders will reject remuneration proposals related to salary that fail to reward high performance accordingly (Carter & Zamora 2009).

As suggested in the Greenbury report (1995, p. 11), the key to encourage enhance performance by directors' lies in remuneration packages which: links to performance by both company and individualThe remuneration committee is a sub-committee established for designing effective incentives for executives linked to performance, and the committee members consist of a non-executive director and an executive director. In addition, Greenbury (1995, p. 14) explains the code of best practice A1:

> "Board of directors set up remuneration committees of non-executive directors to determine on their behalf and on behalf of shareholder within agreed terms of reference, the company`s policy on executive remuneration and specific remuneration packages for each of executive directors including pension rights and any compensation payments."

Initially, remuneration packages are constructed and reviewed by remuneration committees and outside consultants before proceeding to boards and shareholders for approval. As Barkema and Gomez-Mejia (1998, p. 137) explain:

> "the task of such board committee is to develop proposals, which approved by the full board, on the level and mix of CEO compensation. The members of remuneration members are supposed to be outside directors – individuals who are not executives of the firm on whose boards they sit".

The members of remuneration committees should consist wholly or mainly of non-executive directors who do not have preexisting relationships with board members or shareholders and are, thus, independent. Lack of preexisting relationships is important in committee members because only then will they have the ability to transparently design effective remuneration to positively impact performance (Barkema & Gomez-Mejia 1998; Fama & Jensen 1983). As Spira and Bender (2004, p. 494) explain that Remuneration committee members have to deal with schemes that are becoming more and more intricate, and to understand the layers of regulation that have been introduced in recent years. Thus, the following hypotheses:

***H1:*** *There is positive relationship between remuneration committee and director remuneration.*

In family firms, family executives who are members of boards of directors and majority shareholders obtain two benefits if they accept remuneration contracts: First, they receive better remuneration composed of a high salary, large bonuses,

or both, as well as stock options (Basu et al. 2007; Bebchuk & Fried 2003; Croci et al. 2010). Second, as shareholders, they can receive large dividends based on firm performance. The logic of these two incentives can be used to possibly influence majority shareholders to re-orientate their private intentions towards increased shareholder wealth (Andreas et al. 2010; Hölmstrom 1979). Prior studies indicate that there is a positive relationship between CEO remuneration and firm performance (Barkema & Gomez-Mejia 1998; Kaplan 1994; Murphy 1985), which is consistent with agency theory (Fama & Jensen 1983).

Lower remuneration for family executives improves the cash flow for businesses and thus, family members may be willing to accept remuneration below industry norms. Furthermore, lower remuneration is accepted as a contract by executives if they are offered secure positions within the firm (Gomez-Mejia et al. 2003). Past studies have shown an inverse relationship between family ownership and remuneration of family executive (Barontini et al. 2010; Cheung et al. 2005; Gomez-Mejia et al. 2003). For example, Dogan and Smyth (2002) find that salaries and fees paid to all directors were lower with higher ownership concentration. The way power is used to increase personal wealth in family firms may be influenced by their uniqueness. The positive relationship between family ownership and director remuneration is possibly an altruism issue, the way in which parents manage their estates influence the effects of incentives (Schulze et al. 2003).

Past studies have demonstrated a positive relationship between ownership and remuneration (Basu et al. 2007; Cheung et al. 2005; Thillainathan 1999). According to Basu et al. (2007), higher ownership positively impacts executive remuneration. In addition, Cheung et al.'s (2005) study of 412 Hong Kong firms finds that cash emoluments received by executives were related to their shareholdings. A study by Thillainathan (1999) demonstrates that family ownership can manipulate remuneration through cross holding and pyramids; these are common practices in Malaysia. He (2008) explains that, through cross holding and pyramids, control can be maximized by majority shareholders to increase private benefit. This results in losses for minority shareholders due to fewer dividends available for pay out.

Furthermore, remuneration can become emotionally charged as a sign of competence (Moores & Craig 2008). Founders and family members may consider firms to belong to them, leading them to believe they have a right to use the resources as they see fit, many times in the form of higher salaries. If higher remuneration does not seriously affect firm losses, family members may use their power to derive financial benefits (Chourou 2010). According to Wiwattanakantang (2001) majority shareholders have the ability to pay out firms' cash flow to themselves through higher salaries and dividends and hold top management positions, even though they are not qualified.

The family firm intends to provide positions for family members rather than hiring more qualified manager (Moores & Craig 2008) even if they are not talented enough to run a business (Faccio et al. 2001). Thus, a family firm can use remuneration to benefit themselves. This relationship is not against regulations because the firm belongs to them and has a right to be awarded higher remuneration even though they are unqualified as long as it is not proven risky to the firm. Chourou (2010) notes that owner managers use their power to derive financial benefits only when they do not bear the full cost of their actions. This

notion applies to the remuneration committee as well. To ensure that packages are transparent, outside consultants are required to review non-executive directors' advice. As a result, the proposal is linked to performance after consulting in order to ensure that it is more comprehensive and comparable with peer groups in similar industries.

Moreover, the remuneration process is dominated by family members, which causes difficulty for non-executive directors and consultants to address the proposal fairly for all shareholders. Although the executive family is less present in committees, it still can influence decisions regarding key positions. Furthermore, the next step becomes more difficult because family members are board of directors and shareholders. This situation provides an opportunity for family members to increase personal interest.

The non-executive director who is in the remuneration committee has a conflict of interest during their work i.e. either to follow instruction from family member and fulfil their desire by increase personal wealth or respectively of minority shareholder to prevent investment. However, non-executive director prefer to work on family member instruction rather than protect minority shareholder wealth. The following are reasons: first, non-executive director tend to express their appreciation for providing a place in the board of director and remuneration committee. The implication of this action leaves the non-executive director (non-family member) incapable and less against the committees` decision although it harms the minority shareholder. Second, the non-executive (non-family member) still continues to service under remuneration committee in the same firm after retirement (Anderson & Bizjak 2003), this provides a feeling of guilty against the remuneration proposal. Thus, the following hypotheses:

***H2:*** *There is weaker relationship between remuneration committee and director remuneration in family firm*

Many studies have tested hypotheses regarding remuneration and performance, family firm and remuneration with mixed results. However, the prior studies less address the relationship between the remuneration committee and director remuneration in a family firm with respect to expropriation. The higher remuneration awarded to family executives, which is designed by family members, demonstrates the possibility of expropriation being practiced in family firms.

## 3. Research Methodology

### 3.1 Sample and Model

The sample comprises balanced data of 537 firms and 1,611 firm-year observations from Malaysian companies over a 3-year period between 2007 and 2009. The 2007-2009 period has been chosen because disclosure, as required under the *Malaysia Code of Corporate Governance* (MCCG), became effective for annual reports after June 2001, which detailed the activities of the remuneration committee, executive pay structure and level of remuneration. The company data was obtained from Bursa, Malaysia, and consists of 762 family firms and 849 non-family firms.

This study includes only cash-based remuneration for the sample period. Although the disclosure of director remuneration in Malaysia has significantly improved since the implementation of MCCG, the remuneration information is not available in electronic form and, thus, must be manually collected from annual reports. The annual reports are available from Bursa Malaysia (www.bursamalaysia.com). The 2007 to 2009 periods has been chosen because disclosure, as required under the *Malaysia Code of Corporate Governance* (MCCG), is made effective for annual reports after June 2001 which detail out the activities of remuneration committee, executive pay structure and level of remuneration.

This model relates remuneration committee variables to director remuneration with aim identifying expropriation in family owned companies. The remuneration committee variables are size of remuneration committee, family members as executive director, and non-family member as non-executive directors. Previous research shows the remuneration variables are director, executive and non executive remuneration (Abdul Wahab & Abdul Rahman 2009) is related to size, age, debt and incorporate which is need to be control (Anderson & Reeb 2003; Carrasco-Hernandez & Sanchez-Marin 2007; Chalmers et al. 2006; Martinez et al. 2007; Maury 2006). This study use linear regression to test hypotheses and following regression analysis with econometric model:

Equation (1) describes the model used to test the relationship between director remuneration, the remuneration committee, the family firm, and control variables:

$$REM = \beta_0 + \beta_1 REMCOM_{it} + \beta_2 FAM\_FIRM_{it} + \beta_3 SIZE_{it} + \beta_4 DEBT_{it} + \beta_5 AGE_{it} + \beta_6 IND_{it} + \epsilon_{it} \quad (1)$$

Equation (2) illustrates the model used to test the relationship between director remuneration, the remuneration committee, the family firm, interaction between remuneration committee and family firm, and control variables:

$$REM = \beta_0 + \beta_1 REMCOM_{it} + \beta_2 FAM\_FIRM_{it} + (\beta_3 REMCOM_{it} * FAM\_FAM_{it}) + \beta_4 SIZE_{it} + \beta_5 DEBT_{it} + + \beta_6 AGE_{it} + \beta_7 IND_{it} \epsilon_{it} \quad (2)$$

## 3.2 Variables

### 3.2.1 Dependent Variable

Remuneration was measured using proxies representing cash remuneration consisting of salaries, bonuses, benefits of kin, and fees (Abdul Wahab & Abdul Rahman 2009; Basu et al. 2007). As previously discussed, cash remuneration is a popular incentive and has been linked to better performance (Dong & Ozkan 2008; Shaw & Zhang 2010). This measure has been widely used in prior research (i.e. Abdul Wahab & Abdul Rahman 2009; Basu et al. 2007; Jensen & Murphy 1990; Ozkan 2007). All remuneration variables are based on logarithm transformations, where the statistical relationship could be weakened and related to skewed distribution and lead heterosdasticity (Tabachnick & Fidell 2007).

### 3.2.2 Independent Variables

Remuneration committee measures included the size of remuneration committee, family members as executive director[i] and non-family member as non-executive directors. Size of remuneration committee represents the existence of remuneration committees as suggested by governance. The remuneration committee increases director remuneration if family members prioritize personal desires or if non-family members lack independence.

This study focused on family ownership structure according to two criteria: The first criterion is based on Claessens et al. (2002) definition of family as related by blood or marriage and is consistent with others' conceptualizations of family ownership as previously discussed Anderson & Reeb (2003) and Fahlenbrach (2007). Therefore, according to this first criterion, family ownership was measured as members of the board of directors (e.g., CEO, chairman, etc.) who were related by blood or marriage. Annual reports from Bursa Malaysia include disclosure of the relationships among executives under board member profiles, which allows for categorization of directors as family members.

The second criterion for family ownership is that family members hold not less than 20% of the voting stock (La Porta et al. 1999). The equity fraction is calculated based on direct and indirect shareholdings of family members. Either one or both of these criteria need to be fulfilled to be selected as family ownership. Claessens et al. (2002, p. 2746) explain that "we do not consider ownership by individual family members to be separate, and we use total ownership by each family group-defined as a group of people related by blood or marriage-as the unit of analysis".

### 3.2.3 Control Variables

Firm size was measured using the natural log of the book value of total assets, which is consistent with how firm size has been measured in prior studies (i.e. Anderson & Reeb 2003; Chalmers et al. 2006; Maury 2006; Mehran 1995). Firm age needs to be controlled due to significant impacts of age in this research. Firm age is measure based on time of IPO. Publicly listed companies will announce IPO after incorporating in order to increase capital. Firm age is measured by the difference between the current year and the year of IPO, which is the first sale of stock by a company to the public. Next, industry will be included as a control variable to differentiate between industrial sectors. Industry will be dummy coded with 1 representing the consumer products sector, including trading/service, construction, and plantations/mining, and 0 representing other sectors, including banking, finance, and insurance, which are not included in these analyses. Inclusion of industry as a control variable and the dummy coding strategy are consistent with prior research (Carrasco-Hernandez & Sanchez-Marin 2007; Martinez et al. 2007). Debt was represented by capital structure, which was computed by dividing long-term debt by total assets (Anderson & Reeb 2003).

Salim & Wan-Hussin (2009) examine the association between remuneration committee and ownership structures on pay for performance in Malaysia public listed companies. To measuring the remuneration structure, they use items on remuneration characteristic. Sun & Cahan (2009) study on US companies to examine the effect of compensation committee quality on the association between

CEO cash compensation and accounting earnings and the moderating effects of growth opportunities and earnings status. Furthermore, Anderson & Bizjak (2003) examine whether greater CC independence promotes shareholder interests and whether the CEO presence on the CC leads to opportunistic pay structure. They measure the remuneration committee with inside director, affiliated directors, outside directors and size. This study is different with others study due to expropriation matter in family firm with measurement by size, non family member and family member in remuneration committee.

# 4. Results and Discussion

## 4.1 Descriptive Statistic and Correlation Matrix

Panel A of Table 4.1 exhibits the descriptive statistics related to director remunerations. Total director remuneration averages RM2.120 million, with a maximum of RM70.347 million. Further, the mean (median) for executive remuneration and non executive remuneration is RM1.854 (RM1.135) million and RM 265,000 (RM160,000) respectively. In addition, components of executive remuneration are consists of fees and allowance, salary, bonus and benefit of kin averages RM91,000, RM1.359 million, RM219,000 and RM184,000 respectively. Furthermore, components of non executive remuneration are consists of fees and allowance, salary, bonus and benefit of kin averages RM185,000, RM51,000, RM11,000 and RM17,000 respectively. The descriptive findings suggest the obvious that firms allocate more remuneration for executive remuneration rather than non executive remuneration.

Panel B of Table 4.1 presents the descriptive statistic related to remuneration committee. The mean (median) of remuneration committee consist of family member and non family member are 0.390 (0.00) and 2.850 (3.00). Average on board of remuneration committee members is 2.00, with a maximum of 8.00 respectively. Panel C of Table 6.1 reports the descriptive results related to family firm. An average family member on board in family firm is 1, with maximum of 6 members. Further, mean (median) for direct and indirect shareholding are 6.787 (0.000) and 14.445 (0.000) percent respectively. The descriptive findings suggest that the presence of non family member is higher than family firm in remuneration committee.

Panel D of Table 4.1 reports the descriptive statistics for firm characteristic. Average of firm size is RM19.542 million, with maximum RM24.496 million. Others firm characteristic are debt which mean (median) is RM140,000 (RM85,000), with maximum RM3.897. Furthermore, mean (median) of firm age is 13 (12) years, with maximum 48 years respectively.

Table 4.2 present the Pearson correlation for the test variables. Pearson correlation indicates that DIRREM and EXECREM are not correlated with FAM_FIRM. However NEDREM is negatively correlated with FAM_FIRM. This is not proving initial support of family firm influences director remuneration. Correlation between NEDREM and RC_NFM is positive and significantly correlated. Furthermore, the results show that the remuneration committee a measure, REMCOM is positively related to the remuneration variables which providing initial support that

remuneration rewards base on procedure and policies of firm. However, FAM_FIRM is significant negative correlated to NEDREM but not with others remuneration variable.

**Table 4.1: Descriptive Statistic**

| | Mean | Median | Standard Deviation | Minimum | Maximum |
|---|---|---|---|---|---|
| *Panel A:Director Remuneration* | | | | | |
| DIRREM (million) | 2.120 | 1.385 | 4.059 | 0.045 | 70.347 |
| EXECREM (million) | 1.854 | 1.135 | 3.971 | 0.000 | 69.621 |
| EXECFESS (million) | 0.091 | 0.024 | 0.213 | 0.000 | 2.130 |
| EXECSAL (million) | 1.359 | 0.897 | 3.373 | 0.000 | 68.851 |
| EXECBON (million) | 0.219 | 0.000 | 1.170 | 0.000 | 32.111 |
| EXECBEN (million) | 0.184 | 0.039 | 1.072 | 0.000 | 38.165 |
| NEDREM (million) | 0.265 | 0.160 | 0.381 | 0.000 | 5.035 |
| NEDFEES (million) | 0.185 | 0.134 | 0.196 | 0.000 | 2.074 |
| NEDSAL (million) | 0.051 | 0.000 | 0.211 | 0.000 | 3.588 |
| NEDBON (million) | 0.011 | 0.000 | 0.078 | 0.000 | 1.466 |
| NEDBEN (million) | 0.017 | 0.000 | 0.114 | 0.000 | 3.423 |
| *Panel B: Remuneration Committee* | | | | | |
| RC_FM | 0.390 | 0.000 | 0.538 | 0.000 | 3.000 |
| RC_NFM | 2.850 | 3.000 | 0.813 | 0.000 | 8.000 |
| REMCOM | 3.230 | 3.000 | 0.674 | 2.000 | 8.000 |
| *Panel C: Family Firm* | | | | | |
| FAM_MEM | 1.450 | 0.000 | 1.703 | 0.000 | 6.000 |
| DIR_SHARES | 6.787 | 0.000 | 13.402 | 0.000 | 66.400 |
| INDIR_SHARES | 14.445 | 0.000 | 20.864 | 0.000 | 84.250 |
| *Panel D: Control Variables* | | | | | |
| SIZE | 19.542 | 19.417 | 1.317 | 11.755 | 24.496 |
| DEBT | 0.140 | 0.085 | 0.203 | 0.000 | 3.897 |
| AGE | 13.83 | 12.000 | 10.824 | 0.000 | 48.000 |

*Notes: EXECREM and NEDREM are executive and non-executive director remuneration respectively, DIRREM is the total director remuneration respectively. EXECFEES, EXECSAL, EXECBON AND EXECBEN are executive director fees and allowances, salary, bonus and benefit of kin.. NEDFES, NEDSAL, NEDBON AND NEDBEN are non-executive director fees and allowances, salary, bonus and benefit of kin respectively. RC_FM and RC_NFM are remuneration committee for family members and non family members, respectively. REMCOM is a remuneration committee. FAM_MEM is family member as in board of director. DIR_SHARES and INDIR_SHARES are shareholding in family firm. Assets are total assets. Debt is the long term debt over total assets .SIZE is logarithm of total assets and AGE is number of year since IPO.*

## Table 4.2: Correlation Matrix

*Pearson correlations are reported in the table. : EXECREM and NEDREM are executive and non-executive director remuneration; DIRREM is the total director remuneration respectively. RC_FM and RC_NFM is remuneration committee for family members and non family members, respectively. REMCOM is a remuneration committee which is consists of director and non-executive director among family member and non family member. FAM_MEM is family member as in board of director. DIR_SHARES and INDIR_SHARES are shareholding in family firm. INSTOWN is the ringgit and percentage shareholdings by top five (5) institutional investors. MSWG is Minority Shareholder Watchdog group. ASSETS total assets. ROA is the net income divided by total assets. ROE is the net income divided by total equity. Debt is the long term debt over total assets. LN_SIZE is logarithm of total assets and AGE is number of year since IPO. * and ** denote significance at the 5% and 1% level respectively.*

| | DIRREM | EXECREM | NEDREM | FAM_MEM | FAM_FIRMS | DIR_SHARES | INDIR_SHARES | RC_FM | RC_NFM | REMCOM |
|---|---|---|---|---|---|---|---|---|---|---|
| DIRREM | | | | | | | | | | |
| EXECREM | .996** | | | | | | | | | |
| NEDREM | .277** | .187** | | | | | | | | |
| FAM_MEM | .060* | .067** | -.063* | | | | | | | |
| FAM_FIRMS | .020 | .030 | -.103** | .896** | | | | | | |
| DIR_SHARES | -.039 | -.029 | -.108** | .461** | .532** | | | | | |
| INDIR_SHARES | .041 | .047 | -.061* | .719** | .727** | .140** | | | | |
| RC_FM | .014 | .021 | -.066** | .717** | .747** | .366** | .581** | | | |
| RC_NFM | .043 | .028 | .167** | -.453** | -.488** | -.283** | -.348** | -.568** | | |
| REMCOM | .063* | .050* | .149** | .025 | .007 | -.049 | .044 | .113** | .754** | |
| LN_SIZE | .357** | .334** | .315** | .003 | -.033 | -.124** | .054* | -.048 | .102** | .085** |
| DEBT | .067** | .065** | .029 | -.065** | -.084** | -.041 | -.075** | -.053* | .039 | .005 |
| AGE | -.005 | -.003 | -.028 | -.016 | -.039 | .054* | .005 | -.030 | .004 | -.019 |
| IND | -.008 | .004 | -.120** | .076** | .076** | .079** | .091** | .110** | -.151** | -.095** |

**Table 4.2: (continued)**

| | LN_SIZE | DEBT | AGE | IND |
|---|---|---|---|---|
| DIRREM | | | | |
| EXECREM | | | | |
| NEDREM | | | | |
| FAM_MEM | | | | |
| FAM_FIRMS | | | | |
| DIR_SHARES | | | | |
| INDIR_SHARES | | | | |
| RC_FM | | | | |
| RC_NFM | | | | |
| REMCOM | | | | |
| LN_SIZE | | | | |
| DEBT | .108** | | | |
| AGE | .038 | -.026 | | |
| IND | -.069** | .015 | -.010 | |

## 4.2 Univariate Analysis

Table 4.3 exhibits results from the univariate analysis for the test variables between family firm and non-family firm. Panel A of Table 4.3 reports that director remuneration is higher in family firms (RM2.206 million) than in non-family firms (RM2.042 million). The univariate test provided initial support for a positive relationship between family firm and director remuneration. The results show that fees and bonuses of family executives are higher (RM112,000 and RM301,000, respectively) compared with non-family firms, (RM72,000 and RM144,000, respectively). The measures of director remuneration were higher in family firms, providing initial support of existing family members influencing board remuneration. Results also showed that remuneration and fees for non-executives were higher (RM303,000 and RM221,000, respectively) than in family firms (RM224,000 and RM145,000, respectively).

Panel B of Table 4.3 reports that family members on remuneration committees were higher in family firms (0.81) but there are no existing family members in non-family firm. The presence of non-family members is higher (3.22) compared with their counterparts (2.43) in non-family firms. Furthermore, a relationship between size of firm and family firm was significant at $p < 0.05$. The results also indicated that debt was higher (RM156,000) in non-family firms than in family firms (RM122,000) but effects of age of incorporation were non-significant.

Table 4.4 exhibits results from the univariate analysis for the test variables between remuneration committee consisting of family members and non-family members. Panel A of Table 4.4 reports that director remuneration was higher (RM2.244 million) by presence of family members on remuneration committees compared with presence of non-family members (RM2.050 million). The results provide initial support for a positive relationship between director remuneration and family members sitting on remuneration committees. Executive remuneration was higher (RM2.016 million) for family members on remuneration committees compared with non-family members (RM 1.762 million). The presence of family members leads to higher executive fees and bonuses (RM 115,000 and RM348,000, respectively) compared with the presence of non-family members (RM78,000 and RM145,000, respectively). Remuneration and fees for non-executives were higher (RM287,000 and RM205,000, respectively) with presence of non-family members than with family members (RM227,000 and RM151,000, respectively). There was a significant relationship, at $p < 0.05$, between non-executive remuneration and non-family members sitting on remuneration committees. Other variables such as size of firm and debt were not significantly related to remuneration committee.

**Table 4.3: Univariate analysis of differences variables between family firm and non family firm in Malaysia public listed**

| | (n=762) Family Firm = 1 Mean | (n=849) Non Family Firm = 0 Mean | *t* – Test *p* - Value | Mann Whitney *p* - Value |
|---|---|---|---|---|
| *Panel A: Remuneration* | | | | |
| DIRREM (million) | 2.206 | 2.042 | 0.421 | **0.000** |
| EXECREM (million) | 1.981 | 1.739 | 0.223 | **0.000** |
| EXECFESS (million) | 0.112 | 0.072 | **0.000** | **0.000** |
| EXECSAL (million) | 1.361 | 1.435 | 0.976 | **0.000** |
| EXECBON (million) | 0.301 | 0.144 | **0.010** | **0.000** |
| EXECBEN (million) | 0.205 | 0.166 | 0.469 | 0.329 |
| NEDREM (million) | 0.224 | 0.303 | **0.000** | **0.000** |
| NEDFEES (million) | 0.145 | 0.221 | **0.000** | **0.000** |
| NEDSAL (million) | 0.051 | 0.051 | 0.952 | 0.665 |
| NEDBON (million) | 0.008 | 0.013 | 0.219 | 0.074 |
| NEDBEN (million) | 0.018 | 0.016 | 0.780 | 0.133 |
| *Panel B: Remuneration Committee* | | | | |
| RC_FM | 0.81 | 0.00 | **0.000** | **0.000** |
| RC_NFM | 2.43 | 3.22 | **0.000** | **0.000** |
| REMCOM | 3.24 | 3.23 | 0.782 | 0.378 |
| *Panel C: Control Variables* | | | | |
| SIZE | 19.496 | 19.583 | 0.186 | **0.030** |
| DEBT | 0.122 | 0.156 | **0.001** | **0.001** |
| AGE | 13.39 | 14.23 | 0.122 | 0.149 |
| IND | 0.95 | 0.91 | **0.002** | **0.002** |

*Notes: Firms are formed based on family firm, whereby FAM_FIRMS takes the value of 1 for family firms and zero otherwise. EXECREM and NEDREM are executive and non-executive director remuneration; DIRREM is the total director remuneration respectively. EXECFEES, EXECSAL, EXECBON and EXECBEN are executive fees, salary, bonus and benefit of kind. NEDFEES, NEDSAL, NEDBON and NEDBEN are non executive director fees, salary, bonus and benefit of kind. RC_FM and RC_NFM is remuneration committee for family members and non family members, respectively. REMCOM is size for director and non-executive director in remuneration committee. divided by total assets. IND "1" is for the consumer products sector; trading/service sector; construction; plantations/mining; and "0" if others. DEBT is the long term debt over total assets. SIZE is logarithm of total assets and AGE is number of year since IPO. Significant p-values are bold*

**Table 4.4: Univariate analysis of differences variables between family member and non family member who is remuneration committee**

| | (n=514) RC Family members = 1 Mean | (n=1091) RC Non Family members = 0 Mean | *t* – Test *p* - Value | Mann Whitney *p* - Value |
|---|---|---|---|---|
| *Panel A:Director Remuneration* | | | | |
| DIRREM (million) | 2.244 | 2.050 | 0.358 | **0.000** |
| EXECREM (million) | 2.016 | 1.762 | 0.218 | **0.000** |
| EXECFESS (million) | 0.115 | 0.078 | **0.002** | **0.000** |
| EXECSAL (million) | 1.321 | 1.381 | 0.732 | **0.000** |
| EXECBON (million) | 0.348 | 0.145 | **0.009** | **0.000** |
| EXECBEN (million) | 0.231 | 0.157 | 0.183 | 0.291 |
| NEDREM (million) | 0.227 | 0.287 | **0.003** | **0.000** |
| NEDFEES (million) | 0.151 | 0.205 | **0.000** | **0.000** |
| NEDSAL (million) | 0.046 | 0.054 | 0.458 | 0.178 |
| NEDBON (million) | 0.008 | 0.012 | 0.318 | **0.206** |
| NEDBEN (million) | 0.021 | 0.015 | 0.309 | 0.046 |
| *Panel B: Control Variables* | | | | |
| SIZE | 19.485 | 19.574 | 0.195 | 0.039 |
| DEBT | 0.128 | 0.147 | 0.056 | 0.136 |
| AGE | 13.25 | 14.16 | 0.105 | **0.038** |
| IND | 0.96 | 0.92 | **0.012** | **0.000** |

*Notes: Firms are formed based on family firm, whereby DUMRC_FM takes the value of 1 for family members and zero otherwise. EXECREM and NEDREM are executive and non-executive director remuneration; DIRREM is the total director remuneration respectively. EXECFEES, EXECSAL, EXECBON and EXECBEN are executive fees, salary, bonus and benefit of kind. NEDFEES, NEDSAL, NEDBON and NEDBEN are non executive director fees, salary, bonus and benefit of kind. . Debt is the long term debt over total assets. SIZE is logarithm of total assets and AGE is number of year since IPO. Significant p-values are bold*

## 4.3 Multivariate Analysis

The main drawback of univariate analysis is that it examines only one variable at a time. To the extent that the independent variables do interact with each other in affecting the dependent variable, multivariate analysis is more appropriate. Table 4.5 show results from panel regression of director remuneration on various explanatory variables. This study find evidence of director remuneration is influenced by family firm and remuneration committee. Column 1 shows that family firm is positive and significantly (0.279; $t$ = 6.843 and $p$ < 0.05) related to director remuneration. This study suggests that family firm abandon the remuneration policies and procedure in order to reward better remuneration when they are combine power and control. This finding support Basu *et al`s*. (2007) argument that the family appointed top executive tends to increase incentives for themselves.

This study indicates that the relationship between remuneration committee and director remuneration is positive and significantly (0.242; $t$ = 8.056 and $p$ < 0.05) implying that the size of remuneration committees has impact on remuneration. This finding supports Anderson & Bizjak`s (2003) argument that the independent remuneration committee has great effect on remuneration. Since MCCG recommended that the remuneration committee should consist of mainly or wholly non executive directors, our results suggest that committee members can perform effective monitoring which is beneficial in the remuneration setting. They tend to link the remuneration with board of director skills, knowledge, expertise and experience.

As a result, remuneration drives motivation of boards of directors to remain at the firm and strive to achieve firm objectives.

**Table 4.5: Explanatory variables on director remuneration**

| | LN(DIRREM) | | LN(EXECREM) | | LN(NED) | |
|---|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 | 6 |
| FAM_FIRM | 0.279 | | 0.399 | | -0.319 | |
| | ***6.843*** | | ***8.189*** | | ***-7.542*** | |
| REMCOM | | 0.242 | | 0.252 | | 0.222 |
| | | ***8.056*** | | ***6.940*** | | ***7.041*** |
| SIZE | 0.319 | 0.308 | 0.307 | 0.294 | 0.354 | 0.347 |
| | ***20.634*** | ***19.923*** | ***16.565*** | ***15.729*** | ***21.995*** | ***21.447*** |
| DEBT | -0.101 | -0.156 | -0.088 | -0.168 | -0.102 | -0.034 |
| | -1.009 | -1.575 | -0.738 | -1.402 | -0.977 | -0.329 |
| AGE | 0.000 | 0.000 | 0.000 | 0.000 | -0.003 | -0.002 |
| | 0.875 | -0.243 | 0.177 | 0.015 | -1.662 | -1.197 |
| IND | -0.045 | 0.056 | -0.016 | 0.105 | -0.143 | -0.138 |
| | -0.550 | 0.693 | -0.165 | 1.077 | -1.699 | -1.635 |
| CONSTANT | 7.789 | 7.284 | 7.717 | 7.246 | 5.430 | 4.672 |
| | ***24.568*** | ***22.427*** | ***20.347*** | ***18.445*** | ***16.480*** | ***13.734*** |
| Adjusted $R^2$ | 0.224 | 0.233 | 0.171 | 0.162 | 0.258 | 0.255 |
| *F*-statistic | ***94.133*** | ***98.673*** | ***67.563*** | ***63.171*** | ***113.145*** | ***111.237*** |
| Cross-sections | 537 | 537 | 537 | 537 | 537 | 537 |
| Total observation | 1611 | 1611 | 1611 | 1611 | 1611 | 1611 |

*Notes: DIRREM is the total director remuneration respectively. EXECREM and NEDREM is executive remuneration non executive remuneration FAM_FIRM is a dummy with 1= family firm and 0= non family firm. REMCOM is a remuneration committee. DEBT is the long term debt over total assets. SIZE is logarithm of total assets, AGE is number of year since IPO and IND is types of industries. t – Statistics are italicised. ** denote 5 percent significant levels respectively.*

The coefficient on the interaction variable REMCOM*FAM_FIRM is negative and statistically significant, suggesting that the positive relationship between REMCOM and DIRREM is less positive for family firm, as shown in Table 4.6. The regression provides strong support for Hypothesis 2 that higher family ownership mitigates effective effort by remuneration committee on DIRREM. This finding support Moores and Craig (2008) and Bartholomeusz and Tanewski (2006) argument that power and control in the hands of family members can lead them to act according to their own personal interests, which can be at the expense of minority shareholders. Our results suggest that family ownership reduced monitoring effects of remuneration committees and enabled manipulation of power and control for expropriation via remuneration. Regarding of this, the monitoring by remuneration committee in family firms was less effectively implemented than as recommended by the MCCG.

In addition, remuneration-setting is under the control of boards of directors and majority shareholders because it is necessary to obtain approval for remuneration proposals. This creates a situation in which they will tend to approve proposals only when they personally benefit and can increase their personal wealth. According to Moores and Craig (2008), family firms are less interested in hiring outsiders, even when they are more qualified or competent, because they want to maintain top management positions for family members.

**Table 4.6: Regression results of director remuneration by interaction between remuneration committee and family firm**

| | LN(DIRREM) 1 | LN(EXECREM) 2 | LN(NEDREM) 3 |
|---|---|---|---|
| FAM_FIRM | 0.272 | 0.392 | -0.325 |
| | ***6.854*** | ***8.205*** | ***-7.795*** |
| REMCOM | 0.354 | 0.374 | 0.270 |
| | ***9.118*** | ***8.013*** | ***6.636*** |
| REMCOM* FAM_FIRM | -0.271 | -0.298 | -0.105 |
| | ***-4.543*** | ***-4.157*** | 1.681 |
| SIZE | 0.308 | 0.294 | 0.344 |
| | ***20.311*** | ***16.151*** | ***21.648*** |
| DEBT | -0.123 | -0.122 | -0.110 |
| | *-1.255* | *-1.954* | *-1.069* |
| AGE | 0.000 | 0.001 | -0.003 |
| | *0.129* | *0.437* | *-1.484* |
| IND | 0.042 | 0.076 | -0.077 |
| | *0.526* | *0.788* | *-0.926* |
| CONSTANT | 7.939 | 7.873 | 5.563 |
| | ***25.653*** | ***21.138*** | ***17.140*** |
| Adjusted $R^2$ | 0.263 | 0.203 | 0.282 |
| *F*-statistic | ***83.125*** | ***59.634*** | ***91.544*** |
| Cross-sections | 537 | 537 | 537 |
| Total observation | 1611 | 1611 | 1611 |

*Notes: DIRREM is the total director remuneration respectively. EXECREM and NEDREM is executive remuneration non executive remuneration. FAM_FIRM is a dummy with 1= family firm and 0= non family firm. REMCOM is a remuneration committee. RC_NFM is non family member who is remuneration committee. DEBT is the long term debt over total assets. SIZE is logarithm of total assets, AGE is number of year since IPO and IND is types of industries. t – Statistics are italicised. ** denote 5 percent significant levels respectively.*

## 4.4 Further Analysis

This sub-section examines the previous result for Hypothesis 2 by an alternative measure of remuneration committee. This study re-estimates the regression (reported in Table 4.7) by replacing remuneration committee with non-family members. The result is qualitatively similar to the original result shown in Table 4.6. This result finds evidence of family firm influences on remuneration committee which consists of non-family members, as shown in regressions 1, 2, and 3 of Table 4.7. Results of the regressions indicate that the coefficient on the interaction variable RC_NFM*FAMFIRM is negative and statistically significant, suggesting that the positive relationship between RC_NFM and DIRREM, EXECREM and NEDREM is less positive for family firm. For example, Cheng & Firth (2006) the concentration of ownership affect to minority shareholder regarding to expropriation via excessive remuneration. Furthermore, Bartholomeusz & Tanewski (2006) notice that family firms might use their power and control to expropriate wealth via excessive remuneration from minority shareholder.

Robustness testing finds evidence that the relationship of non-family members and directors on remuneration is significantly negative in family firms. Since remuneration committee is required to propose better remuneration, our result

suggests that family firms manipulate power and control to put pressure on remuneration committees to eliminate influence of remuneration committee on director remuneration. Therefore, non-family members prefer to keep their positions secure by acting in accordance with family members' personal goals rather than questioning or countering decisions made by boards or majority shareholders. The presence of family members on remuneration committees puts pressure on non-family members to conform to their personal goals. Our study suggest that the non-family members are less independent and lack power to challenge decision making by the boards of directors and majority shareholders.

## 5. Conclusion

This study examines the relationship between remuneration committee and director remuneration in Malaysian family firms. Based on the sample size of these study 537 firms listed in Bursa, Malaysia with 1611 panel data from 2007 to 2009, we find evidence that remuneration committee keep monitor on director remuneration regarding to their skills, performance, knowledge and experience. Our results suggest that remuneration committee strictly follow the suggestions of governance regulation and best practises by MCCG 2007 (revised) and prevent overpowering by minority shareholder interest. However, this study finds evidence a relationship between remuneration committee and director remuneration influenced by family firm. Our study suggests that the nature of firm when top position dominated by family member, they tend to expropriation via remuneration. Therefore, family members prefer to manipulate power and control to influences remuneration committee proposal for personal beneficial.

Limitation of this study is related to the changing of ownership and may be not generalizable to other periods. Ownership refers to family firms and institutional investor s, which are influenced by the nature of the behavior of shareholders and stock traders. Furthermore, the market price of a business may be influence depending on whether it is sold, and the probability of sale could change firms from family firms to non-family firms. This study uses dummy variable as a proxy for family firm. Further research may use shareholding either direct or indirect shareholding as proxies for family firm. Such investigation could provide a useful insight on the role of family firm in enhancing agency cost.

## Endnotes

[i] Family members only exist in family firms; this variable indicates whether or not the executive director on the remuneration committee is a family member, based on the definition of a family firm.

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# Appendix

**Table 4.7: Regression results of director remuneration by interaction between remuneration committee and family firm**

| | LN(DIRREM) 1 | LN(EXECREM) 2 | LN(NEDREM) 3 |
|---|---|---|---|
| FAM_FIRM | 0.410 | 0.537 | -0.193 |
| | ***9.012*** | ***9.816*** | ***-4.039*** |
| RC_NFM | 0.354 | 0.375 | 0.266 |
| | ***9.113*** | ***8.024*** | ***6.528*** |
| RC_NFM*FAM_FIRM | -0.349 | -0.372 | -0.196 |
| | ***-6.256*** | ***-5.541*** | ***-3.341*** |
| SIZE | 0.309 | 0.295 | 0.344 |
| | ***20.355*** | ***16.195*** | ***21.605*** |
| DEBT | -0.132 | -0.121 | -0.177 |
| | *-1.346* | *-1.029* | *-1.134* |
| AGE | 0.000 | 0.001 | -0.003 |
| | *0.135* | *0.442* | *-1.475* |
| IND | 0.044 | 0.078 | -0.070 |
| | *0.551* | *0.808* | *-0.828* |
| CONSTANT | 7.780 | 7.706 | 5.442 |
| | ***25.133*** | ***20.696*** | ***16.724*** |
| Adjusted $R^2$ | 0.265 | 0.202 | 0.278 |
| *F*-statistic | ***82.498*** | ***59.332*** | ***89.442*** |
| Cross-sections | 537 | 537 | 537 |
| Total observation | 1611 | 1611 | 1611 |

*Notes: DIRREM is the total director remuneration respectively. EXECREM and NEDREM is executive remuneration non executive remuneration. FAM_FIRM is a dummy with 1= family firm and 0= non family firm. REMCOM is a remuneration committee. RC_NFM is non family member who is remuneration committee. DEBT is the long term debt over total assets. SIZE is logarithm of total assets, AGE is number of year since IPO and IND is types of industries. t – Statistics are italicised. ** denote 5 percent significant levels respectively.*