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EXPROPRIATION OF MINORITY SHAREHOLDERS: A STUDY OF FAMILY-OWNED FIRMS IN MALAYSIA

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UNIVERSITI SAINS MALAYSIA
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EXPROPRIATION OF MINORITY SHAREHOLDERS: A STUDY OF FAMILY-OWNED FIRMS IN MALAYSIA

by

LIM BOON LEONG

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EKSPROPRIASI PEMEGANG SAHAM MINORITI: SATU KAJIAN FIRMA MILIK KELUARGA DI MALAYSIA

ABSTRAK

Berasaskan data panel seimbang untuk 191 buah syarikat awam milik keluarga yang tersenarai di Papan Utama Bursa Malaysia antara tahun 2002 dan 2007, kajian ini meneliti sama ada pemegang saham minoriti telah diekspropriasi oleh pengarah eksekutif melalui penetapan ganjaran pengarah. Ia juga bertujuan untuk menentukan komponen mana ganjaran pengarah telah digunakan sebagai cara ekspropriasi; dan pada tahap mana pemilikan saham pengurus telah berlakunya ekspropriasi. Pemeriksaan masalah penyelidikan ini adalah berdasarkan teori kuasa pengurusan yang meramalkan kejadian ekspropriasi diberi ciri-ciri firma milik keluarga di Malaysia. Antara ciri-ciri yang memberi insentif ekspropriasi termasuk perbezaan hak aliran tunai dan hak kawalan, penglibatan pemegang saham kawalan dalam pengurusan firma, dan kehadiran ahli keluarga dalam lembaga pengarah. Analisis regresi menunjukkan bahawa gaji telah digunakan sebagai cara ekspropriasi antara tahap pemilikan saham pengurus 23 – 76%. Kejadian ekspropriasi pada tahap pertengahan pemilikan saham ini adalah disebabkan oleh kesan pengubuan pengurus yang dikemukakan oleh teori kuasa pengurusan. Namun pada tahap pemilikan saham pengurus di bawah 23% (tahap rendah) dan ke atas 76% (tahap tinggi), kesan penjajaran kepentingan berkaitan dengan pemilikan saham pengurus menyebabkan paras gaji yang lebih rendah dibayar kepada pengarah eksekutif. Oleh itu, terdapat perhubungan yang bukan linear antara gaji pengarah dan pemilikan saham pengurus dengan menggunakan model regresi kesan tetap. Sebaliknya, bonus pengarah tidak dipengaruhi oleh pemilikan saham pengurus pada seluruh tahapnya, malah ia adalah berkaitan secara positif kepada prestasi firma. Prestasi firma yang tidak berkaitan

secara positif dengan gaji pengarah mengesahkan kejadian ekspropriasi. Dari perspektif tadbir urus korporat, jawatankuasa ganjaran berupaya menyederhanakan bonus pengarah tetapi bukan untuk hal gaji dan jumlah ganjaran tunai pengarah. Dan pengarah bebas tidak dapat memainkan peranan dalam menyederhanakan gaji pengarah kerana nisbah rendah mereka dalam lembaga pengarah. Reformasi tadbir urus korporat yang tidak berkesan berurusan dengan penumpuan tinggi pemilikan saham dan ketidak-pemisahan pengurusan dari kawalan syarikat mungkin telah menjejaskan keberkesanannya dalam mempengaruhi ganjaran pengarah. Berdasarkan dapatan kajian ini, ia mencadangkan bahawa pemberitahuan ganjaran pengarah eksekutif individu perlu dibuat wajib oleh pihak berkuasa. Memperkenalkan aktivisme pemegang saham seperti “Say-on-Pay”, meningkatkan nisbah pengarah bukan eksekutif bebas dalam lembaga pengarah, dan meninggikan komponen gaji berubah ganjaran pengarah adalah langkah-langkah yang berkesan dalam melegakan ekspropriasi oleh pengarah eksekutif firma milik keluarga Malaysia.

EXPROPRIATION OF MINORITY SHAREHOLDERS: A STUDY OF FAMILY-OWNED FIRMS IN MALAYSIA

ABSTRACT

Based on a balance panel data of 191 family-owned public companies listed on the Main Board of Bursa Malaysia between 2002 and 2007, this study examines whether minority shareholders have been expropriated by executive directors via the setting of directors' remuneration. It also seeks to determine which component of directors' remuneration has been used as the means of expropriation; and at which managerial ownership levels has expropriation taken place. Examination of these research problems is based on the premise of managerial power theory which predicts the occurrence of expropriation given the characteristics of family-owned firms in Malaysia. Among those characteristics that provide the incentives for expropriation include divergence of cash flow and control rights, involvement of controlling shareholders in the firm management, and the presence of family members in the board of directors. The regression analysis shows that salary has been used as the means of expropriation between managerial ownership levels 23 – 76%. The occurrence of expropriation at this medium ownership level is due to the managerial entrenchment effect postulated by managerial power theory. Nevertheless at managerial ownership levels below 23% (low level) and above 76% (high level), the alignment of interest effect associated with managerial ownership brings about a lower level of salary paid to executive directors. Hence there is a non-linear relationship between directors' salary and managerial ownership by using the fixed effect regression model. On the contrary, directors' bonus is not affected by managerial ownership at all its levels, and instead it is positively linked to firm performance. Firm performance which is not positively associated with directors'

salary reaffirms the occurrence of expropriation. From the perspective of corporate governance, remuneration committee is able to moderate downward directors' bonus but not for the case of directors' salary and total cash remuneration. And independent directors are not able to play its role in moderating downward directors' salary because of their lower proportion on the board. Corporate governance reforms which do not effectively deal with high ownership concentration and non separation of management from control might have undermined its effectiveness in affecting directors' remuneration. Based on the findings of this study, it is suggested that disclosure of individual executive director's remuneration should be made mandatory by the authorities. Introducing shareholder activism such as Say-on-Pay, increasing the proportion of independent non-executive directors on the board, and raising the variable pay components of executive remuneration are the effective measures in mitigating expropriation by executive directors of family-owned Malaysian firms.

CHAPTER 1

INTRODUCTION

1.1 Background of the Study

Managerial power theory postulates that executive directors by using their executive power are able to extract executive pay that is both inappropriately high and has inappropriately low levels of incentives (Core et al. 2005). These non optimal executive compensation practices are a form of rent extraction which expropriates the wealth of minority shareholders.

Bebchuk and Fried (2003, 2004) who propagated the managerial power theory argue that managerial power is the source of this expropriation. Because of this managerial power, board of directors of public companies has become not independent and is closely linked to their executive directors. Managerial power has also weakened the independent status and power of compensation committee in its pay negotiations with the executives. It has resulted in executive compensation that does not vary sufficiently with firm performance.

The hypothesis of managerial power theory is not without its relevance given the characteristics of family-owned public corporations in Malaysia. A family firm refers to a business enterprise in which at least 50% of the ownership and management falls in the hands of the family members either related by blood or marriage (Lee-Chua 1997). In the Asian developing economies, the predominant form of median and large scale enterprises is the family-owned or controlled firm (Khan 2000).

Malaysia also had very high percentage of family-owned businesses as 80% of the 890 companies listed on Bursa Malaysia were family companies (Noor 2008).

Ownership of Malaysian family companies was highly concentrated where the largest shareholder (top 3 shareholders) owned 61.58% of the companies' outstanding shares (Roszaini Haniffa and Mohammad Hudaib 2006). And majority of the ownership was in the hands of family members (Noor and Ayoib 2011). These majority shareholders had garnered considerable managerial power from their inside ownership (shares held by officers, directors, their immediate families, as well as shares held in trust and shares held by companies controlled by the same parties – Claessens and Yurtoglu 2012) or managerial ownership which stood at 35% (Chu 2007) and 34.53% (Roszaini Haniffa and Mohammad Hudaib 2006) respectively.

This level of inside/managerial ownership provides the clout to majority shareholders to expropriate minority shareholders – the typical case of Type II agency conflicts where majority shareholders who may be closely involved in the day-to-day management and operations of the firm expropriate minority shareholders (Cheah et al. 2012). With regards to directors' remuneration, expropriation can manifest in the form of majority shareholders (who are the executive directors) drawing high remuneration to enrich themselves at the expense of minority shareholders (Basu et al. 2007; Cheung et al. 2005; Jiang and Peng 2011; Young et al. 2008).

Probability for the occurrence of expropriation is further heightened if good management and corporate governance practices are not observed or being sullied by the managerial power of majority shareholders in Malaysian family companies. Openness in business practices, separation of the post of CEO and board Chairman, and appointment of sufficient number of truly independent non-executive directors to the company board are among the good management and corporate governance practices that public listed companies need to adopt in order to protect minority shareholders'

interests and mitigate Type II agency conflicts. These good practices of corporate governance help to define clear responsibilities and differentiate the role of directing and governance (of the board of directors) from the top management (Goh 2008). With these checks and balances undertaken by the board of directors, there will be no one person having unfettered power to carry out the acts of expropriation in the business firm.

Nevertheless Malaysian family-owned firms are not in favour of adopting and adhering to these good practices of corporate governance. For instance, Malaysian family firms did not embrace openness in their business practices and still adopted a similar business culture to the founders (Ow-Yong and Cheah 2000) despite substantial changes in the business environments. And founders controlled family firms normally practiced paternalistic management style which was characterised by hierarchical relationships, top management control of power and authority, close supervision and distrust of outsiders (Dyer 1986).

Some Malaysian firms were found prefer to practice duality leadership (the post of CEO and Chairman are hold by one person) which gave greater power to the same person who was normally the owner as well as manager of the family firm (Noor and Ayoib 2011). Although consolidation of power through this duality leadership could help to protect family legacy (Chen et al. 2005) and provide greater power to determine company strategies (Davis et al. 1997), it also erodes the influence and ability of independent directors to safeguard the interests of minority shareholders.

The influence and ability of independent non-executive directors to mitigate Type II agency conflicts and expropriation are further dampened down and curtailed by the doubts cast on the independence status of non-executive directors appointed (Siow

2009), family businesses preferred to have family members on the board rather than independent outside directors (Fazilah M. et al. 2008), and the presence of independent non-executive directors was just to fulfill the requirement of the Malaysian Code of Corporate Governance (MCCG). As such executive directors were expected to dominate the discussions in the board meetings (Noor and Ayoib 2011) which are to the detriment of minority shareholders' interests. The power and influence of majority shareholders of Malaysian family-owned firms are so substantial and pervasive that remuneration committee – the front line defence against remuneration expropriation has faltered in fulfilling its important duty. Remuneration committee in family-owned firms had even used by family members for expropriation via the remuneration process (Syaiful Baharee Jaafar et al. 2011).

In view of the probable occurrence of expropriation, business and investment publications weekly such as *The Edge Malaysia* on several occasions had criticized some Malaysian firms on the remuneration paid to their directors. For instance, Barrock (2002) criticized that one company in Malaysia did not pay any dividends to its shareholders for several years but its director received more than comfortable salaries. In another occasion, Tan (2002) revealed that a CEO was paid more than RM1 million while the company suffered a loss and the auditor did not form an opinion. There were also malpractices and impropriety in terms of executive pay structure, link between executive pay and company performance, and disclosure of directors' remuneration.

Is high and excessive executive remuneration common among Malaysian public firms? Are the criticisms of malpractices and impropriety concerning executive remuneration largely isolated cases and only confined to a few unethical firms or "bad apples"? Or are these criticisms on executive pay conveyed the message and served as

the signal for the occurrence of the more profound Type II agency conflicts – expropriation of minority shareholders by owner-managers of Malaysian family-owned firms via the setting of director remuneration?

Academic studies should be carried out to examine these critical issues which have not been adequately dealt with empirically for Malaysian family-owned firms. Hence the main theme of the present study is to examine the issues of expropriation of minority shareholders from the perspective of executive remuneration – its occurrence and element of remuneration which is subject to expropriation, the thresholds of managerial ownership levels which prompt the occurrence of expropriation, and the effect of corporate governance practices adopted by Malaysian family-owned public firms to mitigate such expropriation.

1.2 Issues Surrounding Executive Directors' Remuneration of Malaysian Public Corporations

Although the issues of excessive director remuneration of local public corporations were less serious as compared to those in the Western countries, some malpractices and impropriety concerning remuneration paid to executive directors of Malaysian public corporations had been criticized by certain quarters. These malpractices and impropriety encompassed three aspects namely (i) linkage between compensation and firm performance, (ii) compensation structure, and (iii) disclosure of executive directors' remuneration.

i. Linkage between Compensation and Firm Performance

Agency theory suggests that executive remuneration should be linked to firm performance as a means to align the interests of shareholders and managers (Jensen and Meckling 1976). Nevertheless for the case of Malaysian firms, some studies had shown

that the linkage between executive remuneration and firm performance was either non-existence or rather weak. For instance, Shamsul (2006) in his study on directors' remuneration of Malaysian companies found that directors' remuneration was not associated with firm profitability as measured by return on asset (ROA). When lagged firm performance was used as the regressor, a negative and significant association was even found between directors' remuneration and lagged ROA.

The negative relationship between remuneration and firm profitability was also observed by Mohammad Talha and Abdullah Sallehhuddin (2007). They revealed that out of 488 companies listed in Bursa Malaysia, 40 of them encountered losses in 2005, but still increased their directors' remuneration. On the other hand, Salleh Hassan et al. (2003) found a positive but weak relationship between Malaysian directors' remuneration and firm performance for time periods before and during the Asian financial crisis. They attributed this weak relationship to the prevailing corporate governance structures of Malaysian firms which did not pay much emphasis to the efficient contracting proposition advocated by the agency theory.

The survey conducted by Minority Shareholder Watchdog Group (MSWG) and Universiti Teknologi MARA (UiTM) (MSWG and UiTM 2007) to examine the correlation between directors' remuneration and firm performance also revealed that sectors that paid on average low directors' remuneration generally had higher gross profit margin. But in many cases sectors that rewarded large directors' remuneration registered low gross profit margin. Because of this negative relationship between directors' remuneration and gross profit margin, it was suspected that there were some other non-financial factors that had exerted greater influence on the remuneration policy in those firms that displayed this irregular relationship.

ii. Compensation Structure

In order to ensure managers operate firms to maximize shareholder wealth, agency theory suggests that compensation plan should link management's compensation to the firm's performance. Two possible ways of linking compensation to performance are (i) making a greater percentage of a manager's compensation equity-based through incentive stock options, and (ii) salaries, bonuses, and stock options can be designed to provide big rewards for superior performance and big penalties for poor performance (Jensen and Murphy 2010).

In the case of Malaysian public listed companies, the compensation structure of executive directors was mostly fixed rather than variable or dependent on firm performance. For instance, Singam (2003) observed that the chairman, CEOs and directors of Malaysian firms were mostly paid in fixed salaries. There were only a few companies where CEOs and directors get a fixed salary plus performance-related pay including stock options. The Directors' Remuneration Survey 2006 conducted by KPMG for 1,000 Malaysian public listed companies revealed that only 30% of the companies surveyed were making use of annual bonus to link directors' remuneration to firm performance (KPMG 2006). In an earlier survey conducted by PricewaterhouseCoopers on remuneration and practices of Malaysian board of directors, the percentage of firms which utilized employees' shares options schemes as a means to link pay to performance was even lower at 18% (PricewaterhouseCoopers Malaysia 2001).

Norsiah and Seelen (2003) also observed that a large portion of top executive compensation was based on base salary or allowances that were guaranteed regardless of the performance of the company. Their compensation was driven by position and

market value rather than results. This undesirable phenomenon of high fixed compensation and low variable pay was substantiated by the 2006 Total Rewards Survey conducted by Watson Wyatt (Nath and Lee 2007). The survey showed that for the top management in Malaysia, about 66% of their compensation was comprised of guaranteed pay, and only about 20% was variable pay. This top management included the executive directors who were accorded full benefits as salaried employees because of their higher level of responsibilities and involvement in the companies. This high proportion of fixed pay is very much in the favour of entrenched managers, as they may bias their compensation structure towards low risk components that are not influenced by performance (Toyne et al. 2000).

The fixed compensation or salary of Malaysian executive directors was also found to be rather “sticky” or inflexible downwards. Suria Majdi and Rashidah (2010) found that only those Malaysian firms that faced with the problems of fraud and lawsuit reduced their executives’ remuneration by 6% in the second year after the fraud and lawsuit revelation; while non-fraud and non-lawsuit firms still increased executives’ remuneration by 8.08% during the same period.

This finding showed that Malaysian firms would only “discipline” their executive directors when they had committed grave and serious mistakes or indulged in misconducts or offences that were punishable under the law and irked the public. Executive directors of Malaysian firms were rarely disciplined in terms of salary reduction due to poor performance of firms. Hence it could be surmised that Malaysian firms were still some distance away from closely aligning the interests of managers to shareholders in terms of compensation structure as advocated by the agency theorists.

iii. Disclosure of Executive Directors' Remuneration

Disclosure of executive directors' remuneration is vital as it provides the information needed to evaluate the tie between remuneration and corporate performance, and whether the company is protecting the interests of minority shareholders by adopting appropriate remuneration policy. In particular when there is a mismatch between remuneration and corporate performance, disclosure of executive remuneration can help to highlight weak boards as well as enable shareholders to determine whether resources of the firm are being appropriately expended.

In terms of disclosure of directors' remuneration, starting from the financial year ended 30th June 2001 public listed companies in Malaysia were required to disclose the remuneration paid to their directors under the Revamped Listing Requirements of Bursa Malaysia (formerly known as Kuala Lumpur Stock Exchange) – Paragraph 15.25 and 15.26. Companies were required to disclose the total amount paid to their directors; and the components of directors' remuneration were to be itemized separately. In the case of shares or share options rewarded to company directors, the names of the relevant directors together with the details of the share acquisition, the number and class of shares given to them had to be provided by the company in its annual accounts (Pascoe 1999).

Such disclosure is in accordance with the principle and best practice for good corporate governance recommended by the Malaysian Code on Corporate Governance 2000 (MCCG 2000) (Finance Committee on Corporate Governance 2001). Nevertheless even in the recently launched MCCG 2012, it is still not mandatory for public corporations to disclose how much each director is being remunerated, as well as the components of remuneration given to individual director. Thus disclosure of any such

information is considered as voluntary disclosure beyond the mandatory requirements of the Listing Requirements of Bursa Malaysia and MCCG. In addition Malaysian public listed companies were not required to disclose the value of share options given to their directors (Pascoe 1999). Besides that these companies were also not required to disclose share options as a part of their directors' remuneration (ibid.).

Because of such voluntary nature of disclosure, only very small numbers of Malaysian firms had disclosed the remuneration paid to their directors and its components on an individual basis. For instance, Rashidah et al. (2005) found that in 2002 only 8.9% or 22 companies disclosed the exact amount of individual directors' remuneration; while the figure for such companies was only 8 in 2001. The percentage of companies which disclosed the remuneration of their individual director still remained fairly low between 2009 and 2011. Out of a total of 899 (in 2009), 898 (in 2010), and 864 (in 2011) Malaysian public listed companies surveyed by the Minority Shareholder Watchdog Group (MSWG), only 5.2%, 5.6%, and 8.3% disclosed such information in 2009, 2010, and 2011 respectively (MSWG 2012). For those companies which did not disclose their individual director remuneration, security was cited as the main reason for not revealing such information in their annual reports.

When Malaysian firms are less transparent in disclosing individual executive directors' remuneration, shareholders are being deprived of an essential piece of information to evaluate the link between remuneration paid to an executive director and firm performance. This lack of transparency provides the opportunity for controlling shareholders/insiders of Malaysian firms to maximize their private benefits of control at the expense of minority shareholders (Thillainathan 1999).

Weak linkage between executive pay and firm performance, high proportion of fixed compensation, and scant disclosure of individual director remuneration are not in the best interests of the minority shareholders of Malaysian public corporations at all. These malpractices and impropriety might even be perceived as the signs and indications of expropriation of minority shareholders due to the occurrence and manifestation of Type II agency problems – owner opportunism or the entrenchment effect (Gilson 2006; Villalonga and Amit 2006). This type of agency problem is more likely to occur in family-owned firms with concentrated ownership which dominated the corporate landscape in East Asia countries such as Malaysia.

1.3 Problem Statement

Malaysia is a country where family firms or family-owned businesses are prevalent in the corporate and business world. Malaysia had the second highest percentage of family ownership of listed companies in the region after Indonesia according to an article published in the *South China Morning Post* (dated 28 August 2002, as cited by Jaggi et al. 2009). In terms of types of share ownership, family ownership constituted over 43% of the main board companies of the Bursa Malaysia from 1999 through 2005 (Fazilah M. et al. 2008). Malaysia also had fairly high ownership concentration where the average concentration of the five largest shareholders of Malaysian listed companies was 58.84% and 54.85% in 1998 (Abdul Hadi et al. 2005) and 2006 (Tam and Tan 2007) respectively.

Under this scenario of pervasive family ownership and high ownership concentration in Malaysia, whether family control mitigates or exacerbates agency conflicts within the firm remains an open question (Boubakri et al. 2010). On one hand,

family control brings potential benefits such as higher firm value and operating performance which is due to the alignment effect. It happens as high share ownership closely linked the family's welfare and fortune to firm performance. On the other hand, family ownership may lead to increased potential for expropriation of minority shareholder wealth which is due to the entrenchment effect. This entrenchment effect is most likely to happen when the founding family enjoys substantial equity control and dominates the board of directors (ibid.).

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 overpayment for inputs purchased from such firms. Cash flow expropriation may also in the form of excessive salaries or perquisites for family members or insiders (Bhaumik and Gregoriou 2010).

Besides high ownership concentration, Malaysia public corporations were also characterized by significant divergence between cash flow rights (indicate the ownership of firms) and the control or voting rights (indicate actual control of firms) of the controlling shareholders in family firms (Krishnamurti et al. 2003). This divergence which is resulted from the use of dual class shares, pyramids and cross-holding ownership structures to retain control over family companies (Bhaumik and Gregoriou 2010) provides the incentives for controlling shareholders to indulge in expropriation. It happens as these types of ownership structures enable controlling shareholders to exercise large control/voting rights and gain much benefit from expropriation despite their small cash flow rights – the typical "heads I win, tail you lose" scenario.

The likelihood of expropriation and the extent of its negative repercussions would be largely reduced and contained if there were good corporate governance system and structure in place to monitor the behaviour of public listed corporations in the country. Since Malaysia embarked on its corporate governance reforms shortly after the Asian Financial Crisis 1997, it had achieved considerable good progress as was evidenced from the relatively high score achieved in the Reports on the Observance of Standards and Codes (ROSC) – a series of reports on corporate governance published by the World Bank (McGee 2010).

Malaysia was also placed at fairly good position among 10 Asian countries in the 2003 to 2005 Corporate Governance Watch (CG Watch) reports published jointly by the Asian Corporate Governance Association (ACGA) and Credit Lyonnais Securities Asia (CLSA) (Roche 2005). CG Watch ranks a country's CG score based on five criteria namely rules and regulations (15%), enforcement (25%), political and regulatory (20%), adoption of international accounting standards (20%), and institutional landscape and CG culture (20%).

Even though Malaysia enjoyed fairly good performance in terms of CG score, various weaknesses had also been identified for the CG system and structure in the country by ACGA and CLSA. These weaknesses included securities laws which did not deter insider trading; limited legal remedies for shareholders; suspicion about the true "independence" of independent non-executive directors (INEDs); and limited private enforcement by the market especially at both the institutional and retail level, (CLSA 2007, p.25).

Several academicians had also pointed out some shortcomings and inadequacies of the corporate governance reforms undertaken by the Malaysian government. For

instance legal loophole pertaining to the definition of director remuneration only allowed shareholders to approve the proposal put forward for directors' fees instead of directors' remuneration during the shareholders' annual general meeting (Mohammad Talha et al. 2009a). Corporate governance reforms in the country were also perceived as ineffective because it only solicited "form over substance" kind of compliance from public corporations. Local firms only complied by merely confirming to whatever reporting and legal requirements stated in the MCCG rather than undertook the real and genuine changes that were needed for improving governance standards (Liew 2008).

Although the emphasis of MCCG was on "disclosure", not much headway had been achieved especially with regards to directors' remuneration and other benefits received by directors – the lack of transparency of company annual report (Aida Maria Ismail et al. 2010). Several research findings had even shown that the low level of voluntary disclosure of corporate information which included executive remuneration was associated with high ownership concentration (Sheila Nu 2012), prevalent of family-owned business (Roszaini Haniffa and Cooke 2002), and higher percentage of family members sat on the board (Wan Izyani Adilah and Zunaidah 2010) of Malaysian firms.

1.4 Research Problems and Research Objectives

The above discussions showed that family-owned Malaysian firms are associated with high ownership concentration, divergence of cash flow and control rights, and the dominance of family members on the company board. These characteristics provide the required conditions and incentives for expropriation of minority shareholders by owner-managers of Malaysian family-owned firms. The malpractices and impropriety on

executive remuneration as revealed by several surveys and academic studies seemed to suggest that expropriation could have taken place among public corporations in the country.

Although MCCG provides several guidelines of good corporate governance practices for the determination of executive pay for instance, linking executive directors' remuneration to firm performance, and the setting up of remuneration committee where majority of members are to be comprised of independent-non executive directors (INEDs) to oversee matters related to executive pay, its effectiveness might be undermined by the shortcomings and inadequacies of corporate governance reforms (as pointed out by some academicians), and the high managerial power of majority shareholders of family-owned firms in Malaysia.

Based on these observations on executive remuneration and the scenario surrounding corporate governance reforms in the country as well as high managerial power, there is a need for an academic study to examine the issues of expropriation based on the theoretical framework of Type II agency conflicts which is inherent in family-owned firms – in particular from the perspective of the alignment and entrenchment effects of managerial ownership on executive remuneration. The present study would like to fill up the gap of academic research in this area as there has been little discussion about expropriation in terms of executive directors of family-owned public listed companies setting their own levels of remuneration in Malaysia.

In view of the issues discussed above, the following research problems would be worthy of further investigation.

1. Do majority shareholders of Malaysian family-owned public corporations who normally assume the position of executive directors expropriate minority shareholders by setting their own levels of remuneration through the managerial power conferred by their share ownership in the firms?
2. Which remuneration component – salary, bonus or total cash remuneration is used as the means of expropriation by executive directors on minority shareholders?
3. At which ownership levels does the entrenchment effect of managerial ownership which signifies expropriation of minority shareholders via the managerial power of executive directors occur?

With these research problems in mind, the present study would like to attain the following research objectives:

1. To determine whether expropriation does exist in Malaysian family-owned public listed companies by examining the relationship between managerial ownership and executive directors' remuneration.
2. To examine the relationship between managerial ownership and directors' remuneration which is measured in terms of salary, bonus and total cash remuneration.
3. To estimate the managerial ownership levels in which expropriation of minority shareholders has occurred via the managerial power of executive directors of family-owned Malaysian firms.

1.5 Significance of the Study

The study of expropriation of minority shareholders by majority shareholders of family-owned Malaysian firms via executive remuneration is significant to stakeholders

such as company management and board of directors, policy makers, general public investors and academicians.

The presence of remuneration expropriation serves as the evidence as well as reminder especially to independent directors in the remuneration committee that managerial power is very much alive and lurking in family-owned Malaysian firms. If independent directors of remuneration committee are not able to resolutely and conscientiously uphold the task of protecting minority shareholders' interests, they could easily fall victim to managerial power and become the potent tool for expropriation. As such arm's length negotiation (refers to contracting between executives attempting to get the best possible deal for themselves and boards trying to get the best deal for shareholders – Bebchuk and Fried 2005) is the golden rule and moral law that independent directors of remuneration committee should observe and uphold at all times.

The conscience and resolution of independent directors alone might not be sufficient to withstand the intrusion of managerial power. This study helps to shed light on the possible loopholes and weaknesses in Malaysian corporate governance policies and practices that might actually exacerbate rather than mitigate remuneration expropriation. Based on the findings of this study, appropriate amendments and improvements could be undertaken by policy makers to further fortify and strengthen the structures, crucial functions and responsibilities entrusted to remuneration committee – the front line defense against expropriation.

Identification of the managerial ownership levels that prompt the occurrence of expropriation provides the essential information for making sound equity investment to the general public investors. This information helps retail investors to avoid investing in

family firms where the managerial ownership of majority shareholders falls within these perilous levels or thresholds. Firms that do not adopt good corporate governance practices are expected to show below average or dismayed accounting and stock market performance. What more when expropriation is predicted to occur in family firms that exhibit these perilous levels of managerial ownership. Public investors are also not willing to pay any price premium for shares of family companies that are suspicious of expropriating minority shareholders.

Academicians might have the interest to know the findings of this study as expropriation of minority shareholders via the setting of directors' remuneration is rarely examined empirically for family-owned companies in Malaysia. The empirical evidence of remuneration expropriation, managerial entrenchment effect of majority shareholders' managerial ownership, and the related issues of corporate governance and business practices of family-owned firms enrich the understanding on the manifestation of Type II agency conflicts in Asian emerging economies. This understanding provides the basis and serves as the platform for further improving and strengthening the practice of corporate governance in the effort of mitigating expropriation of minority shareholders by majority shareholders of Malaysian family-owned firms.

1.6 Scope of the Study

This study focuses on family-owned public corporations listed in the main board of Bursa Malaysia whose business activities are involved in five main sectors namely construction, trading and services, properties, consumer products, and industrial products. The main reason for choosing these five sectors is to make the sample firms more uniform and thus helps to reduce potential biases that would arise due to a mix of relatively incompatible sectors (Dogan and Smyth 2002). This study does not include

firms that operate in finance, plantation, and mining sectors. The reason is these sectors used different accounting procedures than those in other sectors.

This study mainly focuses on public listed firms which are owned by individuals/families and other public corporations. It is because there are higher chances for the occurrence of expropriation in these individuals/families firms; and public corporations that exhibit controlling-minority structures in the form of cross-holdings and pyramid ownership structures which are closely related to family-owned enterprises. However this study does not include public corporations that are owned by government or its agencies, government related companies, companies that are owned by local and foreign institutional investors, and foreign companies. The rationale is these types of public corporations might adopt different remuneration policies towards their executives as compared to firms that are owned by individuals/families or family-owned companies.

The time period which this study investigates is from 2002 to 2007. The reason for choosing this time period is because Malaysian public listed firms are only required to disclose the remuneration paid to their executive and non-executive directors starting from the financial year ended 30th June 2001. Before that listed companies only disclosed the aggregate remuneration paid to directors without distinguishing between executive and non-executive directors. Further explanations on the choice of time period of study are provided in section 4.4 of the chapter on methodologies.

1.7 Outline of the Study

This study is organized into six chapters. Following this introduction, chapter two provides the main concepts and theories employed in this study. It includes an introduction to executive remuneration and description on different components of

remuneration given to executives. It is followed by discussions on the various theoretical perspectives in which executive remuneration has been examined – in particular from the viewpoint of managerial power theory and agency theory. This chapter also discusses corporate governance reforms in Malaysia, and what are the likely impacts on directors' remuneration of public listed companies in the country.

Chapter three presents the literature review on executive directors' remuneration and its relationship with managerial or insider ownership and firm performance. This chapter discusses the alignment of interest and managerial entrenchment effects that are associated with managerial ownership and its implications on directors' remuneration. The non-linear relationship between directors' remuneration as an agency cost and managerial ownership is also elaborated in this chapter.

Chapter four describes the methodologies and outlines the research hypotheses that will direct the investigation. This chapter specifies variables, models, and tests to analyse the data. It also develops a set of testable hypotheses which examine the impact of managerial power, internal and external corporate governance mechanisms, and economic characteristics of firms such as firm performance on executive directors' remuneration.

Chapter five reports the main statistical findings for executive remuneration. It also discusses the main findings of the study using the concepts and theories outlined in chapters 2 and 3. The two chosen theoretical models (the managerial power theory and agency theory) are used as the main framework for the presentation of results.

The concluding chapter summarizes the findings of chapter 5 and offers some implications for policy regulation. This chapter also identifies the limitations of the study as well as makes recommendations for future research.

CHAPTER 2

CONCEPTS, THEORIES AND CORPORATE GOVERNANCE REFORMS IN MALAYSIA

2.1 Introduction

This chapter provides the main concepts and theories employed in this study, and also a brief description of corporate governance reforms that Malaysia has undertaken. Section 2.2 introduces the topic of executive remuneration. Section 2.3 describes the different components of remuneration accorded to executives. Section 2.4 relates the concepts of executive remuneration and its various components to the scope of study of this thesis. Section 2.5 discusses the major perspectives in which executive remuneration has been examined. Section 2.6 addresses two prominent theoretical models – managerial power theory and agency theory which explain the relationship among executive pay, managerial ownership and firm performance from their specific perspectives. These two theoretical models also form the basis of analysing the relationship among directors' remuneration, managerial ownership, corporate governance, and firm performance in this study. After looking at the theoretical models of executive remuneration, section 2.7 discusses important determinants of executive remuneration. Section 2.8 looks at corporate governance reforms in Malaysia and makes inferences on its probable influence on executive directors' remuneration. Section 2.9 summarizes this chapter.

2.2 Executive Remuneration

Executive remuneration refers to the rewards or pays given to the executives of firms. Employees who constitute the category of "executives" vary from country to country. In the United States, executives or rather senior executives refer to the chief

executive officer (CEO), chief operating officer (COO), chief financial officer (CFO), chief technology officer, and heads and directors of various departments and divisions (Pepper 2006). But in United Kingdom and Europe, executives are referred in particular to members of the "executive committee", "general management committee", or "executive board" (ibid.). From these definitions it could be said that executives generally refer to the top management of firms. In the context of the present study, executive directors of Malaysian public corporations are categorized under "executives" as those used in the United Kingdom.

From the viewpoint of the whole business organization, executive remuneration is a subset of employee remuneration. Like employee remuneration, it is driven by the business and human resources strategies of firms which aim to achieve organizational excellence which encompasses three essential goals namely (i) continuous stakeholder satisfaction, (ii) perpetual competitive advantage, and (iii) sustained employer of choice (Berger 2008). Besides organizational excellence, maximizing the long-run total value of firm or "enlightened value maximization" has also been suggested as one of the important bases on which executive remuneration should be based (Jensen and Murphy 2004).

Besides its important impacts on the attainment of organizational goals and success, executive remuneration is also regarded as one of the most important incentives that exist in business organizations. This incentive which is in the form of executive remuneration is perceived to have an essential impact on managerial decision making and strategy which have important bearing and implications on firm performance (Finkelstein and Boyd 1998).

Due to its immense influence on business organizations in terms of their survival and success, the design of executive remuneration has to give due and appropriate considerations to a multitude of factors such as shareholders and rule makers, type of company, performance measurements and standards, strategic thinking, market lifecycle, board of directors, structural organizational change, and remuneration elements (Ellig 2007). Adding to this complexity of designing an optimal executive remuneration package, corporate scandals which occurred in Enron, Vivendi, and Skiandia; and ever widening gaps between executive and average worker pays in the United States had further elevated executive remuneration into the limelight of public debate and scrutiny.

Indeed from the amount of news coverage given to and extent of research done on issues related to executive remuneration, and also the enormous debates and inquiries that executive remuneration had entailed, it is appropriate to say that executive remuneration is a large and diverse topic which is enormously complex and sometimes even emotive (Murphy 1986a; Finkelstein and Hambrick 1989; Baron and Kreps 1999; McKnight and Tomkins 1999).

2.3 Basic Components of Executive Remuneration

The design of executive remuneration usually comprised of four basic elements or components. These elements or components are (i) Salary, (ii) Short-term cash incentives, (iii) Long-term cash and equity incentives, and (iv) Benefits and perquisites. Graham et al. (2008) further classified salary, short-term cash incentives, and long-term cash and equity incentives as total direct cash compensation or remuneration paid to executives. If benefits and perquisites are added to total direct cash compensation or