THE IMPACT OF CHANGES IN MALAYSIAN REGULATORY FRAMEWORK ON THE DISCLOSURES OF EXECUTIVE DIRECTORS’ REMUNERATION

SITI SERI DELIMA ABDUL MALAK

Thesis submitted for the degree of

Doctor of Philosophy

Business School
Faculty of the Professions
The University of Adelaide

January 2012
# Table of Contents

ACKNOWLEDGEMENTS ....................................................................................................... 5  
LIST OF TABLES .................................................................................................................. 6  
LIST OF FIGURES ............................................................................................................. 7  
LIST OF EQUATIONS ....................................................................................................... 8  
LIST OF APPENDIX .......................................................................................................... 9  
ABSTRACT ......................................................................................................................... 10  
Thesis Declaration ................................................................................................................ 12  
Chapter 1 Introduction ....................................................................................................... 13  
  1.0. Preamble ..................................................................................................................... 13  
  1.1. Research questions ................................................................................................... 15  
  1.2. Objectives and motivations ..................................................................................... 15  
  1.3. Contributions .......................................................................................................... 18  
  1.4. Scope of research ..................................................................................................... 19  
  1.5. Organization of the remaining chapters .................................................................. 20  
Chapter 2 Background on Malaysian capital market and regulatory framework .......... 21  
  2.0. Introduction ............................................................................................................... 21  
  2.1. Overview of the Malaysian capital market ............................................................... 21  
  2.2. Malaysian regulatory framework ........................................................................... 25  
    2.2.1 The reforms of Malaysian corporate governance framework ......................... 27  
    2.2.2 The reforms on Malaysian accounting standards .............................................. 36  
  2.3. An overview of Malaysian directors’ remuneration practices and disclosure .......... 38  
  2.4. Conclusion .............................................................................................................. 40  
Chapter 3 Literature Review ............................................................................................. 42  
  3.0. Introduction .............................................................................................................. 42  
  3.1. Disclosure of corporate information ....................................................................... 42  
  3.2. Theoretical Review ................................................................................................. 47  
    3.2.1. Agency Theory ................................................................................................. 47  
    3.2.2. Legitimacy Theory .......................................................................................... 85  
    3.2.3. Signaling Theory and Proprietary Costs ......................................................... 96  
    3.2.4. Proprietary costs and disclosure ................................................................... 100  
  3.3. Review of prior empirical studies on the disclosure of executive remuneration ....... 104  
  3.4. Summary ............................................................................................................... 114
Chapter 4 Hypotheses Development ................................................................. 125
  4.0 Introduction ............................................................................................ 125
  4.1 Disclosure of Executive Directors’ Remuneration Pre and Post Reforms ................................................................................................. 125
  4.2 Determinants of Disclosure of Executive Directors’ Remuneration ......................................................................................................................... 126
    4.2.3 Agency Theory .................................................................................... 126
    4.2.4 Legitimacy Theory ............................................................................ 133
    4.2.5 Signaling theory and proprietary costs ................................................ 135
  4.3 Summary of Hypotheses ........................................................................ 138

Chapter 5 Research Methodology and Variables Measurement ......................... 140
  5.0 Introduction ............................................................................................ 140
  5.1 Sampling .................................................................................................. 140
  5.2 Data collection .......................................................................................... 143
  5.3 Empirical scheme ..................................................................................... 145
  5.4 Model development .................................................................................. 156
  5.5 Variable measurement ............................................................................ 159
    5.5.1 Dependent variables .......................................................................... 159
    5.5.2 The disclosure scoring index ............................................................... 160
    5.5.3 Independent variables ........................................................................ 163
    5.5.4 Control variables ................................................................................ 175
  5.6 Summary .................................................................................................. 176

Chapter 6 Empirical results and analysis .......................................................... 184
  6.0 Introduction ............................................................................................ 184
  6.1 Univariate analysis .................................................................................. 184
    6.1.1 Disclosure of executive directors’ remuneration score ......................... 185
    6.1.2 Descriptive statistics and univariate analysis of between score groups .... 192
  6.2 Bivariate analysis .................................................................................... 200
    6.2.1 The Pearson Coefficients of Correlation, r ......................................... 200
  6.3 Multivariate analysis .............................................................................. 202
    6.3.1 Classical Linear Regression Model (CLRM) Assumptions ..................... 202
    6.3.2 Model specifications .......................................................................... 208
    6.3.3 Multiple regression result and discussion ............................................ 216
    6.3.3 Sensitivity analysis ............................................................................. 228
    6.3.4 Determinants of disclosure of individual executive director’s remuneration 237
    6.3.5 Period analysis ................................................................................. 245
ACKNOWLEDGEMENTS

I would like to offer my warmest gratitude to my principal supervisor, Prof. Scott Henderson for his dedication, guidance and encouragements that had enable me to complete this thesis. Thank you for being a wonderful mentor and teacher.

I would also like to thank my co-supervisor, Dr Maxwell Bessell for his advices, Dr George Shan for sharing his wisdoms on statistics and Mrs. Kate Harris for her moral supports. I am also grateful to all my fellow PhD mates for the experience that we shared together and all the advices.

Thank you to the entire academic and support staffs at the Faculty of Business for their help in assisting me to complete my thesis.

Finally, I would like to thank my parents, siblings and family for their undying supports and love that help me throughout this journey. Thank you, mum and dad for giving me the best chances in life. To my best friend Lisa (Mu’adz and Damia), you are my family away from home.

To my dearest husband, words would never be enough to express my gratitude that I always have you by my side. Thank you for all the love, patience and faith in me. To our little Atief, may you be born safely and be proud of your mummy.

“I can no other answer make, but, thanks, and thanks.”

William Shakespeare, Twelfth Night
LIST OF TABLES

Table 1 Number of cases prosecuted by the Securities Commission by years .................. 35
Table 2 Summary of empirical research on ownership structure and voluntary disclosure ... 65
Table 3 Summary of corporate governance and disclosure studies ................................. 80
Table 4 Summary of disclosure of executive remuneration studies .................................. 116
Table 5 Summary of hypotheses and supporting literature ............................................. 139
Table 6 Breakdown of companies for the pooled sample from 2000 to 2008 by sectors ...... 142
Table 7 Distribution of company – years from 2000 to 2008 (N = 1788) ......................... 142
Table 8 Summary of prior studies with similar empirical research framework ............... 148
Table 9 Summary of disclosure scoring index items and scoring values ....................... 161
Table 10 Annual mandatory, voluntary and total score scoring values over 2000 to 2008 ... 162
Table 11 Definition and measurement of independent variables ................................. 174
Table 12 Definition and measurement of control variables ......................................... 175
Table 13 Descriptive statistics for total executive directors’ remuneration score from 2000 to 2008 .............................................................................................................. 185
Table 14 Descriptive statistics for total voluntary score executive directors’ remuneration score from the period 2000 to 2008 ................................................................. 187
Table 15 Distribution of scoring by items for the pooled sample from 2000 to 2008 (n = 1788) ....................................................................................................................... 189
Table 16 Summary statistics for independent variables of the pooled sample from 2000 to 2008 (n = 1788) ................................................................. 192
Table 17 Results of Mann Whitney Wilcoxon test on differences between high total score and low total score companies of the pooled sample from 2000 to 2008 (n = 1788) . 194
Table 18 Results of Mann Whitney Wilcoxon test on differences between high total voluntary score and low total voluntary score companies of the pooled sample from 2000 to 2008 (n = 1788) ……………………………………………………………………………………………………………………………………….. 198
Table 19 Pearson correlation coefficients for total score (N = 1783) .............................. 201
Table 20 Pearson correlation coefficients for voluntary score (N = 1783) ....................... 201
Table 21 Result of the LM Breusch-Pagan tests ............................................................... 209
Table 22 Variance inflation factors for total score ......................................................... 211
Table 23 Variance inflation factors voluntary score ..................................................... 211
Table 24 Correlation matrix for independent variables - quartile director ownership .... 212
Table 25 Hausman’s specification tests ......................................................................... 215
Table 26 Redundant Fixed Effect Tests for cross section fixed effects ......................... 216
Table 27 Result of Wald test of equality of coefficients ................................................. 224
Table 28 Result of Wald test of equality of coefficients ................................................ 227
Table 29 Result of redundant variable tests on research empirical framework (Y = Total score) ......................................................................................................................... 262
Table 30 Result of redundant variable tests on research empirical framework (Y = Voluntary score) ................................................................................................................. 263
Table 31 Summary of the results of the hypothesis testing ......................................... 270
LIST OF FIGURES

Figure 1 Distribution of paid up capital according to types of investors ................................. 22
Figure 2 Distributions of paid up capital according to nationalities ....................................... 24
Figure 3 Overview of Malaysian disclosure of executive directors' remuneration from 2000 to 2008.......................................................................................................................................... 25
Figure 4 Timeframe for shift to disclosure based regulation ................................................... 28
Figure 5 The status of implementation of the Malaysian corporate governance reforms ...... 34
Figure 6 Average corporate governance score in 2008 ........................................................... 39
Figure 7 Ownership and the extent of agency problems.......................................................... 54
Figure 8 Forms of legitimacy and reasons for legitimacy ....................................................... 88
Figure 9 Research empirical scheme for disclosure of executive directors' remuneration .... 147
Figure 10 Disclosure Index of Executive Directors’ Remuneration ...................................... 177
Figure 11 Total executive director remuneration disclosure score from 2000 to 2008 ...... 186
Figure 12 Total executive directors remuneration voluntary disclosure score from 2000 to 2008........................................................................................................................................ 188
Figure 13 Results of regression for determinants of total score according to periods ........... 252
Figure 14 Results of regression for determinants of total score according to periods using winsorised estimators ............................................................................................................. 253
Figure 15 Results of regression for determinants of voluntary score according to periods . 254
Figure 16 Results of regression for determinants of voluntary score according to periods using winsorised estimators ............................................................................................................. 255
LIST OF EQUATIONS

Equation 1 Panel GLS result of determinants of total score from 2000 to 2008 (N=1783) 224
Equation 2 Panel GLS result of determinants of voluntary score from 2000 to 2008 (N=1783) 227
Equation 3 Panel GLS regression for determinants of total score using winsorised estimators (N=1783) 230
Equation 4 Panel GLS regression for determinants of voluntary score using winsorised estimators (N=1783) 230
Equation 5 Panel GLS result of determinants of total score from 2000 to 2008 including industry classifications (N=1783) 233
Equation 6 Panel GLS result of determinants of total score from 2000 to 2008 including industry classifications using winsorised estimators (N=1783) 234
Equation 7 Panel GLS result of determinants of voluntary score from 2000 to 2008 including industry classifications (N=1783) 235
Equation 8 Panel GLS result of determinants of voluntary score from 2000 to 2008 including industry classifications using winsorised estimators (N=1783) 236
Equation 9 Logit regression result of determinants of individual director’s remuneration disclosure from 2000 to 2008 (N=1783) 243
Equation 10 Logit regression result of determinants of individual directors’ remuneration disclosure from 2000 to 2008 using winsorised estimators (N=1783) 244
Equations 11 to 13 Panel regression for determinants for total score according to periods 252
Equations 14 to 16 Panel regression for determinants for voluntary score according to periods 254
Equations 17 to 19 Panel regression for determinants of total score according to periods using winsorised estimates 253
Equations 20 to 21 Panel regression for determinants of voluntary score according to periods using winsorised estimates 255
Equation 23 Panel regression for determinants of total score for HIGH SCORE GROUP (N=1075) 259
Equation 24 Panel regression for determinants of total score for LOW SCORE GROUP (N=708) 259
Equation 25 Panel regression for determinants of voluntary score for HIGH SCORE GROUP (N=843) 260
Equation 26 Panel regression for determinants of voluntary score for LOW SCORE GROUP (N=940) 260


**LIST OF APPENDIX**

Appendix 1 List of sample companies................................................................. 302
Appendix 2 Sample of companies’ justifications for departure from the MCCG requirements .................................................................................................................. 308
Appendix 3 Remuneration survey by the MSWG ................................................. 310
Appendix 4 Descriptive statistics for independent variables ......................... 311
Appendix 5 Distribution of independent variables from 2000 to 2008 (mean) ................ 312
Appendix 6 Summary of scoring guide ................................................................. 313
Appendix 7 Distribution of score per item ......................................................... 314
Appendix 8 Distribution of total and voluntary score from 2001 to 2008 .......... 319
Appendix 9 Definition of an independent director ........................................... 320
Appendix 10 Eviews output for Equation 1 ......................................................... 321
Appendix 11 Eviews output for Equation 2 ......................................................... 322
Appendix 12 Eviews output for Equation 3 ......................................................... 323
Appendix 13 Eviews output for Equation 3 ......................................................... 324
Appendix 14 Eviews output for Equation 5 ......................................................... 325
Appendix 15 Eviews output for equation 6 ......................................................... 326
Appendix 16 Eviews output for Equation 7 ......................................................... 327
Appendix 17 Eviews output for Equation 8 ......................................................... 328
Appendix 18 Eviews output for Equation 9 ......................................................... 329
Appendix 19 Eviews output for Equation 10 ....................................................... 330
Appendix 20 Eviews output for Equation 23 ....................................................... 331
Appendix 21 Eviews output for Equation 24 ....................................................... 332
Appendix 22 Eviews output for Equation 25 ....................................................... 333
Appendix 23 Eviews output for Equation 26 ....................................................... 334
ABSTRACT

The first objective of this study is to analyse the level of disclosure of executive directors’ remuneration before and after introduction of the Malaysian Code on Corporate Governance in 2001, the changes in accounting standards FRS 2 ‘Share based payments’ in 2005 and FRS 124 ‘Related party disclosure’ in 2006 and the changes to the Bursa Malaysia Listing Rule. The study seeks to examine the effectiveness of these reforms in improving the level of disclosure of executive directors’ remuneration. The second objective is to fill the gaps in prior study by empirically testing the determinants of the level of disclosure of executive directors’ remuneration based on agency theory, legitimacy theory, signaling theory and proprietary costs. These theories are represented by several ownership variables, corporate governance variables and firm characteristics.

Using an un-weighted disclosure index, this study scored the level of disclosure of executive directors’ remuneration of 200 publicly listed Malaysian companies over the period of 2000 to 2008. The period captured the revolving nature of the Malaysian regulatory framework on disclosure of executive directors’ remuneration. The disclosure index is based on prior studies and the regulatory framework. The dataset is in the form of a panel data and consisted of 1788 company-years. The study employed non-parametric tests and multivariate analysis to examine any significant changes in the level of disclosure of executive directors’ remuneration and the determinants of the level of disclosure.

The results showed that there were significant improvements in the level of disclosure of executive directors’ remuneration after the reforms. However, Malaysian companies
appeared to take advantage of weaknesses in the reforms to fall back on the practice of disclosing minimum of the mandatory requirements. A significant number of Malaysian companies continued not to disclose on their individual executive directors’ remuneration. The inconsistencies between the mandatory Listing Rule and the voluntary MCCG made it easier for companies not to do so. These implied that the ‘hybrid’ approach adopted by the regulators in implementing in the reforms was not sufficient in ensuring comprehensive disclosure of executive directors’ remuneration.

Hypothesis tests on the determinants of the level of disclosure of executive directors’ remuneration found that traditional dominance by family shareholders was significant and limit the extent of disclosure of executive directors’ remuneration. Other agency players (regulators, foreign investors and creditors) roles appeared to be dwarfed by the presence of controlling family shareholders. However, government shareholdings alleviated to a certain extent, this dominance by significantly pushing for compliance with the reforms. Corporate governance mechanisms of independent directors and level of audit quality were shown to work differently in different disclosure environments in improving the level of disclosure of executive directors’ remuneration. The findings also supported the notions of legitimacy theory and signaling theory that company size, industry differences and profitability were significantly associated with the level of disclosure. This study also showed that contrary to expectations of proprietary costs, companies with higher growth were more likely to disclose the remuneration of individual executive directors.
Thesis Declaration

I, SITI SERI DELIMA ABDUL MALAK certify that this work contains no material which has been accepted for award of any other degree or diploma in any university or other tertiary institutions and, to the best of my knowledge and belief, contains no material previously published or written by another person, except where due reference has been made in the text.

I give consent to this copy of my thesis, when deposited in the University Library, being made available for loan and photocopying, subject to the provisions of the Copyright Act 1968.

I also gave permission for the digital version of my thesis to be made available on the web, via the University’s digital research repository, the Library catalogue and also through web search engines, unless permission has been granted by the University to restrict access for a period of time.