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# THE RELATIONSHIP BETWEEN BOARD DIVERSITY AND EXECUTIVE COMPENSATION AMONG PUBLIC LISTED COMPANY IN MALAYSIA

**ANIS ZAIREEN BINTI AZLANI**



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**FACULTY OF MANAGEMENT AND ECONOMICS  
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## ACKNOWLEDGEMENT

Alhamdulillah, by God's permission, this dissertation is finally complete. I would like to express my deepest gratitude to Dr Nooraisah Binti Katmun @ Katmon for helping me in collecting the data, guide me in writing the thesis, understand the whole matter regarding this thesis and keep giving me advices towards the end. I could not have taken this journey without her advices, motivation, patience and guidance. She always shares her expertise and knowledge to make sure I keep my head up to complete this dissertation. I would like to express my sincere appreciation to my family members for always standing by me, no matter what the circumstances are, and for being my pillars of strength in my life. Last but not least, I would be remiss in not mentioning my husband. His belief in me has kept my spirits and motivation high during this process.

## ABSTRACT

This study empirically examined the relationship between board diversity and executive compensation among public listed company in Malaysia. We extend the prior literature by covering broader dimensions of diversity such as gender, age, ethnicity, nationality, educational background and educational level diversity. A total of 312 observations was made based on selected samples by using stratified random sampling method from Bursa Malaysia from 2016 until 2018. The sample consist of non-financial listed firms from various industry sectors. This study used panel data analysis with random effect to see the relationship between the variables tested. The analysis showed that there are significant relationships between board diversity and executive compensation. The diversity of age, ethnicity and nationality diversity are significantly related to executive compensation. Moreover, some additional tests were done to see the relationship between board diversity and executive compensation, which is OLS Regression, Robust Regression and Fixed-effect Regression. OLS Regression and Robust Regression showed that there are significant relationships between nationality diversity and executive compensations, while Fixed-effect Regression showed significant relationship between ethnicity diversity and executive compensations. In conclusion, this study showed that the diversity of age, ethnicity and nationality are significantly related to the executive compensation. Future study also can add others board diversity in the study such as Political and Shariah diversity to expand the research and result on this matter. The research provides useful insight into the policy makers in setting new regulations in respect of board diversity in Malaysia and other Asian country.

## **HUBUNGAN ANTARA KEPELBAGAIAN LEMBAGA DAN PAMPASAN EKSEKUTIF DI KALANGAN SYARIKAT AWAM YANG TERSENARAI DI MALAYSIA**

### **ABSTRAK**

Kajian ini secara empirikal mengkaji hubungan antara kepelbagaian lembaga pengarah dan pampasan eksekutif dalam kalangan syarikat tersenarai awam di Malaysia. Kami memperluaskan literatur terdahulu dengan merangkumi dimensi kepelbagaian yang lebih luas seperti jantina, umur, etnik, kewarganegaraan, latar belakang pendidikan dan kepelbagaian tahap pendidikan. Sebanyak 312 pemerhatian dibuat berdasarkan sampel terpilih dengan menggunakan kaedah persampelan rawak berstrata daripada Bursa Malaysia dari tahun 2016 hingga 2018. Sampel terdiri daripada firma bukan tersenarai kewangan daripada pelbagai sektor industri. Kajian ini menggunakan analisis data panel dengan kesan rawak untuk melihat hubungan antara pembolehubah yang diuji. Analisis menunjukkan bahawa terdapat hubungan yang signifikan antara kepelbagaian lembaga dan pampasan eksekutif. Kepelbagaian umur, etnik dan kepelbagaian kewarganegaraan mempunyai kaitan yang ketara dengan pampasan eksekutif. Selain itu, beberapa ujian tambahan telah dilakukan untuk melihat hubungan antara kepelbagaian lembaga dan pampasan eksekutif, iaitu Regresi OLS, Regresi Teguh dan Regresi Kesan Tetap. Regresi OLS dan Regresi Teguh menunjukkan bahawa terdapat hubungan yang signifikan antara kepelbagaian kewarganegaraan dan pampasan eksekutif, manakala Regresi Kesan Tetap menunjukkan hubungan yang signifikan antara kepelbagaian etnik dan pampasan eksekutif. Kesimpulannya, kajian ini menunjukkan bahawa kepelbagaian umur, etnik dan kewarganegaraan mempunyai kaitan yang signifikan dengan pampasan eksekutif. Kajian masa depan juga boleh menambah kepelbagaian lembaga lain dalam kajian seperti kepelbagaian Politik dan Syariah untuk mengembangkan penyelidikan dan keputusan mengenai perkara ini. Penyelidikan ini memberikan pandangan yang berguna kepada pembuat dasar dalam menetapkan peraturan baharu berkenaan dengan kepelbagaian lembaga di Malaysia dan negara Asia yang lain.

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## ABBREVIATIONS

AGE	The age of directors on board
BOD	Board of directors
BODINDE	Board of directors independent
BODMEET	Numbers board of directors meeting
BODSIZE	Board of directors' size
DTA	Debt to assets
DTE	Debt to equity
EDUB	The educational background of directors on board
EDUL	The educational level of directors on board
ETHNICITY	The ethnicity of directors on board
GENDER	The gender of directors on board
LAGLOGSIZE	The lagged natural log of firm size
LOGREM	The natural log of remuneration
LOGSIZE	The natural log of firm size (total assets)
MCCG	Malaysian Codes of Corporate Governance
NATION	The nationality of directors on board
REM	The remuneration of the firms
ROA	Return on assets
ROE	Return on equity
VIF	The variance inflation factor



## CHAPTER 1

### INTRODUCTION



#### 1.1 Introduction

The first chapter will outline the main focus of the research. This includes the explanation about the background of the study. The background to a study is the first section of the article and provides the background for the research. The background to a study is the first section of the article and provides the background for the research. It contains the rationale, the statement of the main problem and a brief outline of the research questions that are addressed in the rest of the paper. The background forms the heart of the study because it introduces a public ignorant of the research and its significance in a clear and



logical way. At times, the background may even explore whether the study builds on or refutes findings from previous studies. The background forms the heart of the study because it introduces a public ignorant of the research and its significance in a clear and logical way. Sometimes, the context may even determine whether the study builds on or disproves the findings of previous studies. Specifically, the reason why this study is important will be highlighted in this section.

This section explains the problem statement which is a statement if current issue or issue requires rapid intervention to improve the situation. This statement provides a concise explanation of the barrier that the current problem places between a process or functional product and the current (problematic) status of the business. This problem statement of this current thesis is related to the high remuneration issue among the board of directors, especially from developing country such as Malaysia. This statement is entirely objective, emphasizing only the facts of the problem and omitting all subjective opinions. Later, based on the problem statement that has been discussed, the objective of the research will be outlined. Research question will be also stated in this section. Following this, this chapter 1 will also state the hypotheses that will be used in this study. On top of that, the conceptual framework will also be presented in this chapter to exhibit the association between variables used in this current study. Furthermore, research significant will explain the impact of this study and the benefits of the research results to the organizations, communities, and countries. Lastly, the operational definition will be provided covering main concept that will be used in the research context.

## 1.2 Background of study

This thesis intends to explore the association between Board Diversity and Executive Compensation from Malaysian context. Executive compensation is at the center of discussions on the issue of corporate governance. In Malaysia in particular, after recovering from the Asian financial crisis in 1997-98, much attention was focused on the issue (Talha et al., 2009, p. 553). They also mentioned that “The Malaysian Government, through its relevant authorities such as Securities Commission (SC), Ministry of Finance (MOF), Bursa Malaysia (previously known as Kuala Lumpur Stock Exchange (KLSE)) and Bank Negara Malaysia (Central Bank of Malaysia), has implemented and augmented corporate governance practices including rewarding the directors”. This study is important in the sense that board diversity has been promoted as one of the governance mechanisms referring to the Malaysian Code on Corporate Governance (2021). Specifically, in practice 5.5 of (Commissions, 2021), it is stated that “*Appointment of board and senior management is based on objective criteria, merit and with due regard for diversity in skills, experience, age, culture, background and gender*” (p. 32). While the placement of diverse board might be of useful to improve the governance process in the firm, nevertheless, the effectiveness of diverse boards in the developing country such as Malaysia is still unknown, especially in combating governance issue such as executive compensation.

There are many issues that plagued firms, from fraud, earnings management, executive compensation, and others. This study is aimed to concentrate on executive compensation since this topic is under-researched in the Malaysian context. While studies on fraud and earnings management in Malaysia is numerous (Kamal et al., 2016; Center for Audit Quality, 2010; Omar et al., 2014), nonetheless, and a study on executive compensation is lacking especially when we concentrate on the impact of board diversity. This is something that has been predominantly ignored by the previous literature, although overpaid directors have been one of the controversies that reported in the media.

Moreover, the current study is important given that most previous studies found contradictory conclusions in explaining the link between board diversification and compensation. For instance, recent research has shown that there is a positive relationship between diversity and CEO compensation (Balasubramanian et al., 2015; Pucheta-Martínez et al., 2017; Usman et al., 2018; Wahab et al., 2015), while a study from Wahab et al., (2015) found negative relation between ethnicity and remuneration. Given that this topic is still under-researched, the conflicting findings blur the line between board diversity and executive compensation, especially for a developing, multi-racial and multi-ethnic country like Malaysia.

Unlike the previous literature that concentrated on the limited spectrum of diversity. This study offers a boarder dimension of board diversity of board of compensation in Malaysia such as gender, age, ethnicity, nationality and academic background. This thesis chooses gender diversity because organizational performance can benefit greatly from the incorporation of women into top management positions (Kebede, 2017). While achieving gender diversity within organizations is a challenging task and requires a significant amount of effort and time, it has numerous benefits for companies and the association between diversity of talent and diversity of thought results in increased long-term profits. It is widely accepted that a diverse workforce is essential for organizations and businesses to achieve sustainable success (Hieker & Rushby, 2017).

Moreover, this thesis used age diversity because according to Boehm et al., (2011) age is becoming a crucial aspect of diversity. Demographic change is causing a stronger increase in age diversity in the workplace than other diversity dimensions such as gender or nationality. Boehm et al., (2011) also stated that companies are currently uncertain about how the increase in age diversity will affect their internal processes and states, including their employees' well-being, commitment, and performance.

Besides, much debate and ink has flown due to the complexity of ethnic diversity. This thesis has used ethnicity diversity because according to Koopmans et al.,

(2014) a lively scholarly debate on the effects of ethnic diversity on social cohesion has arisen due to concerns about immigration and the growing visibility of ethnic and racial minorities. This thesis wants to see if ethnic diversity has an effect on executive compensation.

Next, According to Alshabibi et al., (2022) accounting and finance literature has recently gained a significant interest in the diversity of nationalities on corporate boards. Multinational corporations face formidable challenges due to globalization, technological change, and organizational complexity (Boone et al., 2019, p. 278). This thesis used nationality diversity to see if nationality in board an impact on executive compensation has paid. Malaysia is a developing country and has a variety of races, which lead to a variety of cultures that might affect the pattern of management in every company.

Accounting and finance literature has recently become more interested in the diversity of nationalities on corporate boards. The growing globalization, technological change, and organizational complexity pose formidable challenges for multinational corporations (Boone et al., 2019). This thesis used nationality diversity to see if nationality can affect the executive compensation paid. In order for a boardroom to be successful, a diverse group of directors can create a creative atmosphere by exchanging cross-national knowledge and experience, which leads to high-quality decision-making.

It is our expectation that individuals of diverse nationalities have a greater combined set of skills, knowledge, and human capital, which aids them in sensing and seizing innovation opportunities and take advantage of innovation opportunities and participate in a variety of global external knowledge sourcing initiatives. (Boone et al., 2019). This benefit of multinational diversity on the board may lead to a different practice of executive compensation in firm.

On top of that, the environment or terrain in which Gender Compensation Discrimination and the Gender Compensation Gap occur includes higher educational institutions. Another explanation for the pay gap is the disparity in human capital investments in education or work experience between men and women (Grey-Bowen & McFarlane, 2010). According to Grey-Bowen & McFarlane, (2010) in the early and previous century, men were better educated and skilled than women in the dominant fields of industry. Therefore, we have seen that male dominated the board of directors in the past. But nowadays, the female has achieved a higher level of education status, hence, it is important to see the impact of diverse board in relation to the executive compensation behaviors in the firms.

### **1.3 Problem statement**

Executive compensation has always been an interesting topic to research and there are mixed findings according to the different backdrop of the research. According to Ming,



Zheng, Suang, Ling and Yee, (2015, p. 61) in their study regarding Determination Of Executive Directors' Remuneration In Malaysia, they assert that the attention of public of developed and developing countries has been alerted to the issues of executive remuneration. This shows that the executive compensation issue is a common issue in the corporate governance world whether in developed or developing countries.

Nonetheless, executive compensation also has become one of the hot topics in the capital market of Malaysia since this country has suffered from financial crisis in the past, which largely blamed due to over paying of the directors and firm performance issues. Ming et al., (2015. p, 61) claimed that “shareholders and publics started to realize that the executives might receive excess remuneration when compared to what they deserved to”. Ahmad, Nawawi, & Salin (2016, p. 348) point out that some of the companies in Malaysia offer big compensation to the directors than others, even the companies are relatively small. Moreover, there are some companies that overpaying their directors where the situation is totally not align with the company’s performance. Some company still pays high compensation to their directors even the performance of the company is not impressive.

On top of that, referring to Kaur and Tan, (2018) in The Stars, CEO, in a government-linked company (GLCs) in Malaysia has also been reported to receive higher compensation in 2017. Kaur and Tan, (2018) have reported that the new government has



instructed to review the role of GLCs, and the remuneration paid to the executives. For example, the chief of human resources at one of the GLCs earned nearly million Ringgit or RM 80 000 per month in 2017. They also reported that other senior personnel also received higher compensation, with its chief executive paid over one and half million Ringgits in the financial year of 2017, (Kaur and Tan, 2018) in *The Stars*. Furthermore, *The Edge Malaysia*, (2018) also compare the highest-paid CEO compensation with Singapore counterparts and found that the remuneration of 40 highest-paid CEOs of non-Government-related companies in Malaysia, received an average of RM10.4 million, which is relatively higher than that of Singapore companies, which is equivalent to S\$5.13 million without considering the currency exchange.

According to Rasid (2019) the government reorganization of government-related corporate boardrooms (LMCs) should include the remuneration these business leaders receive each year, which is excessive in most cases, based on the opinion of the economists. In the light of the ongoing discussions, it is important to point out that the government must address the excessive remuneration of directors and researcher for the purpose of determining the reason for the over-payment by the board. If this issue is not being controlled, the high compensation paid that is not aligned with companies' performance may spark corruption to the company and country.

## 1.4 Objective of study

Generally, the purpose of this study is to see the relation between board diversity and board compensation in Malaysia context. This thesis will look at descriptive analysis in order to see what the extent of board diversity and executive compensation in the listed firm in Malaysia is. This thesis also will look at how board diversity affects executive compensation. The descriptive statistic will address the information and pattern. The result of descriptive statistic that shows the pattern of every objectives will be discuss in Chapter 4. There are three objectives that have been developed based on the problem statement: -

1.4.1 To examine the extent of board diversity in the listed firm in Malaysia

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1.4.2 To examine the extent of executive compensation in the listed firm in Malaysia

1.4.3 To determine the relationship between board diversity and executive compensation in the listed firm in Malaysia

## 1.5 Research Question

Based on the problem statement that has been discussed, this research was conducted in order to answer the question: -

1.5.1 What is the extent of board diversity in the listed firm in Malaysia?

1.5.2 What is the extent of executive compensation in the listed firm in Malaysia?

### 1.5.3 What is the relationship between board diversity and executive compensation in the listed firm in Malaysia?

This research question is very important in regard to determining the impact of board diversity and executive compensation.

## 1.6 Research Hypothesis

In order to answer all the research questions, few hypotheses have been developed to be tested in this research.

H1: There is a relationship between gender diversity and executive compensation.

H2: There is a relationship between age diversity and executive compensation.

H3: There is a relationship between ethnicity diversity and executive compensation.

H4: There is a relationship between educational background diversity and board executive compensation.

H5: There is a relationship between educational level diversity and executive compensation.

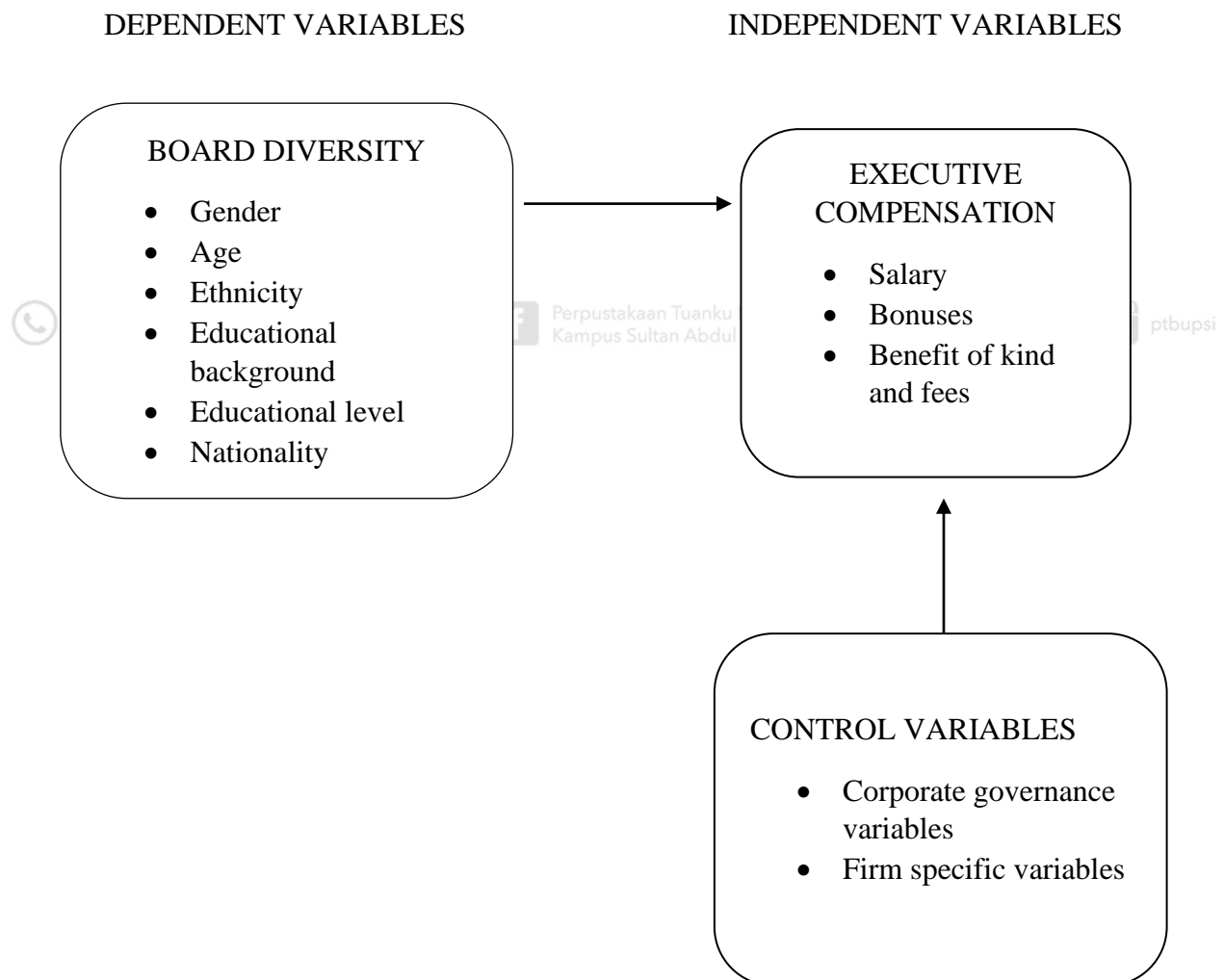
H6: There is a relationship between nationality diversity and executive compensation.

## 1.7 Conceptual Framework

This model will be used as a based model for this research to study the relationship between the independent variable and dependent variables.

**Figure 1.7**

*The Conceptual Framework*



## **1.8 Significant of study**

This research may help the investor, regulators, society, government and market participants in their decision-making process, especially when the information about diversity and executive compensation is under consideration.

### **1.8.1 Investor**

This study will help investors with better the decision-making process. The effectiveness board of director of every company was a very important part of the company to strive their goal. This study suggests that, instead of only paying attention towards how company gains profit, investor can also focus on how board diversity on the board affect the compensation. This is because board diversity on board might affect the compensation either in a positive or negative way, which might affect the monitoring process of the firms.

### **1.8.2 Regulators**

Based on this study, regulators could benefit more in making policies that suit more to the country. The policymakers or regulators can use the finding as a basis and guide to produce a reliable set of policies on board diversity and compensation structure that suits

with the context of our country. Rasid, (2019) has stated in the New Straits Times that the government's revamp of government-linked companies' (GLC) boardrooms should encompass the compensation these corporate leaders take home every year, which is excessive in most cases. Moreover, Asian Strategy & Leadership Institute (Asli) Centre of Public Policy Studies chairman Tan Sri Ramon Navaratnam said that the compensation is excessive, and he believes it should be looked into by the government when considering changes in top executive positions (Rasid, 2019). Since there was a suggestion by an economic expert recently, for government in Malaysia to look back into the compensation received by the executive, government and policymakers might use the finding from this study to evaluate whether is necessary to follow such idea.

### **1.8.3 Researcher**

Researchers could benefit further from this study because there is very little research in this area, particularly from Malaysia's perspective. Malaysia has a variety of cultures and ethnicities, which affect the management of the company in many ways. This study will provide empirical evidence regarding the relationship between board diversity and executive compensation by using Malaysia as a backdrop. On top of that, this study also provides information on how board diversity affects the executive compensation in detail.

### 1.8.4 Corporations

Corporation can understand better the impact of board diversity on compensation, thus will be able to find ways on how to improve their governance structure. This is because, there is less prior study in this scope in Malaysia context. Board diversity might affect compensation since different background of directors brings different inputs and information which lead to better decision-making process, thus combating excessive compensation, hence increasing firm performance. This information can help the top management level to design the composition on the board directors based on the Malaysian setting. This is because, Malaysia, mainly relies on international evidence so far and that might not be able to generalize to Malaysian context. Besides, this study will also help top management to see how far board diversity could affect executive compensation in many ways. Top management also can construct strategies in order to achieve their objectives.

### 1.8.5 Theoretical Perspective

The purpose of educational research is to create theories that guide the design of educational policies and practices. Besides, theories are useful in organizing relevant empirical facts, which can be observed or measured to create a context for understanding phenomena. This thesis can provide new understanding of the scope of board diversity

and executive compensation when applied to this study. This thesis can provide more new information and provides a framework for understanding the phenomenon under investigation and assists the researcher in situating the study within a broader context. The difference in this thesis may lead to different theories that can connect the data dots differently, leading to a multitude of pictures and practices.

## **1.9 Operational Definition**

### **1.9.1 Executive Compensation**

“Compensation is a systematic approach to providing monetary value to employees in exchange for work performed” (Patnaik, 2014, p. 2). Osibanjo, Adeniji, Olubusayo, & Heirsmac, (2014) point out that compensation packages include salaries, bonuses, incentives, allowances, promotion, recognition. Besides, Mitte, Old, & Rumsey, (2013, p. 3) State that compensation includes all payments that made by the employer to their employee for the services made by an employee of the business. Moreover, Ebert, Torres, & Papadakis, (2008) has stated that compensation can be categorized in several distinctions which is between fixed and variable compensation, between compensation in cash and non-cash compensation and between differed and immediate compensation. Fogleman & Mccorkle, (2009) has explained that non-monetary compensation is any benefit an employee receives from an employer because of their hard work, such as praise and recognition, flexible hours and task enjoyment. They also mention that direct

compensation is an employee base salary, while indirect compensation is more various which include insurance, retirement program, paid leave, childcare or moving expenses.

Based on the definition of compensation given by previous research above, this research will use a definition by Osibanjo, Adeniji, Olubusayo, & Heirsmac, (2014) which is the compensation will include all salaries, bonuses, incentives, allowances, promotion, recognition. The present study realized that this definition is suitable to the context of Malaysia since the executive compensation in Malaysia is rewarded based on such categories.

 05-4506832 **1.9.2 Board Diversity**

Board diversity can be define as “human characteristic that make people different form one another” (Gomez-Mejia et al., 2008). Hudson (2014, p. 2) Point out that diversity includes biological characteristics of race, gender, age, color, national origin, as well as family and the society in which they were born into. Moreover, Dardour et al., (2015, p. 3) state that diversity is shown through the variety of people belonging to middle management, top management, and the various committees of organizations. Besides, according to Gonzalez and Zamanian, (2015, p. 3), diversity refers to the extent in which members of an entity, such as a group or organization, differ from one another. Gonzalez & Zamanian, (2015, p. 595) has mentioned that “diversity in attributes such as

nationality, culture, education, function, tenure, ability, sexual orientation, religion, values, personality, goals, and many others”.

Based on the definition above, this thesis uses a definition of diversity, of what Gonzalez & Zamanian, (2015) had mentioned before such as nationality, education, sexual orientation and others. However, this thesis will focus on certain dimensions of diversity such as gender, age, ethnicity, nationality, educational background and educational level on board.

### 1.9.3 Firm Specific Variables

Refer to Handoyo et al., (2023) firm characteristics, such as size, age, industry type, and ownership, are linked to resources, experience accumulation, and the nature of the business. The characteristics of firms most commonly studied are firm size, age, industry type, and ownership (Handoyo et al., 2023). According to many researchers, firm size is the most consistent firm-specific characteristic to explain the level of voluntary disclosure, it's possible that their greater resources will allow them to commit to more reporting (Jaafar et al., 2014). A company's condition can be described by Return on Assets, one of the profitability ratios of money and the higher the ratio, the better as it allows the company to utilize its assets more effectively in generating profits (Mustapa et al., 2021). Moreover, by using the Return on Equity ratio, shareholders can determine the

investment returns they will receive on each amount they invest. According to ROE growth, the company's prospects are improving because it can increase its profits and ROE demonstrates the efficiency of own capital use (Mustapa et al., 2021, p. 220). This thesis will use Firm Size, ROA and ROE as control variables as used by Kaur & Vij, (2017).

#### **1.9.4 Corporate Governance Variables**

Corporate governance has become an important mechanism that has gained attention and developed over the past decades. The common understanding of corporate governance is that it involves the direction, organization, and control of a company. According to Kelly, (2016) the purpose of corporate governance is to professionally direct the company based on good corporate governance principles. This thesis has used Board Independent, Board Size and Board Meet as corporate governance characteristics as used by Johl et al., (2015).

#### **1.10 Structure of thesis**

The structure of the thesis shows the content of every chapter discussed in this thesis. Chapter Two presents the theoretical framework used in this study. The chapter discussed how board diversity affects compensation, how important is board diversity and compensation for company, and how agency theory and the resources dependency theory explain board diversity and executive compensation. Besides, the review of previous

studies related to this research has been discussed in Chapter Two in order to support this research. Hypothesis development will also be discussed in Chapter Two.

Chapter Three presents a research methodology, and all methods are described in detail. Chapter Three also mentions the research design of this thesis and procedure used to collect data. Chapter Four presents the findings from the statistical analysis that has been made. Chapter Five provides the conclusion of this thesis.

### 1.11 Summary

In conclusion, this chapter has concluded the general plan of this research. In this chapter, the background of the study was explained well along with the problem statement on why this research was conducted. The problem statement itself will point out clearly what is the main result expected from this study. Besides, this chapter also states the objective of the study in order to give a clear vision to the researcher on what to achieve at the end of this research. The objective of the study will lead this research in gaining important results of this research. Moreover, several research questions are stated in this chapter and followed by research hypothesis to answer the research question. The result from this research will answer all the research questions at the end of this research. On top of that, the conceptual framework is very important to give a general frame of the variables

involved in this research. Last but not least, the significance of this is stated in order to show why are this thesis conducted and why it is important to be conducted. There are many important factors in this research that will benefit others in many ways, especially in the corporate sector.