

**CORPORATE NETWORKS, CORPORATE GOVERNANCE AND DIRECTORS
REMUNERATION**



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4. Report

4.1 Executive summary

This study endeavor to examine the association between social networks and executive and non-executive directors' remuneration on the financial and non-financial industry. More specifically, this study analyses how the social network elements; independent directors, non-independent directors, executive directors, interlock boards, political connection and directors' prestige could influence the directors' remuneration determination.

Malaysia provides a suitable setting to examine the relation between the social networks and directors' remuneration since it exhibits the scenario of politically connected firms due to their diverse ethnic ownership compared to similar firms in capital markets around the world. The study use a sample of 221 companies for a five-year period from 2006-2010. The results reveal that the main contribution to the level of total directors' remuneration comes from the short-term pay rather than the long-term pay package. Besides, it is found that the non-independent directors, executive directors, political connection and directors' prestige are significantly associated with the short-term pay. The study also found that the non-independent directors, independent directors, executive directors, and directors' prestige are associated with the long-term pay. Lastly, there is a significant relationship between non-independent directors, non-executive directors, executive directors, political connections, and directors' prestige with the total directors' remuneration.

4.2 Introduction

Social network theory recommends that, humans' preferences and decisions are influenced by the acts of others. In the corporate setting, a significant effect of social network among the BODs is that the relationship between directors may impair independence and affect behaviour. As opined by Granovetter (2005), social networks affect economic results based on the premise that the information flow and quality act as a vital basis of reward and punishment and put up trust that others in the social network will do the "right" thing despite a clear balance of incentives to the contrary. Thus, the focus of this study is to examine whether social networks reveal an association with executive and non-executive directors' remuneration. The question of how much companies should pay their directors is not an easy task. Identifying a better directors' remuneration in Malaysia would provide an insight to the interested parties of the firm in evaluating the reasonableness of the existing directors' compensation packages as the Malaysian Code of Corporate Governance (MCCG, 2000 and 2007) provides that "levels of remuneration should be sufficient to attract and retain the directors to run the company successfully".

In Malaysia, the justification of embarking further research on social networks is motivated by Gomez and Jomo (1999) and Johnson and Mitton (2003) who described that the scenario of politically connected firms in Malaysia is rather unique compared to similar firms in capital markets around the world, due to their diverse ethnic ownership and were created to ensure a fair distribution of corporate wealth among the major ethnic groups. In another study, Gomez (2002) argues that the multi-faceted relation between business and politics in East Asia (including Malaysia) attests to the notion of "relationship based" (with political connections being an important form of relationship) or "crony" rather than "market-based" capitalism. A significant aspect of this study addresses the role of political connections as a determinant of directors' remuneration in Malaysian firms.

In a nutshell, the current study aims to minimize some of the unsupported rhetoric in the academic literature and practitioner discussions on directors' remuneration. This study does not aim to resolve all of these controversies,