

# Surprising Find

A post-graduate business student has discovered an unexpected link between companies' shareholders' funds and the amount paid to directors.

A STUDY has revealed something interesting about directors' remuneration: companies' shareholders' funds are negatively correlated with directors' compensation. In other words, the less the company's shareholders' funds, the more its directors are getting paid.

To recap, shareholders' funds is the capital involved in carrying out a

business, meaning the investment committed by shareholders to the business. The typical components which make up shareholders' funds are share capital, reserves of various types and retained profits.

Hence, this finding shows that the more the company was decreasing its investments committed, typically in tough times, the more it was paying its directors.

Similarly, the more the shareholders were

investing into the company, the less it was paying its directors. Good governance would dictate that the opposite should be the case.

The one-year study was completed in September 2003 by local stock market dealer Frank Lin as part of his thesis for his Masters in Business Administration from the Multimedia University.

Lin was seeking to find a connection between directors' remuneration and company performance. He studied a sample of 114 Malaysian listed companies, based on their 2002 annual reports, looking at how much they paid directors vis-à-vis the companies' assets, turnover and shareholders' funds.

He says he chose the yardsticks of companies' assets, turnover and shareholders' funds because they offer an insight into the financial strength of the companies.

Assets, Lin writes, indicate the magnitude of the resources involved in conducting business, while turnover is a direct measure from the group sales of the company and indicate the level of activities going on. In the case of shareholders' funds, it shows how efficiently the directors are working with the investments poured into the company by shareholders.

It should be noted that Lin excluded share options given to directors because the relevant information was not readily available. He also excluded companies in the Practice Note 4 sector that groups companies with negative shareholders' funds.

While Lin found a positive correlation between remuneration and turnover and remuneration and assets, it was the negative correlation between shareholders' funds and directors remuneration that was a surprising find.

Lin stumbled upon this finding, believing that shareholders' funds would also have the same bearing on remuneration as the other two yardsticks.

Based on his research, he found that on average, the compensation of directors was reduced by RM1,602 whenever shareholders' funds increased by RM1 million.



**Lin:** There is a negative correlation between shareholders' funds and directors' remuneration

Lin says while he has some explanations for this phenomenon, his views are not conclusive. 'But it does give us food for thought,' he quips, emphasising that the issue needs more research.

According to Lin, one possible reason for this finding is that during tough economic times like in 2002, companies sought to overcome their tight liquidity problems by disposing of assets, and thereby decreasing their shareholders' funds.

However, when these companies got a new injection of cash in hand,

## Directors' Remuneration and Correlation Between Assets, Shareholders' Funds and Turnover for FY02 (RM'000)

	Director's Remuneration	Assets	Shareholders' Funds	Turnover
<b>Consumer Products</b>				
BAT	7,681	1,768,794	656,478	3,072,952
Carslberg	1,693	655,743	539,781	838,783
Matsumita	4,027	689,089	524,961	830,769
Asia File	779	123,025	105,691	84,906
LHH	2,434	672,708	242,429	576,075
QL	2,118	310,838	99,496	561,822
Mintye	909	89,256	83,187	43,656
Khoe San	2,729	79,407	82,991	47,910
FA Pen	485	61,052	79,442	13,104
<b>Industrial Products</b>				
PetGas	309	10,080,452	6,381,589	1,949,575
JiJasa	715	664,367	798,229	440,295
Esso	1,164	1,798,686	524,803	3,999,915
Camerlin	217	694,669	483,836	499
DMIB	1,052	548,276	312,767	617,829
HWGB	1,531	251,372	202,598	200,137
MSC	958	365,016	193,303	719,457
Evermas	610	165,909	84,179	64,900
LionLand	381	4,164,773	643,643	1,459,299
Top Glove	1,114	162,818	109,137	180,202
Octagon	1,381	82,671	70,841	54,940
CIHldg	371	596,900	254,922	25,389
FCW	260	91,085	92,886	18,338
Sifat	1,596	111,180	78,425	29,533
AISB	109	129,880	68,080	97,825
<b>Construction</b>				
YTL	9,171	20,274,101	4,722,497	2,567,941
Ranhill	5,275	582,182	206,520	620,754
TSRCAP	385	161,064	111,415	234,608
Mitra	2,023	432,051	191,995	312,943
Brem	402	450,810	271,450	82,829
<b>Trading/Services</b>				
Tenaga	900	57,065,500	17,728,100	15,375,100
Celcom	4,512	4,401,904	1,983,649	22,400,810
MAS	868	14,754,298	1,215,290	8,377,901
MRCB	2,263	2,760,452	976,550	419,282
MBMR	1,140	656,486	481,478	697,848
Time	1,486	2,739,323	2,494,360	268,114
Mmosaic	3,013	1,997,344	755,877	753,570
PMind	294	1,384,618	978,422	275,051
KPJ	1,076	720,718	329,964	215,798
Analabs	305	93,704	80,866	37,274
Metplex	37	2,518,676	943,578	268,993
<b>Trading/Services</b>				
Fiamma	1,168	274,166	123,346	211,473
Utusan	1,572	399,433	120,157	335,921
Dkmat	1,586	902,905	305,131	283,362
PDZ	432	115,026	82,843	123,833
<b>Infrastructure</b>				
YTLPower	3,411	1,6203,657	4,488,362	1,503,781
RUBHD	2,133	6,760,966	548,315	377,232
<b>Finance</b>				
Maybank	4,384	149,663,907	23,134,662	7,403,241
RHBCap	10,176	57,311,162	3,815,468	2,614,286
RHB	10,007	58,450,967	1,790,324	2,571,289
BIMB	2,667	15,402,996	1,443,615	408,589
Affin-ACF	194	6,612,434	529,716	522,666
INSAS	3,189	859,927	694,012	133,587
KAF	531	295,522	198,460	15,037

	Director's Remuneration	Assets	Shareholders' Funds	Turnover
<b>Technology</b>				
MPI	2,832	1,545,250	87,4616	768,842
ACI	1,696	455,806	20,0996	403,014
Patimas	2,495	302,067	15,0243	245,479

	Director's Remuneration	Assets	Shareholders' Funds	Turnover
<b>Hotels</b>				
Shangri-la	709	1,503,570	1,192,175	233,540
GCE	614	278,816	196,851	38,315

	Director's Remuneration	Assets	Shareholders' Funds	Turnover
<b>Properties</b>				
IOIProp	2,673	1,764,962	1,416,033	528,847
Sel Prop	462	1,548,867	1,088,159	138,328
YTL Land	1,138	358,439	388,331	23,360
Daiman	557	1,237,848	1,151,604	95,848
Giomac	1,549	493,666	236,284	171,405
A&M	1,537	642,959	455,122	123,197
Sdred	850	393,046	351,500	31,672
Focal	1,741	450,785	290,216	62,054
Binaik	864	259,783	165,807	91,084
CView	663	196,290	144,436	61,044
Jland	495	349,238	277,536	62,403
AHTin	809	85,548	67,760	9,510

	Director's Remuneration	Assets	Shareholders' Funds	Turnover
<b>Plantations</b>				
IOICorp	8,383	5,560,331	2,938,275	2,410,500
PPBOil	2,415	1,443,799	1,214,213	404,633
Chin Tek	1,058	394,077	387,962	70,429
Jtop	505	523,914	406,947	57,451
NSOP	968	247,508	208,510	43,365
Kurnia	417	187,132	141,662	40,142

	Director's Remuneration	Assets	Shareholders' Funds	Turnover
<b>Second Board</b>				
Posim	371	1,804,253	1,526,346	468,074
Cepat	1,477	258,290	204,802	81,412
Pworth	591	126,777	79,740	98,948
Jasakita	807	53,785	50,860	46,385
PLS	676	46,517	27,292	57,938
DeGem	1,529	113,772	77,488	102,276
Yung Kong	1,507	189,242	85,908	159,138
KFM	809	81,698	44,820	98,142
Dunbush	899	383,738	112,871	409,266
KOA	337	67,146	58,372	60,714
Bonia	1,686	148,634	58,329	93,034
Layhong	1,258	90,019	44,445	81,964
Sunchirin	683	93,818	74,231	76,408
Bright	328	72,356	45,107	42,840
OKA	666	53,651	45,766	3,215
Ya Horng	974	77,705	68,680	74,951
Chin Foh	1,297	460,874	85,760	431,538
Amtel	533	65,900	41,867	116,056
SRII	1,420	68,662	52,241	71,817
Hunza	394	131,165	70,354	90,388
Autoair	1,408	64,932	45,713	32,231
SMPC	1,024	233,786	57,388	218,411
Hing Yap	1,104	98,551	60,580	103,280
D'nonce	1,717	83,872	45,486	68,629
Amttek	1,073	125,139	98,195	66,972
HPI	507	168,434	79,241	129,560
Prolexus	1,902	110,213	62,062	157,313
Takaso	682	72,453	37,833	37,744
CN Asia	243	57,103	45,313	21,385
CFM	673	89,867	45,637	45,827
Tenco	509	57,935	52,200	59,143
Transocean	957	65,281	28,999	44,201
Serisar	180	82,001	32,000	8,712
Ngiu Kee	1,111	97,824	39,603	170,721
TGL	312	82,421	21,279	65,486

	Director's Remuneration	Assets	Shareholders' Funds	Turnover
<b>MESDAQ</b>				
YTL	444	154,442	145,031	17,924
PUC	221	16,092	14,582	6,137

the tendency was to pay their directors a little more.

Conversely, when times were good, companies went on an acquisition spree. This used up the companies' monies and in turn, albeit incidentally, led to smaller payouts to directors.

Arguably, this scene has taken place because a high percentage of major shareholders are management themselves.

Another possible reason, according to Lin's thesis is: '...if shareholders' funds depletes due to operating losses, shareholders have little choice but to take drastic action to replace the management and inevitably drive up the compensation level.... On the other hand, if shareholders' funds increases, but compensation comes down, it could be due to the reason that companies are cash-rich and not actively seeking new investment opportunities. Therefore maintaining a skeletal board of directors is sufficient to oversee the operation.'

Lin cites examples of listed government-linked companies, which have huge piles of shareholders' funds but do not pay their directors very much.

Less surprisingly, his thesis found a positive correlation between remuneration and turnover, and remuneration and assets for the companies he sampled.

In other words, the more revenue these companies were earning and the more their assets were rising, the higher was their payout to the board of directors.

Lin writes that turnover has the strongest correlation with compensation. He says a high turnover means there are more activities taking place in the company, which may spread over vast lands involving a bigger workforce and 'compensation of these directors need to commensurate with the level of activities, serving as an incentive to achieve targets'.

He notes that this trend is especially evident when the economy is weak, as shareholders have little choice but to use compensation as an incentive tool for directors.

In his analysis, Lin found that on average, for every RM1 million increase in a company's turnover, total compensation to directors increased by a significant RM3,360.

One question that would inevitably crop up in this discussion is, how much should companies be paying directors?

Lin says 'when shareholders appoint management, they would like to get the best talent that money can buy in terms of capability, connections, influence and integrity. It is a common but questionable belief that the higher the compensation of the directors, the more superior their ability....'

On the other hand, shareholders are always in a dilemma as they are also trying to minimise expenses of the company. 'So how much is management worth?' he poses in his thesis.

Lin reckons that in order to attain a balance between an effective compensation package for directors and not having to spend too much, one needs to understand the relationship between corporate performance and money paid to directors.

To be sure, Lin himself does not claim to have the answers to many of these issues, noting that there is very little research done on this in the context of Malaysia.

He hopes his research is a good start in this direction and would serve as a guide for parties attempting to design or negotiate directors' remuneration for public-listed companies. 