IS THERE A RELATIONSHIP BETWEEN DIRECTORS REMUNERATION AND FIRM PERFORMANCE?

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Abstract

The primary objective of the study is to determine whether there is a positive relationship between directors' fees with the size of the firm and performance, based on the annual report of 246 listed firms. The results indicate a weak positive relationship between directors' remuneration, corporate size (total assets) and corporate performance (operating cash flow on asset). The weak positive relationship between director fees and performance indicates that other factors, such as the director's yearly performance, may also account for the determination of the director's remuneration. The findings support the notion of agency theory and corporate governance that remunerating the top management should be based on individual and corporate performance. In contrast, other performance variables such as return on assets (ROA) and earning per share (EPS) measured indicates no statistical association.

Keywords: director remuneration, company performance, EPS, agency theory

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1. Introduction

Provision of competitive remuneration packages by public listed companies and large corporations is vital in attracting top quality directors and corporate executives. However, there has been spirited debate in high pay rewards and unjustified level of remuneration received by many directors of companies around the world. The argument on this matter is whether such rewards are aligned by the underlying economic performance of the company in question. The study by Kerr and Bettis (1987) on the relationship between executive performance and rewards maintain that there is "no rational basis for the compensation paid to top management".

Empirical analyses of the relationship between top management remuneration, size and performance of firms have provided mixed results (Tosi, 2000; Firth et al., 1996; Conyon, 1995; Jensen and Murphy, 1990; Crespi and Gispert, 1998). The apparent conflicting results from these studies have produced no clear consensus on the relationship between directors' remuneration and firm performance and size. Thus, the current study aims to contribute to the debate on the relationship between director remuneration, size and performance of the firm by examining a sample of Malaysian firms in the period 1997 to 2000.

The basis for undertaking this study is motivated by the lack of published research conducted on the directors' remuneration of Malaysian companies. In addition, results found in the research literature have often been contradicting. Therefore, this study will contribute to existing knowledge and debate on the relationship between directors' remuneration, size and performance of local firms. It will also provide evidence whether Malaysian companies practice the measurement of directors' remuneration based on financial returns to shareholders as proposed by the Malaysian Code on Corporate Governance (MCCG, 1999).

The remainder of the paper is organised as follows. The next section discusses relevant literature and issues relating to directors' remuneration. The third section explains the research methodology, followed by a discussion of the research results in Section Four. The paper ends with a summary and concluding remarks, including avenues for further research.

2. Literature Review

According to Hermalin and Wallace (1997) firms must have an incentive plan which is designed to retain the Chief Executive Officer (CEO) and reward achievement of specific performance objectives during a specified period of time. Companies should establish a formal and transparent procedure for developing a policy on executives' remuneration and for fixing remuneration packages of individuals.

Much of the attention in CEO compensation research, such as Hermalin & Wallace (2000), Crespi & Gispert (1998), Conyon, (1995), Kerr & Bettis (1987), Wickham et al (2001) and Firth et al (1996) centres on the issues of control, that is, to what extent CEOs are held accountable to the stakeholders for compensation received. This is because most CEOs are hired professional managers entrusted with the responsibility of acting on behalf of absentee firm owners in exchange for compensation packages. According to Firth et al (1996), the control mechanism stems from a concern about the motivation of management as well as concerns about equity and fairness. Shareholders in public firms desire maximisation of stock returns for a given level of risks and they naturally wish that their firms design compensation systems that motivate senior executives to pursue policies that meet this objective.

In the agency literature, the problem is to generate the appropriate incentives so as to realign managerial and shareholder interests. Hence, the solution is to offer the manager a contract, which ties the reward received by the manager to a variable that the shareholder is interested in, that is increasing the total shareholder return will increase the compensation received by the agent (Conyon, 1995). The contract with the agent includes (a) the development of a system for monitoring the behaviour and decisions of the agents to ensure that these do not deviate from the interest of owners, and/or (b) the establishment of incentives that reward the agent for outcomes of importance to principals such as profitability (Tosi, 2000). Hence, the agency theory suggests that the directors' pay should be linked to performance of the firm in order to avoid top managers from pursuing personal goals at the expense of the shareholders.

On the other hand, managerialism theory argues that directors' remuneration is primarily a function of firm size as executives are more interested in increasing firm size than maximising profits (Tosi, 2000). In a study on 12 large fortune 500 US firms, Donalson (1984) implies that managers have the incentive to expand their firms beyond the size that maximises shareholder's wealth, and managers are likely to maximise growth through acquisitions since managerial compensation is often based on the rate of firm growth in terms of sales and assets (Murphy, 1985).

Previous studies show that there are conflicting findings with regard to pay, performance and size. In a study of over 2,000 CEOs listed in *Forbes* magazine from 1974 to 1986, Jensen and Murphy (1990) revealed that there is a significant association between pay and performance. Similarly, Miller (1995), Hermalin and Wallace (1997), Tosi (2000), and Wickham et al. (2001) also found a positive relationship between the top management pay and firm performance. Miller (1995) used data of over 800 firms from 1983 to 1989 and found significant association between firm performance (net profit, return on equity (ROE) and earning per share (EPS) and CEO salary. Hermalin & Wallace (1997) used 86 publicly traded saving and loans (thrifts) firms in the US, measured performance by return on asset (ROA) and annual change of stock price. When meta-analysis on 137 articles and unpublished manuscripts is used to examine the relationship between the CEO's pay with firm performance and size, Tosi (2000) found a positive relationship between that of the firm performance and the director's pay. However, when it was analysed with the firm size factor, the result was that firm performance is a very weak predictor of CEO's pay in comparison with firm size.

On the other hand, Conyon (1995) found that there was no significant relationship between pay and performance. Similarly, Firth et. al. (1996) who measured firm performance using return on assets (ROA), return on capital employed (ROCE) and stock return found no association between CEO's pay and performance of 376 Norway listed companies. Veliyath's (1999) study on US pharmaceutical also failed to find any relationship between CEO's pay and firm performance, regardless of the company performance measurement used (total shareholders' return, return on equity, return on long term capital or earning per share). The insignificant relationship between director's remuneration and performance raises doubt on the mechanism by which boardroom pay is determined to realign director's remuneration with shareholder's interests.

With regard to the relationship between pay and firm size, Conyon (1995) who examined private utilities firms in the UK found that firm size, measured by total capital employed is a more important determinant of director's compensation in comparison with firm performance. He claimed that, the potential implication of such an observation is that

directors have the incentive to increase company size, which may not be in the long-term interests of shareholders. Firth et. al. (1996) used sales revenue with other variables such as total asset, number of employees and market capitalization in measuring the size of firms. The results of the study show a positive relationship between CEO's pay and corporate size. Crespi & Gispert (1998), found that there is a positive relationship between board remuneration of 113 Spanish largest public listed companies and firm size, measured by log of total sales. Similar findings were found in studies carried out by Miller (1995), Veliyath (1999), and Tosi (2000).

3. Research Methodology

Questionnaires were distributed to companies listed on the Main Board of the Kuala Lumpur Stock Exchange (currently known as 'Bursa Malaysia') to gauge the opinion and perceptions of directors on a range of issues connected with Director's Remuneration. Out of 3,600 questionnaires distributed to 450 firms, only 132 (3.7%) questionnaires were returned. Since the response rate of 3.7% is low, the study also obtained public available information from the firms' annual report. In addition, Cooper and Schindler (2001) argued that experimental design using secondary data is appropriate when one wishes to discover whether certain variables produce effects in other variables. Furthermore, it provides the most powerful support possible for a hypothesis of causation.

Unlike Conyon (1995), Hermalin & Wallace (1997) and Wickham et al. (2001) who focused on the remuneration of the Chief Executive Officer (CEO), the current study defines top management as the Board of Directors (BOD) of the firm, similar to that used by Crespi and Gispert (1998). Director remuneration includes director's fees and other benefits, as reported in the company's accounts. As for performance measurement, this study uses earning per share (EPS) similar to Conyon (1995) and Wickham (2001); return on asset (ROA), profit before tax divided by total asset, similar to Firth et al (1996) and Hermalin & Wallace (1997). In addition, the operating cash flow, defined as profit before tax adjusted for changes in working capital (which has been shown to manipulation by management) to total asset ratio is also used as performance measurement in this study, similar to that adopted by Abdul Rahman and Limmack (2004).

With regard to firm size, this study defines size of firm as the total asset of the firm at the end of each accounting period, which is similar to Tosi (2000), Firth et al (1996), and Veliyath (1999).

This study uses a seven-year data set for the period between 1996 and 2002 to allow for a longer time frame normally associated with the director's position and decision-making strategy. In other words, directors' decisions may only be translated into changes in corporate performance after a number of accounting periods. Data on each performance measurement and size of firm, measured as total assets, are obtained from the respective company's handbook or annual reports from 1996 to 2002. The data on directors' remuneration is obtained from the respective company's annual reports from 1996 to 2002.

For the purpose of examining the relationship of directors' remuneration reported on the income statement with firm size and performance, the performance and size of firm variables (obtained from 1996 to 2001) are lagged one year to reflect the current year directors' remuneration (obtained from 1997 to 2002). For example, the performance and the firm size variables are taken in the previous year (1996) and compared with the current year (1997) directors' fees variables. Essentially, the current research examines whether directors are rewarded for good company performance obtained in the previous year, and the relationship with firm size that involves the time series behaviour of these variables.

Further, a multiple regression model similar to that of Conyon (1995) and Wickham et al. (2001), is used in this study to examine the relationship between the director's fees, firm size and firm performance:

$$\ln y = \alpha + \beta 1 \ln x1 + \beta 2 x2 + \beta 3 x3 + \beta 4 x4 + \beta 5 x5 + E$$

Where,

y = log of directors' remuneration (1997 to 2002)
α = company fixed effects;
$x1$ = log of total asset (1996 to 2001) (Size)
$x2$ = return on asset (1996 to 2001) (Performance)
$x3$ = operating cash flow to total assets (1996 to 2001) (Performance)
$x4$ = earnings per share (1996 to 2001) (Performance)
$x5$ = industry
$\beta 1$, $\beta 2$, $\beta 3$, $\beta 4$ and $\beta 5$ = the coefficients
E = error variable.

4. Findings

Analysis on Questionnaire

Only a brief analysis based on 132 (3.7%) out of 3,600 questionnaires that were returned is discussed in this section. Out of the total respondents, 91% are male, 41% Malays and 51% Chinese. The data obtained also shows that on average there are 7 members on the Board of

Directors and the majority of the firms have either independent or non-independent non-executive directors (NEDs) constituting about one third of the board. The result is consistent with the study by Abdul Rahman and Haniffa (2003) and a 2001 survey conducted by KLSE/PwC. The result suggests that NEDs remain the majority on Malaysian boards, consistent with the requirement of the Malaysian Code of Corporate Governance (MCCG, 2001) and KLSE Listing Requirements (2002).

Table 1 shows that most of the respondents received multiple benefits, with the highest ranked being EPF employer's contribution (34.4%), followed by medical and company car 33.6% and 26.7%, respectively. On the directors' performance assessment, the majority of the respondents (47%) indicate that they were evaluated based on the Directors' Review, followed by Personal Performance (37.6%), and Company's Performance (33.8%). However, a majority of the respondents (82.7%) perceived that the directors' performance assessment should be based on both the company and director's yearly performance.

Table 1. Benefits Received by Directors

Benefits	Frequency	%
EPF Employer's Contribution	45	34.4
Medical	44	33.6
Company Car	35	26.7
Stock Options / Profit Sharing	33	25.2
Others	21	16
Life Insurance	20	15.3
Gratuity	3	2.3
Housing Loan	1	0.8
Car loan	0	0

Table note: using a 5-point Likert scale, one sample t-test analysis on directors' opinions reveals that the directors did not totally agree (mean 2.67) that the remuneration they got commensurate with their responsibilities, and that it was significantly different at a 1% level. However, on segregating the directors' opinion into executive and non-executive directors, the results based on the 2 sample t-test reveal that there is no significant difference in their opinion

5. Analysis on Annual Reports

The sample used in analysing the company's annual reports consists of 384 public listed firms on the KLSE Main Board, excluding finance, closed-end funds and property trusts due to their different regulations. The study also excluded delisted firms, those transferred from the Second Board, firms with incomplete data and newly listed firms during the period of study 1996 to 2002, resulting in a final sample of 246 companies.

Although listed firms are encouraged to disclose the exact amount paid to their directors (MCCG, 2000), going through each of the annual reports of the 246 sample firms for 2001 and 2002 reveal that most public listed companies are still shying away from disclosing it. The majority merely disclosed the aggregate remuneration of directors in successive bands of RM50,000 as stipulated in the Revamped Listing Requirements of 2001.

Table 2 discloses the directors' remuneration based on bands of the top 25 companies for the year 2001 and 2002, respectively. The findings show that sitting at the top of the pack in terms of the largest payout to directors for the year 2001 and 2002 is leading game operator, Genting Berhad, followed by Resorts World Berhad and the conglomerate Berjaya Group Berhad. Genting Berhad paid RM86.2 million to its directors in 2002, an increase of 94% from the total paid out of RM44.4 million in 2001. While Genting posted a profit of RM1.5 billion for the year 2002, its profits are similar compared to those posted by utility giants, like Tenaga Nasional Berhad and Telekom Malaysia Berhad, which recorded profits of RM1.48 billion and RM1.57 billion, respectively in the year 2002. Yet, the latter two are not ranked in terms of total payout to directors in the sample for 2002. Thus arises the question as to the basis used in paying out directors' remuneration.

Table 2. Directors' remuneration based on bands of the top 25 companies for the year 2001 and 2002

			DIRECTORS' REMUNERATION						NET PROFIT/LOSS	
			TOTAL PAYOUT (RM'000)		HIGHEST BAND (2001)		HIGHEST BAND (2002)		RM'000	RM'000
NO	COMPANIES	CTR	2001	2002	FROM	TO	FROM	TO	2001	2002
1	GENTING BERHAD	TS	44,361	86,167	54600	54650	68500	68550	1034600	1559550
2	RESORTS WORLD BERHAD	TS	24,221	47,567	16650	16700	33700	33750	605400	939600
3	BERJAYA GROUP BERHAD	TS	33,158	34,545	7650	7700	8200	8250	(321533	(357550
4	PPB GROUP BERHAD	CP	16,776	18,444	2200	2250	2650	2700	508883	321566
5	MULPHA INTNL BHD	TS	9,697	12,226	1300	1350	450	500	103118	38527
6	BERJAYA SPORTS TOTO BHD	TS	13,378	11,918	7600	7650	8200	8250	400858	426235
7	BERJAYA LAND BERHAD	TS	12,701	11,268	7600	7650	8200	8250	319832	287936
8	MALAYAN UNITED IND BHD	TS	8,981	11,048	3400	3450	3450	3500	35551	1062817
9	ORIENTAL HOLDINGS BHD	CP	8,798	10,143	1650	1700	2600	2650	204600	254600
10	YTL CORPORATION BERHAD	CON	8,684	9,171	1850	1900	1850	1900	721958	797553
11	LEADER UNIV HOLD. BHD	IP	11,497	9,105	4200	4250	2100	2150	18927	48454
12	COSWAY CORP BHD	CP	8,794	8,862	2350	2400	1450	1500	66940	(123684
13	IOI CORPORATION BERHAD	PLTN	7,357	8,222	5850	5900	6000	6050	458462	570502
14	MK LAND HOLDINGS BHD	PROP	2,433	8,197	NA	NA	3750	3800	265784	98057
15	FFM BERHAD	CP	6,815	7,652	1450	1500	1900	1950	177449	216463
16	UMW HOLDINGS BERHAD	CP	6,453	7,394	NA	NA	750	800	371223	463739
17	HAP SENG CONS BHD	TS	3,300	7,362	NA	NA	4900	4950	381396	151818
18	DRB-HICOM BERHAD	IP	6,077	7,165	1700	1750	2350	2400	411536	391108
19	STAR PUB (M) BHD	TS	5,076	6,191	3850	3900	4600	4650	86328	102876
20	TAN CHONG MOTOR HOLD. BHD	CP	6,407	6,187	2500	2550	NA	NA	620	149428
21	PERNAS INT HOLD. BHD	TS	7,402	6,084	650	700	600	650	(24737)	(153388
22	NAM FATT BERHAD	CON	5,497	5,940	1300	1350	1000	1050	(388196	2479
23	ENG TEKNOLOGI HOLDINGS BHD	TECH	5,553	5,699	1450	1500	1150	1200	16126	(18069)
24	IJM CORPORATION BERHAD	CON	4,732	5,495	600	650	850	900	86599	191770
25	ANTAH HOLDINGS BERHAD	TS	6,334	4,940	350	400	350	400	(12710)	20972

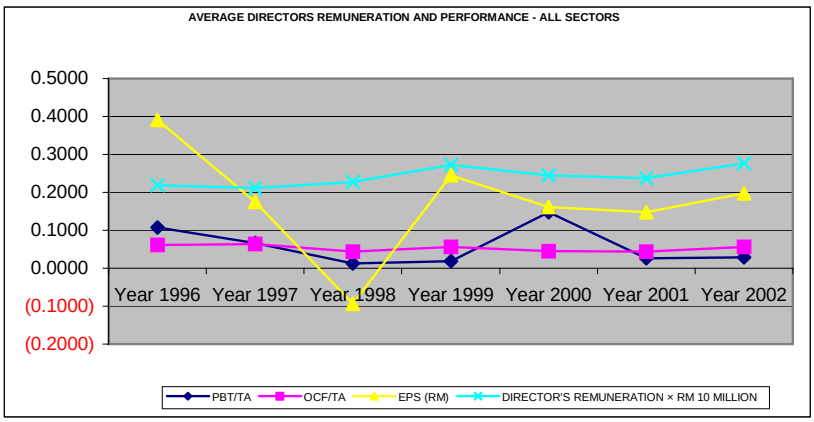
The descriptive statistics as highlighted in Table 3 is used to identify the trend of directors' fees, size (measured by Total Assets) and performance of firms.

Table 3. Descriptive Statistics of Dependent and Independent Variables (1996 to 2002)

Panel A: Directors' Remuneration (RM 000)							
	1996	1997	1998	1999	2000	2001	2002
Mean	2193	2216	2278	2726	2451	2374	2762
Median	1001	1165	1266	1070	1144	1221	1288
Std Deviation	5674	3676	4429	8438	5508	4255	6804
Panel B: Total Assets (RM 000)							
	1996	1997	1998	1999	2000	2001	2002
Mean	1,323,886	1,762,044	1,736,500	1,719,270	1,713,066	1,578,855	1,667,152
Median	474,315	607,730	619,395	589,235	619,850	593,022	618,305
Std Deviation	3,284,549	4,282,530	3,944,509	4,148,605	4,355,869	3,145,650	3,511,094
Panel C: Return on Assets (%)							
	1996	1997	1998	1999	2000	2001	2002
Mean	10.72	6.68	1.19	1.86	14.80	2.63	2.82
Median	8.44	6.15	2.64	3.83	3.99	3.26	3.75
Std Deviation	13.63	11.84	14.85	18.86	181.71	17.47	14.87
Panel D: Earnings Per Share (RM1)							
	1996	1997	1998	1999	2000	2001	2002
Mean	0.39	0.18	(0.09)	0.25	0.16	0.15	0.20
Median	0.30	0.20	0.07	0.18	0.11	0.10	0.12
Std Deviation	0.53	0.79	1.15	0.78	0.53	0.56	0.67
Panel E: Operating Cash Flow to Total Asset Ratio (%)							
	1996	1997	1998	1999	2000	2001	2002
Mean	6.07	6.37	4.41	5.60	4.50	4.33	5.59
Median	5.62	4.80	3.78	4.43	3.36	3.25	3.91
Std Deviation	10.96	13.09	10.24	9.92	8.19	10.54	10.40

Note: Return on asset (ROA) = profit before tax / total asset. Operating cash flow to total asset (CFA) = operating cash flow / total asset. Earning Per Share (EPS) = net profit (loss) attributable to ordinary shareholders / weighted average number of shares.

The results in Panel A of Table 3 show that the average Directors' Remuneration gradually increased from RM2.1 million in 1996 to RM2.7 million in 2002. Panel B of Table 3 highlights that on average, the total assets over the period 1996 to 2002 were RM1.3 Billion, RM1.8 Billion, RM1.7 Billion, RM1.7 Billion, RM1.7 Billion, RM1.6 Billion and RM1.7 Billion, respectively. Focusing on the performance of the firms, the results show that ROA, EPS and CFA was the highest in 1996 but decreased in 1997 and fluctuated in the following years. The companies in Malaysia on average obtained the lowest performance (measured by ROA and EPS) in 1997, possibly due to the economic recession that hit the country that year. Overall, the directors' remuneration did not seem to be the direct function of the companies' previous year's performance. In addition, Chart 1 demonstrates the average directors' remuneration and company performance (ROA, EPS and CFA) over the period 1996-2002, based on all sectors. The results indicate that the average directors' fees for all sectors seemed to correlate with the previous year's operating cash flow return (CFA) but not with other performance measurements (ROA and EPS).



Regression Analysis

To explore the relationship between directors' fees with firm performance and firm size, stepwise regression is used, similar to the method used by Daniel J. Miller (1995), Veliyath (1999), Firth et. al. (1996) and Conyon (1995). Normality test carried out apparently shows that the mean variables for directors' fees and total asset were not normally distributed. Thus, directors' fees and total asset (size) variables are transformed to log form similar to the analysis by Conyon (1995) and Firth et. al.(1996), to ensure normality of the model. In addition, a coefficient of 1.92 (within the range of 1.69 and 2.31) on the Durbin-Watson test indicates no evidence of autocorrelation, that is, there is no time effect of the performance of the companies on the directors' remuneration over the observed period. There is also no problem of collinearity or multicollinearity since the Eigen values are not close to zero and the condition index is not greater than 15.

Table 4. Pearson Correlations Between Directors Remuneration and Firm Performance

		Log Directors' Remuneration	Return On Asset	Earning Per Share	Operating Cash Flow To Total Asset	Total Asset	Industry
Pearson Correlation	Log Directors' Remuneration	1.000	.000	.022	.100	.307	-.017
	Return On Asset	.000	1.000	.122	-.008	-.011	.031
	Earning Per Share	.022	.122	1.000	.137	.028	-.008
	Operating Cash Flow To Total Asset	.100	-.008	.137	1.000	.021	-.016
	Total Asset	.307	-.011	.028	.021	1.000	.136
	Industry	-.017	.031	-.008	-.016	.136	1.00
Sig. (1-tailed)	Log Directors' Remuneration	.	.500	.202	.000	.000	.000
	Return On Asset	.500	.	.000	.379	.336	.336
	Earning Per Share	.202	.000	.	.000	.143	.143
	Operating Cash Flow To Total Asset	.000	.379	.000	.	.215	.215
	Total Asset	.000	.336	.143	.215	.	.000
	Industry	.252	.117	.383	.271	.000	.

Number of companies = 1476

Using Pearson Correlation analysis, Table 4 shows that there are significant positive linear correlations between directors' remuneration (DR) and operating cash flow to total asset (CFA); between directors' remuneration and total assets (TA); but significant negative association between directors' remuneration and industry. However, there is no linear association between directors' remuneration and return on asset (ROA), and Earnings Per Share (EPS).

Similarly, linear regression using stepwise analysis in Table 5 reveals that only operating cash flow to total asset (CFA) as a proxy for performance measurement is significant at the 1% level. Total asset is also significant but the coefficient for CFA is higher than the coefficient for size, indicating a stronger relationship of performance than size to directors' remuneration. However, the relationship between directors' remuneration and Return on Asset (ROA) is not significant, consistent with the findings by Firth et al (1999), although contrary to the findings by Hermalin & Wallace (1997), and Crespi and Gispert (1998) who found positive relationship between firm performance and directors' remuneration.

The results also displays that there is a non-significant linear association between directors' remuneration and Earnings Per Share (EPS), consistent with the findings by Conyon (1995). The result, however, is not in line with earlier findings by Miller (1995) and Wickham (2001), who found a significant association between performance measured by earning per share (EPS) and the CEO's pay.

None of the previous studies have used ratio of operating cash flow to total assets (CFA) as the performance indicator in examining the relationship of directors' remuneration and performance. The CFA has proven to be an important tool in representing non-accruals predictor of performance. Thus, when the non-accruals are excluded from the current profit analysis, the result shows positive relationship

between the ratio of operating cash flow to total assets and directors' fees. However, the relationship between directors' remuneration and operating cash flow to total asset (CFA) is not very strong as evidenced by R squared, where only 10.3% variation in directors' remuneration is explained by the CFA and total asset. Thus, there are other factors that may account for a higher proportion of the variation in the dependent variable.

Table 5. The Relationship between Directors' Fees, Size and Performance of KLSE Firms

(Regression model; log of directors remuneration = Industry + E) EPS + ROA +CFA + log of total assets + +

(1) Intercept	3.019 (99.69)*
(2) CFA (%) (Performance)	0.456 (3.740)*
(3) Log Total Asset (Size)	0.403 (12.583)*
(4) Industry	-0.012 (-2.352)*
(5) No. of Observation	1475
(6) R Square	0.103
(7) Adjusted R Square	0.104
(8) F	58.36*

Note: Dependent variable is the directors' fees (1997 to 2002). Independent variables are from (1996 to 2001). Directors' fees and total asset variables transformed to natural logarithms to ensure normality. CFA = ratio of operating cash flow to total assets. * Significant at the 0.01 level

As illustrated in Table 5, total asset is also significant, indicating that directors remuneration is affected by variation in the size of companies. As such, further analysis is made by classifying the sample firms into small and big firms by using the mean RM1,643,646 of the total asset as the cut-off point. The result in Table 6 shows that that there is a positive linear relationship between the directors' remuneration and operating cash flow to total asset (CFA), at a 1% significant level for small companies below RM1,643,646. However, only 1.4% of the variation in director's remuneration can be explained by the model. The regression analysis on companies that have total assets more than RM1,643,646 as a proxy for big company shows that EPS is now a significant independent variable rather than CFA. However, only 3.8% of the variation in director's remuneration can be explained by the model.

Table 6. The Relationship between Directors' Fees and Performance of KLSE Firms, Based on Firms Size

(Regression model; log of directors remuneration = + Industry + E) EPS + ROA +CFA +

	Small Firms	Big Firms
(1) Intercept	3.025 (94.26)*	3.340 (95.494)*
(2) CFA (%) (Performance)	0.507 (4.033)*	
(3) EPS (%) (Performance)		0.174 (3.482)*
(4) Industry	-0.13 (-2.461)*	
(3) No. of Observation	1165	309
(4) R Square	0.019	0.038
(5) Adjusted R Square	0.018	0.035
(6) F	11.533*	12.122*

Note: Dependent variable is the directors' fees (1997 to 2002). Independent variables are from 1996 to 2001. Directors' fees are transformed to natural logarithms to ensure normality. CFA = ratio of operating cash flow to total assets. EPS = Earnings Per Share. * Significant at the 0.01 level

Thus, the result is consistent with findings by Hermalin & Wallace (1997), who indicate a stronger relationship of performance than size in comparison. However, the result is inconsistent with earlier findings by Conyon (1995), Tosi (2000), and Veliyath (1999), who found size as

the most important predictor of directors' remuneration than performance regardless of any scale of measurement used. Moreover, the result is also inconsistent with earlier theory on managerialism, which indicates that the top managers are only interested in increasing firm size than maximizing profits in relation to receiving better compensation.

Conclusion

The current research addresses the relationship between directors' remuneration with performance and size of 246 listed firms over the period 1996 to 2002. The results in the current study indicate that performance variables such as return on assets (ROA) and earning per share (EPS) have no statistical association with directors' remuneration. On the other hand, there is a positive relationship between directors' remuneration, corporate size (total assets) and corporate performance (operating cash flow on asset). Further analysis shows that performance of firm produced the strongest relationship with directors' fess than size of firm. However, the relationship between directors' remuneration with operating cash flow to total asset (CFA) and size is not very strong as evidenced by R squared, where only 10.3% variation in directors' remuneration is explained by the CFA and total asset. Thus, there are other factors, such as the director's yearly performance as perceived by the respondents from the questionnaire that may also account for the determination of the directors' remuneration. In addition, a majority of the respondents indicate that Director's Performance need to be evaluated based on Directors' Review, followed by Personal Performance and Company's Performance. The findings support the notion of agency theory and corporate governance, that remunerating the top management should be based on individual and corporate performance.

The Board of Directors' remuneration are undoubtedly outcomes of negotiations between the remuneration committee and the Directors. Both parties will have limited information concerning a firm's position within the industry, although directors will certainly have more information than committees. Further research should examine the use of this information in the bargaining process.

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