A Study On Corporate Performance And Executive Compensation: The Case Of Public Listed Companies In Malaysia

Meixi Gong

Xiamen University Malaysia, Xiamen City, Fujian Province, 361000, China

Abstract: This study investigates the influence of corporate performance indicators namely, return on assets (ROA), earnings per share (EPS), net profit and return on equity (ROE) on executives' compensation, and also the moderating effect of independent ratio in the Malaysia listed companies. Based on an analysis of a dataset comprising 100 companies in the fiscal year 2022, encompassing listed businesses in Bursa Malaysia, the results indicate that corporate performance has no significant relationship with executive compensation, but the independent director ratio has a significant moderating effect on the relationship between the corporate performance and executive compensation. This implies that companies may increase executive compensation to incentivize executives to respond when earnings decline and to retain talent. Board independence weakens the relationship between managerial compensation and performance and makes the role of independent directors ambiguous.

Keywords: Corporate Performance, Executive compensation, Independent Director Ratio, Agency Theory

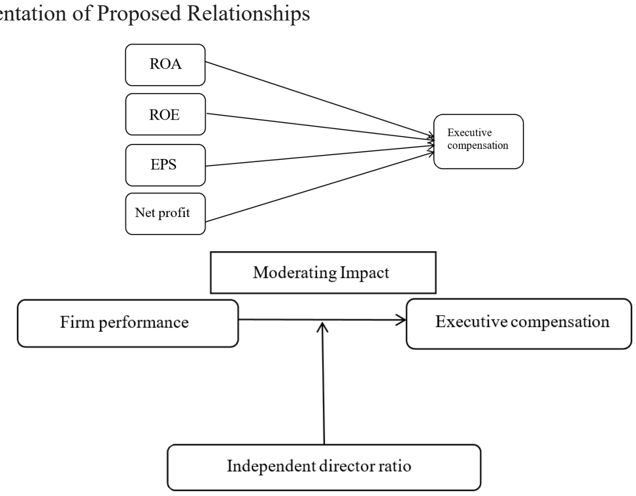
1. Introduction

This study explores executive compensation and corporate performance in Malaysian listed companies. Despite Malaysia's evolving governance norms, no significant relationship between executive compensation and performance indicators (ROA, ROE, EPS, net profit) was found. Recommendations include establishing transparent performance metrics for executive compensation. Additionally, the study highlights the moderating role of independent directors in governance. These findings offer insights for policymakers and practitioners in improving governance practices in Malaysia[].

2. Research Methodology

2.1Research framework

Figure11. Schematic Representation of Proposed Relationships



From Figure 1, the research uses ROA, ROE, EPS and net profit as independent variables, and executive compensation as dependent variable[1]. The four independent variables have a direct impact on executive compensation. When comes to the moderating impact, the research uses firm performance as the independent variable, executive compensation as the dependent variable, and independent director ratio as the moderator. The independent director ratio has a moderating impact on the relationship between firm performance and executive compensation.

2.2 Data collection

Data on executive salaries and corporate governance in Malaysian firms are scarce in conventional databases. Hence, this study directly collected data from the annual reports of 100 corporations from the Bursa Malaysia Website for the fiscal year 2022[3].

2.3 Research model

Because the sample includes 100 non-financial Malaysian listed companies in 2022, this is a cross-section of data. Within the theoretical framework, two methods for estimating executives' salaries are identified: ordinary least squares (OLS) and moderating effects. Regarding the primary factors that influence CEO compensation, based on past research on corporate governance and directors' salary, two models have been developed to express the expected relationship[4]:

Model 1

Executive's compensation = β0 + β1ROA + β2EPS + β3Net profit + β4ROE

Model 2

Executive's compensation = β0 + β1ROA + β2EPS + β3Net profit + β4ROE + β5Independent director ratio + β6(ROAxIDR) + β7(EPSxIDR) + β8(Net profitxIDR)+ β9(ROExIDR)

Model 1 mainly tests company performance, that is, the impact of ROA, ROE, EPS and Net profit on executive compensation. Model 2 mainly tests the moderating effect of the independent director ratio on company performance and executive compensation[].

2.3.1 Dependent variable

Executive remuneration is dependent variable that represents the total compensation earned by all executives in the company. This comprises both cash pay and other associated incentives, which are disclosed in the annual reports of publicly listed companies. This analysis has omitted stock options[].

Table 3.1 Variables measurements

Variable	Measurements
Executive	Totai cheremrmeanion(slsar ses compensation bonuses)
ROA	Retum ofEquity=Net Income/Total assets
	Eamings Per Share(EPS)=Net
EPS	Eamings Per Share(EPS)=Net Income- prefered
Net proft	Proft (loss) after tax
ROE	Reum ofEquity =Net Income Shareholder' s Equity
Independent director ratio	No ofindependae directorNo oftotal directors in the board

2.3.2 Independent variables

ROA, ROE, EPS, and Net profit serve as independent variables. ROE measures shareholders' returns on their investment, while ROA assesses operational effectiveness based on profits generated from total assets. Net profit reflects earnings after deducting taxes and unusual items. EPS indicates the portion of profits allocated to each equity share after taxes and preference dividends deduction.

3. Results and Discussi

3.1Correlation analysis

Provided the results of correlation analysis of executive compensation and corporate performance which includes the ROA, EPS and net profit of the company in fiscal year 2022. Any score from +0.5 to +1 indicates a very strong positive correlation, meaning they increase together.

Table 4.3 Correlation analysis

	Compensation	ROA	EPS	Net profit	ROE	
Compensation	1					
ROA	0.118	1				
EPS	0.163	0.551	1			
Net profit	0.146	0.397	0.783	1		
ROE	0.130	0.312	0.360	0.749		1

The results of table 4.3, illustrates that the correlation coefficient between ROA and executive compensation is 0.118, and there is a positive correlation between the two variables, but the correlation is not strong. The correlation coefficient between EPS and executive compensation is 0.163, indicating that there is a weak positive correlation between the two variables. The correlation coefficient between Net profit and executive compensation is 0.146, which also shows that there is a weak positive correlation between the two variables. In the same situation as ROE and executive compensation, there is a weak positive correlation between the two variables. Among the four corporate performances, the positive correlation between corporate EPS and executive compensation is the strongest.

3.2 Regression analysis

Table3.5 Regression statistics

	Regression Statistics	
Multiple R		0.169
R squared		0.16898516
Adjusted R Square		0.108555984
Standard Error		7660524.704
F-statistic		1.010561
Prob (F-statistic)		0.406017
Observations		100

From Table 3.5, it shows that the standard error is 7660524.704, standard error indicates the average level of the observed value from the regression line. The smaller the S is, the better the model is, and the closer it is to the fitting line. In this model, the fit between the four independent variables and the dependent variable is very low. The value of adjusted R square is 0.1086, which indicates that 10.86% of the change in executive compensation can be explained by changes in the four variables ROA, EPS, ROE and net profit, and the remaining 89.14% is unexplained variance. And value of multiple R is 0.169, and the value is close to 0, indicating that there is a weak positive correlation between the four dependent and independent variables.

3.2.1 ROA and Executive compensation

From the result of Table 4.6, there is no significant relationship between ROA and executive compensation since the p-value is 0.4808, which value is more than 0.05. This result is exactly opposite to Mehran's (2017), Kato and Kubo's (2006) and Boakye et al.' (2020) research results, their research results show that ROA and executive compensation have a significant positive correlation, which means that executive compensation will increase with the growth of ROA. However it is in line with Ghasemi and Razak's (2020) research results, in this study, there is no significant relationship between ROA and executive compensation.

For H1: There is a significant relationship between executive compensation and corporate performance indicators represented by ROA. And this assumption does not hold because the p-value is more than 0.05, accept H0.

3.2.2 EPS and executive compensation

Table 4.6 indicates no significant relationship between EPS and executive compensation (p-value = 0.6658). This aligns with Ghasemi and Razak's (2020) findings but contrasts with Kang and Payal (2009) and Ahmed Alarussi's (2021) results. H2 is accepted, suggesting no significant relationship between EPS and executive compensation.

3.2.3 Net profit and executive compensation

Table 4.6 shows no significant relationship between corporate net profit and executive compensation. This aligns with previous research by Zainol and Salleh (2021), indicating that changes in executive compensation cannot be explained by changes in net profit. However, Rehman et al. (2021) found a significant positive relationship in China. Despite the high incidence of COVID-19 in 2021, which likely impacted Malaysian companies' profits, increasing executive compensation can retain key talent and support strategic decisions for future profitability. Nonetheless, executive compensation may not always reflect actual organizational performance, especially amidst strong share price growth in the stock market. Therefore, H3 is accepted, indicating no significant relationship between corporate net profit and executive compensation.

3.2.4 ROE and executive compensation

Statistical analysis indicates no significant relationship between ROE and executive compensation. The regression coefficient for ROE was 0.2733, showing lack of significance. Previous studies have shown mixed results, with some identifying a significant correlation between ROE and executive compensation, while others did not. Thus, H4 is rejected, suggesting no significant relationship between corporate net profit and executive compensation.

3.3 Discussion of the results

This study analyzed the relationship between executive compensation and financial performance indicators using data from 100 Malaysian listed companies' annual reports for fiscal year 2022. Contrary to expectations, no significant correlations were found between executive compensation and return on assets (ROA), earnings per share (EPS), net profit, or return on equity (ROE). However, the study confirmed the moderating effect of the independent director ratio on the relationship between firm performance and executive compensation, aligning with previous research by Cao, Im, & Syed (2021) and Rehman et al. (2021).

4. Conclusion

This study analyzes factors influencing executive compensation in Malaysian publicly traded firms, particularly focusing on board components. Results indicate no significant relationship between executive compensation and corporate performance, reflecting governance challenges. Independent director ratios, however, moderate this relationship, with potential drawbacks noted in emerging markets due to undisclosed connections between independent directors and executives (Conyon & He, 2011).

References:

[1] Boakye, J. D., Sam, A. G., & Nsorambala, R. (2020). Chief executive officer compensation and financial performance: Evidence from the Alternative Investment Market in the UK. Indian Journal of Corporate Governance, 13(1), 63–84. https://doi.org/10.1177/0974686220923805

[2] Biswas, R. (2023). Malaysian economy shows sustained expansion in early 2023. S&P Global Market Intelligence. https://www.spglobal.com/marketintelligence/en/mi/research-analysis/m alaysian-economy-shows-sustained-expansion-in-early-2023-may23.htm l

[3] Bebchuk, L. A., & Fried, J. M. (2004). Executive compensation as an agency problem. Journal of Economic Perspective 17(3), 71-92.

[4] Ataay, A. (2018). Performance sensitivity of executive pay: The role of ownership structure, board leadership structure and board characteristics. Economic Research-Ekonomska Istrazivanja, 31(1), 1152–1168. https://doi.org/10.1080/1331677X.2018.1456951

[5] Aresu, S., Hooghiemstra, R., & Melis, A. (2022). Integration of CSR criteria into executive compensation contracts: A Cross-Country Analysis. Journal of Management, 0(0). https://doi.org/10.1177/01492063221110200

[6] Ahmed Alarussi, A. S. (2021). Effectiveness, Efficiency and Executive Directors' Compensation Among Listed Companies in Malaysia. SAGE Open, 11(4). https://doi.org/10.1177/21582440211054129