



Are Executive Directors Paid Enough? Evidence from Conflicting Related-Party Transactions

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ABSTRACT

This study examines the association between types (packages) of executive director's remuneration and conflicting related-party transactions (RPT-conflict) among listed companies in Malaysia. The hypotheses are analyzed using a sample of 539 listed companies in Malaysia over the period 2012-2014 with 1,615 observations. The results show that salary (cash-based) and in-kinds remuneration pay to executive director are effective at reducing firm's engagement in RPT-conflict but an executive director fee alone is not attractive enough. The executive directors favor for the combination of remuneration packages, either involving salary and fee, or salary and in-kinds. This study contributes a greater understanding about the effectiveness of different types of executive director's compensation to minimize the firm's engagement with related parties. Additionally, the combination of remuneration package is more attractive and effective at minimizing RPT-conflict than individual payment of director fee or salary. The evidence also contributes to the literature by indicating a compensating relationship between each type of executive director's remuneration and RPT-conflict. The regulators and policy makers, specifically the remuneration committee must concern and seriously consider about the importance relationship between an attractive director's remuneration and RPTs, and thus, takes the right steps to minimize the expropriation risk.

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INTRODUCTION

This study investigates the association between types of director's remuneration and Malaysian listed firms' engagement in conflicting related party transactions (RPT-conflict). Many recent accounting scandals involving large corporations, including Enron and Adelphia in the US, Satyam in India, KMK and Mailyard in China, Tradewind Berhad and Megan Media Berhad in Malaysia are convicted by abusing RPTs (Rahmat and Ali, 2016). These scandals reveal substantial related parties, specifically top management, and executive directors or controlling shareholders who opportunistically utilized RPTs as a tool to expropriate firm's wealth and manipulate a financial reporting (Rahmat and Ali, 2016, Dahya et al., 2008). The related parties may use their position and authority to approve and execute such transaction for extracting cash, transferring or selling assets, goods or services, or obtaining loans, including guarantees on preferential terms (Berkman et al., 2009, Ryngaert and Thomas, 2012) to maximize their personal interests.

This agency problem occurs when functions of agents and principals are not aligned (Fama and Jensen, 1983). Agency theory suggests that executive directors should be rewarded to align interests between the executive directors and shareholders (Aslam et al. 2019; Fama and Jensen, 1983). Director's remuneration should be designed attractively, links with the executive director's aspiration and mind that they are being rewarded sufficiently. The attractive remuneration and rewards can minimize executive director's opportunistic behavior and motivate them to work harder for achieving the firm's objectives (Aswadi Abdul Wahab et al., 2011). However, we discovered a very limited evidence to show empirically that executive director's remuneration is effective to minimize firms' engagement in potentially abusive RPTs (RPT-conflict). A few studies like Kohlbeck and Mayhew (2004), Aswadi Abdul Wahab et al., (2011) and Hope et al., (2019) examined director's remuneration in the context of RPTs, the evidence could not resolve our concern. This leads to questioning which types of remuneration packages could be effective at reducing a firm's engagement in RPT-conflict.

Additionally, executive directors are related parties and thus, it is crucial to understand that remunerations paid to executive directors or top management are also categorized as RPTs. This raises concern as to whether the determination of director's remuneration may consider the executive directors' engagement in RPT. The executive directors can use their positions to influence a firm's decision-making process in RPT's engagement as well as the determination of director's remuneration (Carter and Zamora, 2009). The opportunist executive directors may utilize director's remuneration and other types of RPTs as a tool to maximize personal wealth. Thus, Malaysian listed firms are required under MFRS124 Related Party Disclosure to disclose director's remuneration as a subsection of RPTs disclosure. This circumstance motivates this study to investigate the association between executive director's remuneration and RPT-conflict. Here, RPT-conflict is defined as any type of RPTs engaged by firms and related parties (executive director or executive controlling shareholder) and/or firms and other entities related to the executive director or controlling shareholders.

This study examines 539 firms listed on Bursa Malaysia for the period from 2012 to 2014 with a total of 1,615 observations. Malaysia is an emerging market, and thus an institutional setting and corporate structure may provide a conducive environment for firms to engage in RPTs, particularly the RPT-conflict. Implementation of corporate governance practice in Malaysia has been argued to be less effective and minority investor protection is weak (Peng and Jiang, 2010). Although corporate governance and regulatory reforms have been taken in 2007 to deal with RPTs by revamping the Malaysian Companies Act, 1965 and Stock Exchange regulations, however, the main concern is consistent with Peng and Jiang (2010). They advocated that the formal laws on the books in emerging economies may look increasingly like those found in the West, but the actual implementation is often ineffective due to the dominance of informal norms and cognitions in society and corporate operations. Additionally, the origin of the majority of listed firms in Malaysia is a family business, and normally dominated by single controlling shareholders through concentrated ownership (Johnson and Mitton, 2003; Munir et al., 2013, Villalonga and Amit, 2006). This business landscape, consequently, is conducive for firms to engage in RPTs, which increases the potential of RPTs being executed abusively (Rahmat et al., 2018).

We find that salary and in-kinds remuneration pay to the executive director is effective at reducing firm's engagement in RPT-conflict. The evidence suggests that cash and in-kinds base of remunerations are crucial to minimize the executive director's opportunistic behavior due to conflict of interest. However, fee payment to the executive directors does make an impact on their engagement in RPT-conflict, where the executive directors

favor for a combination of a remuneration package, either salary and fee, or salary and in-kinds. This study contributes a greater understanding of the effectiveness of types of executive director's compensation to minimize the managing director's engagement in opportunistic dealing involving related parties (Aswadi Abdul Wahab et al., 2011), in alignment with the agency theory. The findings contribute to the literature by expanding an indication that executive director's remuneration and RPTs may compensate to each other which is aligned with the contracting theory (Kohlbeck and Mayhew, 2004). This study also contributes by extending the knowledge and understanding that the combination package of remuneration is more attractive and effective at minimizing RPT-conflict than individual payment of director fee or salary.

This paper is organized as follows. Section 2 discusses an institutional background of RPTs and director's remuneration in Malaysia; then, followed by literature review and development of hypotheses on the effect of director's remuneration on RPTs (types) in section 3. In section 4, we describe the data collection and research models. Furthermore, empirical results of firm valuation are presented in section 5, followed by conclusions in the last section.

LITERATURE REVIEW AND DEVELOPMENT OF HYPOTHESES

Institutional Background of RPTs in Malaysia

MFRS 124: Related-Party Disclosure define RPTs as transfer of resources, services or obligations between related parties, regardless of whether a price is charged. On the other hand, related party is defined as a director, major shareholder or person connected with that such director or major shareholder, in which the identified related party can exercise control or has significant influence over the operations or financing policies of the other party. The MFRS 124 requires the disclosure of RPTs to be made separately for each category by documenting the existence of the related parties' interests. The firm also needs to disclose the related-party relationship when control exists, irrespective of whether there have been transactions between the related parties or not. This study relies on the RPTs' disclosure to classify RPTs either efficient or conflict. RPT-conflict occurs when a transaction involves individual related parties' (managers, directors and controlling shareholders) conflict of interest. It could be a direct transaction involves firm and individual related parties, alternatively, indirect transactions involve firm and business entities in which presence of individual related parties' interest in the entities. In contrast, all RPTs involve firm and business entities without any related parties' interest is classified as RPT-efficient.

This information is necessary for users/investors to understand the potential effect of the RPTs and help them making their own judgments, whether the RPTs are value enhancing or value destroying (Fooladi and Shukor, 2011). Hence, disclosure of RPTs is essential to provide stakeholders with useful information to either discipline firms that engage in RPTs or take precautions against them. The disclosure requirement may serve as an effective tool to minimize RPT-conflict. However, the listed firms are yet to agree in disclosing the actual market price of the disclosed RPTs. Bursa Malaysia has also introduced an additional provision to monitor transparency of RPTs by requiring the Malaysian listed firms to disclose RPTs and make an immediate announcement to Bursa Malaysia.

This study concerns that an existing business landscape in Malaysia is conducive for RPTs. Majority of the firms are dominated by a single controlling shareholder through concentrated ownership structure, in which a large number of firms are run by families (Munir et al., 2013). The firm's top management positions are usually occupied by the controlling shareholders' family members (Villalonga and Amit, 2006), while some firms could be influenced by a political connection too (Berkman et al., 2011, Habib et al., 2017). The management positions allow controlling parties to exercise significant influence and control over the corporate affairs, together with a decision to initiate RPTs. The opportunist controlling parties may utilize the incentive to divert firm resources for their private benefits instead of sharing them with the other shareholders. Additionally, lack of protection from corporate governance as well as the regulators also facilitates executive directors to engage in RPTs (Peng and Jiang, 2010, Aswadi Abdul Wahab et al., 2011; Hope et al. 2019). Consequently, RPT-conflict increases the risk of firm's wealth expropriation.

Since year 2000, Malaysian Institute of Corporate Governance (MICG) has introduced the best practice of corporate governance code, which has been revamped several times, i.e. in 2007, 2012 and 2017, to strengthen the corporate governance practice. Nowadays, the code of the best practice of corporate governance in Malaysia

is rather advanced compared with other East Asian countries. The quality of reporting among Malaysian listed firms is better and more reliable. Additionally, the amendment of the Companies Act 1965 in 2007 included specific provisions to ensure transparency and strengthen the accountability of RPTs. For example, the interested director is prohibited from voting or participating in any board discussion on the contract or proposed contract when it is being considered. The amended Companies Act 1965 also prohibits any dealing with loans to directors and persons connected with directors or providing any guarantee in connection to any loan made to such related parties. The amendment is introduced to avoid self-dealing by directors or connected persons who may use the firm's funds for their own benefits. The Malaysian Companies Act 1965 is revamped substantially in which is now renowned as the Malaysian Companies Act 2016. However, there is no substantial revision involving RPTs and executive director's remuneration.

Malaysian government has also established the Minorities Shareholders Watchdog Group (MSWG) to play a role in advising minority shareholders regarding their rights and coordinate legal action, if required. However, the effectiveness of the governance reforms to date in protecting and addressing the abuse of RPTs is not sufficiently explored. The main concern aligns with Peng and Jiang (2010) who emphasized that formal laws written in the books in Malaysia may look and have strong features, similar to that implemented in developed countries, but not in the real practice. Nowadays, RPTs still remain as the favorite dealings involving Malaysian listed firms, which increases potential of RPTs being abused (Ariff and Hashim, 2013).

RPTs and Expropriation of Wealth

Prior studies have debated regarding RPTs from two different points of views, either representing efficient transaction or fulfilling a conflict of interest (Gordon et al., 2004, Rahmat and Ali, 2016). An efficiency view argued that firms get engaged in RPTs since it is more efficient for contracting. RPTs help companies to fulfil their economic and financial needs, and may give benefits to the shareholders by increasing the efficiency of capital resource allocation, reducing transaction costs by sharing technological skills and advertising, and improving firm's profitability (Baiman et al., 2010). RPTs can also serve as an alternative to contractual or market exchanges, which can overcome difficulties that impair production of goods and/or services (Gordon et al., 2004) and source of financial difficulties (Bertrand et al. 2002) due to inefficiency of external markets. The internal contract arrangement is important to ensure efficiency and the continuity of firm's day-to-day operations (Larcker et al., 2007), where the nature of RPTs is viewed as not abusive, does not betray the shareholder's interests and cannot be seen only as dealings for serving fraudulent purposes (Djankov et al., 2008). Downs et al. (2016) and Nor and Ismail (2017) also depicted evidence efficient RPTs can create value to the firm.

In contrast, RPTs are viewed as a conflict of interest (Hasnan et al. 2016), which provides greater incentives to controlling shareholders to expropriate minority shareholders thus managing earnings to mask up such expropriations. The executive directors or controlling shareholders are argued to perform RPTs to maximize their personal wealth (Al-Dhamari et al. 2018, Cheung et al., 2006, Dahya et al. 2008), through tunneling or propping activities. For example, the executive director may structure a loan's contract on favorable terms or provide guarantees for personal loans (Berkman et al., 2009, Huang 2016). The legal and complex nature of RPTs allow executive directors to aggressively manipulate or mislead the accounting treatment or even fraudulent behavior (Pizzo, 2011), resulted from information asymmetry. The opportunistic managing directors then utilize RPTs to hide their personal interest or to conceal their corrupt expropriation activities (Rahmat and Ali 2016). Alternatively, they may provide insufficient disclosure or intentionally not to disclose the RPTs (Erickson et al., 2006).

In many cases, RPTs are carried out in a non-arms-length contract, which usually agreed at over-payment of assets, lower-selling price, or simply using financial services to the benefit of the related parties. The difference in the prices between the agreed RPTs and the market is the benefits gained by these parties at the expense of firms or stakeholders. Thus, a wealth's expropriation occurs if the firm receives fewer net benefits from the RPTs than it could have obtained from arms-length transaction (Feleagă and Neacșu, 2016, Ryngaert and Thomas, 2012). Additionally, the expropriation of wealth through RPTs can also be in the form of cash flows, assets, equity or a combination of two or more of these firms' attributes. For example, an overpayment of asset acquisition can transfer the resources (cash) for the benefit of related parties (Djankov et al., 2008). On the other hand, Bertrand et al. (2002) and Baek et al. (2006) found indicators for tunneling income from a more

profitable firm to non-profitable ones, executed through bail-out or acquisition of failing firm within group firms.

Additionally, Aharoni et al. (2010) showed that parent firms exploit the minority shareholders' wealth by not repaying the outstanding corporate related party loans, while Bertrand et al. (2008) also depicted consistent results from the family controlled firms. The recent evidence by Liu and Ooi (2018) that find firms significantly underperform when they using related party as service providers. These circumstances cause the minority shareholders to suffer from the setback and bearing the costs (Cheung et al., 2006). A reliability of the firm's financial statement has become a question causing the agency cost to increase. Thus, the opponents view RPTs to affect earnings quality by reducing the usefulness for decision-making (Bona-Sánchez et al. 2017, Jian and Wong, 2010, Kohlbeck and Mayhew, 2010, Tambunan et al. 2017).

Types of Executive Director's Remuneration

Remuneration is defined as a reward contract structured for executives, which includes salary and performance-related awards for annual and long-term performance (Barontini et al., 2017, Bender, 2003). Franzoni (2010) addressed remuneration as the wealth generated by the corporate business and its allocation or payment among who manages the company (executive directors), where the effective costs and benefits are obtained through performance. Consistent with the agency theory and findings of several past studies, director's remuneration can mitigate the agency problem and enables the executive director's goals to align with those of the firms (Basu et al., 2007, Ozkan, 2007, Nyambia and Hamdan, 2018). The suitable remuneration components should link with the board of director's abilities and motivation to achieve firms' objectives (Abdul Wahab and Abdul Rahman, 2009, Hartzell and Starks, 2003, Craighead et al., 2004). However, the determination of director's remuneration should be based on accountability, fairness, and competitiveness, as prescribed in the code (Barkema and Gomez-Mejia, 1998, Nelson and Abd Rahim, 2018).

This requires a formal and transparent procedure in the formulation of remuneration packages for the executive directors to ensure that the rewards positively impact their performance (Barkema and Gomez-Mejia, 1998, Nelson and Abd Rahim, 2018). In Malaysia, an independent remuneration committee is responsible to design the director's remuneration for the listed firms. Executive directors should abstain from participating in decision-making discussions regarding their own remunerations. The remuneration committees must ensure that firms' remuneration policies remain supportive of corporate objectives and also justify the best criteria in remuneration setting to generate optimal terms of contracts offered to board of directors to increase shareholders' wealth (Shaw and Zhang, 2010, Leone et al., 2006). In addition, the remuneration committee has a responsibility in evaluating the executive performance and makes recommendations for bonus compensation.

Carter and Zamora (2009) in their study emphasized that the key point to enhance executive director's performance lies within remuneration packages. Furthermore, Leone et al. (2006) and Shaw and Zhang (2010) have shown that firm performance is influenced by the remuneration paid to the executive directors. Aslam et al. (2019) also support a positive relationship between director's compensation and firm's performance. An attractive reward system is effective at minimizing executive director's involvement in opportunistic activities. This study also predicts that the executive director's remuneration affects in reducing RPT-conflict. The remuneration components commonly practiced in Malaysia are in the form of salary, bonus, and fees (monetary compensation) (Abdul Wahab and Abdul Rahman, 2009; 2006, Basu et al., 2007) and benefits of a kind, stock options or warrants (non-monetary compensation) (Barontini and Bozzi, 2011, Ertugrul and Hegde, 2008).

Types of Executive Director's remuneration and RPT-conflict

All stakeholders are calling for the monitoring of RPTs occurrence as such transactions are used abusively to commit fraud and manipulate financial reporting. However, the stakeholders cannot directly prevent RPT-conflict as the related party often involves top management or executive directors, who have power and authority to make all business decisions. Various types of remunerations can be an effective monitoring tool to minimize critical conflict involving related parties, particularly executive directors. Aligned with the agency theory argument, this study contends that the opportunistic executive directors can be interfered by compensation-based contract. The attractive incentive can become an effective motivation driver for executive directors to achieve the firm's objective (Barkema and Gomez-Mejia, 1998, Carter and Zamora, 2009) and simultaneously minimize the abuse of RPT-conflict. Nevertheless, this study finds that the evidence is limited at supporting the proposition that director's remuneration types are negatively associated with RPT-conflict.

Director's remuneration can be paid in the form of cash-based (salary, bonus and fees), in-kinds based (car, property or others), and equity-based (stock option and warrants) (Barontini et al., 2017). Basu et al. (2007) and Ozkan (2007) emphasized that the cash-based remuneration either salary, fees and bonus are the main component of payment to board of directors. Furthermore, Abdul Wahab et al. (2009) similarly agrees that salaries and bonuses are major components of executive's remuneration among listed firms in Malaysia. In addition, Chen and Lee (2008) also discovered that executive directors of Taiwanese public firms tend to receive salaries and bonuses as remuneration. In the US and UK, the magnitude of salaries and bonuses paid to executive directors constitute 80% and 70% out of total remuneration, respectively.

Salary instrument is considered as part of the remuneration, in which the executive directors may gain several benefits (Gallagher et al., 2006). Salary is associated with social status in society, where higher salaries allow higher quality of life and lead to respect and influence in society. Additionally, the executive directors also have a possibility of receiving better bonuses typically linked to accounting performance (Carter and Zamora, 2009). The bonus's payment can motivate the executive directors to strive harder in achieving the firm's objective and encourage controlling shareholders to put aside any personal interests. Other types of remuneration given to executive directors are such as fees and in-kinds remuneration, for example, fee for meeting can attract executive directors to attend and participate in the meeting that results in any important decision able to be decided to achieve firm's objectives. In contrast, at a certain level, senior executive directors may prefer in-kind-based compensations such as cars and property.

At this stage, this study also argues that in-kinds remuneration can reduce executive directors' engagement in abusive RPTs. However, to date, the evidence is limited to show the relationships. Aswadi Abdul Wahab et al. (2011) utilized director's compensation to represent managerial ownership and they found that the attractive compensation can mitigate the negative association between RPTs and firm performance. This evidence may indicate that executive director's compensation and RPTs may compensate each other. Kohlbeck and Mayhew, (2004) and Hope et al. (2019) also contribute evidence but not published in reputable publication. Kohlbeck and Mayhew (2004) suggested that a number and magnitude of RPTs will reduce when the cash compensation to the chief executive officer (CEO) increases, but the evidence is limited to CEO's compensation. Additionally, Hope et al. (2019) examined the impact of compensation for independent directors as a monitoring function, but we argue that the independent directors are not in the position to execute the RPTs. Thus, it is crucial to examine whether executive director's remuneration (types) increase director's satisfaction and lead to reduce in engagement in RPT-conflict.

Nevertheless, Kohlbeck and Mayhew (2004) also found that the director's remuneration association depends on the type of RPTs, where the directors' fees have an inverse association with straight-forward RPTs, while CEO compensation has an inverse association with more complex RPTs. The inverse associations substantially indicate the compensating element between director's remuneration and RPTs. It can be argued that the executive directors intentionally engages in RPTs to gain a substitute for or additional cash, particularly when they are paid with low cash remuneration (Kohlbeck and Mayhew, 2004). Thus, the companies, particularly the remuneration committee should identify the key elements that differentiate a level of the remuneration package (Ahmad et al. 2016), which may be sufficient in appreciating the executive directors. If executive directors perceive that their remuneration incentives are not attractive enough, they may utilize RPTs to maximize their personal satisfaction. Consequently, it would increase the risk of abusive RPTs. Therefore, this study proposes the following hypothesis:

H1: Type of executive director's remuneration has a negative association with the magnitude of RPT-conflict.

Aligned with the argument that the attractive composition of remunerations involving cash-based and in-kinds-based compensations may represent a better monitoring control over agency conflict; this study predicts that the cash or non-cash-based remuneration may be effective at minimizing the abuse of RPTs. The executive directors may favor cash-based compensation than in-kind-based compensation due to its liquidity and a greater proportion of cash is linked to wealth and social prestige (Bushman and Smith, 2001, Leone et al., 2006). Cash can immediately be used whereby they have the resources to purchase cars and houses, travel around the world, dine in at exclusive places, and also leads to respect and influence over the community (Carter and Zamora, 2009).

In contrast, high level of in-kinds-based compensation may create incentives for the executive directors to engage in RPTs. For example, stock option is a less-liquid form of compensation, and it must be exercised within a certain period. Thus, the less-liquid-based compensation is not sufficient for preventing executive directors or controlling shareholders from abusing RPTs as a source of obtaining compensation. This notion aligns with Kohlbeck and Mayhew (2004) that the cash and non-cash-based incentives can motivate or discourage executive directors' engagement in RPTs. If the firms provide relatively low cash compensation, the executive directors have incentives to enter RPTs in order to supplement their cash compensation. Kohlbeck and Mayhew (2004) also found a positive association between options granted to the CEO and RPTs, but when the amount of cash compensations increase, the probability of firms engaging in RPT-conflict decreases.

This study argues that at a certain level, non-cash-based compensations such as cars and property can increase executive directors' satisfaction and reduce their engagement in abusive RPTs. Nevertheless, there is no evidence to date indicating that an additional of in-kinds remuneration on top of director's salary, as a combination remuneration package, is effective in minimizing RPT-conflict. This study expects that there is an inverse association between a combination of the remuneration package for executive directors and RPT-conflict, where the RPT-conflict is reduced if the executive directors receive sufficient cash-based compensation. Thus, the hypothesis H2 is proposed as below:

H2: Combination package of executive director's remuneration (cash-based or in-kinds) has a negative association with the magnitude of RPT-conflict.

RESEARCH DESIGN

Sample Selection

This study examines a sample of firms listed on Bursa Malaysia for three years period, 2012-2014. The sample is selected for the following reasons. Peng and Jiang (2010) emphasized that Malaysia's business landscape is conducive in facilitating RPTs due to the lack of protection for minority shareholders. An ineffective implementation of corporate governance practices and enforcement of specific regulations create an opportunity for abusive activity, including RPTs. Additionally, most of these firms are established and are operated through the concentrated ownership, particularly by single controlling shareholders (La Porta et al., 2000). The controlling shareholder or founder often sits as a board chairman or chief executive officer (Sarkar et al., 2008), and appoints family members or proxies to dominate key top management position (Villalonga and Amit, 2006). Furthermore, the business environment and landscape in Malaysia are likely to encourage firms to engage in RPTs (Aswadi Abdul Wahab et al., 2011, Munir et al., 2013).

Additionally, the data set from 2014 to 2014 used in this study is remained relevance to provide new evidence upon the issue of interest. Since the corporate governance and the Malaysia Companies Acts 1965 were reformed in 2007, there are no substantial changes to those regulations and policies that directly affect RPTs, director's remuneration, corporate governance, and firm's ownership structure in Malaysia. The data set is more than five years after the RPTs regulation under the amendment of Malaysian Companies Act 1965, in which the period is ample enough for the Malaysian firms to comply with the new regulations, as well as minimizing the impact of the amendment of Companies Acts 2016 and the recent corporate governance reform in 2017. In addition, the recent amendment of corporate governance in 2017 only focused on strengthening the ethical value rather than the implementation structure. While the corporate governance reforms in other countries may be at various stages, the Malaysian business settings demonstrate that Malaysia is an appropriate location and time-frame to conduct this study.

Magnitudes of RPTs are collected manually from the firms' annual reports because these types of data are not available in most digital databases. An archival of non-financial data such as previous corporate governance structures, ownership structures and audit quality levels is also collected manually from the annual firm reports. Initially, we select all listed firms in the population except for financial institutions due to their specific regulations (Saad, 2010). However, we also omitted firms with incomplete data for the three-year period. The final sample consists of 539 companies with 1,615 firm-year observations.

Model Specifications and Measurements

This study uses unbalance panel data analysis to examine the hypotheses. The regression model is depicted as following:

$$RPT-conflic_{i,t} = \beta_0 + \beta_1EDRFee_{it} + \beta_2EDRSalary_{it} + \beta_3EDRInKinds_{it} + \beta_4BSize_{it} + \beta_5BInd_{it} + \beta_6ACInd_{it} + \beta_7CFirm_{it} + \beta_8AudQ_{it} + \beta_9ROA_{it} + \beta_{10}FSize_{it} + \beta_{11}Growth_{it} + \beta_{12}Lev_{it} + \beta_{13}(\Sigma^3_{i,j}Year_{i,t}) + \beta_{14}(\Sigma^4_{i,j}Ind_{i,t}) + \varepsilon_{i,t} \quad (1)$$

where *RPT-conflict* represents any transactions engaged by firms in which presents interest (direct or indirectly) of certain related parties. The RPTs may directly involve related parties (executive director or controlling shareholders) or indirect involvement through another business entity related to the related parties. The related parties involved in the *RPT-conflict* has a high opportunity to manipulate and expropriate such transactions to maximize personal benefits. The RPT-conflict is measured by scaling magnitude of RPT-conflict disclosed in the financial statement in the year-end by the firm's beginning total assets (Kohlbeck and Mayhew, 2010, Rahmat and Ali, 2016). *EDRFee* is the executive director's fee, measured by the magnitude of the fee scaled by the beginning total assets while *EDRSalary* is the executive director's salary, measured by the magnitude of the salary scaled by the beginning total assets. Apart from that, *EDRInKinds* is the executive director's in-kinds remuneration, measured by the magnitude of the in-kinds remuneration scaled by the beginning total assets.

The model also includes control variables to represent corporate governance patterns, audit quality levels, firm-specific characteristics, and performance that may affect a firm's engagement in RPTs. Differences in corporate governance practices are controlled by including board size (*BSize*), board independence (*BInd*), audit committee independence (*ACInd*), and audit quality (*AudQ*). On the other hand, firm return on assets (*ROA*), sizes (*FSize*), growth (*Growth*), leverage (*Lev*), and controlled firms (*CFirm*) are included to control firm characteristics and performance differences. *BSize* is measured as numbers of directors whom sits on the board while *BInd* is measured as the ratio of independent non-executive directors to total board members. *ACInd* is measured as the ratio of independent non-executive directors to total audit committee members and *CFirm* is measured as a dummy variable and coded as 1 if the firm is the controlled firm, and coded as 0 otherwise. The firm is categorized as the controlled firm when the largest shareholders held by the firm ownership is 23% or above. Apart from that, *AudQ* is an indicator variable equal to one if the firm is audited by a Big 4 audit firm, and zero otherwise.

ROA is measured as earnings after tax divided by the year-end total assets. *FSize* is measured using the natural logarithm for the book value of the beginning total assets. *Growth* is measured based on the market value of a firm divided by the beginning book value of total assets for the year and *Lev* is scaled by total debt of the year divided by total assets. *Industry* is the industry indicator variable based on the Bursa Malaysia industry classification while *Year* is a vector of year indicator variables (2012, 2013 and 2014). Finally, *e* is an error term. Additionally, an equation 2 below tests the different packages of executive director's remuneration between salary and fee or salary and in-kinds as a package in relation with RPT-conflict.

$$RPT-conflic_{i,t} = \beta_0 + \beta_1EDRSalary_{it} + \beta_2EDRSalary_{it} * EDRFee_{it} + \beta_3EDRSalary_{it} * EDRInKinds_{it} + \beta_4BSize_{it} + \beta_5BInd_{it} + \beta_6ACInd_{it} + \beta_7CFirm_{it} + \beta_8AudQ_{it} + \beta_9ROA_{it} + \beta_{10}FSize_{it} + \beta_{11}Growth_{it} + \beta_{12}Lev_{it} + \beta_{13}(\Sigma^3_{i,j}Year_{i,t}) + \beta_{14}(\Sigma^4_{i,j}Ind_{i,t}) + \varepsilon_{i,t} \quad (2)$$

where all variables are defined and measured as in Equation 1.

RESULTS

Descriptive analysis

Table 1 shows the descriptive statistics for the sample of 1,615 firm-years. The result shows that the mean value of RPTs is 0.111 indicating that the total of RPTs engaged by listed firms in Malaysia on average over the three years is about 11.1% of the firm's total assets. The minimum value is 0.000 indicating that some of the listed firms did not disclose any transactions with related parties (other than director's remuneration). Additionally, the statistic also shows that only about 1.40% out of the RPTs are disclosed as RPT-conflict. As shown in Table 1, the mean value of RPT-conflict is 0.014 with the largest amount disclosed is 1.671.

The statistic shows that listed firms pay remuneration to executive directors at an average of 0.5% (mean value 0.005) of the beginning firm's total asset. There are listed firms that pay executive director's remuneration of 168.9% out of the beginning firm's total assets (the maximum value 1.689). The major components of executive director's remuneration are salary and allowance, with an average of about 0.2% of the beginning total asset rather than fee and in-kinds remunerations. The maximum director fee and in-kinds remuneration are 5.0% and 0.4% out of the firm's total asset, respectively. Table 1 also shows that about 74.2% (1,198 of observations) from the samples are controlled firms. Other results for controlling variables can be referred in Table 1. Overall, the data do not possess critical normality problems (the Skewness and Kurtosis value are not tabulated).

Table 1 Descriptive Analysis

	Mean	Median	Maximum	Minimum	Std. Dev.
RPT	0.111	0.025	7.147	0.000	0.527
RPT-conflict	0.014	0.000	1.671	0.000	0.114
EDRem	0.005	0.000	1.689	0.000	0.006
EDRFee	0.000	0.000	0.050	0.000	0.002
EDRSalary	0.002	0.000	0.121	0.000	0.009
EDRInKinds	0.000	0.000	0.004	0.000	0.000
BSize	7.287	7.000	16.000	1.000	1.900
Bind	0.469	0.430	6.000	0.000	0.192
ACInd	0.894	1.000	1.000	0.333	0.151
CFirm	0.742	1.000	1.000	0.000	0.437
AudQ	0.481	0.000	3.000	0.000	0.505
ROA	3.660	1.480	57.040	-54.050	9.125
FSize	19.753	19.587	24.992	13.203	1.506
Growth	0.870	0.421	22.412	0.000	2.290
Lev	0.596	0.347	31.448	0.000	2.205

Note: *YEAR* and *INDUSTRY* are not reported for brevity. Variable measurements are exhibited in Equation 1.

Table 2 tabulates the results from Pearson's correlation test which shows that no independent variables are highly correlated with each other. The results indicate that there are no significant multicollinearity problem. The highest correlation is between Growth and Lev at 0.65 and correlations with other explanatory variables fall well below 0.65, suggesting that the variables are not being affected by multicollinearity issues (Montgomery et al., 2012, Cohen et al., 2013). Additionally, this study runs Variant Inflation Factor (VIF) analysis to ensure that there is no multicollinearity issue, including the correlation between Growth and Lev. However, the results of VIF are not tabulated.

Table 2 Pearson Correlation Analysis

Probability	EDRFee	EDRSalary	EDRInKind	BSize	Bind	ACInd	CFirm	AudQ	ROA	FSize	Growth
EDRFee											
EDRSalary	0.58***										
EDRInKind	0.48***	0.46***									
BSize	-0.01	-0.04*	-0.04								
Bind	0.06**	0.02	0.04*	-0.29***							
ACInd	0.01	-0.01	-0.02	0.01	0.15***						
CFirm	0.01	0.03	0.03	0.06**	-0.07***	0.03					
AudQ	0.02	0.03	0.07***	0.07***	-0.03	-0.08***	0.07***				
ROA	0.22***	0.15***	0.06**	0.14***	-0.06**	-0.08***	0.04*	0.11***			
FSize	-0.22***	-0.32***	-0.19***	0.21***	-0.06**	-0.03	0.07***	0.30***	0.06**		
Growth	0.01	0.13***	0.07***	0.08***	-0.04	-0.03	0.08***	0.10***	0.22***	0.01	
Lev	0.001	0.10***	0.14***	0.04	0.01	0.02	0.06**	0.05*	-0.04	-0.03	0.65***

Note: *YEAR* and *INDUSTRY* are not reported for brevity. Variable definitions and measurements are exhibited in Equation

Multivariate Regression

This study runs Hausmann test to determine whether fixed effect or random effect analysis is more fits better with the models used in the study. The results are not tabulated, but the results are insignificant to reject the null hypothesis. This indicates that the fixed effect analysis does not fit into the research models. Thus, we run the models by using cross-sectional random effect panel data analysis with weighted (estimated general least square) to test all the hypotheses. The results are shown in Table 3, Model 1 and Model 2.

Model 1 shows the result for the association between types of executive director's remuneration and RPT-conflict. The adjusted R² is 24.34% and the F-test values are 25.72, significant at $p < 0.01$. These values indicate that the model is fit to explain changes in the tested relationships. The coefficient of *EDRFee* is positive but insignificantly associated with RPT-conflict. The finding does not provide evidence to show that the fee paid to reduce executive director's engagement in RPT-conflict. In addition, the *EDRSalary* has a negative relationship to RPT-conflict, the coefficient is -1.002 (t-stat. = -2.86), significant at a level of $p < 0.001$. This evidence indicates that the salary paid to executive directors is effective at reducing their engagement in RPT-conflicts. The *EDRInKinds* is also found effective to avoid executive directors from engaging in RPT-conflict. The coefficient is negative, -4.498 (t-stat. = -2.15), significantly associated with RPT-conflict at a level of $p < 0.01$. This evidence suggests that in-kinds based compensation is substantial at motivating executive directors to perform their roles ethically, and reduce opportunistic engagements with other related parties.

Table 3 Executive Director Remuneration (Types & Combinations) and RPT-conflict

Method: Panel EGLS (Cross-section random effects) Variable	RPT-conflict			
	Model 1		Model 2	
	Coefficient	t-Stat.	Coefficient	t-Stat.
Constant	0.095	1.93*	0.13	1.83*
EDRFee	19.873	1.36		
EDRSalary	-1.002	-2.86***	-0.27	-4.77***
EDRInKinds	-4.498	-2.15**		
EDRSalary*EDRFee			-8.45	-2.30***
EDRSalary*EDRInKind			-3.93	-1.70*
BSize	-0.001	-2.48**	-0.001	-5.32***
Bind	0.001	0.46	0.001	0.30
ACInd	0.003	0.49	0.003	0.50
CFirm	0.015	4.61***	0.015	2.50**
AudQ	0.005	1.63	0.004	1.24
ROA	0.001	2.39**	0.001	2.54**
FSize	-0.015	-2.89***	-0.007	-1.98**
Growth	0.001	0.69	-0.001	-0.02
Lev	0.006	3.74***	0.005	5.81***
Year		Included		Included
Industry		Included		Included
		n = 1,615		n = 1,615
Adjusted R ²		24.34%		19.04%
F-statistic		25.72***		19.07***

Note: ***significance level $p < 0.01$, **significance level $p < 0.05$, *significance level $p < 0.10$. We report t-statistics based on White's (1980) consistent estimator. *Year* and *Industry* are not reported for brevity. Variable definitions and measurements are exhibited in Equation 1.

On the other hand, Model 2 shows the results for the association between two director remuneration's packages, either salary and fee or salary and in-kinds remuneration with RPT-conflict. The adjusted R² is 19.04% and the F-test value is 19.07, significant at $p < 0.01$. The results show that a package of salary and fee remunerations (*EDRSalary*EDRFee*) is negatively associated with RPT-conflict, the coefficient is -8.45 (t-stat. = -2.30). This result suggests that the combination between salary and fee remunerations paid is effective at minimizing executive directors' engagement in RPT-conflict. The package of salary and in-kinds remuneration is also found significant with the coefficient -3.93 (t-stat. = -1.70) to prevent the executive directors from engaging in RPT-conflict.

These findings support the hypothesis in which the inclusion of fee or in-kinds remuneration on top of director's salary enhances the effectiveness of remuneration packages in influencing the executive director to play their role in alignment with the firm's objective. The inclusion of fees or in-kinds based as an additional rewards on top of their basic salaries also increases the executive directors' satisfaction. The findings substantially emphasize that in-kinds based and attractive components are crucial parts of the director's remuneration package that is effective at reducing executive directors' opportunistic behavior of engaging in

RPTs. The results are consistent with the agency theory that suggests an attractive remuneration, either cash or non-cash based, is an effective monitoring cost to minimize the opportunistic behavior among top management

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and executive directors. Apart from EDRFee, hypothesis is supported that type and package of remuneration paid to the executive director can minimize the opportunistic decisions.

CONCLUSIONS

The utilization of RPT as a manipulation tool, which helps in exposing the opportunistic behavior among top management and executive directors as revealed in many well-known accounting scandals (Dahya et al., 2008, Rahmat and Ali, 2016), motivated this study to investigate and determine the appropriate resolution. This study examines the director's remuneration reward system as a mitigating factor to the executive directors' involvement in abusive RPTs (Abdul Wahab and Abdul Rahman, 2009). It provides a broader picture of the association between different types and packages of executive director's remuneration and executive director's engagement with RPT-conflict. It is based on the argument that director's reward system can be an effective mechanism used to reduce the conflict of interest by aligning the interests of all parties. Aligning interests between executive directors and shareholders is crucial to ensure shareholder's wealth is being managed properly. Thus, executive director's remuneration should be attractive to influence the executive directors that they are rewarded sufficiently. It is expected effective to minimize the abusive RPTs (Aswadi Abdul Wahab et al., 2011) but a limited evidence has been found on the examination of this relationship. On the other hand, it is important to understand that remunerations paid to executive directors are also parts of RPTs. Thus, the association between director's remuneration and RPTs could be either complementary or substitution, making this study interesting.

The evidence shows that, except for director's fee, other types of executive director's remuneration (salary and in-kinds) are effective tool at reducing firms to engage in RPT-conflicts. Both cash and non-cash based remunerations are crucial for executive directors to help them minimize the RPT-conflict. To depend solely on executive director's fee is not attractive enough as the executive directors favor a combination of remuneration packages, which either involves salary and fee or salary and in-kinds. This study contributes to the greater understanding of the effectiveness of type and package of executive director's compensation under the agency theory to minimize the managing director's engagement with related parties (Aswadi Abdul Wahab et al., 2011). Additionally, the evidence provides understanding by indicating that executive director remuneration and RPTs compensate each other, which is consistent with the contracting theory (Kohlbeck and Mayhew, 2004). An increase in cash-based (salaries) or in-kinds-based remuneration encourages executive directors to not engage with RPT-conflict. A remuneration package is more effective at minimizing RPT-conflict than individual payment of director's fee or salary. This is in alignment with Fama and Jensen, (1983) and Aswadi Abdul Wahab et al. (2011).

T study also has some limitations that should be taken into consideration in assessing and interpreting the results. First, there are two different views on RPTs, either representing "conflict of interest" or "efficient transaction". However, our study focuses on the RPTs that have a potential to be abused due to the presence of conflict of interest among related parties involved. The abusive assumption is only based on risk as related-party firms often do not disclose the market rate of the RPTs, making it difficult to identify whether the RPT represents a conflict or efficient contract. The findings from our study provide some implications for practice and future research. The regulators, shareholder activism and particularly remuneration committee must concern and seriously consider the potential consequences of attractive director's remuneration and RPTs, and thus, to take the right steps in minimizing the expropriation risk. Remuneration committee must understand on the type and package of incentives that could lead directors to perform their work in alignment with the firm's goals.

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