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Original Article

Remuneration Committee Characteristics and Excess CEO Pay: Evidence from Malaysia

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Abstract: This study examines the monitoring effectiveness of the remuneration committee within corporate boards. Utilizing a dataset of Malaysian listed firms from 2017 to 2021, the findings reveal that an index combining demographic and expertise characteristics (gender, age, ethnicity, educational background, financial expertise, and multiple directorships) better captures remuneration committee diversity than any individual facet. This diversity is associated with a reduction in the Type I agency problem. In contrast, the findings indicate that most independent remuneration committees are ineffective in reducing excess chief executive officer (CEO) pay, potentially exacerbating Type I agency issues. This study offers valuable practical implications for regulators, particularly the Securities Commission Malaysia, as it continues to advance corporate governance reforms. The study also motivates listed companies to adopt best practices in board composition and oversight.

Keywords: Remuneration Committee Diversity; Independence; Agency Problems; Excess CEO pay

1. Introduction

The rapid growth in chief executive officer (CEO) pay since the 1980s (Frydman & Jenter, 2010) and a rapidly widening wage gap (Develay et al., 2024) have garnered significant attention and prompted various corporate governance regulations, beginning with the UK Cadbury Report (1992), which has evolved into today's UK Corporate Governance Code. The lessons learned from these legislative inquiries and reports have had a ripple effect on emerging markets where practices are less regulated and transparent. One such example is Malaysia, where the (Malaysian Code on Corporate Governance, 2017) now incorporates internationally recognized best practices established by global corporate governance codes, such as the UK Corporate Governance Code (2018).

Excess pay occurs when the CEO is being paid amounts that exceed reasonable amounts based on their industry standards, expertise and performance. While remuneration committees oversee CEO pay, their effectiveness may be compromised. Shareholders who elect these committee members may influence compensation decisions to their advantage, potentially by increasing the compensation of committee members themselves. Diverse committees incorporate members with varying backgrounds (gender, age, ethnicity, education, financial expertise, and multiple directorships). Prior literature suggests that gender diversity moderates group decisions (Ahmed et al., 2021; Li et al., 2023). Nevertheless, whether gender

constitutes the primary aspect of remuneration committee diversity remains uncertain, and there exists a significant gap in investigating other dimensions of diversity.

Independent committees are expected to provide objective oversight of CEO pay packages (MCCG, 2017, 2021). Despite expectations of independence, committee members may align with shareholders' preferences to secure reappointment. Remuneration committees comprised of members loyal to shareholders face minimal internal conflict when determining CEO compensation. Committee members who challenge shareholder preferences risk losing their positions, creating a self-reinforcing cycle that eliminates dissent and ultimately undermines the committee's oversight effectiveness in the compensation process. Research on how remuneration committee independence affects excess CEO pay remains limited. Thus, investigating whether a remuneration committee's diversity, combined with committee independence, helps constrain excessive CEO pay represents an intriguing research opportunity.

2. Literature Review and Hypothesis Development

2.1. Remuneration committee diversity

Remuneration committee diversity refers to the variation in the backgrounds and characteristics of its members. There are many different forms of diversity such as gender, age, education, ethnicity etc. Female directors offer unique perspectives and values to board discussions (Chang et al., 2024). The presence of female members on remuneration committees serves as effective monitors of CEO pay (Ahmed, Atif, & Gyapong, 2021). Age is an often overlooked yet crucial factor in corporate governance research on boards and committees. A remuneration committee with financial expertise may lead to a lower pay for the chief financial officer due to more effective monitoring (Mani et al., 2024). Greater heterogeneity along several dimensions may not necessarily improve board efficacy but gender and ethnic diversity may have a stronger effect (Zaman et al., 2024). Overall, the effect of diversity could be due to differences in the backgrounds of the research conducted, the different time periods and cultural attitudes. Therefore, the following hypothesis is formulated:

Hypothesis 1: Remuneration committee diversity is negatively related to excess CEO pay.

2.2. Remuneration committee independent

Agency theory literature highlights that board oversight improves with independent directors (Fama & Jensen, 1983). Although the independence of directors on boards and committees has been thought of as being important for the successful monitoring of the top management (MCCG, 2017; UK Corporate Governance Code, 2018), past studies have raised questions about the effectiveness of independent directors (Arora, 2024). Pascual-Fuster & Crespí-Cladera (2022) suggests that too much independence in the board may result in poorer monitoring. Ntim et al. (2019) argues that from the point of view of agency theory, remuneration committee independence should not affect excess CEO pay, as an optimal set of incentives will provide the necessary motivation for CEOs to perform. No significant evidence was found that links the remuneration committee's independence with pay. Others have shown that a remuneration committee independence was associated with increased CEO pay (Hsu, 2023). Therefore, this study hypothesizes that:

Hypothesis 2: An independent remuneration committee is negatively excess CEO pay.

3. Materials and Methods

3.1. Data sources

The research examined all firms from Malaysia’s main stock exchanges from 2017 to 2021. The year 2017 was selected as the starting point because it was only in the most recent (Malaysian Code on Corporate Governance, 2017) that a detailed breakdown of CEO compensation. Firms in the banking and financial sectors were excluded to maintain consistency due to their distinctive regulatory framework. Additionally, delisted companies and those with incomplete annual reports were also excluded from the analysis. Information was gathered by hand from yearly reports and S&P Capital IQ database and get the final dataset of 3,290 firm-year observations.

3.2. Measurement of variables

3.2.1. Excess CEO Pay

In measuring CEO pay level, total CEO pay combined monetary and non-monetary elements such as salary, bonus, benefit, defined contribution plans, and other allowances for the year. To calculate the excess

CEO pay (Ahmed et al., 2021), this study first determine the expected CEO pay by performing regression analysis on the natural logarithm of CEO pay against economic determinants, specifically examining various firm and CEO characteristics.

$$Log\left(\text{CEO Pay}_{it}\right) = a_{it} + \beta.\text{Firm Characteristics}_{it} + \varepsilon_{it} \quad (1)$$

The economic determinants include various firm characteristics including market value, growth opportunities, current and previous year stock returns, performance metrics for both current and previous years, and industry controls. Specifically: (1) Firm market value is calculated as the logarithm of the combined total market equity value and total book debt value for year t-1; (2) Growth opportunities are measured by the market-to-book ratio (book value of liabilities plus market value of equity divided by book value of assets) for year t-1; (3) Firm performance is quantified using both the current year and previous year stock returns; (4) ROA is calculated by dividing income before extraordinary items by total assets for both current and previous years. The study employed pooled ordinary least squares methodology to estimate equation (1) and calculated expected CEO pay by exponentiating the estimated natural logarithm value of total pay from this equation. Excess pay is calculated as the residual $^{\varepsilon}{}_{it}$ from equation (2), representing the difference between actual total pay and expected pay.

$$\text{Excess CEO pay} = \text{Total CEO pay} - \text{Expected CEO pay} \quad (2)$$

3.2.2. Remuneration Committee Diversity

Following Bernile et al. (2018), this study constructed a comprehensive diversity index integrating six characteristics: gender, age, ethnicity, university background, financial expertise, and multiple directorships. These were categorized into demographic characteristics (gender, age, ethnicity) and cognitive characteristics (university background, financial expertise, multiple directorships). For each board-year observation, the study calculated several metrics: the proportion of female remuneration committee members (Gender), the standard deviation of remuneration committee members' ages (Age), the mean number of other board memberships held by current members in public listed companies (Multiple directorships), and Herfindahl index computed by squaring the proportion of board directors in each category and summing them. To address potential bias from unequal means and variances, each metric was normalized using the formula $z = (x-\mu)/\sigma$, where x represents the component value, μ denotes the mean, σ represents the standard deviation, and z is the normalized index. The Diversity index was calculated by summing the normalized components for gender, age, and ethnicity, then subtracting the sum of the components for multiple directorships, university, and financial expertise. Then this study subtracted the Herfindahl indices because higher values of these indices indicate less diversity. The diversity index is calculated as shown below.

$$\begin{aligned} &Remuneration\ committee\ DIVERSITY \\ &= \text{STDZ}(\text{PCT}_{\text{FEMALE}}) + \text{STDZ}\ (\text{STDEV}_{\text{AGE}}) + \text{STDZ}\ (\text{NUM}_{\text{BOARDS}}) \\ &- \ \text{STDZ}\ (\text{HHI}_{\text{ETHNICITY}}) - \text{STDZ}\ (\text{HHI}_{\text{UNIVERSITY}}) - \ \text{STDZ}\ (\text{HHI}_{\text{FINEXPERT}}) \end{aligned} \quad (3)$$

3.2.3. Remuneration committee independence

An independent director, as defined by Bursa Malaysia's main market listing requirements, maintains independence from management and lacks any relationship, business or otherwise, that might compromise their capacity to provide independent judgement or act in the company's best interests (Bursa Malaysia, 2019). The variable remuneration committee independence is operationalized as the proportion of independent members relative to the total committee size.

3.3. Control variables

This study controlled for various characteristics, including firm characteristics, board characteristics, and CEO characteristics (Edmans & Liu, 2011; Matolcsy et al., 2012; Murphy, 1985; Nanda et al., 2022; Sundaram & Yermack, 2007; Tosi et al., 2000). Leverage is calculated as the ratio of total debt to total assets. *Firm age* is measured as the natural logarithm of the number of years since the firm's incorporation (Nanda et al., 2022). Firm size is measured as the natural logarithm of total assets, serving as a proxy for the complexity of the CEO's role and their responsibilities (Murphy, 1985; Tosi et al., 2000). Following Matolcsy et al. (2012), this study uses price book value as a proxy for firm growth, calculated as the book value of liabilities plus market value of equity divided by the book value of assets for the year. Beyond firm characteristics, this study controls board characteristics, such as board size. Board size is measured as the

natural logarithm of the total number of directors on a board. This study also includes CEO Tenure and CEO Duality. CEO Tenure is the number of years a CEO has held this position in the current firm. CEO-duality is a dummy variable indicating 1 when the CEO is also the chairperson of the board, and 0 otherwise (Core et al., 1999). Appendix A shows the more detailed definitions of these variables.

3.4. Baseline Regression Model

Following Blundell & Bond (1998), this study measures the dynamic relationships using robust standard errors through the following panel equation model:

$$\begin{aligned} Excess\ CEO\ Pay_{it} &= \alpha + \beta_1 Diversity\ index_{it} + \beta_2 Independent_{it} \\ &+ \beta_3 Boardsize_{it}\ \beta_4 Price\ book\ value_{it} + \beta_5 Leverage_{i,t} + \beta_6 Firm\ age_{it} \\ &+ \beta_7 Firm\ size_{it} + \beta_8 CEO\ tenure_{it} + \beta_9 CEO\ duality_{it} + \alpha_i + \varepsilon_{it} \end{aligned} \quad (4)$$

Where, Excess CEO Pay is the residual, which is the difference between total pay and expected pay, and the Diversity index is the combination of six characteristics of gender, age, ethnicity, university backgrounds, financial expertise, and multiple directorships. Independence refers to the proportion of independent directors serving on the committee.

4. Results

4.1. Descriptive Statistics and Correlation Analysis

Table 1 presents the descriptive statistics of the key variables. The results reveal that the average excess CEO pay in the sample is 0.142, with a median value of 0.017. The diversity index has a mean value of 7.517, with substantial variation ranging from -1.793 to 26.455. This shows that firms have diverse approaches to committee diversity. When it comes to the independence of the remuneration committee, the average proportion of all remuneration committees being independent is 0.845, showing that 84.5% of remuneration committees are independent. The sample has a mean board size is 0.843, with an average of 0.845 board members, ranging from a minimum of 0.477 to a maximum of 1.146. Leverage has a mean of 1.115 and a median of 0.965. The price book value with an average of 0.776. Firm age has a mean value of 1.501 and a median of 1.518, while firm size averages 8.682, with a median of 8.636. The CEO tenure has a mean value of 0.882, which is very close to the median value of 0.903, and a standard deviation of 0.409. The mean value of CEO duality is 0.076, with its standard deviation of 0.266.

Table 1. Result of Descriptive Statistics

Variables	(1) Mean	(2) Median	(3) Std. Dev.	(4) Min	(5) Max
Excess CEO pay	0.142	0.017	0.498	-2.633	2.705
Diversity index	7.517	7.403	4.558	-1.793	26.455
Independent	0.845	1.000	0.192	0.000	1.000
Board size	0.843	0.845	0.105	0.477	1.146
Price book value	0.776	0.452	0.921	0.001	7.138
Leverage	1.115	0.965	0.671	0.000	5.218
Firm age	1.501	1.518	0.241	0.301	2.287
Firm size	8.682	8.636	0.718	4.079	11.262
CEO tenure	0.882	0.903	0.409	0.000	1.613
CEO duality	0.076	0.000	0.266	0.000	1.000

Pearson correlation coefficients analysis presented in Table 2 indicating no strong correlations among the key variables examined in this study. Furthermore, all variance inflation factors (VIFs) values are well below the conventional threshold of ten, with an average VIF of 1.11, suggesting that multicollinearity does not pose a concern for this analytical analysis.

Table 2. Result of Pearson Correlation Matrix

	(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**	**(8)**	**(9)**	**(10)**	**(11)**
(1) Excess CEO pay	1.000										
(2) Diversity index	-0.040**	1.000									
(3) Independent	0.017	-0.008	0.083***	1.000							
(4) Board Size	0.197***	-0.011	0.012	-0.053***	1.000						
(5) Price book value	-0.002	0.035**	-0.035**	0.008	-0.001	1.000					
(6) Leverage	-0.091***	0.025	0.047***	0.053***	-0.135***	0.156***	1.000				
(7) Firm age	0.065***	-0.002	0.029*	-0.057***	0.061***	-0.127***	-0.038**	1.000			
(8) Firm size	0.349***	-0.036**	0.027	-0.108***	0.389***	-0.183***	-0.296***	0.220***	1.000		
(9) CEO tenure	0.148***	0.001	0.225***	0.000	0.028*	-0.065***	0.090***	0.139***	0.033*	1.000	
(10) CEO duality	0.026	-0.026	0.095***	0.016	-0.046***	0.068***	0.039**	0.038**	-0.051***	0.093***	1.000

Note: The asterisks *** p<0.01, ** p<0.05, * p<0.1 represent statistical significance at the 10, 5, and 1 percent level, respectively.

4.2. Baseline Results

Table 3 presents the results using fixed effect baseline regression. As shown in Table 3, this study controls for industry fixed effects and year fixed effects in the regression model. The relationship between remuneration committee diversity and excess CEO pay is negative and significant, consistently in column 1 ($\beta = -0.0033$; $p < 0.10$) and column 3 ($\beta = -0.0032$; $p < 0.10$) for the full sample. Hence, hypotheses 1 (H1) is supported. The results in Table 3 indicate that remuneration committee independence has a statistically significant positive effect on excess CEO pay in column 2 ($\beta = 0.1435$; $p < 0.01$) and column 3 ($\beta = 0.1428$; $p < 0.01$) for the full sample which is contrary to the expected sign. Therefore, hypotheses 2 (H2) is not supported.

Across all estimations, the findings reveal that board size, price book value, firm size, and CEO tenure are positively and significantly associated with excess CEO pay at the 1% level, as expected. Larger boards are linked to higher excess pay, likely due to coordination challenges and weaker oversight. CEO tenure shows a significant positive effect, suggesting that more experienced CEOs tend to receive higher excess pay. CEO duality is positively significant at the 10% level in columns (1)–(3), supporting the hypothesis. In contrast, leverage and firm age exhibit no significant relationship with excess CEO pay, indicating their limited influence in this context.

Table 3. Remuneration Committee Diversity, Remuneration Committee Independence and Excess CEO pay

	(1) Excess CEO pay	**(2) Excess CEO pay**	**(3) Full model Excess CEO pay**
Diversity index	-0.0033*		-0.0032*
	(-1.74)		(-1.70)
Independent		0.1435***	0.1428***
		(3.48)	(3.46)
Board size	0.3385***	0.3295***	0.3293***
	(3.65)	(3.70)	(3.70)
Pbvalue	0.0276***	0.0279***	0.0286***
	(2.96)	(2.95)	(3.03)
Leverage	-0.0098	-0.0110	-0.0108
	(-0.78)	(-0.87)	(-0.85)
Firm age	-0.0352	-0.0300	-0.0299
	(-0.94)	(-0.81)	(-0.80)
Firm size	0.2630***	0.2668***	0.2662***
	(15.65)	(15.87)	(15.82)
CEO tenure	0.1661***	0.1662***	0.1665***
	(8.47)	(8.50)	(8.52)
CEO duality	0.0560*	0.0559*	0.0545*
	(1.79)	(1.79)	(1.74)
Constant	-2.6367***	-2.8251***	-2.7950***
	(-18.97)	(-19.11)	(-18.71)
Observations	3,290	3,290	3,290
Adjusted R-squared	0.1627	0.1648	0.1654
Industry fixed effects	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes

Note: Hypotheses 1 and 2

5. Discussion

The study's findings align with international studies that support the monitoring effectiveness of diverse remuneration committees. Research on Australian firms from 2006 to 2014 found that remuneration committee diversity leads to better alignment between actual and expected CEO pay (Ahmed et al., 2021). This supports the view that diverse remuneration committees are better equipped to design effective pay structures that align CEO interests with corporate goals through effective corporate governance. By incorporating varied perspectives, experiences, and expertise, committee diversity improves the evaluation of CEO compensation, ensuring alignment with shareholder interests and strategic objectives. Consistent

with agency theory, stronger and more diverse committees help reduce agency conflicts by broadening available information, enhancing board oversight, and decreasing information asymmetry, thus limiting the potential for managerial opportunism. However, previous studies reveal substantial contradictory evidence that challenges the universality of these findings. More recently, Sarhan et al., (2019) research on Middles East and North African countries found that diversity influences the alignment of pay to performance but not total pay, directly opposing the study's conclusions This means that when CEOs are rewarded for improving the firm's performance and increasing shareholder value, it can be beneficial for both parties, and not merely influenced by moral values.

According to the Type I agency theory, remuneration committees' independence is intended to mitigate these conflicts by ensuring that CEO pay aligns with shareholder interests. However, in practice, the independence of remuneration committees might be compromised. Independent directors may not always be truly impartial; as they might have personal or professional ties to the CEO or other board members, which can influence their decisions (Sánchez-Marín et al., 2022). The findings suggest that mandating majority independence on remuneration committees fails to adequately constrain self-serving behavior by CEOs. Instead, it seems to have unintentional consequences, leading to higher excess pay. This contradicts the findings of previous studies (Jong & Ho, 2019), suggest that remuneration committees' independence do not exert statistically significant influence on CEO pay, which act as a corporate governance device to limit managerial behaviour. Therefore, given the cultural factors, particularly power distance dynamics, play a crucial role in explaining this phenomenon in Malaysia. In this high power-distance culture (Nahar & Mohamad, 2023), independent directors frequently constitute the dominant authority center, with their perspectives commanding greater deference from the board (Mohd Ghazali, 2020).

6. Conclusions

This study provides empirical evidence that diversity within remuneration committees significantly reduces excess CEO pay. Diverse committees enhance governance by encouraging balanced decision-making and reducing groupthink. Notably, diversity appears more effective than independence in curbing excess CEO pay, aligning compensation more closely with shareholder interests. Diversity in remuneration committees significantly mitigates Type 1 agency problems, as these problems arise when managers do not necessarily act in shareholders' best interests. Interestingly, independent remuneration committees are positively associated with excess CEO pay, suggesting they may be more likely to approve higher compensation, even when it's already excessive. The finding provides contextual insights that could contradict the traditional agency theory that remuneration committee independence serves as an effective monitor.

One of the reasons is that Malaysian corporate governance has a relationship-based business environment where social ties may go beyond formal independence (Mohamed Sultan et al., 2024). Furthermore, the study provides practical insights that could inform policy and corporate governance by presenting board members' direct perspectives on diversity attributes that potentially enhance board effectiveness. Without dismissing the importance of gender diversity, this study recommended a broader conception of diversity, emphasizing that board structure should align with monitoring effectiveness. The findings may inspire companies to explore diversity attributes beyond gender, recognizing that board structure should reflect the increasingly multicultural and diverse societal landscape. This approach encourages a more comprehensive understanding of how diverse perspectives can improve organizational leadership. Additionally, this study challenges the effectiveness of the commonly recommended practice of requiring a majority of independent committees, as such committees may still enable excessive CEO pay. This suggests that diversity, rather than independence alone, is critical for strengthening internal governance.

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Appendix A – Summary of the Definition of Operational Variables

Variable(s)	Definition
Dependent variable	
Excess CEO pay	Salary, bonus, benefits in kind, and a defined contribution plan during the year. Excess pay is the residual ε_{it} from the equation (1) which is the difference between the total pay and expected pay.
Independent variable(s)	
Diversity index	These characteristics include female, age, ethnicity, university (academic degree), financial expertise, and directorships. The diversity index is then the sum of the normalized components of female, age, and ethnicity minus the sum of the components' directorships, university, and financial expertise.
Gender	Proportion of female remuneration committee members.
Age	Standard deviation of the remuneration committee members' age.
Ethnicity	Herfindahl concentration indexes of ethnicity.
University backgrounds	Herfindahl concentration indexes for institutions where the remuneration committee members received their bachelor's degree.
Financial expertise	Herfindahl concentration index for remuneration committee members' financial expertise using a binary variable. Members with financial expertise are those who have held a position of significant financial responsibility such as those who served as a) executives on financial institutions including banks and hedge or trust funds, savings and loans, insurance company, or investment bank, b) CFO, controller, treasurer, accountants etc., or c) an academic in a finance or accounting related field.
Multiple Directorships	Average number of other boards that current members serve.
Independent	Proportion of the independent committee to the total number of remuneration committees.
Control variable(s)	
Board size	The natural logarithm of the total number of directors on the board.
Price book value	The book value of liabilities and market value of equity to the book value of assets for the year
Leverage	A ratio of total debt to total assets.
Firm age	The natural logarithm of the number of years from the establishment of the firm to the year of observation.
Firm size	The natural logarithm of the total assets.
CEO tenure	The natural logarithm of the CEO's tenure in years at the end of year t.
CEO duality	Dummy variable being equal to 1 of a firm's CEO also serves as the chairperson of the board of directors, and 0 otherwise.

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