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REMUNERATION COMMITTEE DIVERSITY AND EXCESS CEO PAY: THE MODERATING EFFECT OF FAMILY OWNERSHIP

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ABSTRACT

This study examined how remuneration committee diversity influences their perspectives, which, in turn, influences excess CEO pay using an unbalanced panel of 3,290 public listed firms in Malaysia (2017-2021). The study also explored whether family ownership played a moderating role in this relationship between committee diversity and excess CEO pay. Using an index based on demographic characteristics (gender, age, ethnicity) and cognitive characteristics (education backgrounds, financial expertise, multiple directorship), the study found that aggregate measures better capture diversity than individual attributes. Findings indicated diverse committees exercise greater restraint regarding excess CEO pay, while family ownership reinforces oversight roles, addressing literature gaps across developed and emerging economies. Furthermore, the association between remuneration committee diversity and excess CEO pay was strengthened by family ownership, mitigating type 2 agency conflicts. The study contributes significant influence of a country's institutional setting on the monitoring effectiveness of remuneration committee diversity which contributes to the ongoing discussion on excessive CEO pay.

INTRODUCTION

The controversy surrounding excessively paid CEOs has attracted significant criticism, particularly following major accounting scandals involving companies like Enron and Global Crossing (Heron & Lie, 2007). Boards determine CEO pay levels through remuneration committees recommendations (Daily, Johnson, Ellstrand, & Dalton, 1998), ideally structuring pay to align management incentives with shareholder interests (Jensen & Meckling, 1976).

The Securities Commission Malaysia (2019) reported that half of Malaysia's 20 highest paid CEOs led family-controlled firms, regardless of performance. Since 2008, six countries which are Norway, Spain, France, Belgium, Italy, and Germany have implemented mandatory quotas to improve board gender diversity (Saona, Muro, San Martín, & Baier-Fuentes, 2019). The Malaysian Code on Corporate Governance (2017) recommends that at least 30% female board representation, yet most boards fall short, averaging just 17% (Securities Commission Malaysia, 2021). Following public criticism, Genting Bhd's chairman and CEO voluntarily reduced his salary by 20% (The Star, 2019).

PROBLEM STATEMENT

Recent literature emphasizes board diversity, particularly gender diversity, as a governance tool for fostering equality and broadening director talent pools (Baker, Kent, Pandey, Kumar, and Haldar, 2020). However, its significance in remuneration committee diversity remains uncertain due to limited research on other diversity aspects. Most studies focus on narrow outcomes, primarily firm performance and risk (Bernile, Bhagwat, & Yonker, 2018; Fernández-Temprano & Tejerina-Gaite, 2020). While diversity is associated with balanced decision-making and enhanced monitoring (Bernile et al., 2018), its broader board impact remains unclear.

Previous research suggests board diversity helps curb excess CEO pay, but its interaction with moderating factors remains uncertain. Family ownership crucially shapes firm outcomes, with family firms dominating global corporate ownership (Claessens, Djankov, & Lang, 2000). Family-controlled firms represent 35% of US publicly listed companies (Anderson & Reeb, 2003).

RESEARCH OBJECTIVE

The overall objective of the study aims to examine how remuneration committee diversity and family ownership influence excess CEO pay in Malaysian firms. The specific objectives of the study were as follow:

a. To determine whether remuneration committee diversity is negatively related to excess CEO pay.
b. To identify whether family ownership weakens the negative relationship between remuneration committee diversity and excess CEO pay.

LITERATURE REVIEW

Remuneration committee diversity

Remuneration committee diversity refers to the varied characteristics and backgrounds among individuals who serve on the committee. Committee member diversity encompasses multiple dimensions ranging from gender to ethnicity, as well as from education to functional background, etc. A diverse remuneration committee enhances monitoring by incorporating a range of perspectives. Malhotra, Shen, and Zhu (2021) argue female directors enhance board functioning and CEO pay accountability. Boards with gender diversity demonstrate greater prudence regarding both insufficient and excessive CEO compensation, potentially helping to align actual executive pay more closely with appropriate market expectations (Ahmed, Atif, & Gyapong, 2021). Beyond gender, age, education, and ethnicity also influence board effectiveness (Tee, 2021). Diverse boards also adopt less risky financial policies (Bernile et al., 2018). Despite receiving less attention than other diversity factors, age significantly impacts the performance and efficacy of both boards and their committees (Li et al., 2023). Therefore, this study hypothesizes that:

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

The interaction effect of the family ownership

Family controlled firms are prevalent globally, especially in Malaysia and several Asian nations, where the majority of firms are family controlled. When ownership is concentrated among family controlling shareholders, agency costs may rise. These shareholders may leverage their control rights to pursue private benefits, which can diminish overall firm value. Much research has also been conducted on CEO pay in relation to family management. Some have found that family control is associated to higher excess pay (D'Este & Carabelli, 2022). One study found that when multiple family members are involved, CEO pay is higher (Cheng et al., 2015). Moreover, this issue is intensified in Malaysia, where disclosure levels and legal safeguards for minority shareholders are reported to be among the weakest (Tee & Kasipillai, 2022). The relationship between compensation and performance tends to be weaker in family-controlled firms. Conversely, CEO compensation tends to be lower in family firms with pyramidal ownership structures and high control-ownership deviation (Wang et al., 2020).

Limited research explores how family ownership affects excess CEO pay via remuneration committees. Board compensation tends to decrease as ownership concentration increases (Liew et al., 2022; Zulfiqar & Hussain, 2020). In Malaysia, family ownership positively influences CEO pay, particularly when family CEOs interact with family-controlled remuneration committees (Jong & Ho, 2019).Therefore, this study hypothesizes that:

Hypothesis 2: Family ownership weakens the negative relationship between remuneration committee diversity and excess CEO pay.

METHODOLOGY

Data and sample

This study's sample comprises all publicly listed firms on the Bursa Malaysia Stock Exchange over a five-year period from 2017 to 2021. The data was obtained from annual reports and the S&P Capital IQ database. This study chosed to start from 2017 because only reports from that year onwards provided a comprehensive view of CEO pay based on named individuals. To ensure consistency, this study excluded companies in the banking and financial sectors. The final sample consists of 3,290 firm-year observations. The datasets were analysed using Stata 18 software to conduct a comprehensive assessment of the hypotheses.

Measurement of variables

Excess CEO pay.

The term total CEO pay defines combined cash and non-cash components such as base salary, annual bonus, benefit in kind, defined contribution plans, and other allowances within a given year. Following the residual model of excess CEO pay (Ahmed et al., 2021; Fong, Misangyi, & Tosi, 2010; He & Fang, 2016), to obtain the excess CEO pay, this study determine the expected CEO pay by regressing the natural logarithm of CEO pay against proxies for economic determinants of CEO pay, including specific firm and CEO characteristics. The equation was estimated using the pooled ordinary least squares method, with expected CEO pay obtained by exponentiating the predicted natural log value of total pay.

$$\log(CEO\ \text{pay}_i) = \alpha_i + \boldsymbol{\beta} \cdot \boldsymbol{Firm\ and\ CEO\ characteristics_i} + \varepsilon it \quad (1)$$

Excess pay is the residual ε_{it} from equation (3.2) which is the difference between total pay and expected pay. The excess or residual pay is then given by:

Excess CEO pay = Total CEO pay – Expected CEO pay (2)

Remuneration committee diversity

Building on the methodology of Bernile et al. (2018), this study initially used a composite diversity index that incorporates six characteristics: gender, age, ethnicity, university background, financial expertise, and multiple directorships to assess board diversity.

For each board-year, this study calculates the proportion of female remuneration committee members (Gender), the standard deviation of remuneration committee members' age (Age), the mean number of other board memberships in the public listed companies on which current members serve (Multiple directorships), and Herfindahl index, computed by squaring the proportion of board directors in a particular category and summing them. For the ethnicity index, this study determines ethnicity based on the categories of board members listed in annual reports, which include Malay, Chinese, Indian, and others.

The calculation for the diversity index is as follows:

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

Interaction variables

Family ownership

In this study, family involvement in terms of ownership through the percentage of total ownership owned by controlling shareholders. Family ownership stake is measured as the proportion of all shares across all classes held by the family to the total outstanding shares (Villalonga & Amit, 2006).

Regression models

Two models examine the effects of independent and interaction variables on excess CEO pay. Industry and year fixed effects are included to control for omitted variable bias and time-specific influences. The baseline regression models are outlined as follows:

Mode l

$$\begin{aligned} &\textit{Excess CEO Pay}_{i,t} = \alpha + \beta_1 \textit{Diversity index}_{i,t} + \beta_2 \textit{Boardsize}_{i,t} + \beta_3 \textit{Price book value}_{i,t} + \\ &\beta_4 \textit{Leverage}_{i,t} + \beta_5 \textit{Firm age}_{i,t} + \beta_6 \textit{Firm size}_{i,t} + \beta_7 \textit{CEO tenure}_{i,t} + \beta_8 \textit{CEO duality}_{i,t} + \\ &\alpha_i + \varepsilon_{i,t} \end{aligned}$$

Mode 2

$$\begin{aligned} &\textit{Excess CEO Pay}_{i,t} = \alpha + \beta_1 \textit{Diversity index}_{i,t} + \beta_2 \textit{Family}_{i,t} + \gamma_1 \textit{Family}_i * \\ &\textit{Diversity index}_i + \beta_3 \textit{Boardsize}_{i,t} + \beta_4 \textit{Price book value}_{i,t} + \beta_5 \textit{Leverage}_{i,t} + \\ &\beta_6 \textit{Firm age}_{i,t} + \beta_7 \textit{Firm size}_{i,t} + \beta_8 \textit{CEO tenure}_{i,t} + \beta_9 \textit{CEO duality}_{i,t} + \alpha_i + \varepsilon_{i,t} \end{aligned}$$

FINDINGS

Descriptive statistics

Table 1 shows the descriptive statistics of the main variables. The excess CEO pay shows a mean value of approximately 0.142, with a median of 0.017, suggesting that, on average, CEOs are not overpaid. The diversity index has a mean value of 7.517, with substantial variation ranging from -1.793 to 26.455. This indicates that firms have diverse approaches to committee diversity. Additionally, the average family ownership stake across the entire sample is 25.005 percent. This reveals that family-controlled firms holding the highest stake of approximately 85.45 percent, allowing them to influence corporate decisions.

Table 1 shows the 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
Family ownership	25.005	25.075	25.009	0.000	85.45
Board size	0.843	7.000	1.888	3.000	14.000
Price-to-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

Results

Table 2 reports the fixed-effects baseline regression results examining the relationship between remuneration committee diversity, family ownership, and excess CEO pay. The analysis incorporates industry and year fixed effects, along with control variables including board size, price-to-book ratio, leverage, firm age, firm size, CEO tenure, and CEO duality.

The negative and significant relationship between remuneration committee diversity and excess CEO pay supports H_1, as shown in column 1 (β = -0.0033; $p < 0.10$). The findings suggest that firms with greater remuneration committee diversity are more cautious about the consequences of CEO pay, reducing the likelihood of overcompensation of their CEOs. This helps bridge the gap between actual and expected CEO pay, mitigating agency conflicts. Consistent with Ahmed et al. (2021), diverse boards enhance pay alignment, reinforcing their monitoring role in curbing excessive CEO pay. These findings provide support with Bernile et al. (2018)

suggests the combined effect of different dimensions of diversity can have a greater effect on monitoring rather than any single measure of diversity.

Table 2 also examines the moderating role of family ownership. In column 3, the interaction term (Diversity Index * Family) is negative and statistically significant (ß = -0.0001; $p < 0.05$), which contradicts with H_2. Overall, the results indicate that family firms are associated with lower excess CEO pay, suggesting that family ownership can help reduce type II agency problems. Consistent with agency theory, family ownership provides controlling shareholders with a stronger incentive to restrain excess CEO pay to prevent potential backlash from external investors. This effect is especially evident in firms under family control. This is consistent with recent findings on family ownership proclivity to monitor (Wang et al., 2020) and reduce agency problems. CEO compensation tends to be lower in family firms with pyramidal ownership structures and high control-ownership deviation.

Table 2 shows Correlations Regression results of the association between remuneration committee diversity, family ownership and excess CEO pay

	(1) Excess CEO pay	(2) Excess CEO pay	(3) Excess CEO pay
Diversity index	-0.0033**	-0.0037*	-0.0002
	(-1.74)	(-2.02)	(-0.08)
Diversity index x family			-0.0001**
			(-1.75)
Family ownership		0.0018***	0.0029***
		(5.61)	(4.44)
Board size	0.3385***	0.3245***	0.3362***
	(3.65)	(3.64)	(3.75)
Price book value	0.0276***	0.0307**	0.0317**
	(2.96)	(3.22)	(3.23)
Leverage	-0.0098	-0.0125***	-0.0068***
	(-0.78)	(-0.66)	(-0.51)
Firm age	-0.0352	-0.0211	-0.0155
	(-0.94)	(-0.77)	(-0.40)
Firm size	0.2630***	0.2629***	0.2714***
	(15.65)	(15.66)	(16.27)
CEO tenure	0.1661***	0.1440***	0.1432***
	(8.47)	(7.04)	(7.20)
CEO duality	0.0560**	0.0064*	0.0450*
	(1.79)	(0.00)	(1.43)
Constant	-2.6367***	-2.6707***	-2.8020***
	(-18.97)	(-19.38)	(-20.02)
Observations	3,290	3,290	3,290
Adj R-squared	0.1627	0.1683	0.1678
Number of firms	805	805	805
Industry fixed effects	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes

Notes: This table reports the fixed effect model. Industry and year effects are controlled in all the regressions. The *t*-statistics are shown in parentheses. The asterisks *** p<0.01, ** p<0.05, * p<0.1 represent significant at 1,5 and 10 percent level, respectively. Appendix A provides detailed information on all variables.

CONCLUSION

This study examines diversity within corporate remuneration committees in Malaysia, focusing on how diverse committees influence CEO compensation in emerging markets with concentrated family ownership. Extending agency theory, the research demonstrates that diverse boards possess enhanced skills and board capital, strengthening their capacity to monitor executives effectively and question CEO assumptions.

The study advocates for broader diversity beyond gender, emphasizing that board composition should align with functional effectiveness and reflect our multicultural societal landscape. Findings reveal that firms with diverse remuneration committees reduce excess CEO pay, particularly in family-owned businesses. The effectiveness of diverse committees depends on institutional settings—in Malaysia's family-dominated ownership structure, higher family ownership helps mitigate agency problems.

This research bridges a significant gap in remuneration committee diversity studies, particularly in emerging Asian markets. It highlights the interplay between diversity and family ownership in shaping governance outcomes, providing valuable insights for policy and corporate governance across different institutional environments.

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