

Agency Problem, Managerial Incentive and Financial Controlling Instrument: A Brief Review for Agenda Study in Malaysia

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ABSTRACT

Although the agency theory has been widely used across a variety of corporate finance concepts for the past three decades, little work has been undertaken with regard to how the agency theory could be used to explain simultaneous interrelation among internal solutions for Agency problem. In addition, no general consensus has emerged after many years of investigation and scholars can often disagree about the same empirical evidence. Among other, potential endogeneity of the agency mechanisms, as well as cultural and structural differences between developed and developing markets, has been stated to cause the complexity of corporate governance around the world. This article reviews the theoretical and empirical literature addressing causal effects of managerial incentives and financial controlling instrument due to agency problem. At the same time, the article aims to improve the understanding of how these instruments affect each other. The main part of the discussion is related to the evaluation of theoretical aspects of internal Agency solution and their interrelations, as well as the experiential studies in different countries. As such, specification of Malaysian market is surveyed separately to highlight the need for multi-theoretic process and interrelation effects in future research on corporate agency problems in the Malaysian context.

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INTRODUCTION

Separation of corporate ownership may provide several benefits such as hierarchical decision making policy, firm size and developing investment strategies. However, it may bring harm in the sense that the managers have a lack of incentives to run the company efficiently and make it more profitable (Abdullah *et al.*, 2011). Based on the agency theory, managerial incentives that include ownership and remuneration align the interest between managers and shareholders. On the other hand, it shows that some controlling approaches can resolve this dilemma, with leverage and dividends as two important financial solutions for this particular problem. However, managers are the ones who ultimately make decision about dividends and leverage. To be precise, these internal controlling instruments are methods that are impressed by managers. Conversely, dividends and leverage may affect the feasibility and attractiveness of managerial incentives.

As long as managers own only little portion of firms' shares, they may pursue stock value maximisation due to the discipline of corporate control markets and managerial labour (Morck *et al.*, 1988). However, as managers become large shareholders and have the supremacy to control the firms, they could divert the outside investors' benefits to themselves (Jeelinek & Stuerke, 2009; Benson & Davidson, 2010). Thus, the relation between managerial ownership and other instrument of agency solution is assumed to be complicated. According to

risk-averse hypothesis, managers will be less motivated to have higher ownership at the presence of debt (Ahmed, 2008); therefore, debt is utilised as a monitoring substitute for managerial ownership. On the other hand, the entrenchment hypothesis postulates that owner-managers are liable to involve in actions that are detrimental to the benefits of debt issuers (Jensen & Meckling, 1976) and attempt to restructure capital based on own benefits. Therefore, rational lenders attempt to limit owner-manager with stricter contract. If managerial ownership and dividends are served as monitoring instrument substitutes in controlling agency matter of free cash flow, a negative causal relation from dividends to managerial ownership could therefore be expected. In contrast, with respect to dividend theories (e.g., signalling theory or Lintner model), management will be more motivated to distribute higher dividends to themselves as shareholders.

More than managerial ownership, managerial remuneration is another internal solution of agency problem although the relation between these two managerial incentive instrument on managerial ownership is ambiguous (Attaway, 2000; McConaughy, 2000); factors such as tax, regulation, culture and financial factors of firm (e.g., leverage, risk, dividends and performance) may influence this relation. The convergence of interest hypothesis (COI) posits that increasing share ownership by managers will increase their interest aligned with the shareholders (Ang *et al.*, 2000; Fleming *et al.*, 2005)

although entrenchment hypothesis argues that owner-managers have more influence to derive more remuneration from firms without considering their performance (Allen, 1981; Holderness & Sheehan, 1988; Werner *et al.*, 2005). Moreover, leverage and remuneration are two policies for reducing conflicts between shareholders and managers but applying each one will lead to distress for another (Agha, 2013). Besides, managers have to exercise debt for financing new projects. Managers also try to avoid the risk of leverage because they want to protect their career. Thus, shareholders have to compensate this problem by giving higher remuneration for managers. Firms with high debt, however, will likely have less free cash flow, and are thus less likely able to pay high remuneration. The relation between managerial remuneration and other controlling instruments (i.e., dividend) is indistinctive as well. Some studies have highlighted the association between various forms of executive compensation and the payout policies of a firm (Aboody & Kasznik, 2000; Kahle & Kathleen, 2002). As per the pecking order theory, firms prefer to rely more on internal funds or retained earnings; as a result, the firms will have a tendency to pay less dividend and hence have higher retained earnings. On the other hand, shareholders expect managers of highly profitable firms to pay higher dividends in order to reduce agency costs.

As elaborated earlier on, there are interrelations between managerial incentives and managerial controlling instrument. In other words, not only managerial incentives

affect leverage and dividend, leverage and dividend also have impacts on managerial incentives. In most mechanisms of corporate governance, endogeneity is not considered, and this ignorance of their interrelations leads to an incomprehensive interpretation of their empirical results. This paper aims at providing readers with a comprehensive understanding of simultaneous interrelations among the four mentioned internal instrument of agency problem by reviewing relevant empirical studies based on the original agency theory, Entrenchment hypothesis, Convergence interest hypothesis and pecking order theory.

In addition, this paper also contributes to the internal agency solutions in three ways. First, it describes how studies on internal agency solutions are interrelated and they are illustrated as integrated mechanisms. Second, the literature review of this paper focuses on the simultaneous interrelation between internal agency solutions. To the researchers' understanding, this is the first work studying on this particular issue. Third, the paper highlights several avenues to advance the field of study, while providing useful and practical implications in the Malaysian context at the same time. The remainder of the paper is organised as follows: Section 2 provides theories that explain the interrelation between each pair of four instruments and relevant literature. Section 3 briefly discusses the traits of these instruments in the Malaysian market that may cause different reactions to agency problem compared to developed country. Finally, a brief conclusion is given in Section 4.

REVIEWING PROCESS

Research Methodology

The methodology used in this study is documentary research using electronic databases and data reduction procedures to collect information about the interrelations between managerial ownership, remuneration, dividends and leverage as internal instruments for agency problem. The initial reviews revealed several hundred published articles in every instrument and also their relations. Due to space constraint,

this paper focuses only on the most widely cited papers of each theoretical concept. This study also includes 21 articles that investigated the simultaneous interrelations of the four internal agency solutions. The variables, area of study and methods are illustrated in Table 1 below. The findings can be retrieved from the literature review. Finally, the empirical studies carried out in Malaysia are investigated. A brief review of the Original Agency Theory and two related hypotheses are explained in the subsequent paragraphs.

TABLE 1
Selected studies of interrelation among managerial incentive and internal controlling instruments

Year	Authors	Country	interrelated variables	Methods
2014	Persson	Sweden	Debt, Dividend and Managerial Ownership	3SLS(CMP), 3SLS, 2SLS
2014	Gao and Li	USA	CEO Ownership and Compensation	2SLS
2014	O'Callaghan <i>et al.</i>	UK	Ownership structure, compensation and Performance	2SLS
2014	Vo <i>et al.</i>	Vietnam	Debt, Dividend and Managerial Ownership	3SLS
2014	Moussa and Chichti	Tunisia	Debt ratio and Managerial Ownership	3SLS
2013	Shiyyab <i>et al.</i>	EU	Performance, Large Shareholder, Board Size, Managerial Ownership, , Outside Directors and Executive Compensation	3SLS
2013	Bao and Yang	China	Dividends and Compensation	Tobit regression
2012	Nyonna	USA	Insider Ownership and Debt	2SLS
2012	Lopez <i>et al.</i>	16 Countries	Capital structure, Ownership structure and Valuation	3SLS
2011	Lee and Chen	Taiwan	CEO Compensation, Ownership and Firm Value	2SLS
2009	Zhang	USA	Debt and Executive Stock Options	2SLS
2008	Bhattacharyya <i>et al.</i>	Canada	Dividend and Executive Compensation	Tobit regression
2007	Ghosh	India, USA, UK, Ireland	Leverage, Managerial Ownership and Firm Valuation	3SLS
2007	Kim <i>et al.</i>	Korea	Debt, Dividend, Managerial Ownership	2SLS
2007	Ortiz and Hernan	USA	Leverage and Compensation	2SLAD
2006	Hardjopranoto	Indonesia	Debt, Dividend, Managerial Ownership	3SLS
2006	Joher <i>et al.</i>	Malaysia	Debt and Managerial Ownership	2SLS
2006	Ghosh and Sirmans	USA	CEO ownership, Dividends, Compensation	2SLS
2006	Faulkender <i>et al.</i>	USA	Dividends, Leverage	2SLS
1999	Chen <i>et al.</i>	USA	Director Ownership, Leverage, Dividends, Risk	Nonlinear 2SLS
1992	Jensen <i>et al.</i>	USA	Debt, Dividend, Managerial Ownership	3SLS

2SLS: Two Stage Least Squares, 3SLS: Two Stage Least Squares, 2SLAD: two-stage least absolute deviation

Econometrics Considerations of the Review

According to Gujarati and Porter (2009), “By combining time series of cross-section observations, panel data gives: more informative data, more variability, less collinearity among variables, more degrees of freedom, more efficiency, and better dynamic change.” Therefore, papers using panel data were chosen in this study to investigate the interrelations between the selected variables. In the presence of the simultaneously determined variables, the Ordinary Least Square (OLS) method will produce biased and inconsistent results (Hill *et al.*, 2008). Hill *et al.* (2008) also offer Simultaneous Equation Model (SEM), which is an econometric model for data that is jointly determined by two or more economic relationships as an alternative to OLS. Two alternative approaches (namely, Single equation estimation and System estimation) can be used to estimate a simultaneous equation regression model. The Two Stage Least Squares (2SLS), used by Theil (1961), Basman (1957) and Sargan (1958), was initially propounded as a method of estimation for a single equation’s parameters of a model. Similarly, the Three stage least squares (3SLS) can also be used to estimate a model of simultaneous equations that includes endogenous independent variables with dependent variables’ role of other equations in the model (Zellner & Theil, 1962). The 3SLS technique consists of two different methods, namely, 2SLS and Seemingly Unrelated Regression (SUR).

This technique is used in a system of endogenous equations (Zellner, 1962). For a better understanding of the simultaneous interrelation between the agency instruments, this study also discusses the two-way causality between the variables based on the findings of papers that used the simultaneous equation models as their methodology. For instance, according to the finding by Kim Ph *et al.* (2007) who investigated the relation between leverage and managerial ownership or dividends and managerial ownership, the OLS methods indicated no relation between them; however, when the data were run by using the 2SLS method, the results showed significant relations between them. This finding has also been reported in most of the empirical papers.

The Agency Theory

The Original Agency Theory

The cornerstone of the agency theory is the assumption that the interest of principles and agents diverges (Hill & Jones, 1992). According to the traditional agency theory by Jensen and Meckling (1979), equity agency cost is zero when there is a 100 per cent ownership by the manager’s organisation, and there is a positive relationship between equity agency costs and the separation of ownership and control (Fleming *et al.*, 2005). Jensen and Meckling (1979) hypothesised that managerial ownership is an important mechanism for aligning the interests of managers and shareholders. They also mentioned another way to reduce equity agency costs, i.e.

to use more debt financing. Using more debt reduces total equity financing and in return, this will lower the scope of the manager-stockholder conflict. The agency theory suggests that principals who find it difficult to observe or even monitor agents' behaviour will use higher proportions of compensation (Baker *et al.*, 1988; Jensen & Murphy, 1990). The payment of dividends may serve to align the interests and mitigate the agency problems between managers and shareholders by reducing the discretionary funds available to managers (Rozeff, 1982; Easterbrook, 1984).

Convergence-of-Interest and Entrenchment Hypotheses

There are two opposing viewpoints regarding managerial ownership in the modern agency theory; these being the convergence-of-interest hypothesis and the entrenchment hypothesis, Jensen and Meckling (1979) stated that minimal ownership might cause managers to work less vigorously and/or consume more perquisites. Consequently, increasing managerial ownership leads to a convergence of interests between and ownership, and reduces agency costs. On the other hand, too much managerial ownership leads to entrenchment, and thus an increase in agency costs (Morck *et al.*, 1988). Dividend payments are expected to have a negative effect on debt if the convergence of interest theory is valid. Alternatively, dividends are expected to have positive impact on debt according to the entrenchment theory (Schooley & Barney, 1994). Meanwhile, dividend payout is expected to have a negative

effect on stock ownership if the convergence of interest theory is applicable, and to have a positive impact on stock ownership if the entrenchment theory holds (Chen & Steiner, 1999).

Theoretical and Empirical Debate on the Internal Agency Instrument

Interrelation between Managerial ownership and Dividends

The key idea behind the Agency theory is that the impossibility of perfect contracting inevitably and the existence of information asymmetry cause a conflict of interest between shareholders and management. Shareholders can mitigate this contradiction and also reduce agency costs by increasing dividends (Chen & Steiner, 1999).

Hence, based on the convergence interest hypothesis, managerial ownership and dividends may be considered as substitute mechanisms as they reduce agency costs, and thus, it is not effective to exercise two instruments at the same time to resolve the same problem. Lower dividend increases the likelihood that a company engages in managerial ownership programme and vice versa. Studies such as by Rozeff (1982), Jensen *et al.* (1992), Espen Eckbo and Verma (1994) and Peng *et al.* (2001) found a negative relation between them. On the other hand, the Entrenchment hypothesis claims that a company with higher levels of managerial ownership is intentionally presenting higher level of amount of payout due to the interest of managers (Schooley & Barney, 1994; Hu & Kumar, 2004).

Besides, it has been recognised in the recent academic studies that dividend and managerial ownership policies are interrelated (Short *et al.*, 2002). Jensen *et al.* (1992) used a simultaneous equations model (SEM) and found that inside ownership affects dividends in a negative way. Similarly, the results of the SEM research by Kim *et al.* (2007) showed that dividends are negatively related to inside ownership and vice versa. In contrast, Bao (2013) found that managerial shareholding has positive impact on corporate cash dividends. The results of the study by Vo and Nguyen (2014) indicate that companies with higher levels of managerial holdings deliberately choose higher level of dividends. The recent article by Persson (2014) highlights a two-way causal relation between dividend policies and inside ownership; dividends have a positive effect on inside ownership whereas inside ownership influences dividends in a negative way.

Interrelationship between Managerial Ownership and Leverage

The leverage has high magnitude to the predominant role of the ownership structure (Ezeoha & Okafor, 2010). Exercise of debt may lead to managerial discretion reduction and cause mitigate interest divergence between managers and fund contributors for the firm (Jensen & Meckling, 1976). The convergence of interest (COI) theory posits that leverage and insiders ownership can be assumed as substitutes. However, Bathala *et al.* (1994) argued that slathers

of managerial ownership can lead to entrenchment, and the outcome of the entrenchment hypothesis (ENT) is that owners cannot solve agency problem by presenting managers with more ownership stocks (Ahmed, 2008); this implies that owners will employ leverage instead. Thus, managerial shareholdings should be related to debt policy in a positive way. However, due to the fact that the entrenchment problem causes the controlling insiders to have more probability to make decisions that are harmful for the debt issuers' interests, the debt issuers will strongly attempt to impose more influence on the managerial decision of firms (Short & Keasey, 1999; Demsetz & Villalonga, 2001). Debt holders also may envisage that an upper level of debt cost is linked to the risk of insider ownership. The studies of Anderson and Reeb (2003) and Fields Jr *et al.* (2010), on the other hand, showed that insider ownership is not related to the cost of debt.

The interrelation between inside ownership and leverage is acceptable in the recent academic literature. Givoly *et al.* (1992) found that high managerial ownership firms choose lower levels of debt. Meanwhile, Jensen *et al.* (1992) posited that the financial policies not affecting the levels of inside ownership, but inside ownership affects debt a negative way. The previous research by Chen and Steiner (1999) supports the convergence of interest theory and also suggests that inside ownership is negatively related to debt; this finding is consistent with the

study by Ghosh (2007). Moreover, Kim *et al.* (2007) expressed that inside ownership and debt have a negative interrelationship. Nyonna (2012) found a significant negative relation between them with a causality in both directions. Vo and Nguyen (2014) also indicated that managerial ownership has a negative relationship with leverage. Moussa and Chichti (2014) showed that the ownership structure affects the capital structure in a nonlinear way and vice versa. Persson (2014) argues that the effect from managerial ownership is directly imposed on debt policy in a negative way. In fact, debt policy does not affect inside ownership even though López-Iturriaga and Rodríguez-Sanz (2012) claimed that financial leverage and ownership structure are conditional based on the legal environment. Although both mechanisms work as complementary mechanisms in the civil law system, they seem to be substituting mechanisms in common law firms.

Interrelation between Managerial Ownership and Remuneration

The Traditional Agency theory predicts a negative relationship between managerial equity ownership and managerial remuneration since alignment between shareholders and executives is an increasing function of managerial ownership (Jensen & Meckling, 1976). In this view, researchers believe that managerial ownership eliminates managerial compensation requirement based on convergence interest hypothesis, that is, ownership and

compensation mechanisms may substitute one another and a higher level of ownership concentration may be associated with less necessity for incentive alignment (Mehran, 1995; Aggarwal & Samwick, 1996; Mat Nor & Sulong, 2007; Conyon *et al.*, 2010; Fernandes *et al.*, 2013).

Alternatively, entrenchment managerial ownership may allow managers to impose highly contingent compensation contracts on executives, leading to a positive relationship between managerial ownership and managerial remuneration (Allen, 1981; Holderness & Sheehan, 1988; Cheung *et al.*, 2005; Werner *et al.*, 2005). In other words, ownership and compensation mechanisms may complement each other. As a major explanation for executive compensation, the traditional agency theory has been challenged and criticised as under-socialised for its inability to explain cross country differences (Bruce & Buck, 2005; Mintzberg, 2009; Filatotchev & Allcock, 2010).

Lee and Chen (2011) discovered that CEO ownership and CEO compensation are interdependent and that ownership is positively associated with CEO compensation. Similarly, Gao and Li (2014) also argued that CEO's annual compensation is more important than his equity ownership. That is, managers are interested to enhance compensation benefits in every level of ownership. Recently, O'Callaghan *et al.* (2014) reported sensitivity of executive remuneration to firm performance is associated with the degree of managerial equity ownership and

ownership concentration in negative way. Their results indicated that in a firm where monitoring of managers activities is poorer and the separation of management and ownership is greater, the pay-performance sensitivity is more evident. In general, the impact of managerial ownership structure on managers' pay is vague given the miscellaneous nature of the empirical findings.

The Interrelation between Managerial Remuneration and Dividends

Kahle and Kathleen (2002) suggested that amendments in compensation schemes have caused changes in firms' payout policies. This means that if remuneration scheme achieves to align Managers and shareholders interest based on the convergence interest theory, then the role of dividends as a substitute alternative is mitigated. The study by Bhattacharyya *et al.* (2008) indicates that executive compensation is negatively associated with dividend payout.

Generally, dividend decisions reflect managerial motives and incentives (Tirole, 2010). If dividend payout is an effective tool for mitigating agency costs, efficient managerial compensation packages should then be designed to reward appropriate levels of dividend payout. A stock option compensation for CEOs leads to lower dividends but other kinds of remuneration should be positively related to dividends (Geiler & Renneboog, 2014). Otherwise, dividends may be used as a complement method to reduce the agent theory according

to the entrench hypothesis. In line with this notion, some scholars assigned a positive linkage between executive remuneration and dividend payment (Healy, 1985; Lewellen *et al.*, 1987). Bao (2013) also reported that executive wage has a positive impact on corporate cash dividends, i.e., managers who are entrenched and receive a larger part of compensation through salary and bonus rather than long-term rewards linked to firm performance are less sensitive to shareholder values, and pay higher dividends (Ghosh & Sirmans, 2006). However, the other factors such as investment opportunity has an essential role between managerial remuneration and dividend (Chen, 2010).

The Interrelation between Managerial Remuneration and Leverage

The agency cost of equity hypothesis suggests that debt mitigates shareholder-manager agency problems by inducing lenders to monitor, reducing free cash flow available to managers and forcing managers to focus on value maximisation when facing the threat of bankruptcy (Grossman & Hart, 1982; Jensen, 1986). In addition, explaining the agency theory, Jensen and Meckling (1976) assumed that managers are risk averse and try to reduce the financial risk to protect their jobs and personal wealth (Fosberg, 2004; Hardjopranoto, 2006a). As a result, managers who run companies with higher level of risk should get higher remuneration than managers who handle companies with lower risk. In other words, managers who are willing to tolerate extra

risks and face uncertainty of returns should be compensated accordingly. Moreover, receiving debt by managers leads to more financial risks for firms. Based on this view, and because of the remunerations involved, managers take the financial risk of new projects.

Rational lenders price debt by considering executive incentive structure (Brander & Poitevin, 1992). When shareholders and managerial interests are strongly aligned, managers have the incentives to decide about investment plans that benefit shareholders at the cost of bondholders. Nonetheless, this may lead to higher cost level of debt finance. Since shareholder-bondholder arguments are more intense in more levered companies, these companies may find optimal to decrease agency costs of debt finance by inducing a lower incentive alignment with their executives, even though doing so may raise the agency costs of equity.

Zhang (2009) found that executive stock options and debt practice are substitutes to decrease free cash flow problem. In addition, he also posited his result as more pronounced in firms that tend to have much severe agency problem. Ortiz-Molina (2007) realised reduction in the condition of in direct-debt leverage for performance base payment sensitivity. However, the results of the study by Shiyab *et al.* (2013) indicated that leverage has an insignificant negative impact on executive compensation levels.

The Interrelation between Dividends and Leverage

Easterbrook (1984) revealed that dividends might keep the firm in the capital market because they could monitor managers at a lower cost. Debt and dividends could be substitutes or complements in reducing the agency cost. The policies are substitutes if the convergence of interests is effective (Rozeff, 1982; Faccio *et al.*, 2001) or complements if the entrenchment theory is effective (Hardjopranoto, 2006). If the entrenchment theory is effective, the shareholders could use a combination of debt and dividends to monitor managers because they cannot be monitored by offering them more ownership stakes. This finding suggests that dividends should be positively related to debt.

Meanwhile, Myers and Majluf (1984) explained that firms follow a hierarchy of financial decisions when establishing its capital structure. In fact, the Pecking Order Theory is based on the presence of asymmetric information between managers and outside investors and the assumption that managers act in the interest of existing shareholders (Shen, 2014). Initially, firms first finance projects with the retained earnings because this finance method incurs no flotation costs and requires no disclosure of the firm's financial information (Bevan & Danbolt, 2002). If the retained earnings are not sufficient, the firms will go for debt (DeAngelo & DeAngelo, 2007), and if further financing is required, the last option for the firm is to issue equity. Therefore,

higher level of dividends payout will lead to higher level of debt to finance new investment.

Leverage policy is not determined independently, but rather simultaneously with other factors such as firm's dividend policy (Crutchley *et al.*, 1999). Kim *et al.* (2007) and Faulkender *et al.* (2006) indicated a significant positive impact of leverage on dividend. Furthermore, the findings of Persson (2014) disclosed a positive two-way causal relation between total debt and dividends. Based on the finding by Vo and Nguyen (2014), however, there is a substitution relationship between leverage and dividend in the mechanism of controlling the agency conflicts.

Theoretical Framework

The theoretical discussion on the interrelationship between managerial ownership, compensation, dividend policy and debt policy is summarised in Fig.1 and Table 2 below. The general conclusions that follow from them are that causality may proceed in either direction between each pair of the variables. For instance, Table 2 indicates that the effects of dividends on managerial ownership can be explained based on two different hypotheses; from the Entrenchment hypothesis, the positive effect is expected, and from the convergence of interest view, the negative effect can be predicted (see Arrow 10). Moreover, the same predictions are also possible from the managerial ownership to dividends (see Arrow 9).

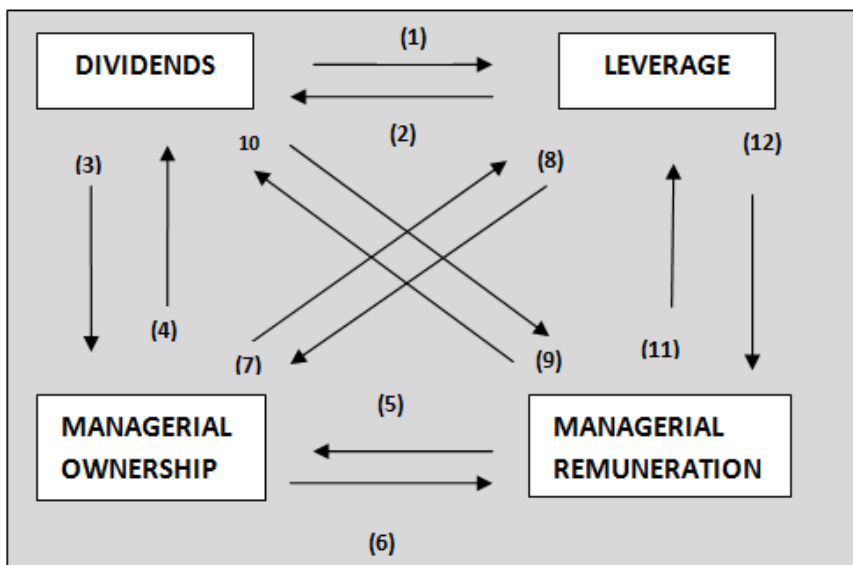


Fig.1: The interrelation framework between internal agency solutions

TABLE 2
Expected Impact amongst the Variables

Arrow no.	Effect prediction
1	Entrenchment hypothesis(+),convergence hypothesis(-), pecking Order Theory(+)
2	Entrenchment hypothesis(+), convergence hypothesis(-)
3	Entrenchment hypothesis(+), convergence hypothesis(-)
4	Entrenchment hypothesis(+), convergence hypothesis(-)
5	Entrenchment hypothesis(+), convergence hypothesis(-)
6	Entrenchment hypothesis(+), convergence hypothesis(-)
7	Entrenchment hypothesis(+), convergence hypothesis(-)
8	Entrenchment hypothesis(+), convergence hypothesis(-)
9	Entrenchment hypothesis(+), convergence hypothesis(-)
10	Entrenchment hypothesis(+), convergence hypothesis(-)
11	Agency theory (-)
12	Agency theory (+)

INTERNAL AGENCY INSTRUMENTS IN THE MALAYSIAN CONTEXT

Malaysia is one of the fast growing economies that have successfully developed from a commodity-based economy to one that focused on manufacturing from the early 1980s through the mid-1990s. The origin of the 1997 financial crisis in Malaysia lies in the structural weaknesses in its domestic financial institutions which were supported by inaccurate macroeconomic policies and moral hazard (Corsetti *et al.*, 1998). Thereafter, policymakers reformed corporate governance in Malaysia several times by codifying Malaysian Code on Corporate Governance, Capital Market Master Plan and Financial Sector Master Plan. However, some natures of the Malaysian capital structures cause difficulty

and complexity in the use of corporate governance instruments. In this section, the specification of the four mentioned internal agency solutions are discussed.

In the case of Malaysia, capital structure is formed by the highest belonging of family businesses [almost 60% by Claessens *et al.* (2000) and 37% by Afza Amran and Che Ahmad (2009)] and the government properties. This means that the Government is involved in firms' business, in which 22% Government Linked Companies (GLCs) in 1999 (Claessens *et al.*, 1999) and this proportion increased to 36% in later years (Mokhtar, 2005). By adding a high proportion of managerial ownership, the issue becomes more complex [43%, as mentioned by Sulong *et al.* (2013), 27% as stated by Mustapha and Ahmad (2011b), 21% by Zunaidah and

Fauzias (2008) and 29 % by Kanapathy (2005)]. In addition, Ahmed (2008) also stated that among 100 blue-chip stocks, a higher level of managerial ownership could reduce the agency conflict between external equity claimholders and managers during the 1997-2001 period. Within these concentrated ownerships of companies, managers might have little influence on decision making policies. In addition, minority shareholders are doubtful to influence the decisions regarding how companies are run, whether qualified managers are running the firms or whether they are chosen based on Relationships or political connections. For this reason, how can agency problem be resolved or faded out by offering firm's share to managers in the Malaysian context?

Other than that, executive compensations are vigorously debated in Malaysia (Wooi and Ming, 2009). Directors' payment increased by 23% in six years (Kaur & Rahim, 2007). Moreover, total directors' payout in top 20 companies increased by 22% in 2009 (Hamsawi, 2011). Family ownership and managerial ownership show uncertainty in relation to managers' remuneration. For instance, Vicknes (2003) found that most owners-managed companies tend to have heftier payout to their managers. Conversely, Dogan and Smyth (2002) reported that board remuneration is negatively associated with ownership concentration for Malaysian listed firms. Likewise, directors' payouts in GLCs have grown approximately 12% lower

compared to others (Minhat & Abdullah, 2014). Similarly, Salim and Wan-Hussin (2009) also found that among pay-without-performance firms, executives earn higher pay as managerial ownership increases, and this suggests that rent extraction through overcompensation is likely to be in tandem with the managerial power theory. Some studies, however, could not find any relation between debt and managerial remuneration in Malaysia (Yatim, 2013; Amin *et al.*, 2014). Consequently, there are different remuneration policies among firms in Malaysia that cause difficulty to account executive remuneration as an instrument for the agency problem.

Mustapha and Ahmad (2011a) stated that debt structure has a significant and negative relationship with total monitoring costs in the firms listed on the Main and Second Boards of Bursa Malaysia. In addition, capital structure is argued as very much dependent on the dominant nature of the ownership structure (Ezeoha & Okafor, 2010). Ahmed (2008) posits that the debt policy, which serves as a positive monitoring substitute for agency conflict as positive and significant in explaining the level of ownership concentration. Mustapha *et al.* (2011) exclaimed that significant relationships exist between debt structure and ownership structure, specifically in the case of Malay executive directors' shareholdings. Meanwhile, Appannan and Sim (2011) confirmed the positive correlation between current dividends with firms' debt equity ratio in the food industry and stated if the debt equity ratio was low,

the dividend payment would be lower. The findings by Ling *et al.* (2008) showed that dividend-paying companies have lower firm leverage as compared to non dividend-paying companies that may be consistent with the agency theory.

As a developing country, Malaysia still lacks studies that look into the most important determinants of the dividend policy for the listed firms (Appannan & Sim, 2011). One of the conflicts about the dividend policy in Malaysian public listed companies is that due to personal tax exemption, managers are reluctant to cut or avoid omitting dividend even when the performance of the companies is deteriorating due to shareholders pressure (Ling *et al.*, 2008). Furthermore, Ahmed (2008) also explains that dividend policies, which also serve as monitoring tools, substitute to reduce agency conflict between manager and external shareholders and do not appear to have any significant impact on managerial ownership. However, the manager-owner concentration strengthens the complicacy of the dividends policy as a financial instrument for the agency conflict.

Due to some characters mentioned in the Malaysian context, these instruments seem to be more complex to solve the agency problem compared to those of the developed country. Moreover, firms usually apply more than one method as a solution for their agency problem or use another method when carrying out their business activities. When the interrelation among them is considered, the agency solution mechanisms are found out be more intricate.

CONCLUSION

This paper reviews the interrelationships between debt policy, dividend policy, managerial ownership and managerial remuneration based on the original agency theory, convergence of interest and entrenchment hypotheses and pecking order theory. Taking COI, ENT and also explaining the variety of simultaneous system studies into consideration, this article has attempted to bridge the conceptual gap of relationship between the influences of individual internal agency instruments and their expected synchronised effects as an aggregated mechanism. For this purpose, three groups of articles were selected: the main theoretical and empirical article, the articles that use SEM, and the articles that identify the characters and related findings of these internal agency solutions in the Malaysian market. By considering the first two groups of articles, this paper has shown that as there was no particular attention given to the interrelationships between these instruments, the researchers were not able to infer the market mechanisms to mitigate agency problems. The interrelation framework and its expected impact table proposed the comprehensive perception to realise intricate agency solutions. In other words, understanding the condition of managers' status based on the COI and ENT hypotheses, as well as considering the simultaneous two-way causality between instruments, leads to understanding of the market mechanism and also the ability to investigate the effectiveness of these instruments. Moreover, the concentrated

ownership structure and some cultural and regulatory differences of the Malaysian market, compared to the developed country that was previously described, highlights the importance of exclusive and extensive studies of simultaneous interrelations among the internal agency instruments in this market. In particular, future survey carried out in Malaysia may enhance the knowledge about the agency theory in the concentrated ownership with sensible managerial ownership.

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