

MySay: Greater pay transparency needed at GLCs and GLICs to improve governance

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This article concerns the transparency of pay at government-linked entities (GLEs) and the influence of pay policies on the behaviour of executives and directors. For the sake of brevity, GLEs refer to government-linked companies (GLCs) and government-linked investment companies (GLICs) in Malaysia. The ultimate stakeholders of GLEs are the rakyat.

The Malaysian Code on Corporate Governance 2017 (MCCG) recognises ethical behaviours and transparency as important pillars of corporate governance and stewardship of investors' capital to produce long-term value. According to the MCCG, "pay policies which do not appropriately link directors' remuneration to company strategy and performance can diminish shareholders' returns, weaken corporate governance and reduce public confidence in business".

The Edge in July reported that the remuneration of GLEs' CEOs is generally lower than that of non-GLC companies. This is consistent with the findings of my earlier study published in *Applied Economics* in 2014. I did not find a strong link between pay and performance at GLCs.

However, it is important to understand that the empirical findings so far are based on limited pay disclosures by companies. Also, to what extent pay is linked to performance at GLEs remains a subject of debate. Providing robust empirical evidence on this aspect will require adequate transparency in directors' pay disclosures and the application of sophisticated statistical analysis.

Inefficient pay hypothesis and rent-seekers

The concern here is not solely about the level of pay but also how pay policies influence the behaviour of executive and non-executive directors at GLEs. My concern has been motivated by the inefficient pay hypothesis that I introduced in 2014. This hypothesis predicts that government control and ownership of companies will provide a convenient platform for the companies' executives to enjoy guaranteed levels of pay that will not incentivise them to produce additional effort that can maximise economic performance.

This proposition views fixed pay, such as salary, as a source of "rent" which may be practically deemed as risk-free pay (that is, taking on additional effort or legitimate risk is not necessary to earn this pay). The inefficient pay hypothesis is consistent with the scholarly thought of Professor Lucian Bebchuk of Harvard Law School who viewed certain pay as "stealth compensation" or "agency costs".

Risk-free pay is sought after by rent-seekers who have little motivation to take on real risk and/or additional effort to improve performance beyond the status quo. The inefficient pay hypothesis is also applicable to non-executive directors who are extracting fixed fees but are not necessarily genuinely interested in instituting and implementing proper governance functions. Protecting public interest is a lower priority to them regardless of their talent.

While it is unknown how many rent-seeking directors are out there, sub-optimal performance and governance failures of some GLEs in Malaysia are no longer a secret. As is known to the public, 1Malaysia Development Bhd is the most tainted by scandal. In addition, the directors of many GLEs were made to resign this year under the new administration. Although cynical views may judge their resignations as motivated by political vengeance, it can also be seen as progress towards improving the governance of GLEs. Entrenched rent-extraction, if any, must be ended to uphold ethical behaviour.

Despite known governance failures at some GLEs, it is largely unknown to what extent the rakyat is aware of how much public resources have already been spent on individual directors of GLEs. The remuneration

received by directors of unlisted GLEs and their subsidiaries remains largely opaque. Only the amount promised to the immediate past CEO of 1MDB was recently publicised as RM5 million. The remuneration received by 13 board members of Khazanah Nasional Bhd remains opaque, despite a claim that suggests “Khazanah upholds rigorous standards of transparency...” (page 10, Khazanah Report 2017).

For the financial year ended 2016, only aggregate pay amounts were disclosed by four GLICs. The aggregate remuneration of key management personnel (board and senior management) of Kumpulan Wang Persaraan Diperbadankan (KWAP) was disclosed as RM13.6 million. The aggregate amount of directors’ emoluments for Lembaga Tabung Angkatan Tentera (LTAT) was disclosed as RM12.3 million. The aggregate honorarium/remuneration for board members and the investment panel of the Employees Provident Fund was disclosed as RM6.4 million, while the aggregate remuneration for its key management personnel was RM10.7 million. The aggregate amount of remuneration of directors and key management personnel of Lembaga Tabung Haji (LTH) was disclosed as RM38.4 million. It is not entirely clear how many individuals’ pay was included in the reported amounts.

It is estimated that a minimum of RM80 million had been spent for the directors and key management personnel at only four GLICs in 2016. Bear in mind that there are more than 40 listed GLCs and it is unknown how many unlisted GLEs are out there. We can only expect the actual spending on directors’ pay to be much greater and future spending will increase. The increasingly sophisticated members of the public will wisely ask whether such spending was reasonable.

Cautious spending is important if excessive exposure to credit risk is a national issue when more resources and opportunities were diverted to the rich few. It is not impossible for the GLEs’ boards to be dominated by a few well-connected elites on the basis of “talent argument”. Whether they are really talented is entirely up to the rakyat to perform a reality check.

The reality is that GLICs are not only exposed to a debt burden but also counterparty credit risk through their lending activities and investment in credit securities and receivables. Based on its financial report for the year ended 2016, LTAT had recognised RM182.6 million for impairment loss of loans, advances and financing. LTH allowed RM91.8 million for impairment on banking’s financing and assets. For the EPF, impairment loss on loans, advances and financing was RM778.3 million, and impairment loss on financial assets available for sale (including credit securities) was RM8.1 billion.

Bear in mind that these GLICs are managing deposits and contributions from members of the public who are the ultimate bearers of the losses. There were more impairment losses that are not mentioned here as evidence of sub-optimal performance of GLICs’ management and governance. I do not think it is wise to spend more than is necessary on directors of GLEs that expose public funds to ballooning credit risk or debt burden, or are tainted with corruption scandals.

Do we wish to pay RM5 million to a CEO who has allegedly condoned money-laundering activities and abuse of public resources? In my opinion, the value of “talented” directors with questionable integrity or sub-optimal performance should be discounted for efficient financial management.

The adequacy of the existing regulation to protect stakeholders’ interests in matters pertaining to directors’ pay is questionable. Self-regulation through a remuneration committee and/or use of pay consultants are not adequate if the independence of these agents are questionable. Findings from my previous research (published in Research in International Business and Finance) suggest that it is plausible for pay consultants to advocate pay under the influence of companies’ management.

The Companies Act 2016 requires listed companies (and their subsidiaries) to seek shareholders’ approval at a general meeting for only non-executive directors’ fees and benefits. Bursa Malaysia’s listing requirements specify that fees payable to non-executive directors shall be by a fixed sum and not by a commission on or percentage of profit or turnover. Obviously, only the remuneration of non-executive directors of listed companies and subsidiaries is regulated.

The remuneration of executive directors is lightly regulated in Malaysia. Detailed disclosure is only encouraged (non-mandatory) through the guidelines specified by the MCGG. The code states that

“companies are encouraged to fully disclose the detailed remuneration of each member of senior management on a named basis”.

Understandably, not all companies have chosen to comply fully with the spirit of the code. It is common for companies not to disclose individual executive director’s remuneration, with only the aggregate pay of several directors disclosed. The amount disclosed also did not necessarily include pay awarded through long-term incentive performance schemes and other perks and benefits.

It is feared that the lack of transparency and the absence of public monitoring or proper oversight of directors’ pay will breed rent-seekers, hence, repeating inefficiencies that were systemically manifested during the previous administration. Adequate pay transparency is a nudge to discipline directors’ behaviour and allows the public to monitor possible rent-seekers.

The rakyat as the ultimate stakeholders should fight for their “right to know” if the regulators fail to protect their interests. Article 19 of the Universal Declaration of Human Rights provides people the right “to seek, receive and impart information and ideas through any media and regardless of frontiers”. This is, of course, a matter of activism.

I urge the accountants to play an active role in advocating for improved regulation and greater transparency in GLE directors’ pay disclosures. Doing nothing is not an option when the public interest is at stake. According to the International Federation of Accountants, “A hallmark of the accountancy profession is its obligation to act in the public interest”. Who else would help the rakyat to push for greater corporate transparency and governance if not the accountants?

The initiative of the Institute of Chartered Accountants in England and Wales (ICAEW) can be taken as a leading example in this case. The ICAEW recently published a guidance document, “How to End Excessive Pay”. It states that, “The best executives know the value of empathy, and they recognise how their company fits into the social and political landscape. They also know that their success depends on blending with society. However, this is impossible unless they leave the comfort of an isolated and elite group.”