

Factors Affecting Director Remuneration: A Study of Manufacturing Companies Listed on ASEAN State Stock Exchanges

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The aim of this study was to examine the effect of financial distress, rewards and company performance using return on assets (ROA), managerial ownership, ownership concentration, directors' composition and leverage on directors' remuneration with company size, leverage and company age as control variables. The study population comprised manufacturing companies in the food and beverage sector listed on the ASEAN state stock exchange. The study used a purposive sampling method. The sample number consisted of 68 manufacturing companies. The data used are secondary data obtained from ASEAN state stock exchanges. Data analysis used multiple linear regression. The results indicate that ROA, managerial ownership, ownership concentration, firm size and leverage have a significant effect on directors' remuneration, while financial distress, reward, company age and state have no significant effect on directors' remuneration. The implications of study mean that boards of directors can conduct a comprehensive evaluation of the directors' remuneration system by establishing a team that has the authority to provide input and formulation of a remuneration system that meets the principle of fairness.

Key words: *Affecting factors, director remuneration, manufacturing company, ASEAN Stock Exchange.*

Introduction

Globalisation has had a huge impact on the world's economy, including in ASEAN countries. Companies are required to increase their productivity, especially now that ASEAN countries have entered the era of globalisation. Increases in a company's productivity are not separated from the contribution of managers and other employees as the human resources of a company. According to Khandekar and Sharma (2006), the contribution of human resources is a significant determinant of performance and long-term competitive advantage in the company. Employees are valuable assets that affect the success of the company, so it is not unusual for a company to continue to encourage employees to improve their performance through remuneration (Dwijayanthi & Dharmadiaksa, 2013; Soetisna et al., 2015; Fitria et al., 2014; Retnoningtyas, 2014).

Motivation plays an important role in increasing employee productivity and performance. Based on data compiled by the Asian Productivity Organization (APO) in 2014, the level of productivity of Indonesian workers reached US\$23,000. *Economic Insight: South East Asian by the Institute of Chartered Accountants in England and Wales (ICAEW)* indicates that for the past 15 years the productivity of the Indonesian workers has increased substantially, so Indonesia is now in the second highest position in ASEAN. Indonesia beat neighbouring countries such as Singapore, Malaysia and Thailand. Although the productivity of Indonesian workers shows good results, according to the World Economic Forum (WEF) report in 2017, Indonesia's competitiveness ranking is still below those of Malaysia, Thailand and Singapore. While competitiveness affects the performance of an organisation in a country, so far the motivation of employees in Indonesia is still relatively low. There is therefore a need for a new approach to providing remuneration in order to develop employee performance.

Remuneration or compensation is a reward for employee performance manifested in the form of financial and non-financial gains. These rewards can be in the form of salaries, bonuses, stock options, stock grants, pension funds and other benefits (Neokleous, 2015). It can be a bridge that connects agents and principals, and reduces conflicts between the two parties.

The remuneration systems of each company will be different, especially between companies in a country dealing with other countries. Directors' remuneration has been practised by five ASEAN countries, namely Singapore, Malaysia, Indonesia, the Philippines and Thailand (Talha et al., 2009). The authorities of ASEAN countries seek to improve directors' remuneration policies and practices to minimise the possibility of agency conflict. The five ASEAN countries are even required to disclose the level and procedure of remuneration in a company's financial statements. Thai companies must fully disclose the benefits paid to directors in their annual report. The company must also disclose the remuneration policies of the directors and top executives related to the contributions and responsibilities of each

person. Similar to Thailand, Singapore requires each company to disclose their remuneration, framework, policy, level and combined remuneration in the company's annual report (Talha et al., 2009). It can thus be concluded that ASEAN countries consider remuneration to be important as a way to minimise agency conflict.

Table 1: Directors' remuneration in several ASEAN countries

Country	Disclose of directors' remuneration	Remuneration committee
Indonesia	√	√
Malaysia	√	√
Singapura	√	√
Thailand	√	√
Philippine	√	√

Source: Talha et al. (2009).

Several empirical studies relate to the factors that determine compensation or remuneration in developed countries, especially the United States and the United Kingdom. In contrast, for developing countries such as Indonesia and other ASEAN countries, remuneration or executive compensation is not a popular topic to discuss (Vidyatmoko et al., 2009) and there are still differences in research findings. This study aims to determine the effect of financial distress, rewards and company performance using return on assets (ROA), managerial ownership and ownership concentration, composition of directors, and leverage on directors' remuneration, with company size, leverage and company age as control variables.

Review on Theory and Literature

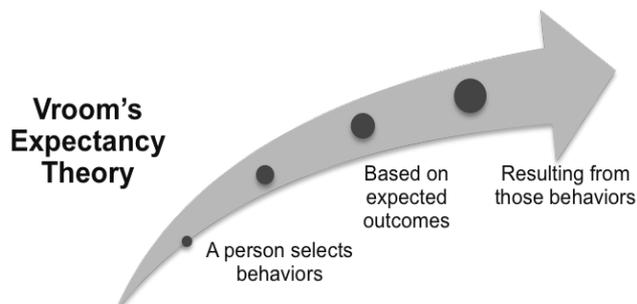
Agency Theory

Agency theory is a basis for the business practices used by companies so far. The main principle of this theory states that the organisation exists in a cooperative relationship between shareholders (principals) and managers (agents), or the company's operating party based on agreed contracts (Jensen & Meckling, 1976). The agency model is built on a philosophy of the importance of examining remuneration issues and their resolution within an economy that has potential problems; these include the inability of agents to perform their duties optimally, agents diverting resources for their own benefit, and time horizon differences. The time horizon difference causes the agent not to care about the effect of their current actions on future conditions.

Jensen and Meckling (1976) argue that agency relations arise due to the contract between the principal and agent by delegating some decision-making authority to the agent. Agency theory assumes that someone behaves in accordance with their respective interests.

Expectancy Theory

Expectancy is the belief that increased effort will lead to increased performance— that effort, which is any work-related behaviour that is the direct result of the effort an employee expends on a job – will lead to first-order outcomes (Murey, 2007). Expectancy theory was suggested by Victor H. Vroom in 1964, then expanded by Porter and Lawler (Dudija, 2012). Whereas Maslow and Herzberg look at the relationship between internal needs and the resulting effort expended to fulfil them, Vroom emphasises outcomes rather than needs, as suggested by Maslow and Herzberg. Vroom’s theory suggests that people choose among alternative behaviours because they anticipate that particular behaviours will lead to one or more desired outcomes and that other behaviours will lead to less desirable outcomes (Vroom, 1983). The theory is shown in Figure 1.



Source: <http://www.free-management-ebooks.com>

Figure 1: Vroom’s expectancy theory

This theory also states that the power of a person’s tendency to act in a certain way depends on the strength of their expectations regarding the results given and their interests (Robins, 2014, in Shadrina & Widawati, 2015). The power that motivates a person to work actively in doing their job depends on the reciprocal relationship between what is desired and needed from the results of the work.

Employee Performance

Employee performance and work motivation are related, with the former influenced by the latter. According to the theory of human resources, performance can be defined as the result of an implementation of a task or process of achieving the objectives of an activity (Nurhayati & Darwansyah, 2013). According to Kusnadi (2003: 264), performance is a movement or action performed consciously which is directed to achieve a certain goal or target. Employee performance can be achieved if someone is motivated to do something maximally. The high and low motivation given will affect the level of employee performance.

Director Remuneration

The Big Indonesian Dictionary defines remuneration as a reward or salary. The term 'remuneration' is often interpreted as compensation. It is closely related to the welfare of employees in a company or organisation, whose existence cannot be ignored in encouraging the achievement of the goals of a company or organisation. According to Surya (2004, p. 8), in Angliawati that remuneration is received by employees as a reward for contributions to the organisation where they work. Remuneration includes all financial and non-financial reward, both routine and non-routine, directly or indirectly.

Factors for Providing Remuneration

Remuneration is influenced by several factors, both internal and external. It must be the main concern of the company to develop a remuneration system, so that the implementation of remuneration can be effective and not have a negative impact. According to Hasibuan (2007, p. 127) potential factors that affect the amount of remuneration include supply and demand for labour, the ability and willingness of the company to pay, employee productivity and performance, position, type of work and attitude. The Jordanian researcher explained that one factor that can affect compensation to CEOs and directors in developing countries is the size of the company and the tenure of the CEO (Abed et al., 2014). The longer the tenure and the bigger the company, the more remuneration will be given to the CEO and directors. In Jordan, big companies seem more complex so that they need managers, CEOs, directors or agents who are able to manage the company well – they must have high qualifications. To attract and maintain an agent who suits the needs of the company, the company also provides high remuneration.

Haron and Akhtaruddin (2013) and Ning et al. (2015) found other factors related to remuneration, including company leverage. The level of company leverage is determined by the cash flow and the ability to fulfil the company's contractual obligations – in other words, the higher the company's leverage, the less the directors' remuneration will be. Companies with high leverage must bind their capital to long-term debt, so the cash flow available for investment, dividend distribution and company operational expenses is reduced. The reduction is done to reserve funds so continuation of the company's operations can be guaranteed.

Probohudono et al. (2016) suggest that several factors determine remuneration, including financial distress, ROA, ownership concentration and board composition. In the case of financial distress, companies tend to decide to give lower remuneration to their employees in order to reduce operating costs, although research conducted by Haron and Akhtaruddin (2013) found that even though the company suffered a loss, Mycom showed a high

remuneration rate of RM2.62 million between 2002 and 2003; Kemayan Corporation, Aokam Perdana and Sriwani Holdings did the same. ROA is a profitability ratio that shows how effectively the company operates to generate profits; it describes the performance of a company. In the case of managerial ownership, where managers are also principals, the objectives of the agent and the principal are linear. Managerial ownership causes the value and performance of the company to increase. Under these conditions, management as the share owner will replace the cash remuneration it receives into a number of ownership shares, which is more useful in the long term (Abdullah, 2006).

Research Method

This research uses a quantitative method. The approach used is descriptive, with the aim of testing hypotheses and answering questions related to the subject studied. Generally, this type of research is related to the assessment of attitudes or opinions on individuals, groups or organisations, events or procedures. Secondary data is used, including the company's annual financial report data obtained from ASEAN state stock exchanges in Indonesia, Malaysia, Singapore, the Philippines and Thailand, which are obtained through the websites <http://www.idx.co.id>, <http://www.bursamalaysia.com>, <http://www.sgx.com>, <http://www.set.or.th> and <http://www.pse.com.ph>. The study population comprised manufacturing companies listed on the ASEAN Stock Exchange from Indonesia, Malaysia, Singapore, the Philippines and Thailand; with 739 companies, the sampling technique was done by purposive sampling. The sample in this study was 68 manufacturing companies in the food and beverage sector.

Results and Discussion

Effect of Financial Distress on Directors' Remuneration

Results of analysis show that the coefficient of financial distress is -0.379 and its significance is 0.290 . It can be concluded that financial distress is negatively significant, so Hypothesis 1 is rejected. This shows that the higher the financial distress experienced by the company, the lower the ability of the company to provide directors' remuneration and vice versa. Financial distress is a condition where the company experiences financial difficulties; it will ultimately result in bankruptcy. One way to determine whether a company is experiencing financial distress is to examine whether there is negative working capital, in which case the company will focus more on reducing corporate expenses such as reallocating directors' remuneration to cover shortages in company finance, so that the company is able to remain sustainable. This condition is also strengthened in a study conducted by Abdullah (2006), Probohudono et al. (2016) and Jamaluddin (2018), the results of which show that companies experiencing financial distress will pay lower remuneration to directors compared with companies that do not experience financial distress or healthy companies.

Effect of Rewards on Directors' Remuneration

The analysis shows that the coefficient of financial distress is 0.215 and its significance value is 0.370. It can be concluded that the reward of shareholders has a positive and insignificant effect, so Hypothesis 2 is rejected. Even though the reward does not have a significant effect, testing shows that the reward has a positive regression coefficient, indicating that higher rewards experienced by the company will result in higher directors' remuneration.

The results show that the rewards of the shareholders have a large composition, > 0.05 . However, the amount of the reward from shareholders is unable to influence the directors' remuneration. This is possible because the rewards of results that represent the performance of the company reflect the total profits or losses obtained by the company. Stock rewards are affected by capital market conditions. Market conditions are influenced by information or material facts, because basically information reflects a price.

Effect of ROA on Directors' Remuneration

The analysis shows that the coefficient of ROA is 4.270 and its significance value is 0.0001. It can be concluded that ROA has a significant positive effect, so Hypothesis 3 is accepted. ROA has a positive regression coefficient, which indicates that a company experiencing higher ROA will have higher directors' remuneration and vice versa.

ROA is often related to company performance, with companies that have good performance achieving sales value, profits, trust from other parties, high investors, and long-term sustainability (Jensen & Murphy, 1990). The higher the ROA value of the company, the better its performance will be. This condition certainly encourages companies to be willing to provide high remuneration. If ROA increases, the payment of directors' remuneration will increase. The results of this study concur with the research conducted by Probodhono et al. (2016), Nytichi (2016), Fitria et al. (2014), Kato (1997) and Jansen and Murphy (1990), which also stated that company performance in ROA had a positive effect on directors' remuneration.

Effect of Managerial Ownership on Directors' Remuneration

The analysis shows that the coefficient of managerial is -1.539 and its significance value is 0.024. It can be concluded that managerial ownership has a significant negative effect, so Hypothesis 4 is accepted. Managerial ownership variables have a negative regression coefficient, indicating that where managerial ownership of a company is higher, the potency of the company to provide director's remuneration will be lower. Firth and Tang (1999) also show that managerial ownership influences remuneration. Management not only wants remuneration; they also want a number of shares.

Effect of Ownership Concentration on Directors' Remuneration

The analysis shows that the coefficient of ownership concentration is -1.241 and its significance value is 0.043 . It can be concluded that ownership concentration has a significant negative effect, so Hypothesis 5 is accepted. Ownership concentration variables have a negative regression coefficient, indicating that the higher the concentration of ownership experienced by the company, the lower the potency of company-provided directors' remuneration will be. According to research conducted by Barontini and Bozzi (2011), shareholders encourage management to implement cost efficiencies so the concentration of ownership negatively affects directors' remuneration. This study successfully proved the research conducted by Barontini and Bozzi (2011) and Probuono et al. (2016) that ownership concentration had a significant negative effect on directors' remuneration.

Effect of Control Variables (Company Size, Leverage, Company Age and State) on Directors' Remuneration

The variables of company size, leverage, company age and state are control variables in this study. The significant value of the company size variable is 0.010 smaller than 0.05 , so it influences directors' remuneration. Company size is the total amount of assets owned by the company. The higher the total assets owned by the company, the higher the directors' remuneration.

The variable of leverage control shows a significant value of $0.026 < 0.05$ so that it affects directors' remuneration. Leverage is the division ratio between total debt and total equity owned by the company. The higher the equity owned by the company, the better the performance. Results stating that leverage affects director's remuneration are also revealed by research conducted by Herlen et al. (2015). The variables company age and the state show a non-significant value, meaning that both are unable to affect directors' remuneration. Company age and the state where the company is registered do not guarantee the success of the company, because the performance of the company is influenced by the performance of the directors and employees of the company itself.

Conclusion

The practical managerial implications that attract employees to companies, such as remuneration, are impacted by a number of factors. Based on analysis of some factors that affect directors' remuneration, this study reaches the following conclusions:

- Financial distress status has no significant negative effect on directors' remuneration. It indicates that the higher the financial distress being experienced by the company, the lower the potency of the company to provide director remuneration will be.
- Shareholders' reward has a positive but not significant effect on directors' remuneration. This indicates that the higher the reward experienced by the company, the higher directors' remuneration will be.
- ROA has a significant positive effect on director remuneration: the higher the ROA obtained by the company, the higher directors' remuneration will be.
- Managerial ownership has a significant negative effect on director remuneration, indicating that the higher the level of managerial ownership experienced by the company, the lower directors' remuneration will be.
- Ownership concentration has a significant negative effect on directors' remuneration, indicating that the higher the concentration of ownership experienced by the company, lower directors' remuneration will be.
- The control variable company size has a significant positive effect on directors' remuneration, indicating that the larger the company, the higher directors' remuneration will be.
- The control variable leverage has a significant negative effect on directors' remuneration, indicating that the higher the leverage experienced by the company, the lower directors' remuneration will be.
- The control variable company age has a negative but not significant effect on directors' remuneration, indicating that the older the company, the lower directors' remuneration will be.
- The control variable the state has a negative but not significant effect on directors' remuneration, indicating that the state in which the company is registered does not guarantee the success of the company, because the performance of the company is influenced by the performance of the directors and employees of the company.

All these indications imply that the companies must improve their remuneration strategy in order to boost employees' dedication and commitment, while efficiently delivering outstanding results. In order to enhance the performance–outcome link, managers should use systems that tie rewards very closely to performance. Managers also need to ensure that the rewards provided are deserved and wanted by the recipients. However, the result is not a reflection of the actual financial situation of the company.

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