Quality of remuneration committee: dimensions and measurement

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Abstract
Establishment of the remuneration committee (RC) is part of the internal mechanisms to enhance corporate governance practices in organizations. However, the effectiveness of such establishment is a function of the quality of remuneration committee. The attainment of the quality of remuneration committee (QRC) is a pivotal concern in recent years. While quality of tangible goods is often measurable, the quality of remuneration committee like most intangibles is largely undefined and under-researched. This study attempts to provide some insights on the measurement of this quality by developing a model of the quality of remuneration committee (QRC) that is built upon the agency theory, corporate governance and management compensation framework.

1. Introduction

The recent worldwide financial crisis which has been described by leading economists as the worst financial crisis since the Great Depression of the 1930s, revived a heated deliberation on the question whether management pay and rewards are subtle and appropriate in the best interests of corporations. Bogle [1] cited a series of unresolved challenges facing capitalism that had contributed to the financial crises but had not been sufficiently addressed. In particular, it raised the issue of “manager's capitalism”, which he argued had replaced “owner's capitalism”, and that had resulted in managers operating the firm for their own benefits rather than those of the shareholders.

In June 2009, President of United States, Barack Obama and his key advisers introduced a series of regulatory proposals. The proposals addressed many issues including those related to executive pay[2, 3]. The President believes that “executive compensation -unmoored from long-term performance or even reality- rewarded recklessness rather than responsibility. And this wasn't just the failure of individuals; this was a failure of the entire system. The actions of many firms escaped scrutiny”[3].

In other developed countries similar concerns are expressed. For instance, the UK government is currently monitoring the trends and regulations pertaining to management compensation. In February 2009 David Walker [4] was asked by the Prime Minister to review corporate governance in UK. He recommended some changes to corporate governance in the UK and to improve management compensation plan design. His report focuses on the practical steps, including structural and behavioural changes, that organisations would need to take.

The financial turmoil of the past years have made the weaknesses even more apparent and the challenges call for a careful assessment of current regulatory approaches. Many features of the current management compensation packages, such as high and increasing pay packages, large option holdings, and generous severance pay, are often cited as evidence that the present compensation practices and corporate governance are seriously flawed. As the establishment of the remuneration committee is part of the internal mechanisms to enhance corporate governance practices in corporations, the effectiveness of remuneration committee and the subsequent management compensation plan design must be assessed within the corporate governance framework.

This study attempts to associate factors that may influence the effectiveness of remuneration committee in designing a proper management compensation plan based on the agency theory and corporate governance framework and propose a conceptual model for evaluation of the quality of remuneration committee for future research.

2. Remuneration Committee

Lately, the issue on the quality of remuneration committee has the focus in a few corporate governance studies. In general, the quality of remuneration committee is not merely a general single fact phenomenon, but it is influence by several firm-specific characteristics, often unexplored; certain corporate governance practices can significantly explain the effectiveness of remuneration committee in designing a management compensation plan that is aligned to corporation’s interest. Of the many factors contributing to the success of a well-run company, the roles of the Board is important. This is because the Board of Directors plays a key role in appointing, supervising and remunerating senior executives to ensure accountability of the management to owners of the company.

The issue of quality of remuneration committee has not been comprehensively investigated and a comprehensive study would enhance a better understanding of how the remuneration committee influencing management compensation plan design and its subsequent implications.
This study proposes a model of the quality dimensions for evaluating the remuneration committee. Specifically, the study examines the following research questions:

1. What are the dimensions and attributes associated with the quality of the remuneration committee?
2. What are the theoretical foundations for the dimensions of quality of the remuneration committee?
3. How could the quality of the remuneration committee be evaluated and measured?

3. **Agency Theory Perspective**

Most large modern companies are not run by the people who own them. While there are advantages to this separation of ownership and control, an apparent problem which arises is the potential divergence between the interest of the managers and those of the shareholders [1]. Agency problems or conflicts arise from the separation of ownership and control [2] that lead to contained by the agency framework, agency conflicts arise from divergences of interest between the two parties.

Agency theory is used to predict managerial behaviour [3] and to explain and interpret the nature and consequences of owners and management relationships. Since the original work of Jensen and Meckling [2] in proposing a theory of the firm based on conflicts of interest between various contracting parties, shareholders and corporate managers, extensive literature has developed in explaining both the nature of these conflicts, and means by which they may be resolved [4].

4. **Agency Theory and Corporate Governance**

The quality of the remuneration committee is based on the agency theory view of corporate governance in corporations [5-9]. Agent or manager i.e. CEO may not act in the best interest of shareholders all of the time when the control of a firm is separate from its ownership. Managers might be satisfiers rather than maximisers, in other words, they tend to play it safe and seek an adequate level of growth because they are more concerned with perpetuating their own existence than with maximising the value of the company for shareholders. However, shareholders give decision-making authority to the non-executive directors with the belief that those directors will act in their best interest. In fact, the board of directors has a fiduciary duty to the shareholders.

Jensen and Meckling [2] show that the principals (the shareholders) can assure themselves that agents will make optimal decisions only if suitable incentives are given and only if the agent is monitored. Incentives include stock options, bonuses and prerequisites which are directly related to how well the results of management’s decisions serve the interests of shareholders. Monitoring consists of bonding the agent, systematic reviews of management prerequisites, financial audits and insertion of specific limits on management decisions. These involve costs, which are unavoidable as a result of the separation of corporate ownership and control. These costs are not necessarily unpleasant for shareholders, but the monitoring activity they finance needs to be efficient.

However, Demsetz [10] and Fama and Jensen [11] pointed out that the primary monitoring of managers comes not from the owners but from the managerial labour market. Management control of a large firm is completely separate from its share ownership. Efficient capital markets provide signals in relation to the value of a firm’s securities and therefore about the performance of its managers. If the managerial labour market is competitive within and outside the company, it will tend to control the manager. As a result, the signals given by changes in the total market value of the company’s securities become very important.

The primary reason for having a corporate governance structure is to reduce the agency problem. Shleifer and Vishny [12] pointed out that expropriation of shareholders by managers can take many forms including building empires, enjoying perks, stealing and transferring money from the firm, insider trading, inappropriate investment due to management incompetence and management entrenchment. Jensen & Meckling [2] define the expropriation as agency costs.

There are huge debates based on the classic owner-manager agency problem [2, 13]. Over the past decades, a considerable number of studies have been conducted on how to mitigate agency costs in the firms. The Board of directors or board vigilance is an important governance mechanism. Agency theory predicts that governance relationships affect firm value either positively, by aligning incentives between shareholders and managers [14-16], or negatively through entrenchment [2].

The owners have to therefore find ways to make sure that managers will act in the shareholders’ interests. Compensation contracts and dismissals are mechanisms for controlling the actions of managers and aligning their interests and shareholders’ interests. These mechanisms perform to reduce agency costs [2, 17].

5. **Agency Theory and Management Compensation**

The agency theory framework used in the majority of the previous theoretical studies on the design of management compensation emphasizes the conflict of interest between shareholders of a publicly owned corporation and its management [18]. Ever since the publication of Berle and Means [13] the main governance problem in listed corporations, given their dispersed ownership, is the separation of ownership and control in...
the sense that management controls the firm without any ownership stake. Jensen and Meckling [2] modelled the main agency problem arising from this separation.

In terms of transaction cost economics, it analyses whether a particular incentive mechanism, namely management compensation, is able to reduce the transaction costs of a particular agency problem, specifically the managerial agency problem. This is a rather specific research topic since management compensation plan includes many kinds of incentive mechanisms, such as remuneration systems that have been claimed to govern the agency relation between top managers and their principals. However, the managerial agency problem is generally thought to be important because the potential economic losses from mismanagement of firms could be huge and management compensation may have a substantial role in reducing these kinds of losses[19].

The discussion regarding the role of management compensation as an incentive mechanism focuses primarily on the agency problems [13] and the misaligned incentives between managers and shareholders[2]. These problems have a negative impact on firm value whereas right management compensation constitutes a potential solution to the manager–shareholder agency conflict.

As agency theory predicts, firms with effective management compensation systems should exhibit superior performance. Incentive structures determine how and why individuals behave in organizations and their role is crucial to developing a suitable theory of the corporation. Although the economic theories of agency and optimal contracts have provided a number of frameworks to think about the composition of management compensation, understanding of compensation arrangements in firms is still primitive. Many common features of organizational incentive systems such as pay systems with extremely low response to performance, the extensive use of incentive systems and tenure all require more extensive study [18].

6. Management compensation

Management compensation structure is a significant area of research in corporate governance studies. The management compensation issue is of major importance for good corporate governance because it relates to the incentives for managers to promote efficiency and enhance performance of the corporation. Sound management compensation plan enhances the firm's ability to attract, retain and motivate the key people responsible for company’s growth and success.

Management compensation is an important mechanism that can be used effectively to align the interests of stockholders and managers. The extent to which the remuneration package can achieve that alignment of interests is an empirical question. From a theoretical point of view, management compensation should correlate with corporate performance. The annual bonus usually is given in times of good as well as bad performance. Good performance pushes the bonus up while bad performance does not depress the bonus [1]. Nevertheless, empirically, the relationship between management compensation and firm performance was detected and shown to exist. Generally, studies have found that there is a positive relation between managerial compensation and firm performance [2, 3].

Using 120 Malaysian public listed companies, Talha, Salim, & Masoud [4] point out that there was a positive relationship between directors' remuneration with board remuneration committee and corporate governance committee. This result prompts a need to re-examine the effectiveness of corporate governance practice through establishment of board committee in determining directors' remuneration.

7. Quality of remuneration committee

According to the code of corporate governance in several developed and developing countries, the public listed companies are required to set up a remuneration committee to provide greater objectivity, transparency and independence in setting remuneration. Remuneration committee should also be set to assess and monitor directors’ performance and their contributions to the company.

Johnson et al. [5] classified responsibilities of directors largely into three defined roles, that is control, service and resource dependence. The control role entails directors monitoring managers as fiduciaries of Shareholders. In this role, the responsibilities of directors include hiring and firing the CEO and other top managers, determining executive pay and otherwise monitoring managers to ensure that they do not expropriate shareholder’s interests. The service role involves directors advising the CEO on executive and other managerial issues, as well as more actively initiating and formulating strategies. The resource dependence role views the board as a means for facilitating the acquisition of resources critical to the success of the company.

The main objective of remuneration committee is to develop a remuneration policy to attract, retain and motivate top management who have the skills needed to achieve the company’s objectives year on year and which balances the interests of the shareholders, the company and its employees. Remuneration committee is one of the least investigated research topic.

Even though the research on management pay has been dominated by US-based studies, the subject has also been researched in few other countries [6]. Remuneration committee, however, only emerged as a topic of academic study in the UK as recently as the early 1990s [7], although the topic of compensation committee has a longer research pedigree in the USA [8, 9]. While corporations have always had a mechanism by which the remuneration of top executives could be set and adjusted, the arrangement that is now identified with the remuneration committee did not appear in popular discussion in the UK until the work of the Cadbury Committee [10] created the first consciousness of the
arrangement in policy circles. Interest has waxed and waned ever since – mostly reflecting subsequent governance reports: the Greenbury study group [11]; the Hampel Committee [12]; and the Higgs report [13].

The Cadbury Committee [10] recommended that the effectiveness of a board is buttressed by its structure and procedures. One aspect of structure is the appointment of committees of the board, such as the remuneration committee. The committee [10] recommended that in disclosing directors’ total emoluments and those of the chairman and highest-paid UK director, separate figures should be given for their salary and performance-related elements and that the criteria on which performance is measured should be explained. Relevant information about stock options, stock appreciation rights, and pension contributions should also be given.

The Cadbury Committee[10] also recommended that the board of directors should appoint remuneration committee, consisting wholly or mainly of non-executive directors and chaired by a non-executive director, and to recommend to the board the remuneration of the executive directors in all its forms, drawing on outside advice as necessary. Executive directors should play no part in decisions on their own remuneration. Membership of the remuneration committee should appear in the Directors’ Report.

Conyon [14] in an examination of the influence of remuneration committee adoption in UK companies finds that, in some circumstances, the adoption lowers the growth rates in top director compensation. Conyon and Peck [15] investigate the affect of outside directors in remuneration committee decisions, and report that they enhance the pay-for-performance sensitivity. However, studies in the US by Anderson and Bizjak [16] and Vafeas [17] report insignificant results on the influence of remuneration committee independence towards level of CEO pay. A recent study by Sun and Cahan [18], attempts to provide explanation for the mixed findings. Using a broader and richer measure of remuneration committee quality instead of just focusing on independence, they show that the sensitivity of CEO compensation to accounting performance is related to the quality of the remuneration committee, for US companies with fully independent remuneration committees.

According to the literature, there are few studies that examine the quality of the remuneration committee. Sun and Cahan [18] using a sample of 812 US firms, developed a measure of compensation committee quality. They employed a composite score to measure the multiple dimensions of compensation committee quality. Their findings imply that compensation committee quality depend on compensation committee characteristics. Six characteristics that they consider are as follows: 1) CEO Appointed Directors, using the proportion of CEO appointed directors in the compensation committee. 2) Senior Directors, using the proportion of directors in the compensation committee with 20 or more years of board service time for the current company. 3) CEO Directors, using the proportion of CEOs of other firms in the compensation committee. 4) Director Shareholdings, using the percentage of shares held by directors in the compensation committee. 5) Additional Directorships, the proportion of directors with three or more additional board seats in the compensation committee. 6) Committee Size, using the number of directors in the compensation committee.

Standard & Poor's and Corporate Governance & Financial Reporting Centre of National University of Singapore (CGFRC) conducted academic research in the areas of corporate governance. Standard & Poor's and CGFRC introduced Corporate Governance Disclosure Scorecard [19] for different countries to research, disseminate and promote best and high quality practices in different aspects of corporate governance. Standard & Poor's and CGFRC introduced “Remuneration Matters Disclosure Scorecard” [19] to examine the corporate governance practices of companies. The analysis is based primarily on the disclosures made in the latest annual report. The proprietary methodology is based on a synthesis of governance codes and guidelines of global best practices, as well as experience in conducting detailed reviews of individual companies. Remuneration Matters Disclosure Scorecard [19] assesses the disclosures regarding remuneration committee practices among the listed companies. The scorecard items reflect principles and best practices embodied in international corporate governance codes. Most important issues in the scorecard include disclosure of remuneration committee, full disclosure and independence of committee members, remuneration packages, link between compensation and performance.

While remuneration committees were once seen merely as an arms-length managerial mechanism to ensure an adequate degree of integrity in the setting of management reward, they are now seen as key agents in the corporate governance process of choosing a remuneration package and arranging that it is calibrated in a way that make sure that it motivates the management.

8. Dimensions and attributes of Quality of Remuneration Committee

According to Sekaran [1] a good conceptual model should identify and label the important variables that are relevant to the problem defined and logically describes the interconnections among these variables.

This study develops a conceptual model on quality of remuneration committee based on the underpinning theories and empirical findings discussed previously. The main theory underlying this model is the agency theory. In the principal-agent relationship, an agency problem arises whenever an owner (the principal) hires another person (the agent) to take action on behalf of the owner and the principal compensates an agent (managers) by providing him or her incentives to take observable actions to increase the principal’s wealth.

As previously mentioned, the key attributes of an effective compensation plan as a way of aligning the interests of the top managers with those of the owners are those with performance-based and long-term oriented incentives. Thus designing a performance-based and long-term oriented remuneration plan is requisite. Similarly, qualification and independence of members are important to enhance the remuneration committee to play its key role of aligning managers’ interest with those of the shareholders. Furthermore, adequate disclosure by the remuneration committee
is intended to provide investors with complete and meaningful information on the application of the board’s remuneration policies that motivate performance of managers of the company. The policies should again serve to promote the fundamental tenets of accountability and fairness.

Figure 1 presents the important dimensions of the quality of remuneration committee. These dimensions can be categorised into six groups; detailed disclosure of remuneration committee, qualification and independence of committee members, existence of a remuneration framework, endorsement of the committee’s recommendations, performance-based incentives and long term-oriented remuneration system.

The quality of remuneration committee could be assessed based on twenty six items under the six categories as shown in Figure 1.

Figure 1. Quality Dimensions of Remuneration Committee

These items are adopted from previous research relating to agency theory, corporate governance, and management compensation. Specifically, finding of the Corporate Governance Scorecard of Standard & Poor’s and Corporate Governance & Financial Reporting Centre of National University of Singapore (CGFRC) [1] and The Malaysian Corporate Governance Report 2009 by The Minority Shareholder Watchdog Group [2] for listed companies have been extensively used for identification of the items indicated in Table 1.

The six main categories of dimensions influencing the quality of remuneration committee are founded based on several theories. Most important theories are agency theory, contract theory, signalling theory, stakeholder theory, disclosure theory, and legitimacy theory. The premise of agency theory has been discussed, in earlier sections. The following sections relate the six key factors to the other theories mentioned.

9. Detailed Disclosure of the Remuneration Committee

Disclosure has many theoretical and practical objectives. Since the 1990s, the rules of corporate governance have the posed more disclosure requirements and demands for accountability information are much broader than those of financial conditions of the corporation[1]. Corporate directors are subject to the disclosure requirements on their responsibilities as fiduciaries and agents of the corporation. These obligations are declared in the form of code of practice, institutional rules, as well as professional and organisational guidance and standards. Ultimately, companies may choose to produce information voluntarily[1]. Information of management extends from personal details regarding directors, to breakdown and levels of their package of compensation to their ability and experience.

The important objectives of disclosure include investor protection, prevention of fraud, corporate governance and managers accountability to the shareholders, efficiency via reduction of monitoring and costs of information search, reduction of competitive injury, standardisation of information making comparison easier, alternative to political and social benefits and regulatory intervention arising from disclosure[1]. If shareholders are given a more equal access to information as the managers, it is likely that they will have a better understanding of management decisions and be able to participate in decision making. One key aspect of participation is monitoring of management and managerial activity. Disclosure is necessary for the managers to be able to explain their actions [1].

There are other reasons to support a system of disclosure in every company. Transparency is an important aspect of any society. In business, information produces power and it is vital to share and distribute information to avoid abuse of power. Consequently voters in organizations will be capable to make further effective decisions if they are more informed. Transparency discourages abuse of power as actions will be judged and examined. Hence disclosure has a function of housecleaning and could be also justified for informed decision making, accountability, protection of shareholders, and corporate action legitimacy[1]. In view of the rationalization, the disclosure requirements on remuneration committee are
10. Qualifications and Independence of Members

Potential employees aim to vend their services to employers in the job market, for some price or wage. Usually, employers would like to pay higher compensations to attract qualified workers. Even thought the individual may identify his/her level of ability, the hiring corporation usually is not able to detect such an intangible attribute, thus giving rise to the adverse selection problem and an information asymmetry exists between agent and its principle. Credentials of education could be used like a signal to the organization, representing a conducive characteristic to the organization.

Stakeholder theory asks what responsibility management has to the stakeholders. This pushes managers to articulate how they want to do business, specifically, what kinds of relationships they want and need to create with their stakeholders to deliver on their purpose[3]. Managers must develop relationships, inspire their stakeholders, and create communities where everyone strives to give their best to deliver the value the firm promises. Indeed shareholders are a significant constituent and profits are a critical feature of this activity. Several companies have developed and run their businesses in terms highly consistent with stakeholder theory. These companies also see the import of values and relationships with stakeholders as a vital element of their ongoing success[3].

Traditionally, the shareholders or stockholders are the owners of the firm, and the corporation has a binding fiduciary obligation to put their needs first, and to enhance their value. In the earlier input-output patterns of the firm, the corporation converts the inputs of investors, suppliers and employees, into usable outputs which customers buy, thereby returning various capital benefits to the company. According to this model, corporations only address the wishes and needs of four groups as investors, suppliers, employees, and customers. However, stakeholder theory have discussing that there are other groups such as trade associations, governmental bodies, trade unions, political groups, associated corporations, communities, prospective customers, prospective employees, and the public at large are involved. Sometimes even competitors are enumerated as stakeholders[4].

The stakeholder framework put shareholders among the manifold stakeholder groups that firm management have to involve in their decision making procedure[5, 6]. The stakeholder groups comprise external, internal, and environmental constituents, who, similar to shareholders, could place demands upon the company[7]. Some studies have cited different benefits accrued to corporations that pay more attention to all stakeholders.

**Table 1. Determinants of the Quality of Remuneration Committee**

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<tr>
<th>Determinants</th>
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<tr>
<td>1. Detailed Disclosure of Remuneration Committee:</td>
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<td>1-1. Disclosure of the committee members in the company’s annual report</td>
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<td>1-2. Disclosure of individual members’ attendance at the committee meetings</td>
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<td>1-3. Disclosure of the frequency of committee meeting in the company’s annual report</td>
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<td>1-4. Meeting of the committee more than 2 times in the year</td>
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<td>1-5. Disclosure of the committee’s processes (e.g., external compensation specialists hired) to ascertain industry practices and salary levels for pay and employment conditions</td>
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<td>1-6. Disclosure of executive directors’ remuneration to shareholders in bands of a particular amount (depend to the law of each country)</td>
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<td>1-7. Disclosure of the details of any shares/options for executive directors, if the company has these (shares issued to employees or options granted) or disclosure of does not having such schemes</td>
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<td>1-8. Full disclosure of remuneration of each director by name in the company’s annual report</td>
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<td>1-9. Early announcement of stock option grants (announcement on the day before the grant)</td>
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<td>2. Qualifications &amp; Independence of members:</td>
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<td>2-1. Having academic qualification</td>
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<td>2-2. Independence of all/majority of committee members</td>
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<td>2-3. Chair the committee by an independent non-executive director</td>
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<td>2-4. Sitting the different independent directors on different committees (the nominating, remuneration and audit) in the company</td>
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<td>2-5. Prevention of directors from deciding on their own remuneration</td>
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<td>3. Existence of a Remuneration Framework:</td>
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<td>3-1. Recommendation of the committee to the board a framework of remuneration for the board and key executives</td>
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<td>3-2. Explanation of the basis for the development of the framework</td>
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<td>3-3. Basis for determination specific packages for executive directors and the CEO by the remuneration committee</td>
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<td>4. Endorsement of the Committee’s Recommendations:</td>
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<td>4-1. Making the committee’s recommendations in consultation with the chairman of the board</td>
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<td>4-2. Submission of the committee’s recommendations for endorsement by the entire board</td>
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<td>4-3. The board recommendation of all components of non-executive director compensation for approval at the Company’s Annual General Meeting</td>
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<td>4-4. Inclusion of the committee’s review all aspects of remuneration (such as salaries, fees, allowances, bonuses and options)</td>
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<td>5. Performance-based Incentives:</td>
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<tr>
<td>5-1. Linkage of executive director compensation to industry, company and/or individual performance</td>
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<tr>
<td>5-2. Linkage of non-executive directors’ compensation to their level of contribution and responsibilities, time spent and effort</td>
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<td>6. Long Term-oriented Remuneration System:</td>
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<tr>
<td>6-1. Inclusion of director remuneration long-term incentives (E.g., bonuses payable after 12 months and/or share option with a vesting period &gt; 12 months)</td>
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<td>6-2. Disclosure of remuneration components analyzed by salaries, variable bonuses, options and long-term incentives</td>
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<tr>
<td>6-3. The vesting period of stock options over 3 years or more</td>
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stakeholders rather than only shareholders. For example, Choi and Wang [8] pointed out that employees will work harder to improve the effectiveness of corporation in stakeholder oriented companies. They suggest also that customers will pay premium prices or raise their demand for the company’s products, as suppliers will be more willing to engage in knowledge sharing with the company[9].

A number of studies emphasis on the independence of directors.

Based on the stakeholder theory, qualifications and independence of the remuneration board members form a basis for legitimacy of the furnish structure or behaviour.

11. Existence of a Remuneration Framework

By designing a remuneration framework based on a sound basis, company tries to demonstrate that management is under monitor and control. Both signalling and legitimacy theories postulate that a sound remuneration framework provide valid signals of legitimacy of the incentive scheme and reduces information uncertainty management excesses [1].

12. Endorsement of the Committee’s Recommendations

When the committee’s recommendations are made in consultation with the chairman of the board and endorse by the entire board, the board’s recommendations of all components of the executive and non-executive director compensation including all aspects of remuneration such as salaries, fees, allowances, bonuses and options have higher validity. Endorsement of the committee’s recommendations represents authorization of the company’s plan and adherence to good corporate governance practice.

Endorsement of decisions made by board of directors also renders legitimacy for the recommendation. “Legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions” [1]. Being legitimate “enables organizations to attract resources necessary for survival (e.g., scarce materials, patronage, political approval)” [2]. Companies try to manage their legitimacy because it “helps to ensure the continued inflow of capital.

13. Performance-based Incentives and Long Term-oriented Remuneration System

Contract theory research shows that economic actors could and do construct contractual arrangements, usually in the presence of information asymmetric information. The theory has associations with agency theory and management incentives. One major application of it is the design of optimal and effective schemes of managerial compensation.

A standard practice of contract theory is to characterize the behaviour of a decision maker under specific numerical utility structures, and subsequently apply an optimization algorithm to recognize optimal decisions. Such a procedure has been used in the contract theory structure to several typical situations, labelled adverse selection, moral hazard, and signalling. The courage of these models lies in finding theoretical ways to motivate agents to take appropriate actions[3]. Allcock and Pass [4] pointed out that before IPO most companies did not have an incentive pay scheme in place, however, after IPO most companies introduced an incentive pay scheme.

In moral hazard models, the information asymmetry is the principal's inability to observe or verify the actions of agent. Performance based incentives and long-term oriented remuneration contracts that depend on observable and verifiable output can frequently be employed to create incentives for the agent to act in the principal's long-term interest. There is a need for companies to link remuneration with performance [5]. According to Epstein and Roy [6] there are a growing number of companies using financial and non-financial metrics, results confirm that CEOs are evaluated on performance in US companies. Fleming and Schaupp [7] opined that non-executive investors place greater weight on factors related to performance.

Pass [8] opined that UK public listed companies use option schemes and increasingly long-term incentive plans to reward their executive directors in order to improve company performance and align their interests more closely with those of the corporation shareholders.

14. Summary and conclusion

The recent global financial crisis has generated extensive research interests in the areas of corporate governance and management compensation. Particularly, the implementation of code of corporate governance in many countries has created potential areas for research. There is a gap of study that explains the determinants the quality of remuneration committee as a part of the corporate governance mechanism. This study attempts to fill the gap by conceptualizing the factors that may influence the quality of remuneration committee. It aims to enhance understanding of the factors that may directly or indirectly contributing to the effectiveness of corporate governance practicing in corporations. It will also add to the growing literature on corporate governance and management compensation.

This study offers several insights and propositions concerning the quality of remuneration committee by pinpointed six key factors that are likely to affect quality of remuneration committee. Specifically, the research revealed 26items that may be used to assess the quality of remuneration committee. The major insights gained through the research suggest a conceptual quality model that will hopefully spawn both academic and practitioner interest in the quality of remuneration committee and serve as a model for further empirical research in this important area.
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