The influence of corporate governance structure on executive pay

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ABSTRACT

This study assesses the effectiveness of the Hong Kong Code on Corporate Governance Practices (CG Code) in protecting shareholders' interests with respect to directors' remuneration by examining whether directors' remuneration is affected by independent non-executive directors where the chairman of the board is a family member. Findings show that where the number of independent non-executive directors on the remuneration committee is high, the committee acts as a means of control, leading to lower directors' remuneration than in situations where family members have more influence on remuneration committee decisions.

Keywords: director remuneration, remuneration committee, executive pay, Hong Kong Code on Corporate Governance Practices, corporate governance

INTRODUCTION

Corporate governance refers to the systems by which companies are directed and controlled, including the institutional arrangements for boardroom pay setting. The way in which a remuneration system is designed reflects a firm's corporate governance and the extent to which it applies free market principles. Executive remuneration has long been a topic of heated debate and the focus of much research in the U.S. and other developed economies (Jensen & Murphy, 1990; Core *et al*, 1999; Conyon & Murphy, 2000; Bebchuk & Fried, 2006). Good corporate governance can help prevent excessive pay for top management and encourage the use of performance-related pay schemes. The rise in executive pay over time has been the subject of much public criticism, which further intensified following the corporate governance scandals that began erupting in late 2001 (Bebchuk & Fried, 2006).

Hong Kong is representative of economies in which firms are mainly family-controlled. A distinctive characteristic of such firms is that a high percentage of their shares are held by CEOs and directors. In 1994, Hong Kong Exchanges and Clearing Limited (HKEx) introduced rules that require listed firms to disclose the number of directors who receive remuneration in various pay bands. Before 2004, there was no requirement to disclose the names of directors whose remuneration fell within each pay band (Cheng & Firth, 2005). The Disclosure of Financial Information rule under HKEx's Listing Rules was amended on 31 March 2004 to require full disclosure, on an individual and named basis, of directors' fees and any other reimbursement or emolument payable to a director. In addition, Hong Kong Financial Reporting Standard 2 (HKFRS 2) requires listed firms to disclose directors' share-based remuneration.

The Code on Corporate Governance Practices (CG Code), which forms part of the Listing Rules issued by HKEx, came into effect on 1 January 2005. According to the Code, Hong Kong's listed firms should be overseen by an effective board, which should assume responsibility for the leadership and control of the listed firm, and the members of which should be collectively responsible for promoting the success of the firm by directing and supervising its affairs. Directors should make decisions objectively in the best interests of the firm. To encourage directors to fulfill these responsibilities, incentive-based remuneration is needed to influence executive actions in ways that affect financial reporting. The CG Code requires the disclosure of information related to the firm's directors' remuneration policy and other remuneration-related matters. There should be a formal and transparent procedure for setting policy on executive directors' remuneration. Remuneration should be set at a level sufficient to attract and retain directors of the caliber required to run the company successfully, but companies should avoid paying more than is necessary.

This study investigates whether compensation awarded to directors in Hong Kong is excessive if the chairman and/or CEO are family members of substantial shareholders. Also explored is the issue of how independent non-executive directors influence directors' remuneration to maximize company wealth and protect shareholders' interests, especially those of minority and non-family shareholders. The focus of this study is on determining the differences, if any, between family-owned firms (FOFs) and non-family-owned firms (NFOFs) with institutional ownership with respect to directors' remuneration. Family-owned firm is defined as a listed firm with at least one director of the board who deems to be substantial shareholder. Substantial shareholder is defined as, according to Section 336 of Part XV of the Securities and Futures Ordinance, individuals and corporations who have interest in 5% or more of any class of voting shares in a listed corporation.

Since empirical research on the determinants of top executive remuneration has found only a very weak statistical link between directors' remuneration (excluding shareholdings and options) and stock performance of their companies (see Jensen & Murphy, 1990, for evidence from the United States; and Gregg *et al*, 1993, for the United Kingdom), this study focuses on the effectiveness of the CG Code regarding directors' remuneration.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Board Structure

The board is expected to represent shareholders and serves as their first line of defense against a self-serving management team. The problem with corporate internal control systems start with the board of directors. The board, at the apex of the internal control system, has the final responsibility for the functioning of the firm (Jensen, 1993). Monitoring of corporate boards by independent non-executive directors will result in corporate boards that are more responsive to investors, and inclusion of independent non-executive directors on boards will improve the firm's compliance with disclosure requirements, which in turn will enhance the comprehensiveness and quality of disclosures (Chen & Jaggi, 2000). An important question relating to board composition concerns the ideal combination of outside and inside members. While outsiders (independent non-executive directors) are more independent than insiders (executive directors and non-executive directors) on a firm's CEO, they are potentially less informed regarding firm projects. Insiders may face distorted incentives due to their lack of independence on the firm's CEO (Bushman *et al.*, 2004).

HKEx Listing Rule 3.10 requires the board of directors of a listed issuer to have at least three independent non-executive directors, which reflects the belief that the appointment of independent non-executive directors is an important element of the board.

Remuneration Committees

Corporate boards of directors provide a source of external control over management decisions that could be self-serving; thus, it is expected that members of the board discourage excessive top-management compensation and at least attempt to link that compensation in some manner to company performance (Cheng & Firth, 2005). External control can be extended with the majority of remuneration committee members being independent non-executive directors

In the 1980s, inclusion of independent non-executive directors on corporate boards started to receive increased attention. Two main arguments have been advanced in support of independent non-executive directors. First, independent non-executive directors provide advice to corporate boards on strategic decisions, which may improve the firm's economic and financial performance. The second argument relates to better monitoring of management decisions and activities by corporate boards (Chen & Jaggi, 2000).

The board of directors' function is to manage the business and affairs of the corporation. Boards can either conduct their work through the full board or delegate their authority to standing committees reporting to the board. Board committees meet separately from the full board, and are composed of subsets of board members. In addition, board committees tend to have specific, narrowly-defined functions. In 1999, remuneration committees were uncommon in Hong Kong, with only few firms reporting their existence (Cheng & Firth, 2005). Studies of

firms in other countries yield conflicting results on the relationship between pay and remuneration committee. Some find that remuneration committees reduce remuneration, whereas others report the opposite (Conyon & Peck, 1998; Ezzamel & Watson, 1998).

The CG Code recommends that the majority of remuneration committee members be independent non-executive directors. Remuneration committees should make recommendations to the board on the firm's policy and structure for all forms of remuneration paid to directors and senior management, and on the establishment of a formal and transparent procedure for developing policy on such remuneration. Independent non-executive directors are unlikely to grant excessive executive director remuneration. One function of independent non-executive directors is to strengthen the monitoring of the firm's management through good corporate governance. The presence of independent non-executive directors on the remuneration committee can be used as monitoring mechanism that prevents excessive remuneration for executive directors (Basu *et al.*, 2007). Hence, the following Hypothesis 1 is tested: All else being equal, lower directors' remuneration is associated with higher proportion of independent non-executive directors for the remuneration committee.

Power of Family Members

Many listed firms are majority-owned by individuals and their family members, a phenomenon that has implications for corporate governance, firm performance and the setting of senior executive pay (La Porta *et al*., 1999; Lawton & Tyler, 2001; Mishra *et al*., 2001). FOFs (NFOFs) are those firms with (without) family ownership or family presence on the board of directors. FOFs are majority-owned by individuals and their families. The positions of the chairman and/or chief executive officer are usually held by family members who can influence the level of remuneration paid to directors. NFOFs are owned by shareholders who are not related to the family or executive directors.

Prior research provides only limited guidance on how to ascertain FOFs. Ownership structure in many Hong Kong companies is characterized by the dominance of one primary owner. This dominant owner holds a percentage of shares significant enough to be the largest shareholder but usually much less than the majority holdings of a company (Chau & Leung, 2006). As specified in Section 336 of Part XV of the Securities and Futures Ordinance, individuals and corporations who have interest of 5% or more in any class of voting shares in a listed corporation are considered substantial shareholders. To distinguish between FOFs and NFOFs, this study classifies a firm as FOF if a family member serves as a director of the Board and if any director owns more than 5% of the firm's equity.

Cheng and Firth (2005, 2006) find that within a family-firm environment, direct compensation paid to top managers tends to be reduced if the directors have substantial stockholdings. Other than Cheng and Firth's study, not much research has been done on corporate governance within a family-controlled environment (Chen & Lee 2008). Given that Hong Kong represents an economy within which firms are mainly family-controlled, this study fills the gap by examining the entire remuneration package to the board of H.K. firms if the chairman or CEO has substantial stockholdings of over 5%.

Family traits, including trust, altruism and paternalism, can encourage an atmosphere of commitment to and love for the business (James, 1999). However, management structure of such firms is often autocratic, leading to the concern that some controlling shareholders might treat their companies as personal fiefdoms (Brewer, 1997). Such companies may lack corporate

transparency, especially in directors' remuneration. Directors who have substantial shareholdings are likely to receive lower compensation. Instead, these directors might receive large dividend payouts, reducing their need for cash compensation. In addition, tax minimization could be an objective when remuneration is set (Deckop, 1988; Ramaswamy *et al.*, 2000). However, tax minimization may not necessarily be the objective in Hong Kong since it is a low-tax region when compared with other countries such as the U.S. Consequently, in Hong Kong, chairmen and/or CEOs may use their power to award themselves generous remuneration packages. Management ownership and family control can be used as ownership mechanisms (Basu *et al.*, 2007). Chairmen and/or CEOs with bargaining power can be expected to influence the size and structure of their remuneration packages to their own benefit (Ryan & Wiggins, 2004). Hence, the following Hypothesis 2 is tested: All else being equal, higher directors' remuneration is associated with firms in which chairman of the board or CEO of the firm is a member of the family that controls the company and holds more than 5% of total issued shares.

DATA COLLECTION

This study examines firms listed on HKEx. Information on directors, remuneration payment, and board composition is collected from annual reports. Sales, stock returns, returns on equity, sales growth, and leverage data is collected from *Datastream*.

Because the CG Code came into effect in 2005, most firms should have had remuneration committees by the 2006 fiscal year-end. Therefore, the sample selection process starts with 975 firms listed on the main board in 2006. Observations are eliminated from the sample if there is missing price or other data needed for regression estimation. Firms involved in takeovers or mergers, those that were subsequently withdrawn or suspended from the main board, newly-listed firms, and those that changed their closing date or their financial statements during the observation period are also excluded.

In addition, foreign companies, H-share firms, and red chip firms are dropped from the sample because their financial profiles are significantly different from other companies. HKEx defines a foreign company as a company that is incorporated overseas and does the majority of its business outside Hong Kong and mainland China. An H-share company is incorporated in the People's Republic of China (PRC) with shares issued under PRC law and listed on HKEx, the par value of which is denominated in RMB, but are subscribed for and traded in HKD. A company is deemed to be a mainland China-controlled company (red chip) if: 1) a total of at least 30% of its shares are held directly by mainland China entities and/or through companies that are controlled by mainland China entities; or 2) a total of between 20% and 30% of its shares are held directly by mainland China entities and/or through companies that are controlled by mainland China entities, and such entities have a strong influence, viewed from a subjective basis, on the company's board of directors.

This study focuses on 10 industry groups based on the HKEx classification system: Conglomerates, Consumer Goods, Energy, Industry, Information Technology, Materials, Property and Construction, Services, Telecommunications and Utilities. Financial industries such as insurance and banking are excluded because their financial profiles are different from those of other industries. The selection process for firms results in a final sample of 484 firms

across 10 industries in 2006 and 2007, with a total of 968 firm-year observations. While there are a total of 9,142 director observations for 2006 and 2007, 1,687 are excluded because of appointment, resignation, removal, re-designation, retirement, or death during 2006 or 2007. The selection process for directors yields a final sample of 7,455 individual firm-year observations.

RESEARCH METHODOLOGY

Cheng and Firth (2005) study top-management pay in Hong Kong and investigate how it is affected by firms' ownership and governance characteristics. They also investigate the role of institutional ownership and board composition in the determination of pay. Observations in Cheng and Firth's study are from 1994 to 1999. However, because the observations used in the present study are for 2006 and 2007, i.e., after the CG Code with its different disclosure requirements came into force, the model is amended as follows.

Dependent Variable

The dependent variable used in Cheng and Firth's (2005) study is average executive directors' remuneration (total remuneration of executive directors divided by number of executive directors). Since the board of directors works as a group, for the dependent variable, this study uses total pay of all board directors to obtain an overall picture of firms in Hong Kong. To mitigate the impact of outliers, the common practice (e.g. Conyon & Peck, 1998) of using logarithms of the average pay among all directors in a company is used.

Directors' pay can be delineated as three separate components: salary, annual performance bonus, and change in the value of share options held. Salary is a fixed form of remuneration and is normally paid without challenge. On the other hand, bonus is a short-term variable component of pay linked to some element of accounting profits generally over a one-year period. Share option is a long-term component of pay that grants the holder the right to purchase a specific number of shares within a definite time period at a pre-arranged price.

Directors' pay structures can be found in annual reports since their disclosure is required by The Disclosure of Financial Information under HKEx's Listing Rules. Directors' fees can be set to ensure directors receive sufficient payment for their work. Salaries can be set to ensure directors receive sufficient payment if they also hold the post of executive. Pensions can act as a long-term protection to attract director work in the long run. Bonus can act as an incentive for directors to run the business successfully. Share-based payments can attract directors to work not just for the firm, but also for themselves as shareholders.

Independent Variables

The ownership and governance variables that Cheng and Firth (2005) use to test their hypotheses are share ownership of directors expressed as a percentage of total issued shares, share ownership of institutions and blockholders (who are not directors or allied to the directors) expressed as a percentage of total issued shares, and number of non-executive directors on the board expressed as a proportion of total number of directors. However, since the introduction of the CG Code, directors' remuneration has been determined by a remuneration committee after consultation with the chairman or CEO of the board. Thus, this study replaces the three

independent variables used in Cheng and Firth's (2005) study with two variables: number of independent non-executive directors divided by total number of directors on the remuneration committee, and whether or not the chairman or CEO of an FOF is a member of the controlling family.

Control Variables

Following Cheng and Firth (2005), this study includes the following control variables that could affect the level of remuneration: company size (log of sales), performance (return on equity, stock return, sales growth), and monitoring (leverage).

In Cheng and Firth's (2005) study, a group of listed companies controlled by a single individual or family is captured as an indicator variable, "Group." However, given that most FOFs are chaired by family members, the problem of multicollinearity arises due to the high correlation between the "Group" and "Family Head" variables. To solve this problem, the "Group" variable is dropped from the model.

Model Used in this Study

In addition to the issues stated above, remuneration received by an individual director may differ according to whether the director is a family member, chairman of the board, CEO of the firm, an independent non-executive director, or a member of the remuneration committee. Therefore, these variable, as well as Industry and Year dummy variables, are included in the ordinary least squares (OLS) regression.

Directors' Pay = $\beta 0 + \beta 1$ INED on RC + $\beta 2$ Family Head + $\beta 3$ Log of Sales + $\beta 4$ Return on Equity + $\beta 5$ Stock Return + $\beta 6$ Sales Growth + $\beta 7$ Leverage + $\beta 8$ Family Member + $\beta 9$ Chairman + $\beta 10$ CEO + $\beta 11$ INED + $\beta 12$ RC + εj

where:

Directors' Pay	=	log of remuneration of all directors in each firm
INED on RC	=	number of independent non-executive directors divided by total number of directors on the remuneration committee
Family Head	=	dummy variable coded one (1) if the chairman of the board or CEO is a member of the family that controls the company and holds more than 5% of total issued shares
Log of Sales	=	log of sales revenues (in HK$ millions) for the fiscal year
Return on Equity	=	net income divided by average shareholders' equity
Stock Return	=	annual return (price change plus dividend) for the fiscal year
Sales Growth	=	yearly proportional change in sales
Leverage	=	debt divided by shareholders' equity
Family Member	=	dummy variable coded one (1) if the director of the

		board is a member of the family that controls the company and holds more than 5% of the total issued shares
Chairman	=	dummy variable coded one (1) if the director is the chairman of the board
CEO	=	dummy variable coded one (1) if the director is the CEO of the firm
INED	=	dummy variable coded one (1) if the director is an independent non-executive director
RC	=	dummy variable coded one (1) if the director is a member of the remuneration committee

RESULTS

Table 1 shows that since the introduction of the CG Code, which requires that the majority of remuneration committee members be independent non-executive directors, the percentage of remuneration committee members who are independent non-executive directors has been approximately 73%. In approximately 83% of firms, the board of directors includes a director who is a member of the family that controls the company and holds more than 5% of the total issued shares. This information indicates that most companies in Hong Kong are FOFs. In approximately 79% of firms, the post of chairman of the board or CEO is held by a member of the family that controls the firm, indicating that most FOFs allow their family members to hold these senior positions.

Percentage of Independent Non-executive Directors on the Remuneration Committee

Table 2 shows the regression results when directors' remuneration is related to various independent variables. The focus is on whether the percentage of independent non-executive directors on the remuneration committee, or a family member being the chairman or CEO of an FOF influences directors' pay. When all directors are considered (Panel A), the independent variables have incremental explanatory power for total payment (R^2 = 43.2%). Regarding different types of remuneration, the independent variable that has the highest incremental explanatory power is Bonuses (R^2 = 36.3%) and the lowest incremental explanatory power is Directors' Fees (R^2 = 23.1%). When directors are considered individually (Panel B), the independent variables have incremental explanatory power for total payment (R^2 = 45.3%). Regarding different types of remuneration, the independent variable that has the highest incremental explanatory power is Basic Salaries and Others (R^2 = 43.2%) and the lowest incremental explanatory power is Directors' Fees (R^2 = 16.1%).

Panel A of Table 2 shows that, as expected, on a firm basis, the percentage of independent non-executive directors on the remuneration committee has negative coefficients for different types of remuneration and total payment, except for Share-based Payments. The results support Hypothesis 1. Directors receive less remuneration when the percentage of independent non-executive directors on the remuneration committee is higher, which suggests that independent non-executive directors can control the emolument paid to all directors. It appears that independent non-executive directors do not support higher pay for all directors, as the regression results for Directors' Fees (p-value 0.004) as well as Basic Salaries and Others

(p-value 0.011) are statistically significant. However, the regression results for Pension Contributions (p-value 0.108) and Bonuses (p-value 0.158) are not statistically significant. In addition, the results suggest that independent non-executive directors cannot control share-based payments made to all directors, with a coefficient that is unexpectedly positive and statistically significant (p-value 0.010).

Panel B of Table 2 shows that, as expected, on an individual basis, the percentage of independent non-executive directors on the remuneration committee has negative coefficients for both Basic Salaries and Others as well as Pension Contributions. These results support Hypothesis 1. Directors receive lower basic salaries and pensions when the percentage of independent non-executive directors on the remuneration committee is higher, which suggests that independent non-executive directors can control the salaries and pensions paid to individual directors. Independent non-executive directors do not appear to support higher Salaries and Pensions for individual directors, as the regression results for these items were statistically significant (p-values are 0.012 for Salaries and 0.000 for Pensions). Unexpected positive regression coefficients for Directors' Fees, Bonuses, Share-based Pay and Total remuneration to individual directors indicate that the percentage of independent non-executive directors on the remuneration committee does not affect the level of these forms of remuneration. However, with the exception of Share-based Pay, the regression results of these variables are not statistically significant (p-values range from 0.116 to 0.814).

The regression results show that on both a firm and an individual basis, there is a significant positive relationship between the percentage of independent non-executive directors on the remuneration committee and share-based payments (p-values are 0.010 for firms—Panel A, and 0.000 for individuals—Panel B). This significance indicates that directors receive higher share-based payments when the percentage of independent non-executive directors on the remuneration committee is higher.

Family Member Being Chairman or CEO

The CG Code states that the remuneration committee can seek advice from the chairman or CEO on the matter of directors' pay. Hence, this study examines whether or not a family member being chairman or CEO of an FOF will influence directors' pay. On a firm basis, this variable has positive coefficients for Salaries, Bonuses, and Total payment (Table 2 Panel A). The results support Hypothesis 2 and are statistically significant (p-values range from 0.001 to 0.058). As expected, director remuneration is, on average, higher for FOFs in which chairman or CEO being a family member than for NFOFs.

On an individual basis, positive coefficients are found only for Salaries, Bonuses, and Total payment, but not at a statistically significant level (p-values range from 0.184 to 0.786). Hence, on an individual basis, the results do not support Hypothesis 2.

Based on the results on a firm basis, when the chairman or CEO of an FOF is a member of the family that has control over the firm (via shareholding of greater than 5%), he or she can influence remuneration committee decisions to increase remuneration for all directors. Ideally, directors' remuneration contracts should be formulated and approved by the remuneration committee, which acts on behalf of the shareholders. These results indicate that substantial family shareholding influences directors' remuneration contracts, an arrangement that may not be favored by all shareholders.

Company Size, Performance, Leverage

Company size (log of sales) is by far the major determinant of different types of remuneration and total directors' pay on both firm and individual levels (p-value is 0.0000 for all types of payments to directors except for Share-based Pay on a firm level, p-value for which is 0.011), The significance of this variable implies that directors' remuneration is higher in large firms, probably because large firms are usually more complex and, therefore, require more skilled and experienced directors.

In terms of performance (Return on Equity, Stock Return, Sales Growth), Panel A of Table 2 shows that executive pay on a firm basis is much less sensitive to performance than has been commonly recognized. The p-value for Return on equity (0.745) is less significant than that for Stock Return (0.078) in terms of total remuneration paid, suggesting that accounting performance is less important than stock performance. Sales growth has a negative relationship with total pay and different types of remuneration on a firm basis, and is statistically significant (p-values from 0.000 to 0.038). The two exceptions are Share-based Pay, which has a significant positive relationship with sales growth, and Salary payments, which has an insignificant negative relationship with sales growth.

The results for executive pay on an individual basis is different from that on a firm basis. Return on Equity has a significant negative relationship with Total remuneration payment (p-value 0.003) on an individual basis (Panel B), but an insignificant positive relation on a firm basis (Panel A). This difference suggests that even among listed firms that are not performing well, individual directors are still generously remunerated. There is a positive relationship between Stock Return (p-value 0.050) and Total remuneration paid, indicating that individual directors are paid more when stock performance is good.

Sales Growth has a negative relationship with Salaries, Pensions, and Bonuses on an individual basis. The results, except for Salaries, are significant at the 5% confidence level (p-values are 0.023 for Pensions and 0.000 for Bonuses).

The view that better-designed directors' remuneration arrangements can generally improve firm performance is supported only by the positive coefficient for Stock Return. Other variables, including Return on Equity and Sales Growth, have negative coefficients. Thus, it appears that Hong Kong listed firms' directors' remuneration may not improve even if firm performance improves.

Stock Return has a positive relationship with directors' pay, suggesting that directors are rewarded at well-performing listed firms (in terms of stock price increases). However, in poorly-performing listed firms, shareholders might sell their shares, leading to a decrease in stock price and directors being penalized through lower pay.

Leverage, with p-values ranging from 0.000 to 0.094, has a positive relationship with the different forms of remuneration for all directors except for Fee and Bonus payments, and is significant at the 10% confidence level for all forms of remuneration except for Share-based Pay (Table 2 Panel A). This positive relationship is consistent with that found by Cheng and Firth (2005). On an individual basis, as shown in Panel B, Leverage (p-values ranging from 0.007 to 0.022) has a positive and significant relationship with Salary, Pension, and Total payments.

SUMMARY

One major variable of interest in this study is whether the percentage of independent

non-executive directors on the remuneration committee has any effect on directors' remuneration. This variable has an expected significantly negative relationship with Directors' Fees, Salaries, and Total remuneration on a firm basis. Regarding payments on an individual basis, this variable also has a significantly negative relationship with Salaries and Pensions. These results suggest that as the level of remuneration committee independence increases, directors are less likely to receive generous remuneration packages. Having independent non-executive directors is effective in monitoring directors' compensation on behalf of shareholders.

Another major variable of interest is whether or not directors' compensation will be affected if a member of the controlling family is chairman or CEO. This variable has an expected significantly positive relationship with Salaries, Bonuses, and Total payment on a firm basis. This positive relationship suggests that chairmen and CEOs can use their position to influence directors' remuneration. On an individual basis, this variable also has a positive relationship with Salaries, Bonuses, and Total payment, although it is not statistically significant.

Panel B of Table 2 shows that for directors' payments on an individual basis, there is a significant positive coefficient for family members in terms of total remuneration, suggesting that directors of the board whose family members control the company (as measured by a holding of more than 5% of the total issued shares) receive more remuneration than non-family directors. The results support the view that the concentration of management power in the hands of a controlling family gives a significant amount of power to that family and enables it to take action that is beneficial to the family. When a family is a substantial shareholder in a firm, family members have an incentive to overpay themselves.

There is a significant positive coefficient for Chairmen in terms of Directors' Fees, Salaries, Bonuses, and Total remuneration at the 1% confidence level, suggesting that chairmen of the board receive more remuneration than their fellow directors. There is also a significant positive coefficient for CEOs in terms of Salaries, Pensions, Bonuses, Share-based Pay, and Total remuneration at the 1% confidence level, suggesting that directors who hold the post of CEO receive more remuneration than their fellow directors. These results, while not surprising, are evidence that chairmen and CEOs use their power to award themselves higher pay.

The results show that independent non-executive directors receive higher Directors' Fees than executive directors but lower Salaries, Pensions, Share-based Pay, and Total remuneration. Directors who are remuneration committee members receive higher Directors' Fees, Bonuses and Total remuneration than those who are not.

Finally, results show that the main variables that determine directors' pay are Sales and Sales Growth. Firms with higher sales, which are normally large firms, will pay higher emoluments to all directors. Sales are a good predictor of variability in directors' remuneration, and remuneration contracts provide an incentive to directors to expand the size of the firm at the expense of profits. This is consistent with the traditionally accepted objective of expanding a firm to maximize shareholder value (Deckop, 1988). On the other hand, results clearly demonstrate that for the firms sampled, directors are not given any incentive to increase sales growth, as the relationship between their remuneration and sales growth is negative.

CONCLUSION

This study finds that the CG Code in Hong Kong is an effective form of control on listed firms in protecting shareholders' interests with respect to directors' remuneration on both a firm and an individual basis. However, family control influences the use of shareholders' funds,

resulting in greater amounts paid out to directors of FOFs. Also, directors of firms with a chairman or CEO who is a member of the controlling family may still receive higher remuneration, as the CG Code allows the remuneration committee to seek advice from the chairman or CEO in determining directors' remuneration.

It appears that board monitoring, measured in terms of the proportion of independent non-executive directors on a remuneration committee, has only limited effect on the level of directors' pay. Even when the majority of remuneration committee members are independent non-executive directors, as required by the CG Code, the independence of these directors remains debatable. Although legal constraints suggest that committee members should act in an independent manner, in that they cannot be a relative of any of the executive directors of or shareholders in the listed firm, friendship between the independent non-executive directors and substantial family shareholders of a listed company may lead to a lack of independence. In addition, the fact that the chairman or CEO is a member of the family that controls a listed firm significantly influences the remuneration decisions made by independent non-executive directors.

Findings of this study suggest that there is a conflict in the CG Code regarding directors' remuneration. The CG Code requires issuers to form remuneration committee with high proportion of independent non-executive directors. This requirement is aimed at enhancing the protection of shareholders' interest. However, the CG Code recommends the remuneration committee to consult the chairman and/or CEO before making any suggestion on the remuneration of other executive directors. The results of this study reflects that directors will get higher remuneration if the chairman and/or CEO is a family member, suggesting that the CG Code requirement is not an effective measure in protecting shareholders' interest in this regard. The CG Code could require the remuneration committee to include a professionally qualified member in human resource management. Membership of the Hong Kong Institute of Human Resource Management or the equivalent can be used as a guideline.

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Table 1: Descriptive Statistics
Panel A: Remuneration of All Directors

		Mean	Range	Minimum	Median	Maximum	SD
1	Director Pay (HK$'000)						
1a	Directors' Fees	789.784	20,400.000	0.000	482.000	20,400.000	1,098.990
1b	Basic Salaries & Others	7,391.336	93,160.000	0.000	5,091.442	93,160.000	8,450.673
1c	Pension Contributions	260.786	9,300.000	0.000	54.000	9,300.000	712.664
1d	Bonuses	3,499.882	280,700.000	0.000	0.000	280,700.000	14,076.061
1e	Share-based Pay	2,345.399	681,823.564	0.000	0.000	681,800.000	23,359.860
1f	Total	14,291.961	721,100.000	0.000	7382.660	721,100.000	31,992.360
2	INED on RC	0.734	1.000	0.000	0.667	1.000	0.145
3	Family Head	0.785	1.000	0.000	1.000	1.000	0.411
4	Sales (HK$ millions)	2,717.637	218,726. 000	0.000	684.738	218,726. 000	11,080.126
5	Return On Equity	-0.460	528.552	-489.691	0.095	38.860	15.800
6	Stock Return	1.230	568.634	-0.883	0.195	567.751	18.337
7	Sales Growth	0.529	143.938	-1.000	0.105	142.938	4.989
8	Leverage	0.527	76.711	-8.237	0.234	68.474	2.453
9	Group	0.833	1.000	0.000	1.000	1.000	0.373

Panel B: Remuneration of Individual Director

		Mean	Range	Minimum	Median	Maximum	SD
1	Director Pay (HK$'000)						
1a	Directors' Fees	143.817	19,199.000	1.000	100.000	19,200.000	323.731
1b	Basic Salaries & Others	1,914.484	31, 535.000	5.000	1,282.900	31,540.000	2,298.134
1c	Pension Contributions	86.098	3,149.000	1.000	12.000	3,150.000	213.525
1d	Bonuses	2,177.005	136,018.000	2.000	605.500	136,020.000	6,215.509
1e	Share-based Pay	1,804.193	220,398.000	2.000	236.000	220,400.000	12,161.460
1f	Total	1,703.427	240,500.000	0.000	250.000	240,500.000	6,356.380
2	INED on RC	0.724	0.667	0.333	0.667	1.000	0.137
3	Family Head	0.789	1.000	0.000	1.000	1.000	0.408
4	Sales(HK$ millions)	3,816.357	218,726.000	0.000	873.090	218,726.000	14,319.262
5	Return On Equity	-0.250	528.552	-489.691	0.109	38.860	12.729
6	Stock Return	0.932	568.634	-0.883	0.198	567.751	14.795
7	Sales Growth	0.523	143.938	-1.000	0.108	142.938	5.514
8	Leverage	0.588	76.711	-8.237	0.236	68.474	3.309
9	Group	0.832	1.000	0.000	1.000	1.000	0.374
10	Family Member	0.248	1.000	0.000	0.000	1.000	0.432
11	Chairman	0.122	1.000	0.000	0.000	1.000	0.328
12	CEO	0.115	1.000	0.000	0.000	1.000	0.319
13	INED	0.374	1.000	0.000	0.000	1.000	0.484
14	RC	0.436	1.000	0.000	0.000	1.000	0.496

Table 2: Regression Analysis

Panel A: Remuneration of All Directors

Variable	Directors' Fees		Basic Salaries & Others		Pension Contributions		Bonuses		Share-based Pay		Total	
	Coeff	p-value	Coeff	p-value	Coeff	p-value	Coeff	p-value	Coeff	p-value	Coeff	p-value
INED on RC	-0.522	0.004 ***	-0.504	0.011 **	-0.417	0.108	-0.787	0.158	1.736	0.010 **	-0.357	0.087 *
Family Head	-0.213	0.000 ***	0.242	0.002 ***	-0.265	0.008 ***	0.305	0.058 *	-0.435	0.086 *	0.200	0.015 **
Log Sales	0.200	0.000 ***	0.300	0.000 ***	0.427	0.000 ***	0.577	0.000 ***	0.167	0.011 **	0.375	0.000 ***
Return on Equity	-0.001	0.000 ***	-0.000	0.360	-0.000	0.962	0.399	0.127	0.017	0.155	0.000	0.745
Stock Return	-0.000	0.860	0.001	0.006 ***	0.026	0.147	0.010	0.785	0.121	0.019 **	0.000	0.078 *
Sales Growth	-0.004	0.038 **	-0.025	0.381	-0.062	0.017 **	-0.134	0.000 ***	0.035	0.058 *	-0.021	0.000 ***
Leverage	-0.002	0.809	0.019	0.000 ***	0.024	0.001 ***	-0.005	0.606	0.002	0.897	0.010	0.094 *
Industry	Included		Included		Included		Included		Included		Included	
Year	Included		Included		Included		Included		Included		Included	
R-squared	0.231		0.350		0.359		0.363		0.232		0.432	
Adjusted R-squared	0.217		0.338		0.346		0.338		0.184		0.422	
N	948		935		885		453		292		965	

Note: *, **, and *** indicate significance at 10%, 5% and 1% level, respectively, in a two-tail test.

Panel B: Remuneration of Individual Director

Variable	Directors' Fees		Basic Salaries & Others		Pension Contributions		Bonuses		Share-based Pay		Total	
	Coeff	p-value	Coeff	p-value	Coeff	p-value	Coeff	p-value	Coeff	p-value	Coeff	p-value
INED on RC	0.030	0.756	-0.466	0.000 ***	-0.610	0.000 ***	0.071	0.814	1.608	0.000 ***	0.162	0.116
Family Head	-0.125	0.000 ***	0.013	0.786	-0.347	0.000 ***	0.126	0.184	-0.509	0.000 ***	0.054	0.200
Log Sales	0.140	0.000 ***	0.220	0.000 ***	0.323	0.000 ***	0.499	0.000 ***	0.123	0.000 ***	0.225	0.000 ***
Return On Equity	-0.001	0.000 ***	-0.001	0.433	0.000	0.648	0.626	0.001 ***	0.044	0.011 **	-0.001	0.003 ***
Stock Return	0.001	0.030 **	0.001	0.248	0.027	0.003 ***	0.012	0.586	0.046	0.070 *	0.001	0.050 **
Sales Growth	0.005	0.008 ***	-0.012	0.202	-0.027	0.023 **	-0.144	0.000 ***	0.044	0.003 ***	0.006	0.046 **
Leverage	0.002	0.217	0.009	0.007 ***	0.011	0.022 **	-0.022	0.196	-0.001	0.931	0.016	0.007 ***
Family Member	-0.178	0.001 ***	0.088	0.020 **	0.021	0.680	-0.096	0.259	-0.156	0.267	0.147	0.005 ***
Chairman	0.388	0.000 ***	0.339	0.000 ***	-0.042	0.511	0.613	0.000 ***	0.265	0.130	0.504	0.000 ***
CEO	0.080	0.346	0.616	0.000 ***	0.302	0.000 ***	0.679	0.000 ***	0.599	0.000 ***	1.263	0.000 ***
INED	0.333	0.000 ***	-2.501	0.000 ***	-1.162	0.000 ***	-0.41	0.109	-1.161	0.000 ***	-1.621	0.000 ***
RC	0.192	0.000 ***	0.062	0.147	-0.089	0.131	0.289	0.003 ***	0.167	0.197	0.116	0.003 ***
Industry	Included		Included		Included		Included		Included		Included	
Year	Included		Included		Included		Included		Included		Included	
R-squared	0.161		0.432		0.285		0.360		0.325		0.453	
Adjusted R-squared	0.157		0.428		0.279		0.350		0.310		0.451	
N	4795		3465		2738		1488		1051		7055	

Note: *, **, and *** indicate significance at 10%, 5% and 1% level, respectively, in a two-tail test.