Board Chairmen's Involvement in the Nomination and Remuneration Committees and Earnings Management

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Abstract

A board chairman is a very influential figure in a firm which may be dominated by an insider director, who, in some cases, is a family member. Consequently, the board chairmen (BC) may play a vital role in the firm's output, especially when they sit on the board committees. Therefore, the current study aims to examine the influence of the BC who are also: the chairmen of the nomination committee (BCNDUAL); ordinary members of the nomination committee (BCNMEM); the chairmen of the remuneration committee (BCRDUAL); and ordinary members of the remuneration committee (BCRMEM), on the level of accrual earnings management (AEM) and real earnings management (REM). This study also tests the overall influence of the BC's involvement in the nomination committee (BCNINV) by combining the terms of BCNDUAL and BCNMEM into BCNINV and the overall influence of BC's involvement in the remuneration committee (BCRINV) by combining the terms of BCRDUAL and BCRMEM into BCRINV, on the level of AEM and REM. This study selected 300 firms listed on the Bursa Malaysia Main Market with the lowest positive performance (based on return on assets (ROA)) for the years 2013 to 2015. The random-effects feasible generalized least squares (FGLS) regression shows that BCNDUAL, BCNMEM and BCNINV have a significant positive relationship with AEM and REM. However, BCRDUAL and BCRINV have a significant negative relationship with AEM but not with REM. This study aims to alert policy makers, firms and their stakeholders, as well as researchers of the need to strengthen their board committees' effectiveness (especially the nomination committee), and to make them more independent.[4]

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Keywords: Board chairmen, nomination committee, remuneration committee, earnings management, Malaysia.

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INTRODUCTION

The attention given by regulators, investors and financial community to the issue of financial scandals has increased over the past decades (Bowen, Freidank, Wannow, & Cavallone, 2017). Among the reasons for these scandals is earnings management (EM), where experience has shown that companies that engage in EM (e.g., creative accounting), often end up committing fraud (Jones, 2011). Basically, EM is an accounting treatment to alter the earnings result in the financial statements (Chandren, 2016; Chandren, Ahmad, & Ali, 2015), either by using the accrual earnings management (AEM) or real earnings management (REM) (Chandren, Ahmad, & Ali, 2017). Therefore, the occurrence of EM practice motivates managers to commit fraud in the future rather than EM (Perols & Lougee, 2011; Sulaiman, Danbatta, & Rahman, 2014). More importantly, the EM problem is not new (Levitt, 1998); it has however increased due to the market growth that is challenging for companies that do not meet investors' expectations (Dechow, Sloan, & Sweeney, 1996; Levitt, 1998). Thus, managers become more likely to report opportunistically to match peer performance (Du & Shen, 2018).

According to Yu (2014), incentives for EM have increased globally. In addition, based on 70,955 firm-observations from 31 countries during the period of 1990 to 1999, Leuz, Nanda, and Wysocki (2003) found that Hong Kong, Malaysia and Singapore have been rated higher than others regarding aggregate AEM. A more recent study by Enomoto, Kimura, and Yamaguchi (2015) which covered the period of 1991 to 2010 for firms from 38 countries, has reported a sharp increase in the Malaysian aggregate AEM score. Moreover, they found that REM in Malaysia is high, which is the sixth highest country among the 38 countries selected in their study. Therefore, Malaysian firms practice both AEM and REM.

Literature has documented that corporate governance (CG) is a useful monitoring mechanism to mitigate EM (Xie, Davidson, & DaDalt, 2003). Therefore, previous studies have extensively examined the influence of CG mechanisms on EM. However, the results are not consistent (Inaam & Khamoussi, 2016). Added to that, the mechanisms of CG in Malaysian companies are currently insufficient to prevent EM, and there is a need for additional efforts to improve CG (Mohammad, Wasiuzzaman, & Salleh, 2016). Indeed, the effectiveness of CG mechanisms depends on how it can reduce managerial opportunism and information asymmetry. Given this, Claessens and Fan (2002) and Cheung and Chan (2004) argued that CG mechanisms in Asia are not strong enough to mitigate agency problems. Hence, firms have to employ other mechanisms to reduce the problems (Claessens & Fan, 2002).

The position of the board chairmen (BC) in a company is crucial. They are leaders and have responsibility for ensuring the effectiveness of the board (Amran, Yusof, Ishak, & Aripin, 2014). However, the presence of BC in one or more of the board's committees may reflect that the BC attempts to dominate the overall CG mechanisms in a firm, especially in firms with high insider directors. The Malaysian Code on Corporate Governance (MCCG) is concerned with the role of BC, who is seen to dominate the board because of their social status and/or political links or because they are the founders of the corporation (Satkunasingam, Yong, & Cherk, 2012). Therefore, the presence of BC in board committees is not ideal in a society where there is deference to dominant personalities or well-connected which could result in board committees that are complicit with the chairmen's directives even if it transgresses CG (Satkunasingam *et al.*, 2012).

The role of BC in the governance process needs to be studied further (Carcello, Hermanson, & Ye, 2011). Previous studies have extensively investigated the separation role of the BC and chief executive officer (CEO) and its impact on EM. However, the impact of BC who chair or are ordinary members of essential board committees, such as nomination committee (NC) and remuneration committee (RC), has not been empirically examined (Satkunasingam *et al.*, 2012). Therefore, very little is known about the social dynamics among the CEO, BC and NC and how it impacts on the appointment process of directors (Walther, Morner, & Calabrò, 2017), as well as the effect of that relationship on EM. Similarly, the effect of social dynamics among the CEO, BC and RC on remuneration policy is unknown, as well as the effect of that relationship on EM.

Indeed, the purpose of the NC is to professionalize the process of selecting directors and to avoid excessive intervention by CEOs or BC (Walther & Morner, 2014), while the purpose of the RC is to provide support and advice to the board regarding the issues of board members' remuneration (Kanapathippillai, Johl, & Wines, 2016). The domination of BC over the NC and RC has become an important issue, particularly, when insider directors dominate a director's selection and compensation policy, as in the case of some companies in Malaysia (The World Bank Report, 2012). To the best knowledge of the researchers, no previous study has empirically investigated the effect of BC who also act as chairmen or who are ordinary members of the NC or RC on EM. Importantly, many countries, such as Thailand and the United Kingdom, have discussed issues pertaining to CG codes and guidelines.

Generally, this study aims to examine whether or not BC who are NC or RC chairmen or merely as ordinary members of these committees, encourage or discourage EM practices. The current study contributes to the body of knowledge by focusing on both types of EM, AEM and REM (Al-Absy, Ku Ismail, & Chandren, 2018; Al-Absy, Ku Ismail, & Chandren, 2019), practically, in the Malaysian context. Further, it introduces a new issue, i.e., the dominance of BC in board committees, namely, the NC and RC. It is argued that the nomination processes are typically controlled by CEOs (Westphal & Zajac, 1995), who are more powerful executives and more likely to serve on the NC (Vafeas, 1999), or affect its composition. The same thing also may happen to the RC. Consequently, the current study expects that BC who are involved in the NC may influence the selection process of directors, and similarly, BC who are involved in the RC may reduce the effectiveness of the RC, primarily in family-controlled firms, which is very much prevalent in developing countries, such as Malaysia.

The reason for selecting Malaysian firms is that controlling shareholders still dominate the selection process of directors by controlling the NC (The World Bank Report, 2012). Therefore, controlling shareholders may attempt to select a BC who is a family member or controlled by them and then appoint the BC either as the chairman or an ordinary member of the NC or RC, or both. Moreover, a high percentage of insider directors is common in Malaysian firms. Insider directors are more likely to accommodate the preferences of CEOs, particularly in the process of selecting new directors (Westphal & Zajac, 1995). According to Abdullah, Ku Ismail, and Nachum (2016) and Mohammad *et al.* (2016), compliance to the CG code in Malaysian firms is not meant for enhancing monitoring; it is for fulfilling the compliance requirement. Therefore, there is a need for regulators to revise the criteria for selecting the directors (Mohammad *et al.*, 2016).

Generally, the results of this study provide evidence of the domination of the NC and RC by BC. It reveals that BC who chair the NC (BCNDUAL), or are ordinary members of the NC (BCNMEM), and are involved in the NC (BCNINV) as either chairman or an ordinary

member, are associated with a higher level of AEM and REM. However, it is also revealed that BC who chair the RC (BCRDUAL) and are involved in the RC (BCNINV) as either a chairman or as an ordinary member, are associated with a lower level of AEM. However, it does not have any relationship with REM. Lastly, the board chairman who is an ordinary member of the remuneration committee (BCRMEM) does not influence the level of AEM or REM.

LITERATURE AND HYPOTHESES DEVELOPMENT

Corporate governance

Agency problems arise between the agent and the owner as a result of "separation of ownership and control" (Jensen & Meckling, 1976). According to agency theory, managers may have an incentive to be self-centred at the expense of shareholders. Furthermore, previous studies have investigated a range of incentives which lead managers to engage in EM, either for their self interests or the shareholders' interests (Abarbanell & Lehavy, 2003; Fields, Lys, & Vincent, 2001), including: (i) forecasting and evaluating the capital market; (ii) contracts based on accounting figures; and (iii) antitrust and other government regulations (Healy & Wahlen, 1999). EM is divided into two types - AEM and REM, anchored on the possibility that such categorization may lead to cash flow consequences directly. AEM is the earnings manipulation by managers through accounting estimates and methods, without any direct effect on cash flows, while REM is the manipulation of earnings by managers via operational activities that directly impact cash flows (Enomoto *et al.*, 2015; Roychowdhury, 2006; Sun, Lan, & Liu, 2014).

It is to be noted that after the grave financial scandals of large companies (e.g., Worldcom and Enron), international efforts have been made to fight managers' opportunistic behaviour by developing and implementing appropriate CG mechanisms (Gulzar, 2011). In this regard, CG codes are designed to achieve high standards of governance processes (Cadbury Committee, 1992) and to enhance the credibility of firms' financial reporting through the elimination of earnings manipulation behaviour (Dechow *et al.*, 1996). The effectiveness of CG mechanisms increases the confidence of foreign investors in the capital markets in East Asia, including Malaysia (Nam & Nam, 2004; The World Bank Report, 2012), protects the rights of the stakeholders, reduces the problem of "asymmetry information" and improves the reporting quality (Gulzar, 2011).

Nonetheless, considering the vital role of corporate boards as a governance mechanism, the high quality requirements in appointing the directors is what determines the effectiveness of the board's monitoring abilities (Vafeas, 1999). Walther and Morner (2014) stated that very little is known about how and on what basis the NC enhances the selection process and minimizes selection inefficiencies, including the possibility of strong CEOs appointing lenient directors. For instance, when the CEO is part of the NC, or there is no NC at all, the firms are likely to appoint more grey outsiders and fewer independent directors, which result in more conflict of interest (Shivdasani & Yermack, 1999). Additionally, the percentage of insider directors has a significant and positive relationship with the new director who shared the same demographic category of CEO (Westphal & Zajac, 1995). Vafeas (1999) argued that there is a need for the NC to not allow any interference from a board which is dominated by a CEO and insiders with no or limited insiders' participation, by which nomination is expected to be in line with shareholders' interest.

Five vital and preliminary tasks of the NC are to: (i) outline and assess the required qualification, competency, knowledge, experience and time expected to be spent, especially by the executive directors and board directors; (ii) evaluate size, structure, composition and findings of the executive board and board of directors annually, and further recommend changes to the board, if any; (iii) appraise the knowledge, competency and experience of the personal members of the management annually and report to the board of directors accordingly; (iv) assess proposals from shareholders, boards members and other relevant persons for the appointment of new directors to the board of directors; and (v) suggest an action plan and proposal for specific changes to the board of directors in the future composition of the board of directors (Denmark recommendations on corporate governance, 2014).

From the Malaysian perspective, the board of each company is required to include an NC with solely non-executive directors, most of whom must be independent, and vested with responsibility for suggesting new nominees to the board as well as to evaluate directors on a continuous basis (MCCG, 2000). The NC would assess the effectiveness of the entire board and the board committees annually, and further evaluate every individual director's contribution (MCCG, 2000). Following the revision of the MCCG in 2007, some amendments were made whereby the NC must consider the knowledge, skills, professionalism, experience, expertise and integrity, specifically of the independent candidates, and thereby assess the candidates' capability to discharge such functions or respond accordingly. Also, the NC must ensure that its appraisal and assessments are done and documented correctly (MCCG, 2007). In the 2012 revised MCCG, it is recommended that the chairman of the NC must be the most senior independent director recognized by the board (MCCG, 2012). The latest version of the MCCG also confirms that the NC should be chaired by a senior independent director or independent director (MCCG, 2017).

Besides the NC, the RC has an essential role with regards to the issues of the remuneration policy of the directors as well as the senior management of the firm. The following are among the prime responsibilities of the RC: (i) suggest an appropriate remuneration policy (including incentive-based remuneration and guidelines) for remunerating the executives and outside directors; (ii) recommend the remuneration of board of directors and further ensure that the remuneration is in line with the company's remuneration policy and performance evaluation of the concerned individual; and (iii) propose a remuneration policy to be used for the company generally (Denmark recommendations on corporate governance, 2014).

However, from the Malaysian perspective, the boards must be the appointees of the RC, which include entirely or mainly non-executive directors. The primary task of the committee is to suggest to the board the remuneration of the non-executive directors and executive directors. Regarding non-executive chairpersons, it should be a matter for the whole board to determine their remuneration. The annual report of the company must include details of each director's remuneration (MCCG, 2000, 2007). Similarly, the MCCG 2012 version recommends that the NC should exclusively or mainly consist of non-executive directors. Furthermore, this version emphasizes that the board must ensure the establishment of a transparent and formal remuneration policy and procedures that would attract and retain directors.

Nomination committee
The NC is an influential committee in a firm, where most CG codes around the world require firms to establish an NC. The composition of this committee differs slightly among these

codes. Regarding the number of NC members, most of the codes, such as in Australia, Bahrain and Singapore, recommend at least three members; In Russia, Australia, Bahrain, Ireland, Mauritius, the United Kingdom and Singapore, the majority of directors should be independent. Other codes require that the NC directors be non-executive (for example in Singapore, the Netherlands, Mauritius and Malaysia), while other codes of CG require that an NC should entirely comprise independent directors (for example Thailand), while others require that the majority of NC directors should be non-executive (for example, Cyprus). Regarding chair positions, some codes of CG require that the NC chairman be an independent director (for example in Australia, Bahrain, Singapore and Malaysia), while others allow the committee to be chaired by a non-executive director (for example, Cyprus).

Regarding BC's involvement in the NC, some codes of CG such as in Australia, Cyprus, the United Kingdom and Denmark, recommend that a BC may also chair the NC, or be a member in case he/she is an independent director, like in Singapore. However, a separate chair must be appointed when the NC deals with the appointment of a successor to the chair as found in the codes of Australia and the United Kingdom. Similarly, the code in Russia recommends that if the NC chairman is the same person as the board chairman, he or she must decline from chairing a meeting of the committee that can determine the replacement of the board successor chairman or recommend his/her election. Further, other codes of CG require that BC should not be at the same time the chair of the NC (such as in Slovenia and Thailand), or a member (such as in Thailand and the United Arab Emirates).

This study suggests that BC must not be involved in the NC, either as a chairperson or an ordinary member. Otherwise, the efficiency of the NC will be low because of the following reasons. First, the insider directors of firms, which in some cases, are family-owned or controlled, tend to appoint a family member to serve on the board (Haniffa & Cooke, 2002). Consequently, the situation becomes a severe problem when the BC is a family member or controlled by the family. Second, the terms of reference of the NC, which are chaired by or involve BC, should be reviewed by the whole board. Thus, it is difficult for the board to evaluate the terms of reference of the NC since the BC is involved in the NC. Finally, the recommendations reported to the board by the NC will be less efficiently evaluated and discussed by the board members since the BC is involved in the NC. Thus, according to the agency theory, the following hypotheses are proposed:

H_1 *Firms whose board chairmen chair the nomination committee are more likely to engage in earnings management.*

H_2 *Firms whose board chairmen are ordinary members of the nomination committee are more likely to engage in earnings management.*

H_3 *Firms whose board chairmen are involved in the nomination committee are more likely to engage in earnings management.*

Remuneration committee

According to Kanapathippillai *et al.* (2016), one of the essential board sub-committees is the RC. The primary role of the committee is to advise and support the board on issues related to remuneration. In essence, most of the codes of CG globally require firms to establish an RC. The composition of this committee varies among codes. However, most of these codes, such as in Mauritius, Cyprus, the Netherlands, Singapore and Malaysia, require the board of directors to form the RC where all the directors should be non-executive. Regarding the number of committee members, most codes of CG require at least three members (examples Australia, Bahrain, Singapore and the United Kingdom), with a majority being independent directors (Australia, Bahrain, Mauritius, Singapore and Thailand). However, other codes of

CG, such as in Russia and Ireland, require that the RC should only comprise independent directors, Regarding the RC chair, most codes of CG recommend that the RC should be chaired by an independent director, such as in Australia, Russia, Bahrain, Thailand, Singapore and the United Kingdom. Regarding BC's involvement in the RC, some codes of CG recommend that BC should not at the same time chair the RC (e.g., Russia, Ireland Slovenia, Thailand, Netherlands and the United Kingdom) or be a member (e.g., Thailand and the United Arab Emirates). On the other hand, some codes of CG allow BC to be a member of the RC, like in the United Kingdom.

The amount paid by the company to directors may affect the attitude of directors to either mitigate or engage in EM. Therefore, the remuneration policy must be adequate to attract, inspire and retain directors with the required skills and qualifications. Paying directors a small amount would make them feel that their services are not important. On the other hand, paying remuneration in excess would cause directors to lose their independence (MCCG, 2000). As one of their functions, the RC directors from time to time would make suggestions to the board on any particular action or decision regarding directors' remuneration (Kanapathippillai *et al.*, 2016). Thus, the recommendations made by RCs, that are chaired by or involve a BC, may be adopted and implemented by the board due to the influence of the BC on all board decisions, especially in those firms with high insider directors or family members. Thus, according to the agency theory, the following hypotheses are proposed:

H₄ Firms whose board chairmen chair the remuneration committee are more likely to engage in earnings management.
H₅ Firms whose board chairmen are ordinary members of the remuneration committee are more likely to engage in earnings management.
H₆ Firms whose board chairmen are involved in the remuneration committee are more likely to engage in earnings management.

RESEARCH METHOD

Based on public firms listed and available on Bursa Malaysia Main Market, 300 firms with the lowest positive earnings (measured by return on assets (ROA)) for three years, i.e., 2013, 2014 and 2015, were selected. This is because EM is high in firms with close to zero earnings because management wants to avoid small losses by converting them into a small profit. In this regard, the firms are called suspect firms (Yuliana, Anshori, & Alim, 2015). Thus, this study followed two steps to get a slightly positive ROA. In the first step, to ensure that the sample is balanced, any company with negative earnings in one or more years was excluded. In the second step, the average ROA for the three years was calculated for each company. Then, the averages were arranged in ascending order to choose 300 companies with the lowest ROA. However, due to missing data, the final sample is 864 firm-observations.

Regarding AEM measurement, this study used Jones (1991) Model which estimates discretionary accruals (DA) that contain the characteristics of accruals emanating from management opportunism (Guay, Kothari, & Watts, 1996). Hence, cross-sectional analysis using ordinary least squares (OLS) were run (21 OLS multiple regression for specific industry and year) to measure the fixed values (coefficients) from the following model:

$$\frac{TAC_{it}}{TA_{it-1}} = \alpha_0 + \alpha_1 \left(\frac{1}{TA_{it-1}} \right) + \alpha_2 \left[\frac{\Delta S_t}{TA_{it-1}} \right] + \alpha_3 \left(\frac{PPE_{it}}{TA_{it-1}} \right) + +\varepsilon_{it} \qquad (1)$$

Where: TAC_{it}= earnings before an extraordinary item minus the cash flow from operations, TA_{it-1}= total assets in the past year, ΔS_t= revenues in year$_t$ minus revenues in year$_{t-1}$, PPE=

Gross property, plant and equipment in year$_t$ and ε_{it}= the regression error terms. Therefore, DA (residuals value) are calculated by using the new option which is available at STATA program "statistics=>post-estimation=>predictions, residuals, etc.=> residuals (equation-level scores)" (Brennan, 2010, p. 621).

In terms of REM measurement, this study used the abnormal levels of cash flow from operations (ABCFO), the abnormal levels of production costs (ABPROD) and the abnormal levels of discretionary expenses (ABDISX), introduced by Roychowdhury (2006) and used by previous studies (Liu, Shi, Wilson & Wu, 2017; Razzaque, Ali, & Mather, 2016). Thus, to estimate the fixed values (coefficients), the models below were used:

$$\frac{CFO_t}{TA_{it-1}} = \alpha_0 + \alpha_1 \left(\frac{1}{TA_{it-1}}\right) + \beta_1 \left(\frac{S_t}{TA_{t-1}}\right) + \beta_2 \left(\frac{\Delta S_t}{TA_{t-1}}\right) + \varepsilon_t, \qquad (2)$$

$$\frac{PROD_t}{TA_{t-1}} = \alpha_0 + \alpha_1 \left(\frac{1}{TA_{t-1}}\right) + \beta_1 \left(\frac{S_t}{TA_{t-1}}\right) + \beta_2 \left(\frac{\Delta S_t}{TA_{t-1}}\right) + \beta_3 \left(\frac{\Delta S_{t-1}}{TA_{t-1}}\right) \varepsilon_t \qquad (3)$$

$$\frac{DISX_t}{TA_{t-1}} = \alpha_0 + \alpha_1 \left(\frac{1}{TA_{t-1}}\right) + \beta \left(\frac{S_{t-1}}{TA_{t-1}}\right) + \varepsilon_t \qquad (4)$$

Where, CFO_t= cash flow from operations, S_t = sales during period t, $PROD_t$= cost of goods sold and change in inventory during period $_t$, $DISX_t$= the sum expenses of research and development, advertising, selling, general and administrative costs in period $_t$ and S_{t-1}= sales at the end of period$_{t-1}$. Therefore, ABCFO, ABPROD and ABDISX were calculated by using the new option which is available at STATA program "statistics => post-estimation => predictions, residuals, etc. => residuals (equation-level scores)" (Brennan, 2010, p. 621). Importantly, by following the majority of previous studies, this study combined the three proxies, and thus, REM = ABCFO^{*-1} + ABPROD+ ABDISX^{*-1}.

The Random-Effects Feasible Generalized Least Squares (FGLS) regression analysis was run to investigate the influence of BCNDUAL, BCNMEM, BCNINV, BCRDUAL, BCRMEM and BCRINV, on the level of AEM and REM. In line with previous studies, this study used the absolute value of DA to reflect AEM (Abdullah & Ku Ismail, 2016) and the absolute value of the sum of ABCFO, ABPROD and ABDISX to reflect REM (Kwon, Na, & Park, 2017). Furthermore, following prior research, this study used several control variables that are related to CG mechanisms, i.e., board size (BSIZE), AC size (ACSIZE), ownership concentration (Conc5) and audit quality (Big4) and firm-specific characteristics, i.e., firm size (FSIZE), leverage (LEV), ROA and type of firm (INDUS). Detailed information on these variables is provided in Table 1.

Table 1. Definition of Variables .

Acronym	Measurement
AEM	The absolute value of DA using Jones Model (1991).
REM	The absolute value of the sum of the three proxies introduced by Roychowdhury (2006)
BCNDUAL	One if board chairmen chair the nomination committee, otherwise is zero
BCNMEM	One if board chairmen are an ordinary member of the nomination committee, otherwise is zero
BCRDUAL	One if board chairmen chair the remuneration committee, otherwise is zero
BCRMEM	One if board chairmen are an ordinary member of the remuneration committee, otherwise is zero
BCNINV	One if board chairmen either chair or an ordinary member of the nomination committee, otherwise is zero
BCRINV	One if board chairmen either chair or an ordinary member of the remuneration committee, otherwise is zero
BSIZE	A total number of board members.
ACSIZE	A number of AC members.
Conc5	The proportion of the sum shares held by the five largest shareholders.
Big4	One if the firm audit by Big4, zero otherwise.
FSIZE	Natural log of total assets.
LEV	Total debt to total assets.
ROA	Net income/total assets.
INDUS	One if the firm is manufacturing, zero otherwise.

The following regressions were used to conclude the result of Hypotheses 1,2,4 and 5:

$AEM = \beta_0 + \beta_1 BCNDUAL + \beta_2 BCNMEM + \beta_3 BCRDUAL + \beta_4 BCRMEM + \beta_5 BSIZE + \beta_{11} ACSIZE + \beta_6 Conc5 + \beta_7 Big4 + \beta_8 FSIZE + \beta_9 LEV + \beta_{10} ROA + \beta_{11} INDUS + \varepsilon.$

Model 1 (A)

$REM = \beta_0 + \beta_1 BCNDUAL + \beta_2 BCNMEM + \beta_3 BCRDUAL + \beta_4 BCRMEM + \beta_5 BSIZE + \beta_{11} ACSIZE + \beta_6 Conc5 + \beta_7 Big4 + \beta_8 FSIZE + \beta_9 LEV + \beta_{10} ROA + \beta_{11} INDUS + \varepsilon.$

Model 2 (A)

Regarding Hypothesis 3, the same regression of Model 1 (A) was used, but by combining the terms of BCNDUAL and BCNMEM into BCNINV (Model 1 (B)). Similarly, for Hypothesis 6, the same regression of Model 2 (A) was used but by combining the terms of BCRDUAL and BCRMEM into BCRINV (Model 2 (B)).

RESULTS AND DISCUSSION

Table 2 shows that the mean value of AEM is 0.048, where the minimum value is 0.001, and the maximum value is 0.216. In terms of REM, the mean value is 0.130, where the minimum value is 0.002, and the maximum value is 0.704. Table 2 also shows the mean of the continuous control variables. The mean values of control variables that are related to CG mechanisms, i.e., BSIZE, ACSIZE and Conc5 are 7.418, 3.244 and 0.546, respectively. In addition, the mean values of control variables that are related to firm-specific characteristics, i.e., FSIZE (log), LEV and ROA are 13.485, 20.775% and 4.412%, respectively.

Table 2. Descriptive statistics of the continuous variables (N=864).

Variables	Mean	SD	Min.	Max.	Skewness	Kurtosis
AEM	0.048	0.045	0.001	0.216	1.566	5.402
REM	0.130	0.123	0.002	0.704	1.972	8.058
BSIZE	7.418	1.909	4.000	17.000	0.985	4.840
ACSIZE	3.244	0.502	3.000	6.000	2.173	8.194
FSIZE	13.485	1.571	10.098	18.579	0.796	3.497
LEV	20.775	15.162	0.000	68.560	0.422	2.475
ROA	4.412	2.510	0.010	15.160	0.657	3.574
Conc5	0.546	0.159	0.141	0.948	-0.083	2.318

Table 3 shows that 158 (18.29%) firm-observations appointed their BC in the NC as chairman while 184 (21.30%) firm-observations appointed their BC in the NC as an ordinary

member. Therefore, 342 (39.59%) firm-observations appointed their BC in the NC as either chairman or an ordinary member. Table 3 also shows that 185 (21.41%) firm-observations appointed their BC in the RC as chairman while 239 (27.66%) firm-observations appointed their BC in the RC as an ordinary member. Therefore, 424 (49.07%) firm-observations appointed their BC in the RC as either chairman or an ordinary member. Regarding the control variable, 459 (53.13%) firm-observations were audited by one of the four biggest accounting firms in Malaysia (Ernst & Young, PricewaterhouseCoopers, Deloitte and KPMG) and 366 (42.36%) firm-observations are manufacturing firms.

Table 3. Descriptive statistics of the dummy variables (N=864).

Variables	Yes (1)		No	
	Freq.	Percent	Freq.	Percent
BCNDUAL	158	18.29	706	81.71
BCNMEM	184	21.30	680	78.70
BCRDUAL	185	21.41	679	78.59
BCRMEM	239	27.66	625	72.34
BCNINV	342	39.59	522	60.42
BCRINV	424	49.07	440	50.93
Big4	459	53.13	405	46.88
INDUS	366	42.36	498	57.64

According to Kurtosis and Skewness as descriptive numerical approaches to test the normality of the different variables, Table 2 shows that the dataset of the individual variables are in line with normality assumption, where the Skewness is not higher than the threshold of ±3, and the Kurtosis is not greater than the threshold of ±10 (Kline, 2015). Furthermore, Table 4 shows the result of the variance inflation factor (VIF) test, where there is no multicollinearity issue. It also shows the result of the Pearson correlation test where there is no correlation among variables.

Table 4. Pearson correlation and variance inflation factor (VIF).

Variables	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	VIF	1/VIF
1 AEM	1.00																-	-
2 REM	**0.31**	1.00															-	-
	0.00																	
3 BCNDUAL	0.00	0.03	1.00														1.48	0.68
	0.97	0.44																
4 BCNMEM	**0.11**	**0.08**	**-0.25**	1.00													1.36	0.73
	0.00	0.02	0.00															
5 BCNINV	**0.10**	**0.09**	**0.58**	**0.64**	1.00												1.42	0.71
	0.01	0.01	0.00	0.00														
6 BCRDUAL	-0.04	0.03	**0.44**	**0.08**	**0.41**	1.00											1.63	0.61
	0.24	0.42	0.00	0.02	0.00													
7 BCRMEM	**0.06**	**0.06**	**-0.07**	**0.32**	**0.21**	**-0.32**	1.00										1.45	0.69
	0.06	0.09	0.06	0.00	0.00	0.00												
8 BCRINV	0.02	**0.07**	**0.30**	**0.35**	**0.53**	**0.53**	**0.63**	1.00									1.47	0.68
	0.47	0.03	0.00	0.00	0.00	0.00	0.00											
9 BSIZE	**-0.08**	**-0.09**	0.03	**-0.16**	**-0.11**	0.03	**-0.24**	**-0.20**	1.00								1.31	0.76
	0.02	0.01	0.36	0.00	0.00	0.44	0.00	0.00										
10 ACSIZE	**-0.07**	**-0.08**	0.03	0.00	0.02	0.03	**-0.10**	**-0.07**	**0.31**	1.00							1.19	0.84
	0.05	0.01	0.44	0.99	0.54	0.43	0.00	0.05	0.00									
11 FSIZE	**-0.11**	**-0.20**	0.05	-0.06	-0.01	0.04	**-0.13**	**-0.08**	**0.36**	**0.27**	1.00						1.80	0.56
	0.00	0.00	0.13	0.07	0.76	0.22	0.00	0.02	0.00	0.00								
12 LEV	0.05	-0.04	**0.07**	-0.03	0.03	-0.01	**-0.10**	**-0.09**	**0.14**	-0.01	**0.34**	1.00					1.21	0.82
	0.11	0.23	0.03	0.36	0.35	0.85	0.00	0.01	0.00	0.79	0.00							
13 ROA	0.05	**0.06**	-0.01	0.02	0.01	0.08	-0.01	**0.06**	0.08	0.00	0.04	**-0.10**	1.00				1.04	0.96
	0.13	0.07	0.72	0.50	0.77	0.02	0.80	0.08	0.02	0.95	0.19	0.00						
14 Big4	**-0.07**	-0.05	0.02	-0.03	-0.01	0.03	**-0.07**	-0.04	**0.12**	**0.20**	**0.47**	**0.13**	0.02	1.00			1.31	0.77
	0.03	0.17	0.59	0.34	0.71	0.34	0.03	0.26	0.00	0.00	0.00	0.00	0.54					
15 Conc5	-0.05	**0.06**	-0.04	-0.03	**-0.06**	**-0.06**	-0.05	**-0.10**	0.05	**0.09**	**0.09**	**-0.08**	0.00	**0.09**	1.00		1.04	0.96
	0.11	0.07	0.22	0.38	0.09	0.07	0.11	0.00	0.16	0.01	0.01	0.02	0.95	0.01				
16 INDUS	0.03	**0.12**	0.01	0.01	0.01	**-0.06**	0.08	0.02	**-0.09**	**-0.14**	**-0.30**	-0.02	0.03	**-0.12**	0.00	1.00	1.13	0.89
	0.40	0.00	0.85	0.86	0.77	0.08	0.02	0.55	0.01	0.00	0.00	0.48	0.34	0.00	0.92			

Note: bold numbers reflect the significant with range from p<0.01 to p<0.1.

Table 5 shows the results of Model 1 (by using the Jones Model) and Model 2 (by using REM). FGLS regression was used with option "panels (heteroskedastic)" to solve the problem of heteroscedasticity. FGLS regression provides reliable estimates in the presence of heteroscedasticity, and has been adopted by previous studies (Al-Dubai, 2014; Yoshikawa & Rasheed, 2010). The result of Model A in Table 5 indicates that BCNDUAL is positively related to the higher level of AEM and REM. Firms whose BC is also the chairman of the NC are more likely to engage in AEM and REM. Similarly, it is found that BCNMEM is positively related to the higher level of AEM and REM. Firms whose BC are ordinary members of the NC are more likely to engage in AEM and REM. Regarding the overall involvement, Model B in Table 5 indicates that BCNINV is positively related to higher level of AEM and REM. Firms whose BC either chair or are ordinary members of the NC, are more likely to engage in AEM and REM.

The results indicate that the appointment of BC in the NC does not improve the effectiveness of the committee. It seems that insider directors, who in some cases, are family members, may dominate the selection process of directors, especially the BC. Therefore, the selection of BC as a chairman of or an ordinary member in the NC may be due to their relationship with a family member on the board or the substantial shareholder. Controlling the firm's highest position of BC by the CEO and other insiders and appointing them in the NC will guarantee that any future nominations will be more likely to be consistent with the CEO and other insiders' interest instead of shareholders' interests. Another reason for the significant result may be that BC who are involved in the NC do not have enough time or energy to do their work effectively.

Table 5. The random-effects feasible generalized least squares (FGLS) regression.

Variables	Model 1 (AEM)		Model 2 (REM)	
	Model A	Model B	Model A	Model B
BCNDUAL	0.00601**		0.0205***	
	(0.00290)		(0.00600)	
BCNMEM	0.0101***		0.0124**	
	(0.00295)		(0.00590)	
BCRDUAL	-0.00900***		0.00258	
	(0.00271)		(0.00583)	
BCRMEM	-0.00239		-0.00435	
	(0.00249)		(0.00499)	
BCNINV		0.00706***		0.0181***
		(0.00233)		(0.00467)
BCRINV		-0.00459**		-0.00112
		(0.00222)		(0.00443)
BSIZE	-0.000473	-0.000594	1.45e-05	0.000175
	(0.000474)	(0.000482)	(0.00130)	(0.00127)
ACSIZE	-0.00344**	-0.00396**	-0.0122***	-0.0129***
	(0.00166)	(0.00161)	(0.00397)	(0.00399)
FSIZE	-0.00243***	-0.00225***	-0.0129***	-0.0128***
	(0.000477)	(0.000450)	(0.00133)	(0.00133)
LEV	0.000364***	0.000354***	0.000324**	0.000334**
	(6.14e-05)	(6.00e-05)	(0.000139)	(0.000140)
ROA	0.00138***	0.00138***	0.00208**	0.00206***
	(0.000364)	(0.000356)	(0.000812)	(0.000799)
Big4	-0.00296	-0.00371**	-0.000106	0.000851
	(0.00188)	(0.00186)	(0.00475)	(0.00469)
Conc5	-0.00631	-0.00656	0.0778***	0.0792***
	(0.00519)	(0.00515)	(0.0124)	(0.0124)
INDUS	-0.00138	-0.000608	0.0196***	0.0191***
	(0.00182)	(0.00175)	(0.00428)	(0.00427)
Constant	0.0796***	0.0804***	0.252***	0.250***
	(0.00832)	(0.00814)	(0.0169)	(0.0169)
Wald chi2	139.93	148.27	493.47	473.45
Prob > chi2	0.0000	0.0000	0.0000	0.0000
Observations	864	864	864	864
Number of ID	288	288	288	288

The results of Model A in Table 5 also indicates that BCRDUAL is negatively related to the level of AEM. Firms whose BC chair the RC are less likely to engage in AEM. However, the BCRDUAL is not related to REM. It also found that the BCRMEM is not related to either AEM nor REM. Regarding the overall involvement, Model B in Table 5 indicates that BCRINV is negatively related to the level of AEM. However, the BCRINV is not related to REM. Regarding control variables, ACSIZE and FSIZE is negatively related to AEM and REM. In addition, Big4 is significantly and negatively related to AEM only in Model B. In contrast, LEV and ROA have a positive relationship with AEM and REM. Moreover, firms with high ownership concentration and considered as manufacturing firms, are more likely to engage in REM.

ENDOGENEITY ISSUE OF THE MAIN MODELS

To control the potential reverse causality problem, Models 1 and 2 were re-estimated by using the lagged values of the independent variables (Al-Jaifi, 2017; Al-Jaifi, Al-Rassas, & AL-Qadasi, 2017; Al-Qadasi & Abidin, 2018; Alves, Couto, & Francisco, 2015; Miletkov, Poulsen, & Wintoki, 2014; Srinidhi, Gul, & Tsui, 2011). Table 6 shows that BCNDUAL, BCNMEM have a positive relationship with AEM and REM which is consistent with Table 5. Regarding the BCNINV, it has a significant positive relationship with REM, which is consistent with Table 5. However, BCNINV does not have a significant relationship with AEM, which is inconsistent with Table 5. Regarding BCRDUAL and BCRINV, they have a significant negative relationship with AEM but not with REM, which is consistent with Table 5. However, BCRMEM does not have a significant relationship with either AEM or REM, which is consistent with Table 5. Therefore, the results of re-estimating the lagged values of the independent variables of Model 1 and 2 indicate that reverse causality may not be likely to be significant for the investigated variables.

Table 6. The random-effects feasible generalized least squares (FGLS) regression.

Variables	Model 1 (AEM)		Model 2 (REM)	
	Model A	Model B	Model A	Model B
L.BCNDUAL	0.00472*		0.0129*	
	(0.00272)		(0.00662)	
L.BCNMEM	0.00483*		0.00911*	
	(0.00260)		(0.00496)	
L.BCRDUAL	-0.00940***		0.00812	
	(0.00252)		(0.00538)	
L.BCRMEM	-0.00263		-0.00146	
	(0.00234)		(0.00453)	
L.BCNINV		0.00176		0.0118***
		(0.00224)		(0.00448)
L.BCRINV		-0.00494**		0.00201
		(0.00221)		(0.00420)
L.BSIZE	-0.000420	-0.000333	0.00324***	0.00347***
	(0.000429)	(0.000451)	(0.00122)	(0.00120)
L.ACSIZE	-0.00335**	-0.00366**	-0.00900**	-0.00918**
	(0.00163)	(0.00165)	(0.00423)	(0.00428)
L.FSIZE	-0.00388***	-0.00371***	-0.0157***	-0.0154***
	(0.000455)	(0.000469)	(0.00132)	(0.00131)
L.LEV	0.000352***	0.000347***	-0.000125	-0.000138
	(5.61e-05)	(5.83e-05)	(0.000131)	(0.000134)
L.ROA	-0.000172	-0.000300	0.000302	0.000311
	(0.000371)	(0.000380)	(0.000625)	(0.000611)
L.Big4	-0.00264	-0.00276	0.0132***	0.0121***
	(0.00169)	(0.00175)	(0.00454)	(0.00465)
L.Conc5	-0.00931*	-0.00906*	0.0811***	0.0819***
	(0.00503)	(0.00521)	(0.0127)	(0.0130)
L.INDUS	0.00370**	0.00341**	0.0255***	0.0257***
	(0.00163)	(0.00167)	(0.00423)	(0.00428)
Constant	0.109***	0.107***	0.265***	0.259***
	(0.00508)	(0.00557)	(0.0182)	(0.0179)
Wald chi2	409.30	257.05	1003.89	1060.52
Prob > chi2	0.0000	0.0000	0.0000	0.0000
Observations	576	576	576	576
Number of ID	288	288	288	288

CONCLUSION

Studies have extensively investigated the influence of CG mechanisms, such as the board of directors and audit committee on EM. However, only a few studies have focused on the nomination and remuneration committees which are the cornerstones that determine the shape of CG mechanisms. The NC is responsible for the appointment of high quality and independent directors, while the RC is responsible for setting an appropriate remuneration policy that encourages directors to monitor the management decisions effectively and be more independent. Therefore, this study attempts to investigate the influence of BC who are involved in the nomination and remuneration committees, either as chairpersons or as ordinary members, on EM.

The results of this study are in line with previous studies, which have claimed that independent directors are not genuinely independent and the criteria for selecting the independent directors need to be revised. It reveals that BCNDUAL, BCNMEM and BCNINV have a significant positive relationship with AEM and REM. However, it is also revealed that BCRDUAL and BCNINV have a significant negative relationship with AEM. However, it does not have any relationship with REM. Lastly, this study reveals that BCRMEM is neither related to the level of AEM nor REM. The findings of this study highlight the issue of BC who may dominate the board committees, which may help investors, shareholders and policymakers to improve the effectiveness of board committees, especially in countries with a high concentration of ownership. Hence, this study recommends that further studies be done on the BC regarding their propensity to dominate

board committees. This is not only concerning EM but also concerning other measurements of financial reporting quality and other areas such as firm performance.

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